# Notices

# **Regulatory Notices**

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# Disciplinary and Other FINRA Actions

to November 3, 2008



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# Regulatory Notice

08-34

# FINRA Automated Systems

SEC Approves Amendments to the Rule 9700 Series to Streamline Existing Procedural Rules Applicable to General Grievances Related to FINRA Automated Systems

Effective Date: August 1, 2008

## **Executive Summary**

Effective August 1, 2008, reviews of FINRA staff determinations under the Rule 9700 Series (Procedures on Grievances Concerning the Automated Systems) will be adjudicated by a Hearing Officer appointed by FINRA's Office of Hearing Officers, subject to discretionary review by the National Adjudicatory Council.¹ The text of the amended rules is set forth in Attachment A of this *Notice*.

Questions regarding this *Notice* may be directed to FINRA Operations at (866) 776-0800; or the Office of General Counsel at (202) 728-8071.

# **Background and Discussion**

The Rule 9700 Series provides redress, where justified, for persons aggrieved by the operations of any automated quotation, execution or communication system owned or operated by FINRA that is not otherwise provided for under the Code of Procedure (Rule 9000 Series) or the Uniform Practice Code (Rule 11000 Series). Historically, the Rule 9700 Series has been used for appeals of staff Over-the-Counter Bulletin Board (OTCBB) eligibility determinations under Rule 6530.<sup>2</sup>

### **July 2008**

#### **Notice Type**

Rule Amendment

#### Suggested Routing

- Executive Representatives
- ➤ Legal
- Operations
- Systems
- Trading

### Key Topic(s)

- Automated Systems
- General Grievances
- Over-the-Counter Bulletin Board (OTCBB)
- ➤ OTCBB Eligibility Rule

#### Referenced Rules & Notices

- NASD Rule 6530
- ➤ NASD Rule 9000 Series
- NASD Rule 9700 Series
- NASD Rule 11000 Series



Under the current version of the Rule 9700 Series, a party that is aggrieved by the operation of a FINRA automated system may request a review by a hearing panel. In accordance with the current provisions, the aggrieved party may, in turn, request a review of the hearing panel's decision by a "Committee" designated by FINRA's Board of Governors (Board).3 With respect to OTCBB eligibility reviews, both of these reviews pursuant to the Rule 9700 Series are solely to determine whether the issuer filed a complete report with the SEC or other appropriate regulator by the applicable due date and, thus, its security is eligible for continued quotation. There is no discretion to grant extensions of time for ineligible securities to become eligible or for any other form of relief.

Given that these reviews focus on one narrow issue, FINRA proposed, and the SEC approved, amendments to the Rule 9700 Series to streamline the review process.<sup>4</sup> As amended, reviews of staff determinations under the Rule 9700 Series are adjudicated by a Hearing Officer appointed by the FINRA Office of Hearing Officers, subject to discretionary review by the National Adjudication Committee (NAC) (acting through its Review Subcommittee).<sup>5</sup> If a staff determination is appealed to a Hearing Officer, the Hearing Officer prepares a written decision that is provided to the NAC's Review Subcommittee, which has the ability to call the decision for review within 21 days after receipt of such decision. Any call for review is at the sole discretion of the NAC's Review Subcommittee and, as such, there is no right to appeal a Hearing Officer decision to the NAC's Review Subcommittee. The Hearing Officer decision, if not called for review by the NAC's Review Subcommittee, constitutes final FINRA action on the matter.

Additionally, the amendments provide that, if a decision is called for review by the NAC's Review Subcommittee, a Subcommittee of the NAC will conduct the review.6 Based on its review, the Subcommittee makes a recommendation to the NAC which, in turn, will issue a decision on the matter. The decision of the NAC constitutes final FINRA action. An aggrieved party continues to have the right to appeal the Hearing Officer's decision, or the NAC decision, as applicable, to the SEC.

These amendments become effective on August 1, 2008. Additional information relating to the operation of the amendments, including how an aggrieved person may request a review and where review requests and applicable fees should be directed, can be found in the "Frequently Asked Questions" on the OTCBB Web site at www.otcbb.com.

#### **Endnotes**

- See Securities Exchange Act Release No. 57786 (May 6, 2008), 73 FR 27595 (May 13, 2008) (order approving SR-NASD-2007-052).
- The OTCBB is a facility for the publication of quotations in eligible OTC equity securities of issuers that are subject to the filing of financial reports with the SEC (or other appropriate regulator) and are current in their reporting. FINRA staff monitors the submission of such periodic reports to determine an issuer's initial and continued eligibility for quotation on the OTCBB and, pursuant to Rule 6530, restricts the quoting of securities of issuers that are late or delinquent in filing periodic reports.
- 3 Currently, the NASDAQ Listing and Hearing Review Council (NLHRC) has authority to review hearing panel decisions. NLHRC decisions may be called for further review by the Board solely upon the request of one or more Governors. Finally, an aggrieved party also has the right to appeal a decision to the SEC.

- FINRA also made conforming and nonsubstantive changes to Rules 6530 and 9120 to reflect the amended review process contained in the Rule 9700 Series.
- Other aspects of the review process, including the scope of review, notifications and time periods for requesting review and applicable fees for review under the Rule 9700 Series, will not be changed by the amendments.
- The timelines for such a review are set forth in amended Rule 9760.

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#### **ATTACHMENT A**

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

\* \* \* \*

#### 6530. OTCBB-Eligible Securities

A member shall be permitted to quote the following categories of securities in the Service:

(a) through (d) No Change.

(e)(1) Notwithstanding the foregoing paragraphs, a member shall not be permitted to quote a security if:

(A)[(1)] while quoted on the OTCBB, the issuer of the security has failed to file a complete required annual or quarterly report by the due date for such report (including, if applicable, any extensions permitted by SEC Rule 12b-25) three times in the prior two-year period; or

(B)[(2)] the security has been removed from the OTCBB due to the issuer's failure to satisfy paragraph (a)(2), (3) or (4), above, two times in the prior two-year period.

(2) If an issuer's security becomes ineligible for quotation on the OTCBB pursuant to paragraph (e)(1)(A) above, the security will be removed from quotation on the OTCBB without the benefit of any grace period for the third delinquency, except that NASD will provide seven calendar days from the date notification is mailed to the issuer pursuant to paragraph (f)(1) to permit an aggrieved party to request a review of the determination by a Hearing Officer (as defined in Rule 9120(p))[hearing panel] pursuant to paragraph (f) below. Following the removal of an issuer's security pursuant to this paragraph (e), such security shall not be eligible for quotation until the issuer has timely filed in a complete form all required annual and quarterly reports due in a one-year period. For purposes of this paragraph, a report filed within any applicable extensions permitted by Rule 12b-25 under the Exchange Act will be considered timely filed. [Furthermore, filings for reporting periods ending before October 1, 2005 will not be considered for purposes of this paragraph (e).]

(f)(1) No Change.

- (2) Pursuant to the Rule 9700 Series, as modified herein, an aggrieved party may request a review by a  $\underline{H}[h]$  earing [panel] Officer of the determination that an issuer's security is ineligible for quotation under this rule. NASD must receive the request for review at least two business days prior to the scheduled removal of the security, together with a \$4,000 hearing fee payable to NASD to cover the cost of review. A request for review under this paragraph (f)(2) will stay the removal of the issuer's security from the Service until the H[h]earing [panel]Officer issues a decision under Rule 9750. The H[h]earing [panel]Officer will consider only the issues of whether the issuer's security is then eligible for quotation in the Service and/or whether the issuer filed a complete report by the applicable due date taking into account any extensions pursuant to Rule 12b-25 under the Exchange Act. The H[h]earing [panel]Officer shall not have discretion to grant any extensions of time for ineligible securities to become eligible. Notwithstanding any contrary provision in the Rule 9700 Series, hearings will be conducted via telephone and NASD will provide the aggrieved party at least five business days notice of the hearing unless the aggrieved party waives such notice.
- (3) [The aggrieved party may request a review of a hearing panel's decision under Rule 9760. Such a request for review must be accompanied by a \$4,000 fee payable to NASD to cover the cost of review.] The decision of the Hearing Officer may be called for review by the Review Subcommittee of the National Adjudicatory Council as set forth in Rule 9760. This review will only consider whether the issuer's security, at the time of the initial review under paragraph (f)(2), was eligible for quotation in the Service and/or whether the issuer filed a complete report by the applicable due date taking into account any extensions pursuant to Rule 12b-25 under the Exchange Act. There will be no discretion to grant extensions of time for ineligible securities to become eligible. [A request for review under this paragraph (f)(3) shall not stay t]The removal of the issuer's security from the Service will be stayed until the earlier of written notice that the National Adjudicatory Council's Review Subcommittee will not call the decision for review, the expiration of the time allowed to exercise a call for review under Rule 9760 or a decision is issued by the National Adjudicatory Council as set forth in Rule 9760 and there will be no discretion to grant extensions of time for ineligible securities to become eligible]. Notwithstanding any contrary provision in the Rule 9700 Series, a review under this paragraph (f)(3) will be based on the written record, unless additional hearings are ordered by the Subcommittee as set forth in Rule 9760. If any further hearings are ordered, the hearings may[will] be conducted via telephone and NASD will provide the aggrieved party at least five business days notice of the hearing unless the aggrieved party waives such notice.

\* \* \* \* \*

#### 9120. Definitions

- (a) through (o) No Change.
- (p) "Hearing Officer"

The term "Hearing Officer" means an employee of NASD who is an attorney and who is appointed by the Chief Hearing Officer to act in an adjudicative role and fulfill various adjudicative responsibilities and duties described in the Rule 9200 Series regarding disciplinary proceedings, the Rule 9550 Series regarding expedited proceedings, the Rule 9700 Series relating to grievances concerning NASD automated systems, and the Rule 9800 Series regarding temporary cease and desist proceedings brought against members and associated persons.

(q) through (cc) No Change.

#### 9700. Procedures on Grievances Concerning the Automated Systems

#### 9710. Purpose

The purpose of this Rule 9700 Series is to provide, where justified, redress for persons aggrieved by the operations of any automated quotation, execution, or communication system owned or operated by NASD, or any subsidiary thereof, and approved by the Commission, not otherwise provided for by NASD Rules [the Code of Procedure as set forth in the Rule 9000 Series, or the Uniform Practice Code as set forth in the Rule 11000 Series].

#### 9720. Form of Application

All applications shall be in writing, and shall specify in reasonable detail the nature of and basis for the redress requested. If the application consists of several allegations, each allegation shall be stated separately. All applications must be signed and shall be directed to NASD's Office of Hearing Officers relating to automated quotation, execution or communications system owned or operated by NASD.

#### 9730. Request for Hearing

Upon request, the applicant shall be granted a hearing after reasonable notice. In the absence of such request for a hearing, NASD's Office of Hearing Officers may, in its discretion, have any application set down for hearing or consider the matter on the basis of the application and supporting documents.

#### 9740. Consideration of Applications

All applications shall be considered by a <u>Hearing Officer</u> (as defined in Rule 9120(p)) appointed by the Chief Hearing Officer (as defined in Rule 9120(b))[hearing panel designated by the Board of Governors]. <u>Unless otherwise specified in NASD rules</u>, [T]the applicant shall be entitled to be heard in person or telephonically and by counsel and to submit any relevant matter. In any such proceeding a record shall be kept.

#### 9750. Decision

Decisions on applications shall be in writing and a copy shall be sent to the National Adjudicatory Council's Review Subcommittee (as defined in Rule 9120(aa)) [by mail to the applicant]. If not called for review in accordance with Rule 9760, the Hearing Officer shall issue its decision after being notified by the National Adjudicatory Council's Review Subcommittee that the decision will not be called for review or upon expiration of the time allowed for call for review. The Hearing Officer[hearing panel may] shall promptly[communicate its determination] provide a copy of the written decision to the applicant [prior to the issuance of a written decision], which shall be effective as of the time of such issuance[communication]. The written decision shall contain the reasons supporting the Hearing Officer's[hearing panel's] conclusions. The Hearing Officer's decision shall constitute final NASD action.

### 9760. [Review by the Committee]

[The decision shall be subject to review by a committee designated by the Board of Governors that is comprised of at least 50% non-industry committee members (the "Committee") on its own motion within 45 calendar days after issuance of the written decision. Any such decision shall also be subject to review upon application of any person aggrieved thereby, filed within 15 calendar days after issuance. The institution of a review, whether on application or on the initiative of the Committee, shall not operate as a stay of the decision.]

#### [9770. Findings of the Committee on Review]

[Upon consideration of the record, and after such further hearings as it shall order, the Committee shall affirm, modify, reverse, dismiss, or remand the decision. The Committee shall set forth specific grounds upon which its determination is based.]

### [9780. Discretionary Review by the Board] Call for Review by the **National Adjudicatory Council**

[Determinations of the Committee may be reviewed by the NASD Board of Governors solely upon the request of one or more Governors not later than the NASD Board meeting next following the Committee's decision but which is 15 calendar days or more following the decision of the Committee. Notwithstanding the preceding sentence, the NASD Board may determine it is advisable to call for review any decision of the Committee within the 15 calendar day period following the decision of the Committee. Such review, which may be undertaken solely at the discretion of the Board, shall be in accordance with resolutions of the Board governing the review of Committee determinations. The Board shall affirm, modify or reverse the determinations of the Committee or remand the matter to the Committee with appropriate instructions. The institution of discretionary review by the Board shall not operate as a stay of the decision.]

The National Adjudicatory Council's Review Subcommittee (as defined in Rule 9120(aa)) may call for review a proposed decision that was prepared pursuant to Rule 9750 within 21 days after receipt of the decision from the Office of Hearing Officers. If the Review Subcommittee calls the proceeding for review within the prescribed time, a Subcommittee (as defined in Rule 9120(cc)) of the National Adjudicatory Council shall meet and conduct a review not later than 40 days after the call for review. The <u>Subcommittee shall be composed in accordance with Rule 9331(a)(1). The</u> Subcommittee may elect to hold a hearing or decide the matter on the basis of the record made before the Hearing Officer. Not later than 60 days after the call for review, the Subcommittee shall make its recommendation to the National Adjudicatory Council. Not later than 60 days after receipt of the Subcommittee's recommendation, the National Adjudicatory Council shall serve a final written decision on the applicant via overnight courier or facsimile. The National Adjudicatory Council may affirm, modify or reverse the decision of the Hearing Officer. In addition, the National Adjudicatory Council may remand the matter to the Office of Hearing Officers for further consideration of specified matters. In any such proceeding a record shall be

kept. The National Adjudicatory Council's written decision shall constitute final NASD action. The institution of a call for review by the National Adjudicatory Council shall stay the effectiveness of the Hearing Officer's decision.

### [9790.]9770. Application to Commission for Review

Any decision <u>issued</u> [not appealed] under <u>Rule 9750 or</u> Rule 9760, <u>as applicable</u>, [or called for review under Rule 9760 or Rule 9780] shall <u>constitute</u> [become the] final NASD action [upon expiration of the time allowed for appeal or call for review]. [In any case where a] <u>A</u> person [feels] aggrieved by any final NASD action issued pursuant to Rule <u>9750[9770]</u> or Rule <u>9760[9780</u>, the person] may make application for review to the Commission in accordance with the Act.

# Regulatory Notice

# 08-35

# Public Offerings of DPPs and REITs

# SEC Approves Amendments to NASD Rule 2810 (Direct Participation Programs)

Effective Date: August 6, 2008

# **Executive Summary**

NASD Rule 2810 (Direct Participation Programs) addresses the regulation of compensation, fees and expenses in public offerings of direct participation programs and unlisted real estate investment trusts. Effective August 6, 2008, amendments to Rule 2810:<sup>1</sup>

- 1. provide greater clarity to the Rule's underwriting compensation limits and the use and allocation of offering proceeds;
- 2. require disclosure regarding the liquidity of prior programs offered by the same sponsor;
- 3. prohibit sales loads on reinvested dividends; and
- **4.** enable *bona fide* training and education meetings at appropriate locations.

Questions concerning this Notice should be directed to

- ➤ Joseph E. Price, Vice President, Corporate Financing Department, at (240) 386-4642;
- ➤ Gary L. Goldsholle, Vice President and Associate General Counsel, Office of the General Counsel (OGC), at (202) 728-8104; or
- Adam H. Arkel, Assistant General Counsel, OGC, at (202) 728-6961.

### **July 2008**

#### **Notice Type**

> Rule Amendment

#### **Suggested Routing**

- Corporate Financing
- Compliance
- ➤ Legal
- Operations
- Senior Management

#### Key Topic(s)

- ➤ Compensation Limitations
- Direct Participation Programs
- ➤ Due Diligence
- ➤ Loads on Reinvested Dividends
- Real Estate Investment Trusts

#### Referenced Rules & Notices

- NASD Rule 1031
- NASD Rule 2810
- ➤ NTM 04-50
- ➤ NTM 82-51



## **Background and Discussion**

NASD Rule 2810 governs the underwriting terms and arrangements of direct participation programs (DPPs) and unlisted real estate investment trusts (REITs) (collectively, Investment Programs). The Rule requires that, prior to participating in a public offering of an Investment Program, the participating member firm, or a participating firm that files on behalf of other member firms, must file information regarding the offering with the FINRA Corporate Financing Department and receive a "no objections" opinion regarding the proposed terms and arrangements in the offering. Among the terms and arrangements that are reviewed by FINRA staff are the level of organization and offering expenses (O&O expenses).

# **O&O** Expenses

Rule 2810 limits the amount of O&O expenses for an Investment Program to 15 percent of the gross proceeds of the offering. O&O expenses have three components: (1) issuer expenses that are reimbursed or paid for with offering proceeds; (2) underwriting compensation; and (3) due diligence expenses. Each of these items is discussed below.

#### A. Issuer Expenses

Issuer expenses that are reimbursed or paid for with offering proceeds in connection with the offering typically include such items as:

- (i) assembling and mailing offering materials, processing subscription agreements and generating advertising and sales materials;
- (ii) legal and accounting services provided to the sponsor or issuer;
- (iii) salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer;
- (iv) transfer agents, escrow holders, depositories, engineers and other experts; and
- (v) registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees.

Issuer expenses that are reimbursed or paid for out of offering proceeds must be specifically identified in the filing with FINRA. Because FINRA staff cannot determine whether unaccountable payments to a sponsor or issuer or payments designated as "miscellaneous" are *bona fide* issuer expenses, FINRA staff will include such payments as part of underwriting compensation.

#### B. Underwriting Compensation

Rule 2810 also limits the amount of underwriting compensation, from whatever source,² that can be paid to underwriters, broker-dealers or affiliates for an Investment Program to 10 percent of the gross proceeds of the offering. The 10 percent limit on underwriting compensation is included as part of the 15 percent limit on 0&O expenses. For example, an Investment Program may have issuer and due diligence expenses equal to 5 percent of the gross proceeds of the offering, and underwriting compensation expenses equal to 10 percent of the gross proceeds from whatever source. It is important to understand that the 10 percent limit for underwriting compensation may not be exceeded, even if the total of all O&O expenses is below 15 percent. By way of further example, an Investment Program with issuer expenses equal to 3 percent of the gross proceeds is not permitted to use 12 percent of the gross proceeds for underwriting compensation; the maximum amount of underwriting compensation is capped at 10 percent of the gross proceeds of the offering.

The limit on underwriting compensation includes all items of compensation, paid from whatever source, such as any amounts deducted from the offering proceeds or amounts paid to member firms, underwriters or affiliates in the form of trail commissions.<sup>3</sup> Once member firms have been paid in the aggregate compensation that reaches this limit, either in the form of front-end commission payments, trail commissions, fee reimbursements or a combination of these payments, then no member firm may receive additional compensation.

Underwriting compensation includes payments to wholesaling or retailing firms engaged in the solicitation, marketing, distribution or sales of Investment Program securities. It also includes payments for training and education meetings, and contributions to conferences and meetings held by non-affiliated broker-dealers for their registered representatives. Payments related to legal services provided to a broker-dealer participating in the offering and advertising and sales material generated by a broker-dealer participating in the offering will also be counted as underwriting compensation.<sup>4</sup>

#### C. Due Diligence

The final component of O&O expenses is due diligence expenses. The amendments to Rule 2810 eliminate the 0.5 percent cap on due diligence expenses. Thus, all bona fide due diligence expenses that are included on a detailed and itemized invoice and presented by the member firm to the Investment Program or other entity that pays or reimburses such expenses will be included as part of the O&O expenses. Alternatively, the amount of due diligence expenses may be treated in the calculation of underwriting compensation as a non-accountable expense provided that, when aggregated with all other non-accountable expenses, the amount does not exceed 3 percent of the offering proceeds.

### Allocation of Compensation

#### A. Dual Employees

Rule 2810(b)(4)(D) addresses the allocation of compensation for dual employees of the issuer or Investment Program sponsor and an affiliated broker-dealer. The amendments are designed to achieve clarity and ease of administration by taking an "all-in" or "all-out" approach to allocating compensation, with two important exceptions discussed below.

In general, payments to registered persons will be "all-in" and included as underwriting compensation, whereas payments to unregistered persons will be "all-out" and not included as underwriting compensation.<sup>7</sup> The Rule contemplates two types of payments to registered persons: (1) transaction-based compensation to registered persons in connection with the offering of the Investment Program; and (2) non-transaction-based compensation to registered persons who are nevertheless engaged in the solicitation, marketing, distribution or sales of an Investment Program's securities. As noted above, both types of payments are "all-in" and included as part of the 10 percent limit on underwriting compensation.

The Rule contains an exception for non-transaction-based compensation to registered persons whose (1) job functions in connection with the offering are solely and exclusively clerical or ministerial or (2) whose sales activities in connection with the Investment Program are *de minimis* and incidental to their clerical or ministerial job functions.<sup>8</sup> The exception does not employ a particular metric with respect to how much time engaged in sales activities would constitute more than a *de minimis* level. The exception is intended to be a very narrow one for registered persons whose sales activities are truly incidental to their primary job functions.

#### B. Allocations in Connection With More Than One Offering

If a dual employee receives compensation, expenses or other payments for services provided in connection with more than one Investment Program, or for private placements in addition to an Investment Program(s), payments to such employees may be reasonably allocated among the offerings. When filing information with FINRA under Rule 2810, firms should provide a reasonable allocation of all payments, expenses and overhead, taking into account relevant factors, including, but not limited to, the time periods spent on particular offerings, the relative sizes of the offerings, resource allocation and the number of investors in each program. The filings should include an explanation of the factors the firm relied on in its proposed allocation of payments and expenses between programs. In the course of FINRA staff's review of particular offerings, information and representations by member firms with respect to such factors will vary. Rule 2810 does not codify these factors and their respective weights; rather, staff will continue its current review practices to permit reasonable basis allocations.

#### C. Individual Employee Analysis

In general, issuers prefer to characterize non-transaction-based compensation as issuer-expenses rather than underwriting compensation. Yet, if a registered representative receives non-transaction-based compensation, all compensation paid to such person will be treated as underwriting compensation under the "all-in" approach outlined above, unless such person falls within the narrow clerical and ministerial or *de minimis* exception. Notwithstanding the efficiencies and clarity provided by the "all-in" approach, FINRA staff will conduct a detailed per-employee analysis for up to ten registered representatives regarding whether a portion of such registered representative's non-transaction-based compensation should be included as part of issuer expenses rather than underwriting compensation. Specifically, FINRA staff will, where sufficient information is provided by the Investment Program, make a determination as to whether some portion of a registered representative's non-transaction based-compensation should be treated as issuer expenses with respect to the following:

- ➤ dual employees of a member firm and the sponsor, issuer or other affiliate with respect to an Investment Program with 10 or fewer registered representatives that engage in solicitation, marketing, distribution or sales of the Investment Program's securities; or
- dual employees who are among the top ten highest-paid executives in an Investment Program based on non-transaction-based compensation.<sup>10</sup>

As discussed above, for all other registered representatives who are dual employees, the amendments provide that their total compensation is either "all in" the underwriting compensation calculation or "all out." In order for FINRA to conduct the per-employee analysis for up to ten dual employees, as noted above, firms must provide information from which FINRA staff can readily determine the time spent in particular job functions. While FINRA staff will always include transaction-based compensation in the compensation calculation, staff may determine based on its review that certain salary or non-transaction-based payments made to a dual employee should be allocated to issuer expenses if the person is engaged in activities other than solicitation, marketing, distribution or sales of the Investment Program's securities.<sup>11</sup>

#### Reinvested Dividends

Rule 2810(b)(4)(B)(vi) provides that it shall be presumed an unfair and unreasonable business practice to charge a sales load or commission on securities purchased through the reinvestment of dividends. To avoid disruption of prior offerings, this prohibition does not apply to any offering the registration statement for which became effective, pursuant to the Securities Act of 1933, prior to August 6, 2008, the effective date of the rule change. In addition, to avoid the indirect payment of loads on reinvested dividends, the Rule provides that the calculation of 10 percent of the gross proceeds of the offering excludes securities purchased through the reinvestment of dividends.

## Liquidity Disclosure

As amended, the disclosure provisions set forth in Rule 2810(b)(3)(D) require member firms and their associated persons to inform prospective investors whether the sponsor has offered prior Investment Programs for which the prospectus disclosed a date or time period when the program might be liquidated, and whether the prior programs in fact liquidated on or around that date or time period. This provision requires that member firms selling Investment Programs must disclose whether prior programs offered by the program sponsor liquidated on or during the date or time period disclosed in the prospectuses for those programs. For example, if a sponsor has offered 10 prior programs and only two of them liquidated by the date or time period set forth in the prospectus, the firm would be required to disclose these facts on a quantified, numerical basis.

FINRA recognizes that delays in liquidity may be due to market conditions and other factors beyond the sponsor's control and that, in some cases, investors may benefit from delays in liquidity. It is permissible to convey these facts, when relevant, in addition to the facts regarding the sponsor's liquidity track record, so long as investors are provided with a complete picture of liquidity issues upon which to base an investment decision.

It is FINRA staff's view that a member firm is permitted to rely upon the liquidity information as provided to the member firm by the sponsor or general partner of the Investment Program, provided that the firm does not know or have reason to know that the information is inaccurate.

# Location of Training and Education Meetings

FINRA believes that an important part of *bona fide* training and education meetings for Investment Programs may be inspecting real estate, oil and gas production facilities, and other types of assets that will be held and managed by the program. Accordingly, Rule 2810(c)(2)(ii) has been amended to provide that a training or education meeting may include a location at which a "significant or representative" asset is located.

#### **Endnotes**

- See Exchange Act Release No. 57803 (May 8, 2008), 73 FR 27869 (May 14, 2008) (Order Approving Proposed Rule Change; File No. SR-NASD-2005-114).
- 2 Payments contributed to or paid by the sponsor, issuer or an affiliate to or on behalf of a participating member will be included in the compensation calculation.
- 3 Trail commissions for Investment Programs are included as part of the 10 percent underwriting compensation. See NASD Notice to Members 04-50 (July 2004) (Treatment of Commodity Pool Trail Commissions under Rule 2810).
- 4 Legal services provided to a broker-dealer typically include, but are not limited to: filing the offering with FINRA; responding to FINRA comments; and drafting and reviewing dealer, marketing and other agreements in connection with the offering.
- 5 The 0.5 percent cap on due diligence expenses, like the 15 percent cap for O&O expenses and the 10 percent cap for underwriting compensation, had been FINRA policy since 1982. See NASD Notice to Members 82-51 (October 1982) (Direct Participation Program Compensation Guidelines).
- 6 An issuer or sponsor may reimburse a law firm conducting due diligence on behalf of a member firm or member firms directly, so that the firm need not go through the extra step of first itself paying the law firm and then seeking reimbursement from the issuer or sponsor. FINRA is of the view that a law firm could not provide bona fide due diligence to the member firm in an offering if its client is the issuer or sponsor. Further, FINRA has no

- view as to the method of reimbursement for due diligence services that should be used so long as it does not undermine the law firm's duties to its client, the broker-dealer.
- 7 Firms that do not appropriately register individuals who are engaged in the member's investment banking or securities business will be in violation of NASD Rule 1031 and subject to enforcement action.
- Though legal, compliance and internal audit personnel are permitted to be registered, their functions would be considered "clerical or ministerial" for purposes of the exception if their functions are confined exclusively to the exercise of their "compliance" responsibilities and do not involve any solicitation, marketing, distribution or sales of the Investment Program (including supervision of anyone involved in such activities).
- 9 The Investment Program may have no more than 10 registered representatives engaged in such activities.
- 10 The term "executive" is not intended as a formal job designation or title, but rather as a characterization of the registered representative dual employee's role in the Investment Program. Member firms must identify in filings which executives are the Investment Program's top ten based on non-transaction-based compensation.
- 11 Payments related to the *supervision of* employees engaged in solicitation, marketing, distribution or sales of an Investment Program's securities (*e.g.*, salaries, bonuses, expense reimbursements and like payments) will be included in the compensation calculation.

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Regulatory Notice

#### **Attachment A**

Text of Proposed Amendments to Rule 2810. Proposed additions are underlined; proposed deletions are in brackets.

#### 2810. Direct Participation Programs

- (a) No Change.
- (b) Requirements
  - (1) Application

No member or person associated with a member shall participate in a public offering of a direct participation program, [or] a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2340(d)(4) ("REIT"), except in accordance with this paragraph (b), provided however, this paragraph (b) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that complies with subparagraph (2)(D).

- (2) No Change.
- (3) Disclosure
- (A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.
  - (B) through (C) No Change.
- (D) Prior to executing a purchase transaction in a direct participation program or a REIT, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment[;]. Included in the pertinent facts shall be information regarding whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during the time period. [provided, however, that paragraph (b) shall not apply to an initial or secondary public offering of a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program which complies with subparagraph (2)(D).]

#### (4) Organization and Offering Expenses

- (A) No member or person associated with a member shall underwrite or participate in a public offering of a direct participation program or REIT if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.
- (B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:
  - (i) organization and offering expenses, as defined in subparagraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor, exceed an amount that equals fifteen percent of the gross proceeds of the offering:
  - [i] (ii) the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail commissions," payable to underwriters, broker/dealers, or affiliates thereof[, which are deemed to be in connection with or related to the distribution of the public offering,] exceeds an amount that equals ten percent of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends) [currently effective compensation guidelines for direct participation programs published by the Association];[\*]
  - [(ii) organization and offering expenses paid by a program in which a member or an affiliate of a member is a sponsor exceed currently effective guidelines for such expenses published by the Association;\*\*]
    - (iii) No change.
  - (iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program or REIT, unless such person is a registered broker/dealer or a person associated with such a broker/dealer; [or]

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program [units] or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an[d] over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items; [provided however, that an arrangement which provides for continuing compensation to a member or person associated with a member in connection with a public offering shall not be presumed to be unfair and unreasonable if all of the following conditions are satisfied:]

[a. the continuing compensation is to be received only after each investor in the program has received cash distributions from the program aggregating an amount equal to his cash investment plus a six percent cumulative annual return on his adjusted investment;]

[b. the continuing compensation is to be calculated as a percentage of program cash distributions;]

[c. the amount of continuing compensation does not exceed three percent for each one percentage point that the total of all compensation pursuant to subparagraph (B)(i) received at the time of the offering and at the time any installment payment is made fall below nine percent; provided, however, that in no event shall the amount of continuing compensation exceed 12 percent of program cash distributions; and

[d. if any portion of the continuing compensation is to be derived from the limited partners' interest in the program cash distributions, the percentage of the continuing compensation shall be no greater than the percentage of program cash distributions to which limited partners are entitled at the time of the payment.]

(vi) the program or REIT charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act of 1933 became effective prior to [the effective date of this proposed rule change]; or

(vii) the member has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

(C) The organization and offering expenses subject to the limitations in subparagraph (b)(4)(B)(i) above include the following:

(i) issuer expenses that are reimbursed or paid for with offering proceeds, including overhead expenses, which issuer expenses include, but are not limited to, expenses for:

<u>a. assembling, printing and mailing offering materials, processing subscription agreements, generating advertising and sales materials;</u>

b. legal and accounting services provided to the sponsor or issuer;

c. salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer;

<u>d. transfer agents, escrow holders depositories, engineers and other experts; and</u>

e. registration and qualification of securities under federal and state law, including taxes and fees and NASD fees;

(ii) underwriting compensation, which includes but is not limited to items of compensation listed in Rule 2710(c)(3) including payments:

<u>a. to any wholesaling or retailing firm that is engaged in the</u> <u>solicitation, marketing, distribution or sales of the program or REIT</u> securities:

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering, except to the extent that such compensation has been included in a. above;

c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities, except:

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- 1. to the extent that such compensation has been included in a. above:
- 2. for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and
- 3. for a registered representative whose sales activities are de minimis and incidental to his or her clerical or ministerial job functions; or
- d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.
- (iii) due diligence expenses incurred when a member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document.
- (D) Notwithstanding subparagraphs (b)(4)(C)(ii)b. and c. above, for every program or REIT filed with the Corporate Financing Department (the "Department") for review, the Department shall, based upon the information provided, make a determination as to whether some portion of a registered representative's non-transaction-based compensation should not be deemed to be underwriting compensation if the registered representative is either:
  - (i) a dual employee of a member and the sponsor, issuer or other affiliate with respect to a program or REIT with ten or fewer registered representatives engaged in wholesaling, in which instance the Department may make such determination with respect to the ten or fewer registered representatives engaged in wholesaling; or
  - (ii) a dual employee of a member and the sponsor, issuer or other affiliate who is one of the top ten highest paid executives based on nontransaction-based compensation in any program or REIT.

[(C)](E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, brokers/dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

[(D)](F) The determination of whether compensation paid to underwriters, broker/dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

- (i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk or purposes of this paragraph (b) if the affiliate:
  - a. through b. No Change.

c. has a net worth equal to at least five percent of the net proceeds of the public offering or \$1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) No Change.

Regulatory Notice

[(E)](G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph [(E)](C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) through (v) No Change.

#### (5) Valuation for Customer Account Statements

No member may participate in a public offering of direct participation program or REIT securities unless[:] [(A)] the general partner or sponsor of the program or <u>REIT</u> will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Act a per share estimated value of the direct participation program securities, the method by which it was developed, and the date of the data used to develop the estimated value.

(6) No Change.

#### (c) Non-Cash Compensation

- (1) No Change.
- (2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation <u>program or</u> <u>REIT</u> securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

- (A) through (B) No Change.
- (C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:
  - (i) No Change.

- (ii) the location is appropriate to the purpose of the meeting, which shall mean a United States[an] office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to [regional] meetings with direct participation programs or REITs, a United States location at which a significant or representative asset of the program or REIT is located;
  - (iii) through (iv) No Change.
- (D) through (E) No Change.
- (d) No Change.

[\* A guideline for underwriting compensation of ten percent of proceeds received, plus a maximum of 0.5% for reimbursement of bona fide diligence expenses was published in Notice to Members 82-51 (October 19, 1982).]

[\*\* A guideline for organization and offering expenses of 15 percent proceeds received was published in Notice to Members 82-51 (October 19, 1982).]

Regulatory Notice

# Regulatory Notice

# 08-36

# Fair Prices and Commissions

# SEC Approves Amendments to Expand the Scope of NASD Rule 2440 and IM-2440-1 to All Securities Transactions

Effective Date: June 13, 2008

# **Executive Summary**

Effective June 13, 2008, the requirements in NASD Rule 2440 and IM-2440-1 relating to fair prices and commissions expressly apply to all securities transactions involving member firms and their customers, whether executed over-the-counter or on an exchange.¹ The text of Rule 2440 and IM-2440-1, as amended, is set forth in Attachment A of this *Notice*.

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or the Office of General Counsel at (202) 728-8071.

# Background and Discussion

NASD Rule 2440 (Fair Prices and Commissions) generally requires member firms, in any over-the-counter (OTC) transaction with or for a customer, to charge only fair commissions or charges, and to buy or sell securities only at fair prices. Specifically, Rule 2440 provides that when acting for its own account in a transaction with a customer, a member firm must buy or sell the security at a fair price to the customer, "taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that [the firm] is entitled to a profit." Additionally, the Rule provides that when acting as agent on behalf of its customer, the firm must not "charge [its] customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service [the firm] may have rendered by reason of [its] experience in and knowledge of such security and the market therefore."

### **July 2008**

#### **Notice Type**

Rule Amendment

#### **Suggested Routing**

- Compliance
- Executive Representatives
- ➤ Legal
- Operations
- Senior Management
- ➤ Systems
- Trading
- Training

#### Key Topic(s)

- Commissions
- Mark-Downs
- Mark-Ups
- ➤ Mark-Up Policy
- Prices

#### Referenced Rules & Notices

- ➤ NASD IM-2440-1
- ➤ NASD IM-2440-2
- ➤ NASD Rule 2110
- NASD Rule 2440



The related Mark-Up Policy, NASD IM-2440-1, provides additional guidance on mark-ups and fair pricing of securities transactions with customers, and states that it is inconsistent with just and equitable principles of trade under NASD Rule 2110 for a member firm to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission that is not reasonable.2

Although the text of Rule 2440 and IM-2440-1 was limited to OTC transactions prior to the recent amendments, FINRA has taken the position that a firm charging excessive compensation in a transaction with a customer executed on an exchange violates Rule 2110. That Rule requires that a member firm must, in the conduct of its business, "observe high standards of commercial honor and just and equitable principles of trade."3

To further clarify firms' obligations to charge fair commissions and mark-ups (or mark-downs), FINRA proposed, and the Securities and Exchange Commission (SEC) approved, amendments to Rule 2440 and IM-2440-1 to apply these provisions expressly to all securities transactions, whether they occur in the OTC market or on an exchange.4 Thus, a member firm that charges unfair and excessive commissions or mark-ups (mark-downs) in any customer transaction, whether it is an OTC or exchange transaction, would potentially violate Rule 2440 and the interpretive material thereunder, as applicable.

These amendments became effective on June 13, 2008, the SEC approval date.

#### **Endnotes**

- See Securities Exchange Act Release No. 57964 (June 13, 2008), 73 FR 35180 (June 20, 2008) (order approving SR-NASD-2006-005).
- Subsequent to the filing of the amendments described herein, the SEC approved amendments that, among other things, renumbered IM-2440 as IM-2440-1 and adopted NASD IM-2440-2, which supplements the guidance provided in IM-2440-1. See Securities Exchange Act Release No. 55638 (April 16, 2007), 72 FR 20150 (April 23, 2007) (order approving SR-NASD-2003-141). Accordingly, the revised scope of Rule 2440 and IM-2440-1 described herein also applies to IM-2440-2.
- 3 See Rule 2110. See also Atlanta-One, Inc. v. SEC, 100 F.3d 105, 107 n.1 (9th Cir. 1996), which states "[a]lthough [Rule 2440] deals with the appropriate level of compensation in retail transactions in the over-the-counter market, the [Rule] provides guidance by analogy as to appropriate commissions for exchange transactions."
- Currently, Rule 2440 and IM-2440-1 do not apply to transactions in municipal securities and exempt securities, nor do they apply to member firm-to-member firm transactions. The amendments do not change this.

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#### **ATTACHMENT A**

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

\* \* \* \* \*

#### 2440. Fair Prices and Commissions

In ["over-the-counter"] <u>securities</u> transactions, whether in "listed" or "unlisted" securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefore.

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

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

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

- (a) through (b) No change.
- (c) Transactions to Which the Policy is Applicable

The policy applies to all securities[ handled in the over-the-counter market], whether oil royalties or any other security, in the following types of transactions:

- (1) through (5) No change.
- (d) No change.

\* \* \* \* \*

# Regulatory Notice

# 08-37

# **Trading Activity Fee**

FINRA Reminds Firms that the Trading Activity Fee Is Assessed on Exchange-Listed Options Transactions when FINRA Is the DOEA

# **Background & Discussion**

FINRA is required to assess a Trading Activity Fee (TAF) on all member firms for the sale of covered securities pursuant to Section 1 of Schedule A to the FINRA By-Laws. The TAF, along with other revenue components, funds FINRA's member regulatory activities. FINRA assesses the TAF on its member firms through clearing and self-clearing firms.

Among the transactions excluded from the TAF are those in exchange-listed options effected by a member firm when FINRA is not the designated options examining authority (DOEA) for that firm.<sup>1</sup> This exclusion was created so that the TAF applies only to those firms for which FINRA has regulatory responsibility for options activities, *i.e.*, those firms for which FINRA acts as the DOEA in accordance with a joint plan adopted pursuant to the provisions of Rule 17d-2 under the Securities Exchange Act.<sup>2</sup>

As a result of the consolidation of NASD and NYSE member regulation operations in 2007, FINRA has assumed DOEA responsibilities for those firms that were previously assigned to the NYSE. Consequently, FINRA currently serves as DOEA for all FINRA member firms<sup>3</sup> and the list published in NTM 05-03 is no longer accurate. An updated list of all FINRA member firms can be found at www.finra.org/memberfirms.

FINRA reminds member firms that they should ensure the TAF is reported and paid on exchange-listed options in conformity with Section 1 of Schedule A to the FINRA By-Laws. In addition, FINRA reminds clearing firms that they must report and pay the TAF on transactions in exchange-listed options on behalf of all correspondent firms that are members of FINRA.

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

### **July 2008**

#### **Notice Type**

➤ Guidance

#### **Suggested Routing**

- Compliance
- Legal
- Operations
- Senior Management

### Key Topic(s)

- ➤ Options Exemption
- Regulatory Fees
- ➤ Trading Activity Fee

#### **Referenced Rules & Notices**

- ➤ NTM 05-03
- Schedule A to the FINRA By-Laws



#### **Endnotes**

- See Section 1(b)(2)(K) of Schedule A to the FINRA By-Laws.
- See Order Granting Approval of Proposed Rule Change and Amendment Nos. 1 and 2, and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., to Eliminate the Regulatory Fee and Institute a Transaction-Based Trading Activity Fee, Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (SR-NASD-2002-148) and NTM 05-03.
- See Notice of Filing and Order Approving and Declaring Effective an Amendment to the Plan for the Allocation of Regulatory Responsibilities Among the American Stock Exchange LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the International Securities Exchange, LLC, Financial Industry Regulatory Authority, Inc., The New York Stock Exchange, LLC, the NYSE Arca, Inc., The NASDAQ Stock Market LLC, and the Philadelphia Stock Exchange, Inc., Securities Exchange Act Release No. 57987 (June 18, 2008), 73 FR 36156 (June 25, 2008).

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# Regulatory Notice

# 08-38

# SEC Emergency Orders on Short Selling

# FINRA Provides Clarification on SEC Guidance Regarding Emergency Orders Concerning Short Selling

## **Executive Summary**

On July 15, 2008, the Securities and Exchange Commission (SEC) issued an Emergency Order concerning short selling and on July 18, 2008, issued an Amendment to Emergency Order (Orders). On July 18, 2008, the SEC staff of the Division of Trading and Markets issued *Guidance Regarding the Commission's Emergency Order Concerning Short Selling* (Guidance). The Orders and Guidance address the naked short selling of 19 public companies.

In part, the Orders provided that "no person may effect a short sale in these securities using the means or instrumentalities of interstate commerce unless such person or its agent has borrowed or arranged to borrow the security or otherwise has the security available to borrow in its inventory prior to effecting such short sale and delivers the security on settlement date." Questions have arisen as to how to document and operationally handle these pre-borrows, especially in light of the possession and control requirement under Securities Exchange Act (SEA) Rule 15c3-3.

This *Regulatory Notice* explains that when using pre-borrowed shares to make delivery on a short sale of a security covered by the Orders, the firm must clearly document the link between the borrow, the short sale and the related delivery, so as to demonstrate that it has not otherwise violated possession or control requirements of SEA Rules 15c3-3(b) and (d). Failure to follow these steps will likely cause violations of the Orders or SEA Rule 15c3-3.

Questions regarding this *Notice* should be directed to Yui Chan, Managing Director, Risk Oversight & Operational Regulation, at (646) 315-8426.

### **July 2008**

#### **Notice Type**

➤ Guidance

#### **Suggested Routing**

- Compliance
- ➤ Legal
- Operations
- Senior Management

### Key Topic(s)

- Short Selling
- Possession or Control

#### Referenced Rules & Notices

➤ SEA Rule 15c3-3



# **Background and Discussion**

Several firms have indicated that they intend to comply with the Orders by borrowing or arranging to borrow a security prior to effecting the short sale of that security for themselves or their customers. Since the borrow or arrangement to borrow must take place no later than trade date of the short sale (*i.e.*, three business days before settlement date), other activity in that security, such as the possession or control requirements of SEA Rule 15c3-3, can interfere with the use of the borrowed shares to satisfy the delivery obligations under the Orders. For example, if a firm arranges to borrow shares and then on settlement date finds it has a possession or control deficit in the same security, under the normal operation of Rule 15c3-3, part or all of the borrowed shares would need to be retained to satisfy the deficit before the remaining shares, if any, were delivered in satisfaction of the short sale delivery requirement. The SEC addresses this issue in Question 7 of the Guidance, which reads as follows:

Question: How does the Order apply if a broker-dealer that has a delivery obligation with respect to a short sale of a security subject to this Order has a deficit in its possession-and-control obligation for that security under Exchange Act Rule 15c3-3(b)?

Answer: The broker-dealer must comply with the applicable provisions of Rule 15c3-3(b). Generally, a delivery of securities that are in a possession-and-control deficit is prohibited if it would create or increase a deficiency in the quantity of securities by class and issuer required to be in possession and control. The SEC staff has issued no-action relief from certain possession and control provisions of Rule 15c3-3 to broker-dealers that conduct a securities-borrowed-and-loan-"conduit" business. That relief also applies to the publicly traded securities traded under the ticker symbols listed in Appendix A to the Order.

FINRA has received several inquiries from firms regarding the operational implementation of Question 7 as it relates to the "conduit" interpretation. As a result of these inquiries, FINRA has discussed with the SEC Staff of the Division of Trading and Markets how the no-action relief related to "conduit" business may be used to comply with the Orders.

In 1991, SEC staff issued a no-action letter that required six conditions to be met in order for a broker-dealer to conduct a conduit securities borrow and loan business outside of the limits of Rule 15c3-3(d). If all six conditions were met, the broker-dealer did not need to recall securities loaned in the conduit account to ameliorate a possession or control deficit because the securities that were part of the conduit account were considered separate from the customer-related securities borrows and loans. SEC staff is using the same concept to allow securities borrowed to be used in making a delivery on the short sale of any security covered by the Orders.

Specifically, SEC staff has stated that a broker-dealer may use borrowed shares to meet its delivery obligation under the Orders, if it can satisfy two conditions similar to those contained in the 1991 no-action letter addressing conduit business, without regard to the segregation requirements of SEA Rule 15c3-3(b). First, the firm must be able to identify in its books and records that the securities to be delivered have been borrowed to complete the short sales. It is up to each firm to devise an acceptable method of identifying such shares and attributing those shares to specific short sales. Acceptable methods include the use of ledger codes, separate internal account types or subaccounts. Second, the borrowed shares may not be commingled with other customer or proprietary positions and must be distinguished from other securities lending transactions. The prohibition on commingling may be satisfied through the firm's records as described above; a separate clearance account is not required.

If these conditions can be met, the firm will be allowed to use borrowed shares to meet its delivery requirements under the Orders, irrespective of whether a possession or control deficit under SEA Rule 15c3-3 exists. Firms should note that use of the borrowed shares to meet their delivery requirements under the Orders does not alleviate their responsibility to take appropriate and timely action, as required by SEA Rules 15c3-3(b) and (d), to reduce to possession or control securities affected by the Orders.

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# Regulatory Notice

08-39

# Variable Insurance Products

# FINRA Requests Comments on Proposed New Rules Governing Communications About Variable Insurance Products

Comment Period Expires: September 30, 2008

# **Executive Summary**

FINRA requests comment on proposed changes to guidelines on illustrations of tax-deferred versus taxable compounding in advertising and sales literature (NASD Interpretive Material 2210-1) and communications with the public about variable life insurance and variable annuities (NASD Interpretive Material 2210-2). The proposal would:

- shorten and simplify existing provisions regarding product identification, liquidity and guarantee claims;
- consolidate previous FINRA staff guidance concerning variable insurance product communications;
- address changes in variable insurance products and the manner in which they are advertised, particularly with regard to riders, hypothetical illustrations and investment analysis tools; and
- codify FINRA staff guidance concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding.

Questions concerning this *Notice* should be directed to Joseph P. Savage, Vice President and Counsel, Investment Companies Regulation, at (240) 386-4534; or Thomas A. Pappas, Vice President and Director, Advertising Regulation, at (240) 386-4553.

# **July 2008**

#### **Notice Type**

Request for Comment

#### **Suggested Routing**

- Advertising
- ➤ Legal & Compliance
- Operations
- Senior Management

#### Key Topic(s)

- Communications with the Public
- Supervision
- ➤ Variable Insurance Products

#### Referenced Rules & Notices

- NASD Rule 2210
- ➤ NASD IM-2210-1
- ➤ NASD IM-2210-2
- ➤ NASD IM-2210-3
- ➤ NASD IM-2210-6
- ➤ NTM 99-35



### **Action Requested**

FINRA encourages all interested parties to comment on the proposed changes. Comments must be received by September 30, 2008. Member firms and other interested parties can submit their comments by:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:

Marcia E. Asquith Office of the Corporate Secretary **FINRA** 1735 K Street, NW Washington, DC 20006-1500

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposals.

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

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the Federal Register.<sup>2</sup>

# **Background & Discussion**

#### A. **Background**

FINRA proposes to update and consolidate the rules governing member firm communications with the public about variable insurance products. The core of these rules is found in NASD Interpretive Material 2210-2 (Communications with the Public About Variable Life Insurance and Variable Annuities) (Guidelines). FINRA adopted the Guidelines in 1993 and has issued related interpretations in various publications since then. Through the review of communications submitted by firms to FINRA's advertising filings program, the FINRA Advertising Regulation Department staff has developed additional interpretations of the Guidelines.

FINRA proposes to modernize the Guidelines in a number of respects. Certain of its provisions would be shortened and simplified. Other changes would address areas that have seen significant changes since the Guidelines were first issued, particularly with respect to the use of riders and hypothetical illustrations. The proposal also would codify previous FINRA guidance concerning the use of comparative illustrations of the mathematical principles of tax-deferred versus taxable compounding in communications.

#### B. Definitions

Proposed IM-2210-2 would contain for the first time a separate paragraph of defined terms. The purpose of this section is to clarify the meaning of certain terms used throughout the proposed rule. The definitions section is not intended to define insurance-related terms in other contexts beyond the scope of this rule.

#### C. <u>Product Identification and Liquidity</u>

Proposed paragraphs (b) and (c) in IM-2210-2 would address product identification and liquidity issues raised by variable insurance products communications. These provisions would shorten and simplify the provisions currently contained in paragraphs (a)(1) and (a)(2) of the Guidelines.

Proposed paragraph (b) would require that all communications clearly identify the type of product discussed and would prohibit communications from representing or implying that a variable insurance product is a mutual fund.

Proposed paragraph (c) would prohibit communications from falsely implying that variable insurance products are short-term, liquid investments. Paragraph (c) also would require any presentation regarding access to account values to be balanced by a description of the potential effect of all charges, penalties or tax consequences resulting from a redemption or surrender. In addition, any discussion of loans and withdrawals would have to explain their impact on account values and death benefits. These requirements generally reflect provisions contained in the Guidelines.<sup>3</sup>

#### D. Guarantee Claims and Riders

Communications concerning variable insurance products frequently emphasize guarantees or riders, particularly to the extent that they protect an investor in a down market. FINRA recognizes the need to communicate the features of these guarantees and riders through sales material. However, it is equally important that these communications discuss guarantees and riders in a fair and balanced manner.

Currently, the Guidelines address claims about guarantees but do not specifically address riders. The proposal would incorporate the concepts concerning guarantee claims in the Guidelines and also propose specific provisions regarding riders.<sup>4</sup>

Similar to the Guidelines, the proposal would prohibit member firms from exaggerating the relative benefits of a guarantee, or an insurance company's financial strength or credit rating. Any discussion of a guarantee would have to disclose all material applicable limitations or qualifications. In addition, communications regarding guarantees would have to disclose that the investment return and principal value of an investment option are not guaranteed and will fluctuate.

Paragraph (d)(3) of the proposal states that communications that discuss the circumstances under which a guarantee or rider will benefit the customer must be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer. While this provision would not require exhaustive disclosure of every circumstance in which a rider would not benefit a customer, any presentation regarding riders could not be one-sided and would have to present a fair and balanced description of the circumstances under which the rider would not benefit customers. In addition, paragraph (d)(4) would require rider discussions to explain the nature of the rider, its costs and limitations and the fact that it is an optional feature of the contract.

#### E. **Oualified Plans**

FINRA previously has expressed concerns with recommendations to purchase a variable annuity through a tax-qualified account, such as an individual retirement account. The concerns relate to the fact that a variable annuity does not provide any additional tax-deferred treatment of earnings beyond the treatment provided by the tax-qualified retirement plan itself. FINRA recognizes that there may be reasons other than tax deferral to recommend the purchase of a variable annuity through a tax-qualified account. However, we have reminded firms that a registered representative should recommend the purchase of a variable annuity through a tax-qualified account only when other benefits, such as lifetime income payments, family protection through the death benefit or guaranteed fees, support the recommendation.<sup>5</sup>

The same rationale applies to communications concerning a variable insurance product offered through a tax-qualified retirement plan. Accordingly, paragraph (e) of the proposal would prohibit any such communication from indicating that the tax-deferred treatment of earnings is available only through investment in the contract, and would require disclosure that the contract does not provide any additional tax-deferred treatment of earnings beyond the treatment of earnings provided by the retirement plan.

#### **Historical Performance**

Proposed paragraph (f) would govern the various types of variable insurance product historical performance that a member firm may include in communications. These provisions generally reflect positions that FINRA staff has taken through the filings review program.

#### **Variable Annuity Performance**

Proposed paragraph (f)(1) would provide that member firms may present historical performance in communications regarding variable annuities only in accordance with Rule 482 under the Securities Act of 1933 or Rule 34b-1 under the Investment Company Act of 1940, as applicable.

#### **Variable Life Insurance Policy Performance**

Proposed paragraph (f)(2) would allow member firms to present historical performance information in communications regarding variable life insurance policies. The standards imposed by this paragraph generally reflect standards that FINRA staff previously has published regarding variable life insurance policy performance information.<sup>6</sup> At a minimum, this performance must reflect the deduction of all fees and charges applicable at the investment option level.<sup>7</sup>

Communications that present variable life insurance policy performance also would have to prominently disclose:

- whether the performance reflects the deduction of additional fees and charges disclosed in the prospectus other than at the investment option level;
- ➤ the fees and charges disclosed in the prospectus not deducted from the performance (e.g., life insurance premiums); and
- ➤ that if all fees and charges disclosed in the prospectus had been deducted, the performance quoted would have been lower.

Proposed paragraph (f)(2)(C) would require communications that present variable life insurance policy performance to urge investors to obtain a personalized hypothetical illustration. Upon such investor request, a member firm would be required to provide an illustration that reflects all applicable fees and charges disclosed in the prospectus, including the cost of insurance. The illustration also would have to conform to the provisions governing assumed rate hypothetical illustrations contained in paragraph (g) and would have to be customized to reflect an individual investor's characteristics and preferences.<sup>8</sup>

Presentations of investment option performance in variable life insurance communications would have to be consistent with the standards for the presentation of open-end management investment company performance in SEC Rule 482. Thus, such performance would have to be current to the most recent calendar-quarter ended prior to the submission of the communication for publication, and show the average annual total return for one-, five- and ten-year periods, or since its inception if the investment option's registration statement had been in effect for less than those periods. This requirement is consistent with current industry practice.

#### **Pre-Dated Performance**

Proposed paragraph (f)(3) would allow, but not require, member firms to present the performance of an investment option that occurred during the period prior to its availability through the separate account of a variable insurance product. For example, this provision would allow a firm to show an investment option's entire performance history, even if the investment option became available through the separate account subsequent to its inception. This provision reflects current FINRA policy to permit pre-dated performance, 10 subject to certain conditions:

- First, any such presentation would have to meet the requirements of paragraphs (f)(1) and (f)(2), as applicable. Because pre-dated performance is non-standardized performance for purposes of SEC Rule 482, it would have to be accompanied by the investment option's standardized performance if the investment option has been available through the separate account for more than one year. In such a circumstance, the pre-dated performance would have to be accompanied by the investment option's performance commencing on the date it became available through the separate account.
- Second, pre-dated performance for variable annuities either would have to be net of maximum guaranteed charges, or would have to be accompanied by performance that is net of such charges.<sup>11</sup>
- ➤ Third, there could not be any significant change to the investment objectives, strategies or policies of the investment option during the period for which performance is shown. For example, it would not be appropriate to present pre-dated performance of an investment option that formerly had the objective of investing in growth stocks and had since converted into a fixed-income fund.
- > Fourth, the pre-dated performance could not reflect the performance of a fund that is not available as an investment option through the separate account. Thus, presentation of the performance of a similar "clone" fund that is not available through the separate account would not be permitted.
- > Fifth, the communication would have to identify the period during which the pre-dated performance occurred and would have to explain that the performance pre-dates the availability of the investment option through the separate account.

#### **Combined Historical Performance**

Proposed paragraph (f)(4) would allow, but not require, a member firm to present the combined performance of multiple investment options, subject to certain conditions:

 First, the presentation would have to satisfy the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable. For example, if the combined historical performance included pre-dated performance, the presentation would have to meet the requirements of paragraph (f)(3).

- ➤ Second, the communication also would have to present the individual performance of each investment option included within the combined performance. Again, this performance would have to be consistent with the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable.
- ➤ Third, the communication would have to disclose the names of the investment options included in the combined performance, the investment percentage allocated to each investment option for purposes of the combined performance calculation and that the combined historical performance is hypothetical because it is based on assumed investment allocations.

#### Historical Performance Illustrations

Proposed paragraph (f)(5) would allow, but not require, a member firm to present an illustration based on the historical performance of individual investment options or combinations of investment options using assumed dollar investments, subject to certain conditions:

- First, the illustration would have to be accompanied by historical performance that satisfies the requirements of paragraphs (f)(1), (f)(2), (f)(3) and (f)(4), as applicable.
- > Second, the illustration would have to present dollar values that are net of fees imposed at the investment option level, and for variable annuity illustrations, net of maximum guaranteed charges.
- Third, the illustration would have to present year-by-year account values in a tabular or bar-chart format that labels and defines all columns or bars.
- ➤ Fourth, the illustration would have to explain that it is based on a hypothetical dollar investment and that it is not intended to predict or project future performance.

#### **Historical Performance of Selected Investment Options**

In some cases, a firm may present the performance of one or more investment options without presenting the performance of all investment options available through the separate account. In such situations, the member firm would have to disclose that the investment options depicted are not the only ones offered within a product.

#### G. <u>Illustrations Based on Assumed Rates of Return</u>

Proposed paragraph (g) would address the use of illustrations that are based on assumed rates of return rather than on investment options' historical performance. Firms could present hypothetical illustrations based on assumed rates of return to demonstrate the way a variable insurance product operates, subject to a number of conditions.

#### Single Assumed Rates of Return

Proposed paragraph (g)(2) would allow, but not require, member firms to show investment results based on an assumed positive gross annual rate of return of up to 10 percent, so long as the results reflected the deduction of the maximum guaranteed charges. Assumed rates of return would have to be reasonable considering market conditions and the available investment options.<sup>12</sup>

Proposed paragraph (g)(3) would allow, but not require, a member firm to present an illustration based on an assumed negative annual gross rate of return. Typically, a firm will present a negative assumed annual gross rate of return to show the benefits of a rider that is intended to protect investors in a down market. If a negative assumed rate of return is used, the illustration would have to:

- > show negative investment results that reflect the deduction of maximum guaranteed charges; and
- > show separate investment results that are based on an assumed positive gross annual rate of return of at least 5 percent and not more than 10 percent and that reflect the deduction of maximum guaranteed charges.

The purpose of requiring the presentation of investment results based on a positive rate of return in addition to the negative return is because, over the long term, market returns have been positive. FINRA staff does not believe it is useful to show illustrations where the annual rate of return is constantly negative without balancing such an illustration by also showing a positive rate of return.

#### Multiple Assumed Rates of Return

Proposed paragraph (g)(4) would allow, but not require, a member firm to present an illustration based on multiple assumed rates of return that vary year by year. Currently, FINRA staff allows multiple-rate illustrations based on so-called "random" rates that are determined by the member firm. Under this provision, any illustration that uses multiple rates of return would have to be based on the actual performance of a broadbased securities market index for the period shown by the illustration. "Random-rate" illustrations would no longer be allowed to the extent that they do not reflect the actual performance of a broad-based securities index.

The broad-based securities market index would have to be one that is used as a basis for comparison in discussions of fund performance in prospectuses of available investment options. Thus, for example, if the prospectus for an equity investment option shows the performance of the Standard & Poor's 500 Index as the basis of comparison, the actual performance of this index could be used in a multiple assumed rate illustration.13

Investment results shown for multiple rate illustrations would have to reflect the deduction of maximum guaranteed charges. The illustration also would have to disclose the broad-based securities market index used and that the index does not reflect the performance of any investment option.

FINRA staff believes that requiring member firms to use the actual performance of a broad-based securities market index, rather than so-called "random" rates, is appropriate for two reasons. First, the historical performance of market indices allows investors to see how a variable insurance product would have operated under actual market conditions, rather than under some assumed random series of returns. Second, the use of broad-based securities market indices would enhance comparisons between products, since many illustrations would use the same index.

While member firms would be permitted to use multiple rates of return based on the actual performance of a broad-based securities market index, communications could not state or infer that index performance reflects or is a proxy for the performance of an investment option available through a variable product.

#### **Other Requirements**

Assumed-rate illustrations also would have to meet certain other conditions, regardless of whether they employ a single or multiple assumed rates of return:

- ➤ First, all illustrations would have to show investment results that are based on an assumed gross annual rate of return of 0 percent and that reflect the deduction of the maximum guaranteed charges.
- Second, the illustration would have to be presented in a format that is readily understandable and depicts, at a minimum, year-by-year account values.
- Third, the illustration would have to clearly label and define all values and disclose the gross and net rates of return depicted.
- ➤ Fourth, the illustration either would have to reflect an arithmetic average of all investment option expenses, <sup>14</sup> or reflect a weighted average of investment option expenses. If a firm chose to use a weighted average, the illustration would have to identify the investment options being used and the investment amount allocated to each option. In addition, if a member firm used an illustration that employed a weighted average of expenses with more than one customer, the illustration would have to reflect the current actual weighted average of investment options held by all investors through the separate account. <sup>15</sup>
- ➤ Fifth, the illustration would have to explain prominently that its purpose is to show how the performance of the investment accounts could affect the policy cash value and death benefit, that the illustration is hypothetical and that it does not project or predict future performance.

Although these provisions reflect in part policies that FINRA staff has applied to communications over the years, in some cases (such as with regard to multiple-rate illustrations) these provisions would be new. Firms are invited to comment on whether these provisions provide a useful basis for preparing assumed-rate illustrations. In particular, comment is sought on whether illustrations should be based on current charges imposed on investors rather than the maximum guaranteed charges.

#### H. <u>Use of Rankings</u>

Proposed paragraph (h) would address the use of rankings in variable insurance products communications. This provision would permit member firms to include rankings in advertisements and sales literature, provided that their use is consistent with the standards contained in Interpretive Material 2210-3 (Use of Rankings in Investment Companies Advertisements and Sales Literature).

#### I. <u>Investment Analysis Tools</u>

Proposed paragraph (i) would address the use of investment analysis tools in connection with the offer or sale of variable insurance products. Investment analysis tools are interactive technological tools that present the likelihood of various investment outcomes for named investments or investment strategies. Often these tools employ Monte Carlo simulations to project a range of possible outcomes for certain investments. Proposed paragraph (i) would allow the use of such tools, provided that the firm complied with Interpretive Material 2210-6 (Requirements for the Use of Investment Analysis Tools). In addition, member firms would have to employ a tool that either:

- > produces results that reflect the deduction of maximum guaranteed charges; or
- provides the user with a personalized hypothetical illustration that reflects these charges.

#### J. <u>Comparative Illustrations</u>

The proposal also would add new language to paragraph (5) of IM-2210-1 (Guidelines to Ensure that Communications with the Public Are Not Misleading) concerning comparative illustrations of the mathematical principle of tax-deferred versus taxable compounding contained in communications. Much of this language reflects previous guidance that FINRA has provided regarding tax-deferral illustrations. <sup>16</sup> By placing this rule language in IM-2210-1, FINRA is clarifying that these standards apply to any illustration of tax-deferred versus taxable compounding, regardless of whether it appears in a communication promoting variable insurance products or some other communication, such as one discussing the benefits of investing through a 401(k) retirement plan or individual retirement account.

Communications concerning such comparative illustrations would have to meet certain requirements:

- ➤ First, the illustration would have to depict both the taxable and tax-deferred investments using identical investment amounts and identical assumed gross rates of return, which could not exceed 10 percent per annum.
- Second, the illustration would have to use and identify actual federal income tax rates.
- Third, the illustration could (but would not have to) reflect an actual state income tax rate, provided that the communication is used only with investors that reside in the identified state.
- ➤ Fourth, tax rates used in an illustration that is intended for a target audience would have to reasonably reflect its tax bracket as well as the tax character of capital gains and ordinary income. Thus, for example, if money that is withdrawn from a tax-deferred account is taxed as ordinary income, the illustration could not employ a lower capital gains income tax rate.
- Fifth, if the illustration covered the payout period for an investment, the illustration would have to reflect the impact of taxes during this period.
- > Sixth, the illustration could not assume an unreasonable period of tax deferral.
- > Seventh, the illustration would have to include certain disclosures, as applicable. It would have to disclose the extent to which tax rates on capital gains and dividends would affect the taxable investment's return and state its underlying assumptions and the potential impact resulting from federal or state tax penalties for early withdrawals. The illustration also would have to state that an investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision, as it may not reflect these factors.

#### **Endnotes**

- 1 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See Notice to Members 03-73 (November 2003) (NASD Announces Online Availability of Comments).
- 2 Section 19 of the Securities Exchange Act (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and the rules thereunder.
- 3 See IM-2210-2(a)(2).
- 4 The proposal would define the term "rider" as "an additional provision to a contract that adds or excludes coverage." *See* proposed paragraph IM-2210-2(a)(6).
- 5 See Notice to Members 99-35 (May 1999) (The NASD Reminds Members Of Their Responsibilities Regarding The Sales Of Variable Annuities).
- 6 See "Presentation Of Variable Life Insurance Performance In Member Communications," NASD Regulation, Inc., Regulatory & Compliance Alert (Winter 2001) pp. 3-4.
- 7 "Investment option" would be defined as "an open-end management investment company (or series thereof) offered through the separate account." See proposed IM-2210-2(a)(3). Thus, this provision would require, at a minimum, the deduction of expenses imposed at the underlying fund (sub-account) level, but not the deduction of expenses imposed at the separate account or contract level.

- 8 See proposed IM-2210-2(a)(5).
- 9 See SEC Rules 482(d)(3) and 482(g)(1)(i) under the Securities Act of 1933.
- 10 See IM-2210-2(b)(1). See also "Variable Annuity Performance," NASD Regulatory & Compliance Alert (Summer 2002) pp. 8-9.
- 11 The proposal would define "maximum guaranteed charges" as "the maximum recurring and non-recurring charges as disclosed in the prospectus of a variable insurance product that all investors incur at the variable insurance contract level, but does not include charges for optional riders. The term also includes the cost of insurance for purposes of a communication concerning a variable life insurance policy." See proposed IM-2210-2(a)(4).
- 12 In the past, FINRA has permitted assumed rates of return of up to 12 percent per annum, as long as they were accompanied by illustrations showing a 0 percent assumed rate of return. See, e.g., "Internal Rates of Return in Variable Life Hypothetical Illustrations," NASD Regulation, Inc., Regulatory & Compliance Alert (Winter 1998), pp. 31-32. FINRA proposes to decrease the maximum single assumed rate of return to 10 percent.
- 13 Assumed rates of return based on the actual performance of a broad-based securities market index would not be subject to the 10 percent maximum set forth in paragraph (g)(2). In addition, to the extent a broad-based securities market index reflects negative performance in certain years, the illustration would not be required also to show an assumed positive rate of return as required under paragraph (g)(3).

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# **Endnotes (cont'd)**

- 14 The proposal would define "arithmetic average of investment option expenses" as "the number obtained by dividing the sum of all investment option expenses by the number of investment options offered through the separate account." See proposed IM-2210-2(a)(1).
- 15 In the past, FINRA has permitted member firms to reflect a weighted average of fund level expenses in variable life insurance hypothetical illustrations used with more than one customer, subject to certain conditions. The illustration had to be accompanied or preceded by a policy prospectus, and it had to be accompanied by a general illustration that reflects the arithmetic average of underlying fund expenses. See "Fund Level Expenses in Variable Life Hypothetical Illustrations," NASD Regulation, Inc., Regulatory & Compliance Alert (Spring 2002) p. 12. FINRA proposes to alter the requirements applicable to the use of a weighted average of expenses with more than one customer by no longer requiring that they be accompanied by a prospectus, and by requiring the illustration to reflect the current actual weighted average of investment options held by all investors through the separate account.
- 16 See "NASD Reminds Members of Their Responsibilities Regarding Hypothetical Tax-Deferral Illustrations in Variable Annuity Illustrations," NASD Member Alert (May 10, 2004).

#### ATTACHMENT A

Below is the text of the proposed changes to IM-2210-1. New text is underlined.

# IM-2210-1. Guidelines to Ensure That Communications With the Public **Are Not Misleading**

Every member is responsible for determining whether any communication with the public, including material that has been filed with the Department, complies with all applicable standards, including the requirement that the communication not be misleading. In order to meet this responsibility, member communications with the public must conform with the following guidelines. These guidelines do not represent an exclusive list of considerations that a member must make in determining whether a communication with the public complies with all applicable standards.

(1) - (4) No Change.

#### (5) Tax Considerations

(A) In advertisements and sales literature, references to tax-free or taxexempt income must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

(B) A comparative illustration of the mathematical principles of tax-<u>deferred versus taxable compounding must meet the following requirements:</u>

(i) The illustration must depict both the taxable investment and the tax-deferred investment using identical investment amounts and identical assumed gross investment rates of return, which may not exceed 10 percent per annum.

(ii) The illustration must use and identify actual federal income tax rates.

(iii) The illustration also may reflect an actual state income tax rate, provided that the communication is used only with investors that reside in the identified state.

- (iv) Tax rates used in an illustration that is intended for a target audience must reasonably reflect its tax bracket or brackets as well as the tax character of capital gains and ordinary income.
- (v) If the illustration covers the payout period for an investment, the illustration must reflect the impact of taxes during this period.
- (vi) The illustration may not assume an unreasonable period of tax deferral.
  - (vii) The illustration must disclose, as applicable:
  - (a) the extent to which tax rates on capital gains and dividends would affect the taxable investment's return;
    - (b) its underlying assumptions;
  - (c) the potential impact resulting from federal or state tax penalties for early withdrawals; and
  - (d) that an investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision, as the illustration may not reflect these factors.
- (6) No Change.

Below is the text of the proposed changes to IM-2210-2, which replaces the current text in its entirety.

### IM-2210-2. Communications with the Public About Variable Insurance **Products**

This Interpretive Material applies to all communications with the public about variable insurance products other than institutional sales material.

#### (a) Definitions

For purposes of this Interpretive Material, the following definitions will apply:

- (1) "Arithmetic average of investment option expenses" means the number obtained by dividing the sum of all investment option expenses by the number of investment options offered through the separate account.
- (2) "Cost of insurance" means the investor's actual cost of life insurance protection for a variable life insurance policy.
- (3) "Investment option" means an open-end management investment company (or series thereof) offered through the separate account.
- (4) "Maximum guaranteed charges" means the maximum recurring and nonrecurring charges as disclosed in the prospectus of a variable insurance product that all investors incur at the variable insurance contract level, but does not include charges for optional riders. This term includes the cost of insurance for purposes of a communication concerning a variable life insurance policy.
- (5) "Personalized hypothetical illustration" means an illustration that conforms to the provisions of paragraph (g) below, customized to reflect an individual investor's characteristics and preferences.
- (6) "Rider" means an additional provision to a contract that adds or excludes coverage.
- (7) "Weighted average of investment option expenses" means an average of investment option expenses that is proportional to the allocation of assets to each investment option.

#### (b) Product Identification

All communications must clearly identify the type of product discussed. The communication may not represent or imply that variable insurance products are mutual funds.

#### (c) Liquidity

The communication may not falsely imply that variable insurance products are short-term, liquid investments. Presentations regarding access to account values must be balanced by a description of the potential effect of all charges, penalties, or tax consequences resulting from redemption or surrender. Discussions of loans and withdrawals must explain their impact on account values and death benefits.

#### (d) Guarantee Claims and Riders

- (1) Communications may not exaggerate the relative benefits of a guarantee, or the insurance company's financial strength or rating. Discussions of guarantees must disclose all material applicable limitations or qualifications.
- (2) Communications that discuss a guarantee must disclose that the investment return and principal value of the investment options are not guaranteed and will fluctuate.
- (3) Communications that discuss the circumstances under which a guarantee or rider will benefit the customer must be fair and balanced considering the circumstances under which the guarantee or rider will not benefit the customer.
- (4) Any communication that discusses a rider must explain the rider, its costs and limitations, and the fact that the rider is an optional feature of the contract.

#### (e) Qualified Plans

Any member communication concerning a variable insurance product offered within a tax-qualified retirement plan:

- (1) must not indicate that tax-deferred treatment of earnings is available only through investment in the contract; and
- (2) must disclose that the contract does not provide any additional tax-deferred treatment of earnings beyond the treatment of earnings provided by the tax-qualified retirement plan.

#### (f) Historical Performance

#### (1) Variable Annuity Historical Performance

Members may present historical performance information in communications regarding variable annuities only in accordance with SEC Rule 482 under the Securities Act of 1933 or SEC Rule 34b-1 under the Investment Company Act of 1940, as applicable.

#### (2) Variable Life Historical Performance

Members may present historical performance information in communications regarding variable life insurance policies only in accordance with the following conditions:

- (A) At a minimum, the performance must reflect the deduction of all fees and charges applicable at the investment option level.
  - (B) The communication must prominently disclose:
  - (i) whether the performance reflects the deduction of additional fees and charges disclosed in the prospectus other than at the investment option level;
  - (ii) the fees and charges disclosed in the prospectus not deducted from the performance; and
  - (iii) that, if all fees and charges disclosed in the prospectus had been deducted, the performance quoted would be lower.
- (C) The communication must urge investors to obtain a personalized hypothetical illustration. If an investor requests a personalized hypothetical illustration, the illustration must reflect all applicable fees and charges disclosed in the prospectus, including the cost of insurance.
- (D) Any presentation of investment option performance must be consistent with the standards for the presentation of performance information for open-end management investment companies in SEC Rule 482 under the Securities Act of 1933.

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# (3) Investment Option Performance Predating Its Availability through the Separate Account

Communications may present the performance of an investment option that occurred during the period prior to its availability through the separate account of a variable insurance product ("pre-dated performance"), provided that the communication meets the following conditions:

- (A) The presentation of performance satisfies the requirements of paragraphs (f)(1) and (f)(2), as applicable. In particular, if the investment option has been available through the separate account for more than one year, the pre-dated performance is accompanied by performance of the investment option for the period commencing on the date the investment option became available through the separate account.
- (B) Pre-dated performance for variable annuities must be, or must be accompanied by performance that is, net of maximum guaranteed charges.
- (C) There has been no significant change to the investment objectives, strategies or policies of the investment option during the period for which performance is shown.
- (D) The communication does not include the performance of a fund that is not available as an investment option through the separate account.
- (E) The communication identifies the period during which the pre-dated performance occurred and explains that the performance pre-dates the availability of the investment option through the separate account.

#### (4) Combined Historical Performance

Members may present combined historical performance of multiple investment options, provided the communication satisfies the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable, and meets the following conditions:

(A) The communication presents individual performance of each investment option included within the combined performance consistent with the requirements of paragraphs (f)(1), (f)(2) and (f)(3), as applicable.

- (B) The communication prominently discloses:
- (i) the names of the investment options included in the combined performance;
- (ii) the investment percentage allocated to each investment option for purposes of the combined historical performance calculation; and
- (iii) that the combined historical performance is hypothetical because it is based on assumed investment allocations.

#### (5) Illustrations Based on Historical Performance

Members may present illustrations based on historical performance of individual investment options or combinations of investment options available through a separate account using assumed dollar investments. Such illustrations must be accompanied by historical performance that satisfies the requirements of paragraphs (f)(1), (f)(2), (f)(3) and (f)(4), as applicable, and must:

- (A) present dollar values that are net of fees imposed at the investment option level, and for variable annuity illustrations, net of maximum guaranteed charges;
- (B) present year-by-year account values in a tabular or bar-chart format that labels and defines all columns or bars: and
- (C) prominently explain that the illustration is based on a hypothetical dollar investment and that it is not intended to predict or project future performance.
- (6) Historical Performance of Selected Investment Options

To the extent applicable, communications that present historical performance of one or more selected investment options must disclose that the investment options depicted are not the only ones offered within the product.

#### (g) Illustrations Based on Assumed Rates of Return

Members may present hypothetical illustrations based on assumed rates of return in communications to demonstrate the way a variable insurance product operates, provided that the illustration meets the following conditions:

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- (1) The illustration prominently shows investment results that are based on an assumed gross annual rate of return of 0% and that reflect the deduction of the maximum guaranteed charges.
- (2) At the member's option, the illustration shows investment results that are based on an assumed positive gross annual rate of return of up to 10% and that reflect the deduction of the maximum guaranteed charges. Assumed rates of return must be reasonable considering market conditions and the available investment options.
- (3) At the member's option, the illustration shows investment results that are based on an assumed negative gross annual rate of return and that reflect the deduction of the maximum guaranteed charges. Any such illustration also must show investment results that are based on an assumed positive gross annual rate of return of at least 5% and not more than 10% and that reflect the deduction of the maximum guaranteed charges.
- (4) At the member's option, the illustration shows investment results that are based on the actual performance of an appropriate broad-based securities market index for the period shown by the illustration. The broad-based securities market index must be one that is used as a basis for comparison in discussions of fund performance in the prospectuses of available investment options. The investment results must reflect the deduction of the maximum guaranteed charges. The illustration must disclose the broad-based securities market index used and that the index does not reflect the performance of any investment option.
- (5) The illustration is presented in a format that is readily understandable and depicts, at a minimum, year-by-year account values.
- (6) The illustration clearly labels and defines all values and discloses the gross and net rates of return depicted.
  - (7) The illustration either:
    - (A) reflects an arithmetic average of all investment option expenses; or

- (B) reflects a weighted average of investment option expenses, provided that:
  - (i) the illustration identifies the investment options being used and the amount of investment allocated to each investment option; and
  - (ii) if the illustration is used with more than one customer, it must reflect the current actual weighted average of investment options held by all investors through the separate account.
- (8) The illustration explains prominently that its purpose is to show how the performance of the investment accounts could affect the policy cash value and death benefit, that the illustration is hypothetical and that it does not project or predict future performance.

#### (h) Use of Rankings

Performance rankings may be included in advertisements and sales literature provided their use is consistent with the standards contained in Interpretive Material 2210-3.

#### (i) Investment Analysis Tools

Members that use investment analysis tools in connection with the offer or sale of a variable insurance product must comply with the provisions of Interpretive Material 2210-6. In addition, members must either:

- (1) employ an investment analysis tool the results of which reflect the deduction of maximum guaranteed charges; or
- (2) employ an investment analysis tool that provides a personalized hypothetical illustration which reflects the maximum guaranteed charges.

# Trade Reporting Notice

# FINRA Announces the Effective Date of Modifications to the TRACE System

Effective Date: August 4, 2008

# **Executive Summary**

In a *Trade Reporting Notice* dated February 22, 2008, FINRA announced that it had modified the TRACE system to accept equity CUSIPs<sup>1</sup>, and reminded member firms that they must report transactions to TRACE in securities that are "TRACE-eligible securities," such as unlisted convertible debt, unlisted equity-linked notes and similar debt securities. FINRA also reminded firms that only unlisted convertible debt and unlisted equity-linked notes are treated as debt for purposes of trade reporting; convertible debt and equity-linked notes that are listed on a national securities exchange must be reported to the appropriate equity trade reporting facility.

Effective August 4, 2008, modifications to the TRACE system will allow firms to more easily meet certain of the reporting requirements set forth in the February 22, 2008 *Notice*.<sup>2</sup> FINRA will issue a Technical Notice detailing the system changes and the impact to member firms and data vendors.

Questions concerning this Notice should be directed to:

- tracefeedback@finra.org;
- > FINRA Operations, at (866) 776-0800;
- ➤ Elliot Levine, Chief Counsel, Transparency Services, at (202) 728-8405;
- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973; or
- Office of General Counsel, at (202) 728-8071.

July 1, 2008

### Key Topic(s)

- ➤ Debt Securities with Equity CUSIPs
- ➤ Equity-Linked Notes
- ➤ TRACE

#### Referenced Rules & Notices

- NASD Rule 6200 Series
- ➤ Trade Reporting Notice 02/22/08



#### Discussion

In a *Trade Reporting Notice* dated February 22, 2008, FINRA announced that it had modified the Trade Reporting and Compliance Engine (TRACE) system to accept transaction reports for TRACE-eligible securities that have equity CUSIPs. The February 22, 2008 *Notice* also reminded firms that convertible debt and equity-linked notes that are *not listed* on a national securities exchange are considered debt securities for purposes of trade reporting and must be reported to TRACE. However, when these securities are *listed* on a national securities exchange and traded over-the-counter, they must be reported to FINRA's Alternative Display Facility or one of FINRA's Trade Reporting Facilities.

Effective August 4, 2008, the TRACE system will allow firms to more easily meet certain reporting requirements set forth in the February 22, 2008 *Notice*. Specifically, since certain TRACE-eligible securities such as equity-linked notes often have par values less than \$1000, FINRA is modifying the TRACE system so that transactions in such securities can be reported and disseminated without the need to submit a modified trade entry. FINRA will issue a Technical Notice detailing the system changes and the impact to data vendors and member firms, and also providing guidance on reporting trades in equity-linked notes with par values of less than \$1000.

The modifications will be effective on August 4, 2008.

#### **Endnotes**

- 1 CUSIP stands for Committee on Uniform Securities Identification Procedures and is a registered trademark of Standard and Poor's, Inc. (S&P). Each security is assigned a unique CUSIP by a service administered by S&P. The configuration of an equity CUSIP differs from a debt CUSIP. When the TRACE System was built, it was not designed to accept equity CUSIPs.
- 2 Until the modifications are effective, member firms should report transactions in TRACEeligible securities with equity CUSIPs to Market Regulation via e-mail to the bondreporting@finra.org mailbox or via Paper Form T.

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# Trade Reporting Notice

# FINRA Extends Effective Date of Modifications to the TRACE System to November 3, 2008

In a *Trade Reporting (TR) Notice* dated February 22, 2008, FINRA announced that it modified the Trade Reporting and Compliance Engine (TRACE) System to accept equity CUSIPs, and reminded member firms that they must report transactions to TRACE in securities that are "TRACE-eligible," such as unlisted convertible debt, unlisted equity-linked notes (ELNs) and similar debt securities. FINRA also reminded firms that only unlisted convertible debt and unlisted ELNs are treated as debt for trade reporting purposes; firms must report convertible debt and ELNs that are listed on a national securities exchange to the appropriate equity trade reporting facility.

In a *TR Notice* dated July 1, 2008, FINRA announced that modifications to TRACE that would allow firms to more easily meet certain reporting requirements (as set forth in the February 22, 2008 *TR Notice*) would become effective August 4, 2008. The modifications were to permit firms to report to TRACE, in an automated fashion, transactions in ELNs with par values other than \$1,000. FINRA also issued a Technical Notice email on July 2, 2008, detailing the TRACE changes and anticipated effect on firms and data vendors. On July 26, 2008, FINRA scheduled voluntary testing for firms to determine readiness for the modifications scheduled for August 4, 2008.

FINRA is now changing the effective date for reporting ELNs from August 4, 2008, to November 3, 2008. This extension does not affect any other securities discussed in the February 22 *TR Notice*. FINRA believes that extending the effective date will permit firms to make all necessary changes to their systems, to test the modifications with FINRA prior to November 3 (during scheduled testing dates to be identified by FINRA) and to make system modifications after testing as necessary to comply with TRACE reporting requirements as of November 3.

July 28, 2008

### Key Topic(s)

- Equity-Linked Notes with Equity CUSIPs
- ➤ TRACE

#### Referenced Rules & Notices

- NASD Rule 6200 Series
- Trade Reporting Notice 02/22/08
- Trade Reporting Notice 07/01/08



Questions concerning this *Notice* should be directed to:

- tracefeedback@finra.org;
- > FINRA Operations, at (866) 776-0800;
- ➤ Elliot Levine, Chief Counsel, Transparency Services, at (202) 728-8405;
- > Patrick Geraghty, Director, Market Regulation, at (240) 386-4973; or
- > Office of General Counsel, at (202) 728-8071.

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# Disciplinary and Other FINRA Actions

# Firm Fined, Individual Sanctioned

James I. Black & Company (CRD #1249, Lakeland, Florida) and Jess Gove Tucker III (CRD #450126, Registered Principal, Lakeland, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$125,000, jointly and severally with Tucker, and required to have all of its personnel register for 16 hours of anti-money laundering (AML) training within 60 days of issuance of this AWC. Tucker was suspended from association with any FINRA member in any principal or supervisory capacity for three months. Tucker's fine must be paid either immediately upon reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, the firm and Tucker consented to the described sanctions and to the entry of findings that the firm, acting through Tucker, failed to adequately implement an AML compliance program, in that it failed to adequately detect, investigate and report potentially suspicious activity. The findings stated that the firm, acting through Tucker, failed to conduct sufficient independent tests of its AML program on an annual basis and conduct annual AML training for its personnel.

Tucker's suspension in any principal or supervisory capacity is in effect from June 2, 2008, through September 1, 2008. **(FINRA Case #2006007424601)** 

#### Firms Fined

AIS Financial, Inc. (CRD #41462, Irvine, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$11,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to preserve all of the firm's business-related electronic communications, in that some associated persons frequently used personal email accounts to conduct firm business. The findings stated that some emails were copied or forwarded to an employee with a firm-sponsored account and were, therefore, preserved—but the remaining emails were not. The findings also stated that the firm's written supervisory procedures prohibited firm personnel from sending the firm's business-related electronic communications from a home computer and/or using non-company sponsored electronic communications, but failed to enforce the procedures with respect to the employees who frequently used personal email accounts. (FINRA Case #20070085026-01)

### Reported for July 2008

FINRA has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB).



American Funds Distributors, Inc. (CRD #6247, Los Angeles, California) was censured and fined \$5,000,000. The National Adjudicatory Council (NAC) imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm, as the principal underwriter and distributor of a family of mutual funds, requested and arranged for its parent company to direct a specific amount or percentage of brokerage commissions to other FINRA member firms conditioned upon their sales of the firm's mutual funds.

This decision has been appealed to the Securities and Exchange Commission (SEC), and the sanctions are not in effect pending consideration of the appeal. (FINRA Case #CE320050003)

Cowen and Company, LLC (CRD #7616, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$15,000 and required to revise its written supervisory procedures concerning market order protection and trade reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it incorrectly reported the first leg of "riskless" principal transactions in designated securities to the FINRA/NASDAO Trade Reporting Facility (TRF) because it incorrectly designated the capacity of the transactions as riskless or agent; and incorrectly reported the offsetting, "riskless" portion of "riskless" principal transactions in designated securities to the TRF because it incorrectly designated the capacity of the transactions as principal. The findings stated that the firm failed to report last sale reports of transactions in designated securities to the TRF, and incorrectly denoted a long sale as short exempt on its trading ledger. 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 market order protection and trade reporting. (FINRA Case #20060061841-01)

Crowell, Weedon & Co. (CRD #193, Los Angeles, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to promptly file Submissions of Required Information Pertaining to Members, Member Organizations, Allied Members, Registered and Non-Registered Employees (Forms RE-3) with the New York Stock Exchange (NYSE) in connection with the misappropriation of funds by firm employees. The findings stated that the firm failed to implement a business continuity plan that addressed procedures relating to an emergency or significant business disruption. The findings also stated that the firm failed to make and keep current order tickets identifying who entered or accepted the orders on the customer's behalf of and the receipt time of the orders. (FINRA Cases #2007009457601)

Donnelly Penman & Partners (CRD #104448, Grosse Pointe, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$17,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to conduct and evidence an independent test of its AML program despite the requirement that it monitor compliance with the requirements of the Bank Secrecy Act and the regulations promulgated thereunder and despite prior notifications from FINRA, which included a

Letter of Caution. The findings stated that the firm received checks totaling \$825,843.75 from public customers, placed the checks in a locked drawer rather than in a Special Reserve Bank Account for the Exclusive Benefit of Customers and failed to perform any reserve calculations regarding the checks that the firm held. The findings also stated that the firm failed to abide by the terms of its membership agreement with FINRA, failed to file a request to change its agreement with FINRA 30 days prior to making a material change in its business operations and engaged in business activities without maintaining the required minimum net capital. The findings also included that the firm failed to maintain a checks received and dispersed blotter in violation of SEC Rule 17a-3. (FINRA Case #2007007331401)

EKN Financial Services Inc. (CRD #113525, Woodbury, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$80,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to meet disclosure requirements for research reports; failed to include the required disclosures on the front page of reports in a prominent, clear and comprehensive manner; failed to provide a valuation method to determine the price target and a disclosure of risks that impeded achievement of price targets; failed to maintain records of public appearances by research analysts; failed to balance favorable discussions with disclosures of associated risks; failed to enforce its procedures for reviewing duplicate account statements for the accounts of its brokers, including research analysts, to detect an analyst's purchase of restricted stock; and failed to conduct an annual attestation that the firm had adopted and implemented its research analyst rule procedures.

The findings stated that the firm maintained inaccurate balances in its general ledger and trial balance, and filed inaccurate Financial and Operational Combined Uniform Single (FOCUS) reports. The findings also stated that the firm conducted a securities business while failing to maintain the required minimum net capital, and failed to timely file a FOCUS Part IIA report and an annual audit. The findings also included that the firm failed to amend or file Uniform Applications for Securities Industry Registration or Transfer (Forms U4) and Uniform Termination Notices for Securities Industry Registry (Forms U5), and filed Forms U5 late.

FINRA found that the firm failed to report customer complaints, employee suspensions and an arbitration, and filed reports late or inaccurately pursuant to the NASD Rule 3070 reporting system. FINRA also found that the firm failed to maintain or preserve order tickets and confirmations in connection with equity, corporate debt, short sales and mutual fund transactions. In addition, FINRA determined that the firm failed to preserve and maintain time of order receipt, solicitation status, associated registered representative and/or customer name, and execution price on order tickets for municipal, government security or corporate debt transactions. Moreover, FINRA found that the firm failed to preserve and maintain, in an accessible place, written incoming and outgoing correspondence. Furthermore, FINRA found that the firm indicated on confirmations that it was a market maker in a security when it was not. FINRA also found that the firm permitted \$7,312.91 in excessive commissions to be charged in equity retail transactions, which the firm has since refunded to the affected customers. (FINRA Case #ELI2005000604)

Ferris, Baker Watts, Incorporated (CRD #285, Washington, DC) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$14,000 and required to revise its written supervisory procedures regarding SEC Rule 602 of Regulation NMS (the "one-percent rule"), NASD Rule 2320(g) (the "three-quote rule"), the prohibition against anti-intimidation/coordination, transaction reporting, the handling and transaction reporting of sale transactions, and books and records. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it incorrectly reported the second leg of riskless principal transactions in a designated security to the NASDAQ National Market Center (NMC) because it incorrectly designated the capacity of the transactions as principal; incorrectly reported riskless principal transactions in eligible securities to the NMC because it incorrectly reported the transactions as riskless principal when only a portion of the transactions was riskless; and incorrectly reported a riskless principal transaction in an eligible security to the NMC because it incorrectly reported the transaction was riskless.

The findings stated that the firm, when it acted as principal for its own account, failed to provide written notification disclosing to its customer that it was a market maker in the security; and failed to provide written notification disclosing to its customer that the transaction was executed at an average price. The findings also stated that the firm failed to show the correct price on the ledger itemizing purchases or sales of securities, and failed to show the terms and conditions on brokerage order memoranda. The findings also included that the firm made a report available on the covered orders in national market system securities that it received for execution from any person that included incorrect and incomplete SEC Rule 605 report information. FINRA found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning SEC Rule 602 of Regulation NMS, NASD Rule 2320(g), the prohibition against anti-intimidation/ coordination, transaction reporting, the handling and transaction reporting of sale transactions, and books and records. (FINRA Case #20050004861-01)

Fixed Income Securities, LP nka Advisors Asset Management, Inc. (CRD #46727, Monument, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$15,000, ordered to pay \$1,038.64, plus interest, in restitution to customers, and required to revise its written supervisory procedures concerning fair prices and commissions. Satisfactory proof of restitution or of reasonable and documented efforts undertaken to effect restitution was to be provided to FINRA no later than 120 days after acceptance of the AWC. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it purchased municipal securities for its own account from customers and/or sold municipal securities for its own account to customers at an aggregate price (including any markdown or markup) that was not fair and reasonable, taking into consideration all relevant factors, including the best judgment of the broker, dealer or municipal securities dealer as to the fair market value of the securities at the time of the transactions, and of any securities exchanged or traded in connection with the transactions, the expense involved in effecting the transactions, the fact that the

broker, dealer or municipal securities dealer is entitled to a profit and the total dollar amount of the transactions. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and MSRB rules concerning fair prices and commissions. (FINRA Case #20050001658-01)

HSBC Securities (USA), Inc. (CRD #19585, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$200,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that customers who maintained escrow accounts with the firm's bank affiliate were charged commissions—which were higher than the commissions charged in the past, and, in certain instances, higher than the industry standard—for fixed income securities trades the firm executed on the customers' behalf. The findings stated that the firm failed to take adequate steps to assess the fairness of these commissions and the higher commission charges were premised on the provision of a former registered representative's additional services to the customers when, in fact, he did not provide such services. The findings also stated that the firm lacked adequate written guidelines for markups and commissions on trades for fixed income products, and failed to establish and maintain adequate procedures to monitor the appropriateness of commissions charged to these customers in that the firm: a) failed to establish adequate written guidelines for markups and commissions on fixed income products; b) failed to give adequate guidance as to what factors should be considered in determining what is a fair markup or commission on fixed income products; c) failed to include trades executed for the customers in branch examination reviews; and d) failed to establish reasonable procedures for monitoring fixed income security markups and commissions. (FINRA Case # 2007009471401)

KeyBanc Capital Markets, Inc. (CRD #566, Cleveland, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$30,000 and ordered to pay \$8,378.30, plus interest, in restitution to customers. Satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, was to be provided to FINRA no later than 120 days after acceptance of the AWC. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it sold or bought corporate bonds to or from customers and failed to sell or buy the bonds at a price that was fair, taking into consideration all relevant circumstances, including market conditions with respect to each bond at the time of the transaction, the expense involved and that the firm was entitled to a profit. The findings stated that the firm failed to enforce its written supervisory procedures that specified that no exceptions from its markup/markdown schedule may be made without prior approval of the senior trading manager or sales manager, and that the basis for a markup/markdown in excess of the firm's internal schedule should be demonstrated and documented. (FINRA Case #20060042695-01)

Merrill Lynch, Pierce, Fenner & Smith Incorporated, (CRD # 7691, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$50,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it distributed an informational brochure to a national telecommunications provider's employees detailing its handling of the company's employee stock option plan, but failed to provide a sound basis for evaluating the facts with regard to employing the exercise and hold strategy on margin by omitting disclosure of the associated risks. (FINRA Case #2008013132401)

Morgan Stanley & Co. Incorporated (CRD #8209, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$425,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit, or cause to be submitted, the fingerprints of certain permanent employees, temporary workers, interns and consultants, and failed to investigate the individuals' previous records. The findings stated that the firm failed to provide for, establish and maintain adequate procedures to ensure compliance with NASD rules and federal securities laws relating to the employment of certain permanent employees, temporary workers, interns and consultants who may have been subject to statutory disqualification. (FINRA Case #2007009428301)

Next Financial Group, Inc. (CRD #46214, Houston, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to timely report statistical and summary information regarding customer complaints to FINRA. The findings stated that the firm failed to timely file Form U4 and Form U5 amendments with FINRA to reflect customer complaints against registered representatives. (FINRA Case #2007007165602)

Penson Financial Services, Inc. (CRD #25866, Dallas, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to the Order Audit Trail System (OATS) on 77 business days. The findings stated that the firm failed to report all of its Reportable Order Events (ROEs) it was required to report on these days. (FINRA Case #20060066641-01)

UBS Securities LLC (CRD #7654, Stamford, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that as an Intermarket Trading System/Computer Assisted Execution System (ITS/CAES) market maker, it purchased or sold ITS/CAES securities, whether in a principal capacity or as an agent, at a price lower than the bid or higher than the offer displayed from an ITS participant exchange or ITS/CAES market maker. (FINRA Case #20060047246-01)

# Individuals Barred or Suspended

Jeffrey Steven Adler (CRD #1102075, Registered Representative, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. The fine must be paid either immediately upon Adler's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Adler consented to the described sanctions and to the entry of findings that he settled a customer complaint without notifying his current or previous member firm.

The suspension in any capacity was in effect from June 2, 2008, through June 13, 2008. (FINRA Case #2007009020301)

Marcelo L. Assis (CRD #5137579, Associated Person, Pickerington, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Assis consented to the described sanction and to the entry of findings that he used information obtained from a public customer's driver's license to open a bank account under the customer's name without the customer's consent and knowledge, and signed a bank signature card that would allow him to make deposits into the account and also obtained a debit card for the account. The findings stated that Assis took a \$749 money order made out to a corporate customer to fund the bank account he secretly opened and controlled, and used the debit card for the account to pay for personal items for himself and a friend. The findings stated that Assis also withdrew some of the money from the account through automatic teller machine (ATM) transactions for personal expenses. (FINRA Case #2006006758901)

Philip James Atteberry (CRD #1243495, Registered Principal, BatonRouge, Louisiana) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$15,000 and suspended from association with any FINRA member in any capacity for 90 days. The fine must be paid either immediately upon Atteberry's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Atteberry consented to the described sanctions and to the entry of findings that he exercised discretion in public customer accounts without written discretionary authority and without his member firm's acceptance of the accounts as discretionary.

The suspension in any capacity is in effect from June 2, 2008, through August 30, 2008. **(FINRA Case #2007009205701)** 

Frederick Ingwert Braren Jr. (CRD #4915850, Registered Representative, Ponte Vedra Beach, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for one year. The fine must be paid either immediately upon Braren's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Braren consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form IIA

The suspension in any capacity is in effect from May 19, 2008, through May 18, 2009. (FINRA Case #2007008605601)

Glenn Ferrell Bruce Jr. (CRD #4598002, Registered Representative, Dunn, North Carolina) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for one month. Without admitting or denying the allegations, Bruce consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without prompt written notice to his member firm.

The suspension in any capacity is in effect from June 16, 2008, through July 15, 2008. (FINRA Case #2007009269801)

Steven Ernest Bryant (CRD #1620470, Registered Principal, Pompano Beach, Florida) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Bryant operated an unregistered securities dealer in violation of Section 15(a)(1) of the Securities Exchange Act. The findings stated that Bryant failed to respond to a FINRA request for information and documents. (FINRA Case #E072005001101)

William Brian Butler (CRD #1554307, Registered Representative, Baldwin, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was censured, fined \$5,000 and suspended from association with any FINRA member in any capacity for six months. The fine must be paid either immediately upon Butler's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Butler consented to the described sanctions and to the entry of findings that he engaged in stock loans and borrows with a family member who was a trader in the securities lending department at another member firm. The findings stated that the trades were often below the rates of other transactions in the same securities Butler made on the same day at his member firm, and he sometimes agreed to terms less favorable for the firm than those originally offered by the other member firm. The findings also stated that Butler entered into conduit, or what the firm described as "put-through," securities lending transactions with the other member firm, although it was not necessary to do so. The findings also included that Butler gave the family member inappropriate access to his firm's secondary "push list," which is the list of securities the firm needed to borrow or lend after its initial list of needs was met. FINRA found that Butler sent the "push list" to the family member before he distributed it more broadly to the market and his other counterparties.

The suspension in any capacity is in effect from June 16, 2008, through December 15, 2008. (FINRA Case #2007009409901)

Benjamin Allan Centeno (CRD # 4213394, Registered Representative, Chino, California) and Jeffrey Ken Santohigashi (CRD # 4212326, Registered Representative, San Antonio, Texas) submitted Offers of Settlement in which Centeno was fined \$10,000 and suspended from association with any FINRA member in any capacity for 30 days, Santohigashi was fined \$10,000 and suspended from association with any FINRA member in any capacity for 20 days. Without admitting or denying the allegations, Centeno and Santohigashi consented to the described sanctions and to the entry of findings that they sold unregistered shares of a thinly traded penny stock quoted on the Pink Sheets on public customers' behalf, and failed to determine whether the securities were registered or were going to be sold in transactions exempt from the registration requirements of Section 5 of the Securities Act of 1933.

Centeno's suspension in any capacity was in effect from June 2, 2008, through July 1, 2008. Santohigashi's suspension in any capacity was in effect from June 2, 2008, through June 21, 2008. (FINRA Case #2005000075703)

Clare M. Cranford (CRD # 5097942, Associated Person, Atascadero, California) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$10,000 and suspended from association with any FINRA member in any capacity for two years. The fine must be paid either immediately upon Cranford's reassociation with a FINRA member firm following her suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Cranford consented to the described sanctions and to the entry of findings that she submitted an application for long-term care insurance to an insurance company that public customers signed with the understanding that they had not committed to any policy and no policy would be activated unless they later submitted payment for the first month's premium. The findings stated that Cranford submitted the application with a check for the first month's premiums for each policy, thereby effecting the purchase of insurance policies for the customers without their knowledge, authorization or consent. The findings also stated that Cranford signed the customers' names on policy delivery receipts pertaining to the policies without the customers' knowledge, authorization or consent, and then submitted the forged receipts to the insurance company.

The suspension in any capacity is in effect from June 2, 2008, through June 1, 2010. **(FINRA Case #20070081750-01)** 

Reynold Arthur Currier Jr. (CRD #1307615, Registered Representative, Southport, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for six months. The fine must be paid either immediately upon Currier's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Currier consented to the described sanctions and to

the entry of findings that he signed a public customer's name to account documents without the customer's written authorization and contrary to his member firm's procedures prohibiting representatives from signing customer's names, regardless of whether the customers had given their authorization.

The suspension in any capacity is in effect from June 2, 2008, through December 1, 2008. (FINRA Case #2006006835501)

Richard C. Dergance Jr. (CRD #4143798, Registered Representative, Las Vegas, Nevada) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000, suspended from association with any FINRA member in any capacity for four months and ordered to disgorge \$18,541, plus interest, in commissions as partial restitution to public customers. The fine and restitution must be paid either immediately upon Dergance's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Dergance consented to the described sanctions and to the entry of findings that he participated in private securities transactions, for compensation, without prior written notice to his member firm.

The suspension in any capacity is in effect from May 19, 2008, through September 18, 2008. (FINRA Case #20070081647-01)

Brent Keith Deviney (CRD #2131402, Registered Representative, West Palm Beach, Florida) was fined \$5,000 and suspended from association with any FINRA member in any capacity for six months, with credit to be given for three months served, and the \$5,000 fine paid in fulfillment of sanctions imposed by the State of Florida. The sanctions were based on findings that Deviney forged public customer signatures on Change of Dealer Forms and submitted the forged forms to his member firm and a non-member insurance company.

The suspension in any capacity is in effect from May 19, 2008, through August 18, 2008. (FINRA Case #2006004992601)

Donald William Dormeier (CRD #70557, Registered Supervisor, Fort Wayne, Indiana) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. The fine must be paid either immediately upon Dormeier's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Dormeier consented to the described sanctions and to the entry of findings that he exercised discretion in public customer accounts without written authorization to do so.

The suspension in any capacity was in effect from June 16, 2008, through June 27, 2008. (FINRA Case #2007009425101)

Morton Bruce Erenstein (CRD #201845, Registered Representative, Boca Raton, Florida) was suspended from association with any FINRA member in any capacity for one year. The SEC affirmed the NAC's decision following appeal of an OHO decision. The sanction was based on findings that Erenstein failed to respond to a question during a FINRA on-the-record interview and failed to timely respond to a FINRA request for information.

The suspension in any capacity is in effect from January 22, 2008, through January 21, 2009. This decision has been appealed to the U.S. Court of Appeals, and the sanction is in effect at Erenstein's request. (FINRA Case #C9B20040080)

John Danis Garcia (CRD #4621646, Registered Representative, Bronx, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Garcia consented to the described sanction and to the entry of findings that he failed to appear for a FINRA on-the-record interview. (FINRA Case #2006005957301)

Kevin Howard Gavigan (CRD #2674135, Registered Representative, Millville, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Gavigan consented to the described sanction and to the entry of findings that he wrote \$51,400 worth of checks from a sailing club's bank account payable to "cash," cashed the checks and converted the proceeds to his own use and benefit without the club's authorization or consent. The findings stated that Gavigan willfully failed to amend his Form U4 to disclose material information. (FINRA Case #2007011492501)

Janette Olga Glassing (CRD #5133622, Associated Person, Cottage Grove, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Glassing consented to the described sanction and to the entry of findings that she failed to respond to FINRA requests for documents and information. (FINRA Case #20070104356-01)

Robert Frederick Glessner Jr. (CRD #2354148, Registered Representative, Mansfield, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Glessner consented to the described sanction and to the entry of findings that he wrote checks to himself totaling \$38,000 from an association for which he was the treasurer, used the funds for some purpose other than for the association's benefit and without the knowledge or consent of the association or its authorized representatives. The findings stated that Glessner failed to respond to FINRA requests for documents and information. (FINRA Case #2007008425501)

Alexander Goldstein (CRD #4373969, Registered Representative, Marlboro, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Goldstein consented to the described sanction and to the entry of findings that he intentionally effected paired security transactions between his personal brokerage account and brokerage accounts he traded on behalf of a foreign-owned financial institution (the bank) and knowingly failed to disclose to the bank that he

was the party on the other side of the transactions. The findings stated that Goldstein realized trading profits of at least \$25,667.72 from the transactions, and the bank incurred a loss. The findings also stated that by the use of means or instrumentalities of interstate commerce, or of the mails, Goldstein intentionally and recklessly effected transactions in, and induced the purchase and sale of, NASDAQ securities by means of deceptive, manipulative and other fraudulent devices or contrivances. (FINRA Case #20070075515-01)

Scott Burtenshaw Gordon (CRD #2852211, Registered Principal, Holladay, Utah) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Gordon consented to the described sanction and to the entry of findings that he engaged in private securities transactions, for compensation, and failed to provide prior written notice to his member firm describing the proposed transactions and his role therein, and failed to obtain his member firm's written approval. The findings stated that Gordon received \$67,500 from public customers to invest but, instead, used the money to fund expenses incurred in connection with the general operations of his approved outside business activity company. (FINRA Case #2006006584301)

Kevin Guzman (CRD #4497415, Registered Principal, New York, New York) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Guzman recommended and effected unsuitable and excessive transactions in public customers' account and also churned the account, demonstrating that his excessive trading was to derive a profit at the customers' expense. The findings stated that Guzman included false financial information and investment experience on the customers' account application documents, which the customers signed and Guzman submitted to his member firm. The findings also stated that Guzman made misrepresentations to public customers regarding their account balances to conceal their losses. (FINRA Case #20050000720-02)

Vivian Veryle Gwin (CRD #4228943, Registered Representative, Bismarck, North Dakota) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Gwin consented to the described sanction and to the entry of findings that she participated in private securities transactions, for compensation, without prior written notice to, and written approval from, her member firm. The findings stated that Gwin failed to appear for a FINRA on-the-record interview. (FINRA Case #20060072975-01)

Andrew Walter Holtmeyer (CRD #1924765, Registered Principal, Dix Hills, New York) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 20 business days. Without admitting or denying the allegations, Holtmeyer consented to the described sanctions and to the entry of findings that he failed to disclose material information on his Form U4.

The suspension in any capacity was in effect from June 2, 2008, through June 27, 2008. (FINRA Case #2007007959701)

Primitivo Andrade Iglesias (CRD # 1871845, Registered Principal, Locust Valley, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any FINRA member in any principal capacity for two months. In light of Iglesias' financial status, no monetary sanction has been imposed. Without admitting or denying the findings, Iglesias consented to the described sanction and to the entry of findings that he failed to reasonably supervise a registered representative with respect to the charging of commissions to public customers. The findings stated that Iglesias failed to take adequate steps to assess the fairness of these commissions or to ensure that the representative was providing the additional services he had represented. The findings also stated that Iglesias excluded these commissions from his review of the Daily Trade Blotter, and failed to ensure the representative was submitting Large Trade Approval forms for trades made on these customers' behalf.

The suspension in any principal capacity is in effect from June 2, 2008, through August 1, 2008. (FINRA Case #2008013269401)

Sean Christopher Jordan (CRD #3052479, Registered Representative, Auburn Hills, Michigan) was fined \$5,000 and suspended from association with any FINRA member in any capacity for one year. The fine must be paid either immediately upon Jordan's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. The sanctions were based on findings that Jordan failed to timely respond to FINRA requests for information.

The suspension in any capacity is in effect from June 2, 2008, through May 31, 2009. (FINRA Case #2006005038102)

Hyung Suk Kim aka Tony Suk Kim (CRD #5022658, Registered Representative, North Hills, California) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 60 days. The fine must be paid either immediately upon Kim's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Kim consented to the described sanctions and to the entry of findings that he signed a public customer's name on an electronic funds transfer authorization form to transer funds from the customer's bank account to his brokerage account, without the customer's knowledge or consent, to expedite the transaction.

The suspension in any capacity is in effect from May 19, 2008, through July 17, 2008. (FINRA Case #2007009351201)

Christopher Thomas Kline (CRD #1641746, Registered Representative, York, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$19,000, which includes disgorgement of \$11,500 in commissions received, ordered to pay \$6,000 in restitution to a public customer and suspended from association with any FINRA member in any capacity for six months. The fine and restitution must be paid either immediately upon Kline's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without

admitting or denying the findings, Kline consented to the described sanctions and to the entry of findings that he recommended and engaged in excessive and unsuitable trading in public customers' accounts. The findings stated that Kline exercised discretion in the customers' accounts without the customers' prior written authorization and his member firm's written acceptance of the accounts as discretionary.

The suspension in any capacity is in effect from May 19, 2008, through November 18, 2008. (FINRA Case #2006005286102)

James R. Klosterman (CRD #865318, Registered Representative, Seattle, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 15 business days. Without admitting or denying the findings, Klosterman consented to the described sanctions and to the entry of findings that he exercised discretion in public customers' accounts without the customers' prior written authorization and without his member firm's acceptance of the accounts as discretionary.

The suspension in any capacity was in effect from June 2, 2008, through June 20, 2008. (FINRA Case #2006006518401)

Gregg Edward Maguire (CRD #2723583, Registered Representative, Cathedral City, California) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for five months. The fine must be paid either immediately upon Maguire's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Maguire consented to the described sanctions and to the entry of findings that he signed public customers' names on various investment-related forms without their knowledge, authorization or consent.

The suspension in any capacity is in effect from June 2, 2008, through November 1, 2008. (FINRA Case #20070089983-01)

Michael Joseph Martella (CRD #1719329, Registered Representative, New York, New York) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Martella failed to respond to FINRA requests to appear for an on-the-record interview. (FINRA Case #2006003772301)

Sean Patrick Martin (CRD #4860100, Registered Representative, Albany, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 30 days. The fine must be paid either immediately upon Martin's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Martin consented to the described sanctions and to the entry of findings that he affixed a public customer's signature on an asset reallocation form by cutting and pasting it from another document, and submitted the form for processing without the customer's authorization or consent.

The suspension in any capacity was in effect from May 19, 2008, through June 17, 2008. **(FINRA Case #2007011008801)** 

Michael Harold McClellan (CRD #325497, Registered Principal, Bakersfield, California) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, McClellan consented to the described sanction and to the entry of findings that he was appointed trustee for trusts public customers' established and, without authorization, disbursed \$301,127.59 from the trusts' bank and money market accounts and a trust's brokerage account, and used the funds for his own benefit, thereby converting \$301,127.59 of the trusts' assets. (FINRA Case #2007009610101)

Maura Ellen Mitchell (CRD #4736301, Registered Representative, Miami Beach, Florida) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Mitchell accessed her member firm's computer system and entered securities sales transactions in variable annuity sub-accounts for public customers and applied the proceeds of the sales to purchase different securities in their variable annuity policies, without their knowledge or consent. The findings stated that Mitchell provided false and misleading information and testimony to FINRA. (FINRA Case #2005003584601)

Carolyn Ann Monahan (CRD #4963922, Registered Representative, Traverse City, Michigan) submitted an Offer of Settlement in which she was fined \$2,500 and suspended from association with any FINRA member in any capacity for six months. In light of Monahan's financial status, a fine of \$2,500 has been imposed. The fine must be paid either immediately upon Monahan's reassociation with a FINRA member firm following her suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the allegations, Monahan consented to the described sanctions and to the entry of findings that she engaged in outside business activities, for compensation, without prompt written notice to her member firm. The findings stated that Monahan failed to timely respond to FINRA requests for documents and information.

The suspension in any capacity is in effect from June 2, 2008, through December 1, 2008. **(FINRA Case #2006006773501)** 

Jason John Morawski (CRD #2451447, Registered Principal, Bayshore, New York) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Morawski willfully failed to disclose material information on Forms U4 and failed to respond to FINRA requests for information. (FINRA Case #2005003382401)

Frieda Mae Nettles (CRD #2598071, Associated Person, Apex, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Nettles consented to the described sanction and to the entry of findings that she failed to respond to FINRA requests for documents and information. (FINRA Case #20070099550-01)

Michael Scott Olson (CRD #3021448, Registered Principal, Oak Park, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in a principal capacity for nine months. Without admitting or denying the findings, Olson consented to the described sanctions and to the entry of findings that he failed to reasonably and properly supervise equity traders' pre-opening quoting and trading activity. The findings stated that as his member firm's chief compliance officer, Olson failed to establish and maintain a system to supervise his firm's equity traders' conduct that was reasonably designed to achieve compliance with applicable NASD and SEC rules, in that the firm did not have a supervisory system in place to review manipulative quoting and trading in the pre-opening market.

The suspension in a principal capacity is in effect from June 16, 2008, through March 15, 2009. (FINRA Case #20050001741-03)

Anthony Gregory Palmer (CRD #2143341, Registered Principal, University Park, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 15 business days. The fine must be paid either immediately upon Palmer's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Palmer consented to the described sanctions and to the entry of findings that, in connection with his financial services seminars, he used invitations and an informational brochure without his member firm's prior approval of a registered principal. The findings stated that the invitation failed to make proper disclosures regarding fees and how a guaranteed high rate of return was being calculated.

The suspension in any capacity was in effect from June 2, 2008, through June 20, 2008. (FINRA Case #2006006298701)

Charles Thomas Popenoe (CRD #5449870, Associated Person, Reynoldsburg, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Popenoe consented to the described sanction and to the entry of findings that he took \$550 in cash lying on a counter at a bank and, without the bank's knowledge or consent, used the funds for his own benefit or for some benefit other than that of the bank. (FINRA Case #2008012250201)

Robert Ramsey (CRD #4825175, Registered Representative, Blandon, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for one year. The fine must be paid either immediately upon Ramsey's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Ramsey consented to the described sanctions and to the entry of findings that he received \$19,770.84 from public customers to purchase a mutual fund, but neglected to process the transaction and failed to tell the customers or his member firm that he had not purchased the mutual fund.

The suspension in any capacity is in effect from May 19, 2008, through May 18, 2009. (FINRA Case #2007009269501)

William Howard Roberts (CRD #833352, Registered Principal, Hummelstown, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any principal capacity for 30 days. Without admitting or denying the findings, Roberts consented to the described sanctions and to the entry of findings that he failed to take adequate action to supervise a registered representative that was reasonably designed to detect and prevent his excessive and unsuitable trading in public customer accounts.

The suspension in any principal capacity was in effect from June 2, 2008, through July 1, 2008. (FINRA Case #2006005286101)

Paul Herschell Rundbaken (CRD #1742139, Registered Representative, Charleston, South Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Rundbaken consented to the described sanctions and to the entry of findings that he exercised discretion in a public customer's account without written discretionary authority and without his member firm's acceptance of the account as discretionary.

The suspension in any capacity was in effect from June 16, 2008, through June 27, 2008. (FINRA Case #2006006569201)

Bernard Factora Santos (CRD #4838431, Associated Person, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Santos consented to the described sanction and to the entry of findings that he misappropriated a member firm's funds for his own use and benefit. The findings stated that Santos falsified dividend claims and supporting documentation from legitimate customers in order to effect wire transfers from a firm account established to pay dividends, without the firm's knowledge or authorization. The findings also stated that Santos initiated wire payments totaling \$523,000 made to accounts he controlled at different banks, based upon the falsified dividend claims. The findings also included that Santos failed to respond to a FINRA request for information. (FINRA Case #2007009411601)

Martin Howard Scharf (CRD #803465, Registered Representative, Hurricane, West Virginia) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Scharf consented to the described sanction and to the entry of findings that he forged, or caused to be forged, public customers' names on various insurance documents and submitted the documents to his member firm for processing. (FINRA Case #2007008785901)

Michael Hollis Stewart (CRD #4243807, Registered Representative, McHenry, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 30 business days. Without admitting or denying the findings, Stewart consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, and failed to give prompt written notice to his member firm.

The suspension in any capacity was in effect from June 2, 2008, through July 14, 2008. (FINRA Case #2006007225201)

Thomas Edward Sullivan (CRD #4591223, Registered Representative, Coppell, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Sullivan consented to the described sanction and to the entry of findings that he participated in private securities transactions and failed to notify his member firms of his participation in the transactions. (FINRA Case #2006006995901)

Aaron Donald Vallett (CRD #4421122, Registered Principal, Nashville, Tennessee) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for four months. Without admitting or denying the findings, Vallett consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without prompt written notice to his member firm. The findings stated that Vallett completed a firm questionnaire in which he represented that he was not engaged in outside employment or business activity. The findings also stated that Vallett signed a firm form acknowledging that firm employees were not permitted to sell equity-indexed annuities and were required to report past sales, despite his past sales of equity-indexed annuities.

The suspension in any capacity is in effect from June 16, 2008, through October 15, 2008. (FINRA Case #2006005754402)

Josue Amaro Villarreal (CRD #4743080, Registered Representative, Dallas, Texas) submitted an Offer of Settlement in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the allegations, Villarreal consented to the described sanction and to the entry of findings that he converted to his own use and benefit \$6,083.05 received from insurance customers to pay for their policy premiums. The findings stated that Villarreal failed to respond to FINRA requests for information. (FINRA Case #2006006947101)

Clifford Lee Weaver (CRD #2590623, Registered Principal, Ephrata, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Weaver consented to the described sanction and to the entry of findings that he entered materially false and/or inaccurate public customer information on firm documents, thereby causing his member firm to maintain false or inaccurate records. The findings stated that Weaver signed a customer's name on investment-related forms

without the customer's authorization or consent. The findings also stated that Weaver made a \$550 payment to the customer in settlement of her complaint without his member firm's knowledge. (FINRA Case #2007011240801)

John David Webberly (CRD #4537337, Registered Principal, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was censured and suspended from association with any FINRA member in any capacity for two years. In light of Webberly's financial status, no monetary sanction has been imposed. Webberly also consented to cooperate with FINRA in its continued prosecution of matters related to his FINRA-registered employment, including, but not limited to, matters arising from FINRA's investigation into the activities at his former member firm without the need to resort to NASD Rule 8210 and testifying truthfully at any hearing held in connection with the investigation.

Without admitting or denying the findings, Webberly consented to the described sanctions and to the entry of findings that he made recommendations to public customers to open accounts with his member firm to buy and sell Collateralized Mortgage Obligation (CMO) securities, but each of the customers who opened accounts to invest in CMOs incurred substantial losses. The findings stated that Webberly did "not have reasonable grounds to believe that his recommendations to invest in CMOs were suitable based on the customers' financial situations and needs. The findings also stated that in recommending that customers invest in CMOs, Webberly made misstatements and omitted material facts in connection with the CMO investments. The findings also included that Webberly knew at the time that he opened accounts for his customers that another registered representative would be exercising discretion over the accounts, and failed to obtain written authorization from any of his clients and a firm principal, to authorize him or anyone at the firm to exercise discretion in any of his customer accounts. FINRA found that Webberly was aware that all of his customers had non-discretionary accounts and that he needed to receive authorization from the customers before each and every trade, but delegated the authority to this other individual to (a) select particular CMO investments for his customers; (b) decide how much of the security his customers would buy and when; and (c) decide how much margin borrowing would be utilized to purchase CMOs.

The suspension in any capacity is in effect from June 16, 2008, through June 15, 2010. (FINRA Case #2006005546001)

James Robert Zitch (CRD #819961, Registered Principal, Bryn Mawr, Pennsylvania), Richard Joseph Massaux (CRD #2746156, Registered Representative, Voorhees, New Jersey) and John Jay Parker (CRD #2423679, Registered Representative, Voorhees, New Jersey) submitted Letters of Acceptance, Waiver and Consent in which Zitch was fined \$25,000 and suspended from association with any FINRA member in any principal capacity for 30 days. The fine must be paid either immediately upon Zitch's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Massaux was fined \$86,014, including disgorgement of \$43,007, and suspended from association with any FINRA member in any capacity for three months. Parker was fined \$106,392, including disgorgement of \$53,196, and suspended from association with any FINRA member in any capacity for three months.

Without admitting or denying the findings, Zitch, Massaux and Parker consented to the described sanctions and to the entry of findings that Massaux and Parker facilitated a hedge fund customer's use of deceptive practices to engage in market timing of mutual fund shares. The findings stated that Massaux and Parker executed trades for the customer through multiple accounts, which used multiple partnership names and traded through multiple registered representative numbers. The findings also stated that these activities allowed the hedge fund customer to avoid detection of its market timing activities by mutual fund companies in many instances, and to circumvent numerous restrictions on additional trading the companies imposed. The findings also included that Zitch failed to adequately supervise Massaux and Parker, and should have known that they were engaged in deceptive market timing practices.

Zitch's suspension in a principal capacity was in effect from June 2, 2008, through July 1, 2008. Massaux' and Parkers' suspensions in any capacity are in effect from May 27, 2008, through August 26, 2008. (FINRA Cases #2006004542201/2006004542202)

### **Decisions** Issued

The Office of Hearing Officers (OHO) issued the following decisions, which the NAC has appealed to or called for review as of May 31, 2008. The NAC may increase, decrease, modify or reverse the findings and sanctions imposed in the decision. Initial decisions which time for appeal has not yet expired will be reported in the next FINRA *Notices*.

Robert Thomas Conway (CRD #2329507, Registered Representative, East Islip, New York) and Kakit Ng (CRD #2677132, Registered Representative, Bronx, New York).

Conway was fined \$178,720, which includes \$78,720 in disgorgement, and suspended from association with any FINRA member in any capacity for 18 months. Ng was fined \$20,000 and suspended from association with any FINRA member in any capacity for nine months. The fines shall be due and payable when and if either Conway or Ng seeks to return to the securities industry. The sanctions were based on findings that Conway and Ng engaged in late trading for their hedge fund customers by submitting trades for execution in violation of the SEC forward pricing rule, and engaged in deceptive activity to facilitate their clients' continued market timing after mutual fund companies instructed the clients to stop trading.

This decision has been appealed to the NAC and the sanctions are not in effect pending consideration of the appeals. (FINRA Case #E102003025201)

Paul-Bryan Joel Zenke (CRD #3254506, Registered Representative, Aitkin, Minnesota) was fined \$5,000, suspended from association with any FINRA member in any capacity for 20 business days and must requalify by exam in all capacities. The sanctions were based on findings that Zenke sold shares of no-load mutual funds to public customers and charged impermissible commissions totaling \$2,790 in connection with the transactions without his member firm's permission.

This decision has been appealed to the NAC and the sanctions are not in effect pending consideration of the appeal. (FINRA Case #2006004377701)

## Complaints Filed

FINRA issued the following complaints. Issuance of a disciplinary complaint represents FINRA's initiation of a formal proceeding in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding these allegations in the complaint.

Ronald Edward Hardy Jr. (CRD #2668695, Registered Representative, Port Jefferson Station, New York) was named as a respondent in a FINRA complaint alleging that he falsified, or caused to be falsified, new account records for public customers to open securities accounts in their names at his member firm, without their knowledge, authorization or consent. The complaint alleges that Hardy executed unauthorized transactions in public customers' accounts. (FINRA Case #2005001502703)

Sanford Lefler (CRD #2783117, Registered Representative, Rockville, Maryland) was named as a respondent in a FINRA complaint alleging that a public customer directed Lefler to transfer \$60,000 from his bank account to a securities account. The complaint alleges that Lefler altered the signed withdrawal form by crossing out the \$60,000, writing in \$57,226 and placing the customer's initials next to the crossed out amount. The complaint also alleges that Lefler prepared a second withdrawal form for withdrawal of \$2,274 from the customer's bank account, obtained a cashier's check, and used the funds for his personal use without the customer's authorization or consent. The complaint further alleges that Lefler willfully failed to disclose material information on his Form U4. In addition, the complaint alleges that Lefler failed to respond to FINRA requests for testimony and documents. (FINRA Case #2007011497801)

Christopher Dominick O'Connor (CRD #2887894, Registered Supervisor, Hastings, New York) was named as a respondent in a FINRA complaint alleging that he wrongfully converted funds totaling \$59,590.41 from a public customer's account. The complaint alleges that O'Connor signed another customer's name on a Letter of Authorization (LOA), without the customer's consent, to withdraw \$26,018.63 from a minor's trust account. The complaint also alleges that O'Connor falsified, or caused to be falsified, account records and statements to conceal both the conversion and the withdrawal of funds from the minor's trust account. (FINRA Case #2007009440101)

## Firms Suspended for Failure to Supply Financial Information

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

### Astral Financial Group, LLC Orlando, Florida (May 29, 2008)

### Fifth Street Capital, LLC Austin, Texas (May 1, 2008 – June 2, 2008)

### IDX Derivatives, LLC New York, New York (May 29, 2008 – June 3, 2008)

### Westor Capital Group, Inc. Mohawk, New York (May 9, 2008)

### Individuals Revoked for Failing to Pay Fines and/or Costs Pursuant to NASD Rule 8320

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

### John F. Helbock Holmdel, New Jersey (October 23, 2006 – May 2, 2008)

### John Fitzgerald Tyus Brooklyn, New York (May 22, 2008)

# Individuals Barred Pursuant to NASD Rule 9552(h)

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

### David P. Gardner New Rochelle, New York (May 5, 2008)

### Eric Martin Garwes Savannah, Georgia (May 12, 2008)

### Donald Wayne Griffin Birmingham, Alabama (May 5, 2008)

### Milton L. Hagelberger III Sarasota, Florida (May 5, 2008)

### Gale Andrew Harvey Mount Juliet, Tennessee (May 21, 2008)

### Inderbir Singh Sahni New York, New York (May 12, 2008)

### Sean Daniel Scheans Lake Oswego, Oregon (May 16, 2008)

### Charita N. Teasley Detroit, Michigan (May 16, 2008)

### Fiona Patrice White Willingboro, New Jersey (May 19, 2008)

# Individuals Suspended Pursuant to NASD Rule 9552(d)

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

### **Niteen Chandra Bhattacharyya** Maple Grove, Minnesota

(May 5, 2008)

## George Nickos Gounelas

Shirley, New York (May 29, 2008)

### **Moses Raymond Tuckler**

Elizabeth, New Jersey (December 24, 2007 – May 28, 2008)

#### John Edward Underwood

Jonesboro, Georgia (May 19, 2008)

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

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

### Jonathan Wayne Barkman

Bath, Pennsylvania (May 21, 2008)

### Paul Gene Gaydos

West Palm Beach, Florida (May 14, 2008)

#### Joel David Griffin

Lubbock, Texas (May 29, 2008)

### **Robert Byron Kehler**

Conway, Arkansas (May 6, 2008)

### Steven Douglas Klein

Lynbrook, New York (May 29, 2008)

#### James Wright Langston Jr.

Metairie, Louisiana (February 7, 2005 – May 14, 2008)

#### Charlene F. Marant

New York, New York (May 14, 2008)

#### **Gene Paul Ramos**

Jersey City, New Jersey (May 8, 2008)

## GunnAllen Financial Pays \$750,000 to Settle Charges Involving Former Head Trader's Trade Allocation Scheme, AML and Supervisory Deficiencies, Additional Charges

## Supervisor of Rogue Trader Suspended and Fined; Firm Also Lacked Procedures to Prevent Misuse of Investment Banking Information

FINRA has fined GunnAllen Financial, Inc., of Tampa, FL \$750,000 for its role in a trade allocation scheme conducted by the firm's former head trader, as well as for various Anti-Money Laundering (AML), reporting, record-keeping and supervisory deficiencies. Kelley McMahon, the former head trader's supervisor, was suspended for six months from association with any FINRA-registered firm in any principal capacity and fined \$25,000, jointly and severally with the firm.

FINRA barred Alexis J. Rivera, the former head trader, in connection with the trade allocation scheme, in December 2006. FINRA found that in 2002 and 2003, the firm, acting through Rivera, engaged in a "cherry picking" scheme in which Rivera allocated profitable stock trades to his wife's personal account instead of to the accounts of firm customers. Rivera garnered improper profits of more than \$270,000 through this misconduct, which violated the anti-fraud provisions of the federal securities laws and FINRA rules. Rivera was barred in December 2006.

"Broker-dealers have an obligation to supervise their registered representatives with a view to preventing them from engaging in conduct that violates fundamental rules, such as the anti-fraud provisions of the federal securities laws," said Susan Merrill, FINRA Executive Vice President and Chief of Enforcement. "The supervisory deficiencies here permitted the firm's trader to perpetrate a scheme that allowed him to benefit at the expense of the firm's customers, and contributed to serious violations in other areas of the firm's business. One such area was the investment banking department, where the firm's failures resulted in an absence of procedures to prevent the misuse of material, non-public information."

In connection with the firm's investment banking business, FINRA found that prior to March 2005, GunnAllen never put any stock of a company on a restricted or watch list even though the firm was conducting investment banking business with these companies. During the same period, GunnAllen failed to inform its own compliance department of the investment banking activities in which the firm was involved.

FINRA also sanctioned GunnAllen for failing to report to FINRA that its parent firm had entered into a consulting contract with an individual who had been previously barred by FINRA. In addition, the firm was sanctioned for failing to preserve e-mails and instant messages, for failing to implement an adequate AML compliance program and for supervisory and complaint reporting deficiencies. Supervisory deficiencies included a failure to ensure that markups and commissions charged on equity transactions were reasonable. In reviewing markups on equity transactions, the firm did little more than ensure that commission charges did not exceed 5 percent. GunnAllen and McMahon settled these matters without admitting or denying the allegations, but consented to the entry of FINRA's findings.

# FINRA Fines Three Firms a Total of \$1.6 Million for OATS Reporting and Supervision Violations

The Financial Industry Regulatory Authority (FINRA) has fined TradeStation Securities, Inc., E\*Trade Securities, LLC and CIBC World Markets Corp. a total of \$1.6 million for multi-year violations relating to FINRA's Order Audit Trail System (OATS) rules and related supervisory failures.

Under the OATS rules, firms must report information related to the handling and execution of customer orders, as well as for certain proprietary orders for Nasdaq and OTC Equity securities. This information allows FINRA to recreate the life cycle of an order and is critical to effective regulation.

"Firms must be vigilant in monitoring the accuracy and completeness of the data they provide to regulators and each firm must ensure that it reports all required order information, no matter which desk receives or handles the order," said Tom Gira, Executive Vice President of FINRA's Market Regulation Department.

TradeStation Securities, Inc. was fined \$750,000 for failing to report approximately 23.5 million Reportable Order Events relating to orders received. E\*Trade Securities was fined \$500,000 for failing to report "New Order Reports" and "Route Reports." CIBC was fined \$350,000 for failing to report to OATS over 28 million orders which were generated by an affiliate.

FINRA further found that the three firms did not have adequate systems of supervision in place to monitor their OATS reporting compliance.

The fine for CIBC was reduced in recognition of the firm's actions in reporting the problem to FINRA and taking prompt remedial actions to correct the problem. In settling these matters, the firms neither admitted nor denied the charges, but consented to the entry of FINRA's findings.