

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Senior Management

KEY TOPICS

Investment Analysis Tools
Rule 2210

REQUEST FOR COMMENT ACTION REQUESTED BY SEPTEMBER 13, 2002

Investment Analysis Tools

NASD Requests Comment on Proposed Interpretative Material Regarding Investment Analysis Tools.
Comment Period Expires on September 13, 2002.

Executive Summary

NASD Rule 2210(d)(2)(N) prohibits NASD member firms from making predictions or projections of investment results to the public.¹ NASD staff has interpreted the rule to prohibit members from providing customers with access to interactive technological tools that produce simulations and statistical analyses showing a range of probabilities that various investment outcomes might occur. The proposed Interpretive Material to Rule 2210 (Attachment A) would provide a limited exception to Rule 2210(d)(2)(N), allowing members to provide customers direct access to such tools under certain circumstances. NASD seeks comment on whether it should amend Rule 2210(d)(2)(N) to create such an exception and, if so, on the specific provisions of the proposed Interpretive Material.

Action Requested

NASD requests comment from all interested parties on whether and to what extent NASD should amend Rule 2210(d)(2)(N) to allow members to provide investment analysis tools directly to their customers. Comments must be received by **September 13, 2002**. Members and interested persons can submit their comments using the following methods:

- ◆ mailing Attachment B—Request for Comment Form—along with written comments to NASD
- ◆ mailing written comments to NASD
- ◆ e-mailing written comments to pubcom@nasd.com
- ◆ submitting written comments online on the NASD Web Site (www.nasd.com)

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Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted in writing or by e-mail.

Before becoming effective, any rule change developed as a result of comments received must be submitted to and approved by the Securities and Exchange Commission (SEC).

Questions/Further Information

Questions or comments concerning the information contained in this *Notice to Members (NtM)* may be directed to Nancy C. Libin, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8835 or nancy.libin@nasd.com, or James S. Wrona, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8270 or jim.wrona@nasd.com, or Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (240) 386-4534 or joe.savage@nasd.com.

Background

In recent years, the public increasingly has sought access to additional investment information and tools to make investment decisions. Technology has been a key component of members' attempts to meet this investor demand.² NASD's proposed Interpretive Material

to Rule 2210 seeks to modernize certain aspects of the rule to keep pace with investor needs and technological developments. In doing so, however, NASD does not want to compromise Rule 2210's general purpose—to ensure that "communications [with the public] are fair, balanced, and not misleading."³

NASD Rule 2210(d)(2)(N) prohibits members from predicting or projecting investment results in communications to the public. NASD staff has interpreted this provision to prohibit members from providing their customers with access to automated tools that indicate the probability that an investment strategy will produce a desired result. NASD seeks comment on its proposal to modify that interpretation to allow members to provide customers direct access to such tools under certain, limited circumstances.

The proposed Interpretive Material would allow members to make available to their customers "investment analysis tools," defined as interactive technological tools that produce simulations and statistical analyses showing a range of probabilities that various investment outcomes might occur. In general, these tools express in quantitative terms the likelihood that a specific event—such as meeting a financial goal—might occur. A customer using such a tool usually enters information regarding, for example, his or her age, financial situation, and investment objectives to receive personalized investment advice.

Although NASD staff has not permitted members to provide customers direct access to such tools under NASD's current rules,⁴ other financial advisors and institutions have offered public access to similar automated tools for some time. With appropriate disclosures and other safeguards, NASD believes that investors

could properly use these tools in making judgments about how an investment strategy might perform. Importantly, under the proposed Interpretive Material, the tools could not predict that a particular outcome will in fact occur.

NASD is proposing certain requirements for members' use of the tools with their customers. For instance, among other requirements, members would have to:

- ◆ Disclose the entire range of possible outcomes, giving both downside risk and upside gain.
- ◆ Disclose the universe of investments considered and state that other investments not considered might have characteristics similar to those that the tools analyze.
- ◆ Explain all material assumptions in a clear and understandable manner.
- ◆ Disclose whether the tools search, analyze or in any way favor certain securities within the universe of securities considered and explain the reasons for such selectivity.

Members also would need to provide NASD with access to the tools prior to their use and file with NASD any related sales material for its review. The proposed Interpretive Material, moreover, makes clear that, to the extent that these tools make investment recommendations, NASD's suitability rule, Rule 2310, would apply.⁵

Request For Comment on Proposed Interpretive Material to Rule 2210 Regarding Investment Analysis Tools

NASD is soliciting comments on its proposed Interpretive Material to Rule 2210. NASD requests that members and other interested parties comment on whether Rule 2210(d)(2)(N) should be amended to create an exception that allows members to provide customers direct access to investment analysis tools that indicate probabilities of certain investment outcomes. In addition, NASD seeks comments on the proposed Interpretive Material's specific provisions. NASD also is interested in receiving comments on the benefits and risks associated with customers' use of these tools on members' Web sites.⁶

NASD has found comments from member firms and the public, as well as state and federal regulators, to be a valuable resource in the decision-making process. NASD encourages all interested parties to comment on the concepts discussed above regarding the proposed "investment analysis tools" exception to Rule 2210(d)(2)(N)'s prohibitions. NASD will consider the comments it receives in determining whether to submit the Interpretive Material as a formal rule change to the SEC and, if so, the form that rule change will take. Comments must be submitted by **September 13, 2002**.

Endnotes

- 1 NASD Rule 2210(d)(2)(N) states that:

In communications with the public, investment results cannot be predicted or projected. Investment performance illustrations may not imply that gain or income realized in the past will be repeated in the future. However, for purposes of this Rule, hypothetical illustrations of mathematical principles are not considered projections of performance; e.g., illustrations designed to show the effects of dollar cost averaging, tax-free compounding, or the mechanics of variable annuity contracts or variable life policies.
 - 2 See Commissioner Laura Unger, SEC, *On-Line Brokerage: Keeping Apace of Cyberspace*, 1 (Nov. 1999), available at <http://www.sec.gov/pdf/cybrtnd.pdf> ("[I]nvestors can—from the comfort of their own homes—access a wealth of financial information on the same terms as market professionals, including breaking news developments and market data. In addition, on-line brokerage provides investors with tools to analyze this information, such as research reports, calculators, and portfolio analyzers."); Use of Electronic Media, Release Nos. 33-7856, 34-42728, IC-24426, 65 Fed. Reg. 25843, 25844 (May 4, 2000), 2000 SEC LEXIS 847, at *4 (Apr. 28, 2000) (discussing technology's impact on the securities industry).
 - 3 SEC Order Approving Proposed Rule Change Relating to Standards for Individual Correspondence, Release No. 34-40365, 63 Fed. Reg. 47062, 47062 (Sept. 3, 1998), 1998 SEC LEXIS 1841, at *3 (Aug. 26, 1998). As the SEC has commented, regulators need to be "sensitive to the regulatory challenges of a changing technological environment" and must "balance the benefits of encouraging innovation and the use of new technologies against the need to protect investors and maintain orderly markets." SEC Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets (Sept. 1997), available at <http://www.sec.gov/news/studies/techrp97.htm>.
 - 4 As a general matter, members are responsible for hyperlinked information, including any information contained in a hyperlinked Web site that provides an investment analysis tool. However, under certain limited circumstances, members are not responsible for the content and filing of material that appears on independent, third-party Web sites. See Interpretive Letter from Thomas Selman, Director of NASD Advertising/Investment Companies Regulation, to Craig S. Tyle, General Counsel of Investment Company Institute (Nov. 11, 1997), available at http://www.nasdr.com/2910/2210_01.htm (providing guidance regarding members' regulatory responsibilities for hyperlinks to third-party Web sites). Because the circumstances surrounding hyperlinks will vary, members should file with NASD's Advertising Regulation Department any Web pages that include hyperlinks to Web sites that contain investment analysis tools to determine the extent to which the member is responsible for the content and filing of such sites.
 - 5 In April 2001, NASD issued its Online Suitability Policy Statement, *Notice to Members 01-23*, 66 Fed. Reg. 20697 (Apr. 24, 2001), 2001 NASD LEXIS 28 (Apr. 2001), available at <http://www.nasdr.com/pdf-text/0123ntm.pdf>. The Policy Statement discusses the circumstances under which "recommendations" are made in the online environment for purposes of the suitability rule. The Policy Statement also states that the suitability rule applies to recommendations made by computer programs.
 - 6 Will access to these products improve investors' ability to make investment decisions and properly allocate their assets? Are there any risks that investors will rely too heavily on projected returns without recognizing that their actual returns may be different?
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ATTACHMENT A

Text of Proposed Interpretive Material to Rule 2210

IM-2210- . Requirements for the Use of Investment Analysis Tools

(a) General Considerations

This Interpretive Material provides a limited exception to NASD Rule 2210(d)(2)(N).¹ No member may imply that NASD endorses or approves the use of any investment analysis tool or any recommendation based on such a tool. Members that intend to offer an investment analysis tool under this Interpretive Material must provide NASD's Advertising Regulation Department (Department) with access to the investment analysis tool at least 30 days prior to first use and must file any sales material concerning the tool with the Department at least 30 days prior to use. Members also must provide any supplemental information requested by the Department. If the Department requests changes to the investment analysis tool or sales material, the tool or sales material may not be offered or used until all changes specified by the Department have been made and approved by the Department. In addition, as in all cases, a member's compliance with this Interpretive Material does not mean that the member is acting in conformity with other applicable laws and rules. Members that offer an investment analysis tool under this Interpretive Material are responsible for ensuring that use of the investment analysis tool and all recommendations based on the investment analysis tool comply with NASD's suitability rule, Rule 2310, the other provisions of Rule 2210, and the other applicable federal securities laws and Securities and Exchange Commission and NASD rules.

(b) Definition

For purposes of this Interpretive Material and any interpretation thereof, an "investment analysis tool" is an interactive technological tool that produces simulations and statistical analyses that present a range of probabilities that various investment outcomes might occur thereby enabling investors to evaluate the potential risks of and returns on particular investments.

¹ NASD Rule 2210(d)(2)(N) prohibits NASD member firms from making predictions or projections of investment results to the public. In the past, the rule also had been interpreted as prohibiting members from providing customers with direct access to investment analysis tools. This Interpretive Material allows member firms to offer such tools in certain circumstances.

(c) Use of Investment Analysis Tools and Related Sales Material

Members may provide investment analysis tools and use related sales material only if they:

- (1) present a range of probabilities that various investment outcomes might occur and do not state that a particular investment outcome will, in fact, occur;
- (2) prominently disclose the range of all possible investment outcomes generated by the investment analysis tool;
- (3) use a reproducible mathematical process;
- (4) describe the criteria and methodology used;²
- (5) give investors a fair and balanced presentation of the risks as well as the potential rewards of using the investment analysis tool, including, but not limited to:
 - (A) identification and explanation of the limitations of the methodology employed; and
 - (B) an explanation that it is likely that the analysis will change over time with respect to the same investments.
- (6) disclose the universe of investments considered in the analysis and state that other investments not considered may have characteristics similar to those being analyzed;
- (7) disclose whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered, beyond the criteria and methodology disclosed under paragraph (c)(4), and the reasons for this selectivity;³ and

2 This disclosure should provide detailed information about how the tool conducts its analyses and the principles on which those analyses are based, including, but not limited to, the security- or fund-specific attributes of the recommended securities or mutual funds, transaction costs, tax implications, interest rate and inflationary analysis, historical performance, and the consistency of that performance over time.

3 This disclosure should indicate, among other things, whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered based on revenue received by the member in connection with the sale of those securities or based on relationships or understandings between the member and the entity that created the investment analysis tool. The disclosure also should indicate whether the investment analysis tool is limited to searching, analyzing or in any way favoring securities in which the member makes a market or has any other direct or indirect interest.

(8) explain all material assumptions in a clear and understandable manner.⁴

(d) Disclosures

- (1) The disclosures and other required information discussed in paragraphs (c) and (d)(2) must be in narrative form, may not be contained in footnotes or in a font size that is inconsistent with the tool's overall written presentation, and, where feasible, should be located in areas related to the subject of the disclosure or other required information; and
- (2) members must prominently display the following additional disclosure:
"IMPORTANT: The forecasts or other information generated by [brand name of investment analysis tool] regarding the probabilities that various investment outcomes might occur are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. [Brand name of investment analysis tool] only presents a range of possible outcomes."

4 The investment analysis tool should provide the investor with information sufficient to evaluate the tool's analysis and forecast. The tool also should explain fully the differences between the securities or mutual funds previously owned and the securities or mutual funds recommended so that the customer can assess the tool's analysis. If the tool recommends a mutual fund, the tool should provide information about the fund's investment objectives, fees and expenses and other pertinent information, and the fact that these attributes can change.

ATTACHMENT B

Request for Comments Form

Proposed Interpretive Material to Rule 2210 Regarding Members' Ability to Provide Customers Direct Access to Investment Analysis Tools

We have provided below a form that members and other interested parties may use in addition to written comments. This form is intended to offer a convenient way to participate in the comment process, but it does not cover all aspects of the proposal described in the *Notice to Members (NtM)*. We therefore encourage members and other interested parties to review the entire *NtM* and provide written comments, as necessary.

Instructions

Comments must be received by **September 13, 2002**. Members and interested parties can submit their comments using the following methods:

- ◆ mailing Attachment B—Request for Comment Form—along with written comments to NASD
- ◆ mailing written comments to NASD
- ◆ e-mailing written comments to pubcom@nasd.com
- ◆ submitting written comments online on the NASD Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Proposed Interpretive Material to Rule 2210 Regarding Members' Ability to Provide Customers Direct Access to Investment Analysis Tools

NASD requests comment from all interested parties on whether and to what extent Rule 2210 should be amended to allow members to provide investment analysis tools directly to their customers. In particular, NASD seeks input on the following topics:

1. Should NASD amend Rule 2210(d)(2)(N) to permit members to provide investment analysis tools directly to their customers?
 Yes No See my attached written comments

2. If yes, should members be permitted to provide investment analysis tools directly to their customers and use related sales material only if they present a range of probabilities that various investment outcomes might occur and do not state that a particular investment outcome will, in fact, occur?
 Yes No See my attached written comments

3. Should members be permitted to provide investment analysis tools directly to their customers and use related sales material only if they use a reproducible mathematical process?
 Yes No See my attached written comments

4. Should firms be required to provide the information listed below?
 - a. The range of all possible investment outcomes generated by the investment analysis tool.
 Yes No See my attached written comments

 - b. The criteria and methodology used.
 Yes No See my attached written comments

 - c. The risks as well as the potential rewards of using the investment analysis tool, including, but not limited to: identification and explanation of the limitations of the methodology employed; and an explanation that it is likely that the analysis will change over time with respect to the same investments.
 Yes No See my attached written comments

d. The universe of investments considered in the analysis and whether other investments not considered may have characteristics similar to those being analyzed.

Yes No See my attached written comments

e. Whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered and the reasons for this selectivity.

Yes No See my attached written comments

5. Should members also be required to display the following additional disclosure?

“IMPORTANT: The forecasts or other information generated by [brand name of investment analysis tool] regarding the probabilities that various investment outcomes might occur are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. [Brand name of investment analysis tool] only presents a range of possible outcomes.”

Yes No See my attached written comments

6. Will access to these products improve investors' ability to make investment decisions and properly allocate their assets?

Yes No See my attached written comments

7. Are there any risks that investors will rely too heavily on projected returns without recognizing that their actual returns may be different?

Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

- An NASD Member
- An Investor
- A Registered Representative
- Other: _____

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

CRD
Legal & Compliance
Member Regulation
Operations
Senior Management

REQUEST FOR COMMENT ACTION REQUESTED BY SEPTEMBER 20, 2002

Branch Office Definition

NASD Requests Comment on Proposed Amendments to NASD Rule 3010(g)(2) ("Branch Office Definition");
Comment Period Expires on September 20, 2002

KEY TOPICS

Branch Office Definition
Rule Modernization
Rule 3010(g)(2)

Executive Summary

NASD requests comment from members, investors, and other interested parties on proposed amendments to NASD Rule 3010(g)(2) ("Branch Office Definition"), which were developed collectively by NASD, the New York Stock Exchange, Inc. (the NYSE) and the North American Securities Administrators Association, Inc. (NASAA), with the intention of creating a uniform definition of the term among regulators. Currently, there is no uniform approach among regulators for classifying locations at which securities operations are conducted. The creation of a uniform branch office definition would allow NASD to pursue registration of branch offices through NASD's Central Registration Depository (CRD) system.

NASD seeks comment on the proposed definition of branch office, including on whether the proposed uniform definition: (1) provides greater clarity on when a location is required to be registered as a branch office; (2) provides a cost savings to firms as a result of centralized registration of locations through NASD's CRD system; (3) minimizes regulatory compliance burdens; (4) significantly affects the number of locations that a firm is required to register; and (5) adequately addresses evolving business practices based on technological innovations. Additionally, NASD seeks comment on whether the proposed exceptions to the branch office are appropriate. Commenters are encouraged to provide empirical data where possible to support their views.

Questions/Further Information

Questions concerning this *Notice* may be directed to Kosha Dalal, Assistant General Counsel, Office of General Counsel, NASD

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Regulatory Policy and Oversight, at (202) 728-6903; or questions concerning NASD coordination with the NYSE and NASAA may be directed to Chip Jones, Associate Vice President, NASD Registration and Disclosure, at (240) 386-4797.

Request for Comment

NASD requests comment on the proposed amendments to Rule 3010(g)(2). Comments must be received by September 20, 2002. Members and interested persons can submit their comments using the following methods:

- ◆ mail Attachment B—Request for Comment Form—along with written comments
- ◆ mail written comments
- ◆ e-mail written comments to pubcom@nasd.com
- ◆ submit written comments online on our Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted by mail, e-mail, or those submitted to the NASD Web Site.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the Securities and Exchange Commission.

Background

In July 2001, NASD announced in *Notice to Members 01-35* its intention to move forward with an initiative designed to ensure that NASD rules are as streamlined as possible, and impose the least burden to accomplish their objectives while achieving investor protection. In response to *NASD Notice to Members 01-35*, NASD received 37 comment letters identifying rules that should be the focus of our rule modernization effort. After reviewing these comment letters, in *NASD Notice to Members 02-10* (January 2002), NASD requested comment on certain proposals that were under consideration, including establishing a uniform branch office definition. Of the approximately 65 commenters who responded regarding Rule 3010(g)(2), the responses were overwhelmingly in favor of developing a uniform definition that would allow centralized registration through the CRD system.

Current Definition

NASD Rule 3010(g)(2) defines a branch office generally as any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business ("holding out"). The current definition excludes certain locations that only are identified in telephone listings, business cards, or letterhead, or referred to in advertising, or identified in a member's sales literature, provided that the address and telephone number of the branch office or office of supervisory jurisdiction (OSJ) from which the associated person is supervised is given.

NASD designates locations from which associated persons work, other than the main office, as either branch offices or unregistered locations. This designation primarily affects the supervisory responsibilities of, and the fees paid by, members. An office that is designated a "branch office" under NASD rules must pay an annual registration fee and have onsite supervision by a branch manager. A branch office is further classified as an OSJ if any one of the following enumerated activities occurs at the location: order execution, maintenance of customer funds and securities, final approval of new accounts and advertisements, review of customer orders, and supervision of associated persons at other branch offices. An office that is designated an OSJ must have a registered principal onsite. The proposed uniform definition would not affect or change the definition, or responsibilities, of an OSJ.

Need for Uniformity

Currently, there is no uniform approach among regulators for classifying locations at which securities operations are conducted. NASD, the Securities and Exchange Commission (the SEC), the NYSE, and state regulators define the term (or a similar term) differently. The term also has different significance based on who classifies it. Under NASD rules, for example, the term triggers supervisory obligations and fees and, under the SEC rules, the term triggers record keeping requirements. NASD believes that a uniform definition of the term branch office would reduce regulatory burdens on firms because (1) there would be no need to keep track of varying definitions in numerous jurisdictions; (2) the risk of non-

compliance would be reduced; and (3) a centralized registration process would provide efficiencies.

The SEC's books and records rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934 ("Exchange Act")(hereinafter the "Books and Records Rules"), specify minimum requirements with respect to the records that broker/dealers must make, and how long those records and other documents relating to a broker/dealer's business must be kept. The proposed branch office definition would not alter or affect the obligations of a firm to comply with the requirements of the Books and Records Rules. The definition proposed here, and agreed upon by representatives of NASAA and the NYSE, largely tracks the definition in the SEC's Books and Records Rules for the term "office."¹

In July 2002, the NASD Board approved publication of this *Notice* seeking comment on the proposed uniform definition. In August 2002, the Board of Directors of the NYSE approved the proposed uniform definition and authorized its staff to file a proposed rule change with the SEC. In addition, NASAA's Broker-Dealer Section Committee has approved the proposed definition. NASAA also has committed to support the adoption of the uniform definition with the various states.

Proposed Definition of "Branch Office"

As proposed, a "branch office" would be any location, other than the main office, where one or more associated persons of a member regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or that is held out as such.

The interpretation of what it means to “regularly conduct the business of effecting transactions in, or inducing or attempting to induce the purchase or sale of any security” under the proposed uniform definition would include activities such as: (1) soliciting new accounts or orders; (2) opening new accounts; (3) accepting or entering orders; and (4) conducting seminars for existing or prospective customers. In addition, “holding out” a location would include references to a location on or in business cards, stationery, advertisements, sales literature, and signage that would lead investors to believe that they are dealing with a branch office of a member firm, regardless of whether the location from which the office is supervised is listed on the communication.

The definition of “branch office” would expressly exclude, subject to the satisfaction of certain conditions:

- (1) a location that operates as a back office;
- (2) a representative’s primary residence, provided the residence is used for securities business for less than 50 days annually and not held out to the public;
- (3) a location, other than a primary residence, provided that it is used for securities business for less than 30 days annually and not held out to the public (e.g., a vacation home);
- (4) a location used by a circuit-rider to meet with customers occasionally and exclusively by appointment;
- (5) a location that is primarily used for non-securities business (e.g., by insurance agents to sell non-securities insurance products) and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year;
- (6) the floor of a registered exchange; and
- (7) a temporary location established in response to implementation of a business continuity plan.

See Attachment A for a full description of the conditions that need to be satisfied for each exception to apply.

Comparison of Current Definition vs. Proposed New Definition

The current NASD branch office definition is based on a “holding out” standard (any location identified to the public or customers as a location at which the member conducts an investment banking or securities business). The definition is broad and is not dependent on the number of associated persons working at any particular location. The current definition excludes certain locations held out to the public so long as the identification of such locations is limited and sets forth the address and telephone number of the branch office or OSJ of the firm from which the associated person is directly supervised (for example, a business card or letterhead can list a non-branch location so long as the address and telephone number of the branch office or OSJ is

also listed). Under the proposed uniform definition, this type of exception would no longer exist.

The proposed uniform definition is intended to provide clarity in application and consistency between self-regulatory organizations (SROs) and state securities administrators. Under the proposed definition, any location where one or more associated persons regularly conduct the business of effecting transactions in, or inducing or attempting to induce the purchase or sale of, any security or that is held out as such is subject to registration as a branch office unless the location meets one of the seven specific exclusions. The exclusions are intended to provide firms with the flexibility that today's business environment demands (for example, many associated persons work from home for some part of the year, or conduct business while on vacation).

The chart on the next page briefly compares the two definitions.

Location	Current Definition	Proposed New Definition
Back Office	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as no sales activities occur at the location and it is not held out to the public as a branch office
Primary Residence	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as the primary residence is used for securities business for less than 50 business days per year and other conditions are satisfied
Vacation Locations	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as the location is used for securities business for less than 30 business days per year and other conditions are satisfied
Bank Circuit Rider	Not subject to registration so long as the address and phone number of the branch office or OSJ are also identified	Not subject to registration so long as not held out (signage required by banking regulations is permitted)
Non-securities Business	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Not subject to registration so long as location is used primarily to conduct non-securities business (e.g., sell non-security insurance products) and no more than 25 securities transactions are effected in one year and address and phone number of branch or OSJ is identified
Floor of Registered National Securities Exchange	Potentially subject to registration	Not subject to registration
Temporary Location for Business Continuity	Potentially subject to registration	Not subject to registration

Benefits of Proposed New Definition

NASD believes that a uniform definition would benefit member firms by reducing regulatory burdens and costs, without jeopardizing investor protection. In addition, the potential to use the CRD system for centralized registration of branch offices should provide greater clarity, efficiency, and time and potential liability savings resulting from uniformity. Currently, members with numerous offices must register with each individual state that requires registration; in some jurisdictions, failure to timely register can result in significant sanctions.

NASD, therefore, solicits comment on whether to amend the Branch Office Definition as proposed in Attachment A. NASD also solicits comment specifically on whether the proposed uniform definition: (1) provides greater clarity on when a location is required to be registered as a branch office; (2) provides a cost savings to firms as a result of centralized registration of locations through CRD; (3) minimizes regulatory compliance burdens; (4) significantly affects the number of locations that a firm is required to register; and (5) adequately addresses evolving business practices based on technological innovations. Additionally, NASD seeks comment on whether the proposed exceptions to the branch office definition are appropriate. Commenters are encouraged to provide empirical data where possible to support their views.

Endnote

¹ Rule 17a-3(g)(1) under the Exchange Act defines the term "office" to mean any location where one or more associated persons regularly conduct the business of handling funds or securities or effecting any transactions in, or inducing or attempting to induce the purchase or sale, of any security.

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ATTACHMENT A

Proposed New Text of Rule 3010(g)(2) - "Branch Office" Definition

A "branch office" is any location, other than the main office, where one or more associated persons of a member regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or that is held out as such, excluding:

- (A) any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;
- (B) any location that is the associated person's primary residence; provided that (i) the location is used for securities business for less than 50 business days in any one calendar year; (ii) only one person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location; (iii) the location is not held out to the public as an office and the associated person does not meet with customers at the location; (iv) neither customer funds nor securities are handled at that location; (v) the associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements and other communications to the public by such associated person; (vi) the associated person's correspondence and communications with the public are subject to the firm's supervision; (vii) electronic communications (*i.e.*, e-mail) are made through the member's electronic system; (viii) all orders are entered through the designated branch office; (ix) written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and (x) a list of the residence locations are maintained by the member;

- (C) any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member complies with the provisions of paragraph (B) above;
- (D) any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as a branch office (Where such location is on bank premises, only signage required by the Interagency Statement (Statement on Retail Sales of Nondeposit Investment Products required under Banking Regulations) may be displayed);
- (E) any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any advertisements or sales literature identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised; or
- (F) the Floor of a registered national securities exchange where a member conducts a direct access business with public customers; and
- (G) a temporary location established in response to the implementation of a business continuity plan.

The term "business day" as used herein shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

ATTACHMENT B

Request for Comment Form

We have provided below a form that members and other interested parties may use in addition to written comments. This form is intended to offer a convenient way to participate in the comment process, but does not cover all aspects of the proposal described in the *Notice*. We therefore encourage members and other interested parties to review the entire *Notice* and provide written comments, as necessary.

Instructions

Comments must be received by September 20, 2002. Members and interested parties can submit their comments using the following methods:

- ◆ mail Attachment B—Request for Comment Form—
along with written comments
- ◆ mail written comments
- ◆ e-mail written comments to *pubcom@nasd.com*
- ◆ submit written comments online on our Web Site
(*www.nasd.com*)

This form and/or written comments should be mailed to:

Barbara Z. Sweeney
NASD, Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Proposed Amendments to Rule 3010(g)(2) - "Branch Office" Definition

1. Should NASD adopt the proposed uniform branch office definition?
 Yes No See my attached written comments

2. Should NASD provide for the centralized registration of branch offices for NASD and other regulators through the CRD system?
 Yes No See my attached written comments

3. Are the exceptions to branch office definition appropriate?
 Yes No See my attached written comments

4. How many registered branch offices do you currently have?

5. How many registered branch offices would you have under the proposed uniform definition?

6. In how many states do you register branch offices?

7. a. How much of a cost savings or increase will you have as a result of the proposed uniform definition?
\$ _____

- b. If you expect the proposed definition would increase your costs, then would the efficiencies created by the ability to register branch offices through CRD offset such increased costs?
 Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

- An NASD Member
- An Investor
- A Registered Representative
- Other: _____

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

Legal and Compliance
Operations
Senior Management

NASD Rule 3070

NASD Files Proposal to Amend Rule 3070 to Require Filing of Criminal and Civil Complaints and Arbitration Claims with NASD; Revises Letters Sent When Determination Made to Close an Investigation Without Further Action

KEY TOPICS

NASD Rule 3070
NASD Rule 2110

Executive Summary

NASD has undertaken two initiatives to improve the quality and flow of information to it about allegations of broker misconduct. First, on August 14, 2002, NASD filed with the Securities and Exchange Commission (SEC) a rule proposal to amend NASD Rule 3070 to require members promptly to file with NASD copies of certain criminal and civil complaints and arbitration claims that name a member or an associated person as defendant or respondent. Specifically, the proposed rule change would require members to file with NASD copies of (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by the rule; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member; and (4) any criminal complaint or plea agreement, private civil complaint or arbitration claim against an associated person that is reportable under Question 14 on Form U-4, irrespective of any dollar threshold requirements that question imposes for notification. Members would not be required to file copies of any arbitration claims filed in the NASD Dispute Resolution forum. NASD recently began to review copies of claims filed in that forum for possible regulatory response.

Second, NASD has revised the letters it sends to customers and members when a determination is made to close an investigation without disciplinary action. The revised letters state that a determination by NASD not to take action against a member or a member's associated person has no evidentiary weight in any mediation, arbitration, or judicial proceeding. Further, NASD considers it inconsistent with just and equitable principles of trade (Rule 2110) for a member or a member's associated person to attempt to introduce such a determination into evidence in any of those proceedings.

02-53

The text of the proposed amendments to Rule 3070 is attached. Comments on the proposal should be directed in writing to the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549.

Questions concerning this Notice should be directed to Philip Shaikun, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

Background and Discussion

Rule 3070

Rule 3070 currently requires, among other things, that a member report to NASD when it is a defendant or respondent in felony criminal proceedings, certain misdemeanor criminal proceedings, or in certain civil or arbitration actions. As to the latter, Rule 3070(a)(7) requires that a member report to NASD when the member or a person associated with the member is a defendant or respondent in securities or commodities-related civil litigation or arbitration only when the proceeding has been disposed of by a judgment, award or settlement in an amount exceeding either \$15,000 (if the defendant or respondent is an associated person) or \$25,000 (if the defendant or respondent is the member). No existing rules require a member routinely to file copies with NASD of complaints filed against it in any legal proceedings.

Similar to Rule 3070, Question 14 on Form U-4 requires notice that an associated person has been **charged** or convicted of a felony or certain misdemeanors. It further requires notice that an associated person has been named as a respondent or defendant in a

consumer-initiated arbitration or civil litigation involving a sales practice violation that is pending, resulted in a judgment, settled for \$10,000 or more, or contains a claim for compensatory damages of at least \$5,000. However, Form U-4 does not require that the member or associated person file with NASD a copy of the complaint that initiates such proceedings or any plea agreements to resolve reportable criminal charges.

By requiring members to file with NASD copies of certain criminal and civil complaints and arbitration claims, the proposed amendments to Rule 3070 will provide NASD with additional sources of pertinent information regarding broker misconduct. As a result, NASD can enhance investor protection efforts by promptly taking appropriate regulatory action to address specific allegations and to prevent similar or related misconduct in the future. Moreover, the information can be combined with other sources of regulatory intelligence to identify patterns and trends at the earliest possible stage, thereby deploying resources to higher risk areas that better protect investors. With respect to associated persons, it is important to receive copies of complaints and claims reportable under Question 14 on Form U-4, even when they fall below specified dollar thresholds, as such matters may also point to trends or otherwise flag conduct where regulatory action might be warranted.

NASD now makes copies, at its own expense, of all arbitration claims filed in the NASD Dispute Resolution forum. Those claims are forwarded after copying to a unit within NASD that reviews the allegations in the claims for possible regulatory action.

NASD would treat similarly copies of other complaints, claims and plea agreements required to be filed with NASD under the rule proposal.

The rule proposal minimizes the burden on members in that the rule requires only the filing of those complaints and claims most likely to reveal information to assist NASD's regulatory mission. For example, members would not be required to file private civil litigation complaints or arbitration claims that do not relate to securities or commodities-related conduct. Furthermore, as discussed above, the proposal would not require members to file with NASD any arbitration claims that are originally filed in the NASD Dispute Resolution forum. NASD is already incurring the cost to make copies of those claims and will continue to do so under the proposal.

Content and Use of Close-Out Letters

In a related initiative, NASD recently revised the letters that are sent to customers and members when a determination is made to close an investigation without further disciplinary action. This step was taken after NASD learned that some customers chose not to bring allegations to the attention of NASD out of concern that a letter declining further action would be offered as exculpatory evidence in an arbitration, mediation, or judicial proceeding.

NASD is not litigating a private arbitration claim when it conducts a regulatory review. As a result, the revised letters now state NASD's contention that a determination not to take action

against a member has no evidentiary weight in a subsequent proceeding, such as mediation, arbitration, or a judicial action. In addition, NASD now gives the customer the option not to receive a close-out letter. To opt out, a customer must notify NASD of this decision in writing or by e-mail. In the event a customer does opt out, NASD will not issue a final close-out letter.

Furthermore, the revised letters warn that NASD considers it inconsistent with just and equitable principles of trade (Rule 2110) for a member or associated person to attempt to introduce the letter, or the fact that NASD declined further action, as evidence in a subsequent legal proceeding. NASD's decision to close an investigation without further action can result from many factors unrelated to the merits of a complaint, such as jurisdictional limitations or the existence of an ongoing or completed enforcement action by another law enforcement or regulatory agency. As such, NASD considers it unethical and potentially misleading to suggest to an adjudicator or mediator that NASD's determination is probative evidence in a dispute on the merits of a related claim.

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ATTACHMENT A

Proposed Amendment to NASD Rule 3070

Additions are underlined. Deletions are in brackets.

3070. Reporting Requirements

(a) through (c) No change.

(d) Nothing contained in [paragraphs (a), (b) and (c) of] this Rule shall eliminate, reduce, or otherwise abrogate the responsibilities of a member or person associated with a member to promptly file with full disclosure, required amendments to Form BD, Forms U-4 and U-5, or other required filings, and to respond to [the Association] NASD with respect to any customer complaint, examination, or inquiry.

(e) Any member subject to substantially similar reporting requirements of another self-regulatory organization of which it is a member is exempt from [the provisions] paragraphs (a), (b) and (c) of this Rule.

(f) Each member shall promptly file with NASD copies of:

(1) any indictment, information or other criminal complaint or plea agreement for conduct reportable under paragraph (a)(5) of this Rule;

(2) any complaint in which a member is named as a defendant or respondent in any securities or commodities-related private civil litigation;

(3) any securities or commodities-related arbitration claim filed against a member in any forum other than the NASD Dispute Resolution forum;

(4) any indictment, information or other criminal complaint, any plea agreement, or any private civil complaint or arbitration claim against a person associated with a member that is reportable under question 14 on Form U-4, irrespective of any dollar thresholds Form U-4 imposes for notification, unless, in the case of an arbitration claim, the claim has been filed in the NASD Dispute Resolution forum.

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

Legal & Compliance
Senior Management

REQUEST FOR COMMENT ACTION REQUESTED BY SEPTEMBER 20, 2002

Membership Application Rules

NASD Requests Comment on Proposed Amendments to Rules 1014 and 1017; **Comment Period Expires September 20, 2002**

KEY TOPICS

Membership Application Process
Membership Continuation Process
Rule 1014
Rule 1017

Executive Summary

NASD requests comment on proposed amendments to Rules 1014 and 1017. Rule 1017(a) sets forth certain events relating to changes in a member's ownership, control, or business operations, which require a member to apply and obtain approval from NASD staff.¹ Rule 1014 establishes the standards for approval of both new member applications under Rule 1013 and "continuing member applications" under Rule 1017. NASD is proposing amendments to Rules 1014 and 1017 to clarify and further strengthen NASD's authority under these rules in an effort to stay abreast of market developments.

Specifically, NASD has experienced an increase in member consolidations, business restructurings, and asset sales. NASD has reviewed proposed transactions that could have an adverse effect on the payment of arbitration awards and satisfaction of other customer claims. To address concerns raised in such transactions, NASD seeks comment on amendments to Rules 1014 and 1017 that would: (1) expand NASD's authority to review asset transfers to include any transfer involving a material amount of assets and/or revenues that contribute materially to earnings; (2) require that any seller that is not a member of the New York Stock Exchange (NYSE) file an application for asset transfers covered by the rule even in the case where the buyer to the transaction is an NYSE member (which currently is a situation excluded from review under Rule 1017); and (3) create a new standard of admission explicitly identifying as decisional criteria unpaid arbitration awards or other adjudicated customer awards, as well as pending arbitration claims by an applicant, its controlling persons, principals, registered representatives, any lender of 5% or more of the applicant's net capital, and any other member with respect to which these persons were a controlling person or a 5% lender of its net capital.

02-54

In addition, former members or their associated persons with a significant disciplinary history, including a history of unpaid arbitrations, may later seek to re-enter the securities industry. NASD is concerned about the investor protection issues and the potential adverse impact on the integrity of the marketplace posed by these persons. In this regard, as further outlined below, NASD is requesting comments on an amendment that would place the burden on applicants to demonstrate that their applications should be approved notwithstanding that the applicant has a history of certain regulatory events.

NASD further seeks comment on whether Rule 1014 should be amended to include reference to entities as controlling persons in light of the fact that NASD's current definition of "associated persons" does not include non-natural persons.

Questions/Further Information

Questions regarding this *Notice to Members* may be directed to the NASD Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071; or the NASD Member Regulation Department, Regulatory Policy and Oversight, at (202) 728-8221.

Request for Comment

NASD requests comment on the proposed amendments to Rules 1014 and 1017 described in this *Notice*. For your convenience, we have provided a checklist (see Attachment B) that offers a convenient method to participate in the comment process concerning the proposed amendments.

Comments must be received by **September 20, 2002**. Members and interested persons can submit their comments using the following methods:

- ◆ mail Attachment B—Request for Comment Form—along with written comments
- ◆ mail written comments
- ◆ e-mail written comments to pubcom@nasd.com
- ◆ submit written comments online on our Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted by mail, e-mail, or those submitted to the NASD Web Site.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the Securities and Exchange Commission.

Background

The membership application and membership continuation processes have played an important role in investor protection by helping to ensure that new members and members that make a material change to their business comply and continue to comply with

rigorous standards. Rule 1014, which sets forth the standards used when reviewing new member and continuing member applications, specifically requires NASD to consider the public interest and protection of investors when reviewing applications.

Recently, there has been an increase in company restructurings, including the selling of company assets. Asset transfer applications filed pursuant to Rule 1017 are often time-sensitive and may be the first step in a member's withdrawal from the securities business. While asset transfers often serve legitimate business purposes, they also can raise customer protection issues. NASD has encountered several instances where the effect of a member attempting to restructure by transferring assets is to insulate the member and its owners from responsibility for payment of pending or unpaid arbitrations. In some cases, the member will transfer its assets without a corresponding transfer of its liabilities. Because the corporate format used by many members seeks to insulate the owners from liabilities of the member, a customer with an award or judgment against the member may only be able to be paid from the member's assets. Thus, an asset transfer may transform the member from an operating business that can generate value over time to a shell holding the firm's liquidated value, leaving behind customers with arbitration claims pending against, or arbitration awards unsatisfied by, a member.

Discussion

Based on NASD's experience in applying the membership application procedures, especially in light of increasing concerns

regarding the potentially negative effects of asset transfers on former and current customers, NASD believes that Rules 1014 and 1017 should be amended to allow NASD to better identify and respond to applications that may leave pending arbitrations and customer claims unaccounted for.

1. Review of Material Transfer of Member's Assets

NASD believes it is important that it has the opportunity to review all member transactions that can materially adversely affect current and former customers. Rule 1017(a)(3) requires a member to submit an application only upon the transfer of substantially all of the member's assets. However, this may potentially eliminate from NASD's review a member's piecemeal transfer of its assets that, while not "substantially all" in amount, may nevertheless have a material impact on the operations or profitability of the selling member. In this regard, NASD proposes broadening the scope of Rule 1017(a)(3) to require members to submit applications prior to the transfer of a material amount of the member's assets or prior to the transfer of any asset, business or line of operation that generates revenues comprising a material portion of the selling member's earnings.² NASD further seeks comment on whether "material" should be more specifically defined in the Rule and, if so, the appropriate standard of materiality. For example, should NASD define "material" for these purposes to be 25% or more of the member's assets or any asset, business or line of operation that generates revenues of 25% or greater of the selling member's earnings. NASD seeks comment on whether some other standard is more appropriate.

2. Clarification of Members Required to Submit Applications

Because of concerns that a selling member's customers may be left unprotected following an asset transfer, NASD believes that the seller's situation should be reviewed in connection with all such transactions. Rule 1017(a) currently exempts selling members from the requirement to submit applications if the acquiring firm is a member of the NYSE. The proposed amendments would require all non-NYSE selling members to submit an application regardless of whether the buyer is an NYSE member. NASD does not intend to put applicants through duplicative approval processes where the transaction is otherwise subject to adequate customer protection safeguards. Rather, in requiring an application regardless of whether the acquirer is a member of the NYSE, NASD will be assured of receiving notice and will be in a position to target particular aspects of the transaction for additional review, if necessary.

3. Consideration of Arbitrations in Application Process

Comporting with NASD's attempts to foster compliance with the terms of arbitration and other adjudicated customer awards, NASD proposes to amend Rule 1014(a)(3) explicitly to include as factors in the consideration of both new and continuing member applications the unpaid arbitration awards or other adjudicated customer awards, as well as pending arbitration claims against an applicant and other persons that may have significant control or influence over the applicant, including its controlling persons, principals, registered representatives, any lender of 5% or more of the applicant's net capital,

and any other member with respect to which these persons were a controlling person or a 5% lender of its net capital.³

4. Burden of Proof

NASD has seen instances where an applicant (both new member and change of ownership/control) has a disciplinary history of some concern that falls short of a statutory disqualification. Many of these cases involve applications from closely held firms where, even if the broker/dealer establishes heightened supervisory procedures, the influence of the control person on the small broker/dealer may overcome the supervisory structures. Rule 1014(a)(3) requires NASD to determine whether an applicant and its associated persons "are capable of complying with" federal securities laws and the rules of NASD. A variety of specific events, including past and current disciplinary actions and customer claims, are among the considerations referenced in the rule. However, there is little case precedent to guide NASD in applying this standard, particularly in the context of the key principals and control persons of smaller firms.

NASD is proposing to further enhance its authority under Rule 1014(a), for all categories of applications, to consider the impact of an applicant's past behavior by creating a rebuttable presumption that the presence of any of the events enumerated in Rule 1014(a)(3)(A) and (C) though (E), places the burden on the applicant to demonstrate that the application should be approved notwithstanding the presence of that regulatory history. The rebuttable presumption does not create new standards for admission, but merely shifts the burden of proof to applicants to

show that they should be allowed admission. NASD believes that investor protection and service of the public interest demands that applicants with a regulatory history bear the burden of overcoming the rebuttable presumption that their application should be denied.

Additional Issue for Comment

Finally, NASD proposes to amend Rule 1014 to include reference to non-natural controlling persons in light of the fact that NASD's current definition of "associated persons" does not encompass non-natural persons.

Endnotes

1 The changes requiring application and approval are: mergers, the acquisition of a member, the acquisition of substantially all of a member's assets, a change in ownership or control of a member, and a material change in a member's business operations.

2 As with other Rule 1017 applications, Rule 1017(c)(1) allows NASD to place interim restrictions on any asset transfer if NASD believes that the application does not meet Rule 1014 standards. These interim restrictions are meant for the protection of investors and ordinarily would not prevent a transaction from moving forward. However, there may be some instances where the protection of investors will require that interim restrictions will prohibit or delay a transaction from closing.

3 NASD further notes that Rule 2110 applies to efforts by a firm and its owners to unfairly prejudice customers seeking relief in arbitration proceedings.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

1014. Department Decision

(a) Standards for Admission

After considering the application, the membership interview, other information and documents provided by the Applicant, other information and documents obtained by the Department, and the public interest and the protection of investors, the Department shall determine whether the Applicant meets each of the following standards:

(1) – (2) No Change.

(3) The Applicant and its Associated Persons are capable of complying with the federal securities laws, the rules and regulations thereunder, and the Rules of the Association, including observing high standards of commercial honor and just and equitable principles of trade. In determining whether this standard is met, the Department may take into consideration whether:

(A) – (B) No Change.

(C) an Applicant or Associated Person is the subject of a pending, adjudicated, or settled regulatory action or investigation by the Commission, the Commodity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization; a pending, adjudicated, or settled investment-related civil action for damages or an injunction; or a criminal action (other than a minor traffic violation) that is pending, adjudicated, or that has resulted in a guilty or no contest plea; or an Applicant, its control persons, principals, registered representatives, any lender of 5% or more of the Applicant's net capital, and any other member with respect to which these persons were a control person or a 5% lender of its net capital is subject to unpaid arbitration awards, other adjudicated customer awards, unpaid arbitration settlements, or pending arbitrations;

(D) – (F) No Change.

(4) – (14) No Change.

(b) Granting or Denying Application

(1) In reviewing an application for membership, the Department shall consider whether the applicant meets each of the standards in paragraph (a), provided the Applicant overcomes the presumption that the application should be denied where one or more of the circumstances identified in Rule 1014(a)(3)(A) and (C) through (E) exist.

(2) [(1)] If the Department determines that the Applicant meets each of the standards in paragraph (a), the Department shall grant the application for membership.

(3) [(2)] If the Department determines that the Applicant does not meet one or more of the standards in paragraph (a) in whole or in part, the Department shall:

(A) grant the application subject to one or more restrictions reasonably designed to address a specific financial, operational, supervisory, disciplinary, investor protection, or other regulatory concern based on the standards for admission in Rule 1014(a); or

(B) deny the application.

(c) – (g) No Change.

(h) Definition of Associated Person

For purposes of this Rule 1014, the term “Associated Person” shall mean (1) a natural person registered under the Rules of NASD; or (2) a sole proprietor, partner, officer, director, branch manager, or other natural person, company, government, or political subdivision, agency, or instrumentality of a government occupying a similar status or performing similar functions who will be or is anticipated to be associated with the Applicant, or a natural person or company, government, or political subdivision, agency, or instrumentality of a government engaged in the investment banking or securities business who will be or is anticipated to be directly or indirectly controlling or controlled by the Applicant, whether or not any such person or company, government, or political subdivision, agency, or instrumentality of a government is registered or exempt from registration under the NASD By-Laws or the Rules of NASD.

1017. Application for Approval of Change in Ownership, Control, or Business Operations

(a) Events Requiring Application

A member shall file an application for approval of any of the following changes to its ownership, control, or business operations:

(1) a merger of the member with another member, unless both are members of the New York Stock Exchange, Inc. or the surviving entity will continue to be a member of the New York Stock Exchange, Inc.;

(2) a direct or indirect acquisition by the member of another member, unless the acquiring member is a member of the New York Stock Exchange, Inc.;

(3) a direct or indirect acquisition of [substantially all] a material amount of the member's assets or any asset, business or line of operation that generates revenues comprising a material portion of the member's earnings, unless [the acquirer is a member] both the seller and acquirer are members of the New York Stock Exchange, Inc.;

(4) a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital; or

(5) a material change in business operations as defined in Rule 1011(i).

(b) – (f) No Change.

(g) Department Decision

(1) The Department shall consider the application, the membership interview, other information and documents provided by the Applicant or obtained by the Department, the public interest, and the protection of investors. In rendering a decision on an application submitted under Rule 1017(a), the Department shall consider whether the applicant meets each of the standards in Rule 1014(a), provided the Applicant overcomes the presumption that the application should be denied where one or more of the circumstances identified in Rule 1014(a)(3)(A) and (C) through (E) exist.

(A) In rendering a decision on an application for approval of a change in ownership or control, or an application for approval of a material change in business operations that does not involve modification or removal of a membership agreement restriction, the Department shall determine if the Applicant would continue to meet the standards in Rule 1014(a) upon approval of the application.

(B) In rendering a decision on an application requesting the modification or removal of a membership agreement restriction, the Department shall consider whether the maintenance of the restriction is appropriate in light of:

- (i) the standards set forth in Rule 1014;
- (ii) the circumstances that gave rise to the imposition of the restriction;
- (iii) the Applicant's operations since the restriction was imposed;
- (iv) any change in ownership or control or supervisors and principals; and
- (v) any new evidence submitted in connection with the application.

(2) – (4) No Change.

(h) – (k) No Change.

ATTACHMENT B

Request For Comment Form

We have provided below a form that members and other interested parties may use in addition to written comments. This form is intended to offer a convenient way to participate in the comment process, but does not cover all aspects of the proposal described in the *Notice*. We therefore encourage members and other interested parties to review the entire *Notice* and provide written comments, as necessary.

Instructions

Comments must be received by **September 20, 2002**. Members and interested parties can submit their comments using the following methods:

- ◆ mail Attachment B—Request for Comment Form—
along with written comments
- ◆ mail written comments
- ◆ e-mail written comments to *pubcom@nasd.com*
- ◆ submit written comments online on our Web Site
(*www.nasd.com*)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Proposed Amendments to Rules 1014 and 1017

1. Is it appropriate for NASD to review transfers of a material amount of a member's assets or transfers of any asset, business or line of operation that generates revenues comprising a material portion of the selling member's earnings?
 Yes No See my attached written comments
2. In connection with the proposed expanded review of asset transfers, should NASD include a more specific standard of materiality in the Rules?
 Yes No See my attached written comments
3. Should NASD review other types of transactions that are not currently included in the Rules?
 Yes No See my attached written comments
4. Should NASD require all non-NYSE selling members to submit applications to NASD for approval prior to the transfer of assets?
 Yes No See my attached written comments
5. (a) Is it appropriate for applicants to bear the burden of proof to demonstrate that they should be approved for membership despite the presence of a regulatory history and,
 Yes No See my attached written comments
(b) if so, is it appropriate to impose this burden for pending matters such as pending investigations and arbitrations?
 Yes No See my attached written comments
6. Should the scope of Rule 1014 be expanded to include non-natural persons?
 Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

- An NASD Member
- An Investor
- A Registered Representative
- Other: _____

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

Corporate Financing
Legal & Compliance
Registered Representatives
Senior Management
Trading & Market Making

KEY TOPICS

Flipping
IPO Allocations
NASD Rule 2710
NASD Rule 2712
Penalty Bids
Spinning
Underwriting Compensation

REQUEST FOR COMMENT ACTION REQUESTED BY SEPTEMBER 9, 2002

Regulation of IPO Allocations and Distributions

NASD Requests Comment on Proposed New Rule 2712 (IPO Allocations and Distributions) and on an Amendment to Rule 2710 (Corporate Financing Rule); **Comment Period Expires September 9, 2002.**

Executive Summary

NASD is proposing to create new Rule 2712 and amend existing Rule 2710 to prohibit certain IPO allocation abuses. The federal securities laws¹ and existing NASD rules² already prohibit certain IPO allocation abuses. These laws and rules would continue to apply if NASD adopts proposed new Rule 2712. Nevertheless, new, specifically targeted provisions in Rule 2712 would aid member compliance efforts and help to maintain investor confidence in the capital markets. In particular, the proposal would expressly prohibit the following types of conduct:

- ◆ the allocation of IPO shares as consideration or inducement for the payment of excessive compensation for other services provided by the member;
- ◆ the solicitation of aftermarket orders for the allocation of IPO shares;
- ◆ the allocation of IPO shares to an executive officer or director of a company on the condition that the officer or director send the company's investment banking business to the member, or as consideration for investment banking services previously rendered; and
- ◆ the imposition of a penalty on registered representatives whose retail customers have "flipped" IPO shares when similar penalties have not been imposed with respect to syndicate members.

02-55

The proposal would require members to adopt procedures reasonably designed to ensure that the requirements and prohibitions in Rule 2712 are followed. The proposal also would amend Rule 2710 to allow NASD to collect certain data on potential "spinning" abuses from members. See Exhibits A and B for rule language.

Action Requested

NASD encourages all interested parties to comment on the proposal. Comments must be received by September 9, 2002. Comments should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted via e-mail or in writing.

Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

Questions/Further Information

As noted, written comment should be submitted to Barbara Z. Sweeney. Questions concerning this *Notice to Members — Request for Comment* may be directed to Joseph E. Price, Director, Corporate Financing Department, NASD Regulatory Policy and Oversight, at (240) 386-4623, or Gary Goldsholle, Associate

General Counsel, NASD, Regulatory Policy and Oversight, at (202) 728-8104.

Background

NASD is proposing new Rule 2712 and an amendment to Rule 2710. These rule changes will better ensure that members avoid unacceptable conduct when they engage in the allocation and distribution of IPOs. In addition, these rule changes are intended to sustain public confidence in the IPO process, which is critical to the continued success of the capital markets.

Members are reminded that each provision in proposed Rule 2712 would apply independently. Compliance with one provision would not provide a safe harbor with respect to the other provisions of the rule. Moreover, members would have to ensure that their participation in the allocation and distribution of IPOs complies not only with Rule 2712, but with applicable federal securities laws and other NASD rules, including those referred to above.

1. Prohibition of Abusive Allocation Arrangements

Rule 2712(a) would expressly prohibit a member and its associated persons from offering or threatening to withhold an IPO allocation as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member. This provision would prohibit this activity not only with respect to services, but any service offered by the member.

NASD does not intend that this prohibition interfere with legitimate customer relationships. For example, the prohibition is not intended to prohibit

a member from allocating IPO shares to a customer because the customer has separately retained the member for other services, when the customer has not paid excessive compensation in relation to those services. NASD requests comment on whether this provision appropriately balances the need to protect the integrity of the IPO allocation process with the desire to avoid undue interference with legitimate customer relationships.

2. Prohibition of Aftermarket Tie-in Agreements

Rule 2712(b) would expressly prohibit a member or an associated person that is participating in an IPO from requesting that a customer purchase shares in the aftermarket as a condition to being allocated shares in the IPO. In August 2000, the SEC's Division of Market Regulation issued *Staff Legal Bulletin No. 10*, in which it stated that requiring a customer to agree to buy additional shares in the aftermarket as a condition to being allocated shares in the distribution violates Rules 101 and 102 of Regulation M and may violate other anti-fraud and anti-manipulation provisions of the federal securities laws. The *Staff Legal Bulletin* explained that aftermarket tie-in agreements are a particularly egregious form of solicited transaction prohibited by Regulation M. The SEC staff wrote that "solicitations and tie-in agreements for aftermarket purchases are manipulative because they undermine the integrity of the market as an independent pricing mechanism." Rule 2712(b) would expressly prohibit these types of aftermarket tie-in agreements, thereby supplementing existing prohibitions in Regulation M and Rule 2110.

The proposed rule would prohibit discussions in which after-market

purchases are requested as a condition for the receipt of an IPO allocation. We request comment on this provision.

3. Prohibition of Spinning

Rule 2712(c) would expressly prohibit a member and its associated persons from allocating IPO shares to an executive officer or director of a company on the condition that the executive officer or director, on behalf of the company, direct future investment banking business to the member. The rule also would prohibit IPO allocations to an executive officer or director as consideration for directing investment banking services previously rendered by the member to the company.

"Spinning" or awarding IPO shares to the executive officers and directors of the company divides the loyalty of the agents of the company (i.e., the executive officers and directors) from the principal (i.e., the company) on whose behalf they must act. This practice is inconsistent with just and equitable principles of trade.

Rule 2712(c) would prohibit the allocation of IPO shares on the condition that the executive officer or director send investment banking business to the member, or as consideration for previously directed investment banking business. The provision is not intended to prohibit a member from allocating IPO shares to a customer merely because the customer is an executive officer or director of a company.

NASD also is proposing to amend Rule 2710, the Corporate Financing Rule, to require that members file information regarding the allocation of IPO shares to executive officers and directors of a company that hires a member to be the book-running managing underwriter of the company's IPO. This information would assist the staff in monitoring the

possibility that improper allocations to executive officers or directors may have occurred. This information also may alert the staff to allocations that could violate Rule 2712(a).

4. Restrictions on Penalty Bids

Rule 2712(d) would prohibit members from penalizing registered representatives whose customers have "flipped" IPO shares that they have purchased through the member, unless a penalty bid, as defined in Regulation M Rule 101 has been imposed. Rule 101 defines a penalty bid as "an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions."

Regulation M and Nasdaq Stock Market Rule 4624 provide notice and recordkeeping requirements for penalty bids. Penalty bids typically are used in the aftermarket of an offering that is under downward price pressure from an imbalance of sell orders relative to purchase orders. NASD does not oppose this use of penalty bids. However, some members have penalized their registered representatives in connection with flipping by retail customers, even when the managing underwriter has not imposed a penalty bid on the syndicate members. For example, members have penalized their registered representatives by recouping the commission or credits previously granted for the sale of IPO shares.

The practical consequence of this practice is that registered representatives are penalized, and their retail customers may be pressured to retain their long position in the IPO shares, while representatives for institutional customers generally are not penalized at all for their flipping activity. The inequity of this selective penalization is most difficult to justify in light of the fact that most IPO shares are typically allocated to institutional customers, and the need to encourage institutional customers to remain committed to the issuer may therefore be greater. The proposed rule would effectively prohibit this selective practice by permitting members to impose internal penalties on their registered representatives only when the managing underwriter has imposed a penalty bid on the syndicate members. The provision would not place any limit on syndicate penalty bids, however.

5. Requirement for Procedures

Rule 2712(d) would require members to adopt procedures reasonably designed to ensure that the requirements and prohibitions in Rule 2712 are followed. The proposal would not mandate specific procedures that would apply to all members. Instead, it would permit members to tailor the required procedures to their particular corporate structure and the nature of their underwriting and distribution activities. Accordingly, members that do not engage in the allocation or distribution of IPOs would not be required to adopt procedures under Rule 2712.

Endnote

- 1 *E.g.*, Rules 10b-5 (Employment of Manipulative and Deceptive Devices) and Rule 100 (Regulation M).
- 2 *E.g.*, Rules 2110 (Standards of Commercial Honor and Principles of Trade), 2710 (Corporate Financing Rule), 2330 (Customers' Securities or Funds), 3010 (Supervision), and 3060 (Influencing or Rewarding Employees of Others).

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EXHIBIT A

Rule 2712. IPO Allocations and Distribution

(a) **Abusive Allocations.** No member or person associated with a member may offer or threaten to withhold shares it allocates in an initial public offering ("IPO") as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.

(b) **Aftermarket Tie-in Agreements.** No member or person associated with a member that is participating in an IPO may request that a customer purchase shares in the aftermarket as a condition to being allocated shares in the IPO distribution.

(c) **Spinning.** No member or person associated with a member may allocate IPO shares to an executive officer or director of a company:

(1) on the condition that the executive officer or director, on behalf of the company, direct future investment banking business to the member, or

(2) as consideration for directing investment banking services previously rendered by the member to the company.

(d) **Policies Concerning Flipping.** No member or person associated with a member may directly or indirectly recoup, or attempt to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares in an IPO as a penalty or disincentive for selling the shares to a customer that engaged in flipping, unless the managing underwriter has assessed a penalty bid on the member.

(1) In connection with its obligation to maintain records relating to penalty bids under SEC Rule 17a-2(c)(1), a member must promptly record and maintain information regarding any penalty or disincentive assessed on its associated persons in connection with a penalty bid.

(2) Definitions

For purposes of this Rule, the following terms shall have the meanings stated below.

(A) "Flipping," means the initial sale of IPO shares purchased in an offering within 30 days following the effective date of such offering.

(B) "Penalty bid" means an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.

(e) Supervisory Procedures. Each member subject to this rule must adopt and implement written procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule.

EXHIBIT B

New language is underlined.

Rule 2710. Corporate Financing Rule – Underwriting Terms and Arrangements

* * *

(b) Filing Requirements

(1) – (3) No change

(4) Requirement for Filing

(A) Unless filed by the issuer, the managing underwriter, or another member, a member that anticipates participating in a public offering of securities subject to this Rule shall file with the Association the documents and information with respect to the offering specified in subparagraphs (5) and (6) below no later than one business day after the filing of any such documents:

* * *

; provided, however, that the information required under Rule 2710(b)(6)(A)(viii) must be filed no later than 15 calendar days after the conclusion of the 180 calendar-day period immediately following the effective date of the offering.

(5) No change

(6) Information Required to be Filed

(A) Any person filing documents with the Association pursuant to subparagraph (4) above shall provide the following information with respect to the offering:

(i) - (vi) No change.

(vii) a statement regarding whether any executive officer or director of the issuer acquired from the book-running managing underwriter of the public offering any shares in an initial public offering of securities (“IPO”) during the 180 calendar-day period immediately preceding the required filing date of the offering. For each executive officer or director of the issuer who acquired those IPO shares, the statement must disclose:

a. the name of the executive officer or director;

b. the date of the IPO, the name of the issuer in the IPO, the number of securities purchased or received by the executive officer or director and the price paid for those securities;
and

c. whether the executive officer or director participated in any capacity in the selection of the book-running managing underwriter for the issuer's public offering.

(vii) a statement containing the information required in Rule 2710(b)(6)(vii)(a)-(c) if any executive officer or director of the issuer purchases or acquires from the book-running managing underwriter any shares in an IPO within 180 calendar days after the effective date of the offering.

Disciplinary Actions

REPORTED FOR AUGUST

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of July 2002.

Firms Fined, Individuals Sanctioned

The Partners Financial Group, Inc. (CRD #31979, Miami, Florida) and Oilda Caradad Hernandez (CRD #1076766, Registered Principal, Miami, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000, jointly and severally, with Hernandez. In addition, Hernandez was suspended from association with any NASD member as a general securities principal for five business days. Without admitting or denying the allegations, the firm and Hernandez consented to the described sanctions and to the entry of findings that they permitted a representative to act in a registered capacity while his registration was inactive. The findings also stated that the firm and Hernandez failed to maintain written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD Rules regarding monitoring compliance with the requirements of the Regulatory Element of continuing education requirements by its registered representatives.

Hernandez' suspension began July 15, 2002, and concluded at the close of business July 19, 2002. (NASD Case #C07020049)

Taglich Brothers, Inc. (CRD #29102, New York, New York) and Michael Nicholas Taglich (CRD #1343730, Registered Principal, Sag Harbor, New York) submitted an Offer of Settlement in which they were censured and fined \$35,000, jointly and severally. In addition, the firm was fined an additional \$5,000 and Taglich was required to requalify by exam as a general securities principal (Series 24) within 90 days of issuance of the Order Accepting the Offer of Settlement. If Taglich fails to requalify, he will be prohibited from serving in a principal capacity with any firm until he successfully requalifies. Without admitting or denying the allegations, the firm and Taglich consented to the described sanctions and to the entry of findings that they failed to disclose to public customers that they had an arrangement whereby the firm's clearing firm would make markets in securities requested by the firm and then pay the firm a portion of the clearing firm's spread earned on some, but not all, trades executed by the clearing firm in these securities. The findings stated that the amount of the spread—which was not disclosed to customers on confirmations—would be split between the firm and the registered representative generating the trade who also received a regular commission. In addition, the firm failed to correct the confirmation slips to reflect the additional compensation, and the confirmations failed to state clearly whether

the firm or the clearing firm was acting in a principal or agency capacity. NASD also found that the firm failed to detect and correct this ambiguity on confirmation slips for these trades. Moreover, NASD found that the firm failed to create and maintain order tickets that reflected the times the orders were received and executed. (NASD Case #CAF010028)

Firms Fined

Alexander, Wescott, & Co., Inc. (CRD #35935, Utica, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$5,000, jointly and severally. The firm was also fined an additional \$5,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to the Automated Transaction ServiceSM (ACTSM) transactions in non-Nasdaq and Nasdaq SmallCapSM securities effected by the firm, and failed to record the time of execution or cancellations on sales memoranda for transactions effected by the firm. The findings also stated that the firm, acting through an individual, conducted a securities business while failing to maintain the minimum required net capital. (NASD Case #C10020056)

C.E. Unterberg, Towbin (CRD #24790, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening; received a Trade-or-Move message in each instance through SelectNet;[®] and, within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. (NASD Case #CMS020110)

Goldman, Sachs & Company (CRD #361, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$17,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed, entered bid or asked quotations in the Nasdaq Stock Market that caused a locked or crossed market condition to occur in each instance. (NASD Case #CMS020112)

HD Brous & Co., Inc. (CRD #22062, Great Neck, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it submitted to the Order Audit Trail SystemSM (OATSSM) reports with respect to equity

securities traded on the Nasdaq Stock Market that were not in the electronic form prescribed by NASD. The findings also stated that the firm failed to follow written supervisory procedures concerning OATS and thus failed to maintain a system that was reasonably designed to achieve compliance with NASD Marketplace Rule 6955(a). (NASD Case #CMS020108)

J. Alexander Securities, Inc. (CRD #7809, Los Angeles, California) 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 within 30 business days of acceptance of the AWC by NASD. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published quotations for Over-the-Counter (OTC) equity securities, or directly or indirectly submitted such quotations for publication, in a quotation medium, and did not have in its records the documentation required by SEC Rule 15c2-11(a); did not have a reasonable basis under the circumstances for believing the information was accurate in all material respects or that the sources of the information were reliable; and failed to represent a customer's indication of unsolicited interest. The findings also stated that the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation medium. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable rules and regulations concerning SEC Rule 15c2-11 and NASD Marketplace Rule 6740, including a statement of the steps to be taken to ensure compliance and a statement as to how enforcement of such written supervisory procedures should be documented at the firm. (NASD Case #CMS020103)

J.B. Oxford & Company (CRD #14343, Beverly Hills, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$27,000, and required to pay \$1,018.75, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short sale orders in certain securities and failed to make an affirmative determination prior to executing the transactions. The findings also stated that the firm failed to display immediately customer limit orders in Nasdaq securities in its public quotation when each such order was at a price that would have improved the firm's bid or offer in each such security, or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each such security, and the size of the order represented more than a de minimis change in relation to the size associated with the firm's bid or offer in each such security. NASD also found that the firm failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. In addition, NASD found that the firm improperly transmitted duplicate execution reports to OATS. (NASD Case #CMS020101)

Ladenburg Capital Management f/k/a GBI Capital Partners, Inc. (CRD #14623, Bethpage, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it used confidentiality clauses in written settlement agreements with public customers that contained language that may have impeded NASD investigations and NASD's prosecution of disciplinary actions. The findings also stated that the firm's sales personnel engaged in improper telemarketing practices in an effort to induce public customers to establish accounts with the firm including harassment, intimidation, and indecorous language. (NASD Case #C10020055)

Lehman Brothers, Inc. (CRD #7506, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$23,000, and required to pay \$568.75, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, in transactions for or with a customer, to use reasonable diligence to ascertain the best inter-dealer market; failed to buy or sell in such market so that the resultant price to its customers was as favorable as possible under prevailing market conditions; and failed to execute an order fully and promptly. The findings also stated that the firm executed short sale orders in certain securities and failed to maintain a written record of the affirmative determination made for such orders; executed short sale transactions and failed to report each of these transactions to ACT with a short sale modifier; failed to disclose on customer confirmations that the disclosed price was an average price; and failed to reference on the required average price legend that details of the transactions would be provided upon request. NASD also found that the firm failed to display immediately customer limit orders in Nasdaq securities in its public quotation when each such order was at a price that would have improved the firm's bid or offer in each such security, or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. (NASD Case #CMS020113)

Needham & Company, Inc. (CRD #16360, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$67,500, and required to revise the firm's written supervisory procedures with respect to firm quotations. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to execute orders presented to the firm at its published bid or offer in an amount up to its published quotation size, thereby failing to honor its published quotations. The findings also stated that the firm's supervisory system failed

to provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning firm quotations.

NASD found that the firm, as a market maker in securities, caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation, that locked or crossed another market maker's quotations, without immediately sending through SelectNet to the market maker(s) whose quote(s) it locked or crossed a Trade-or-Move Message that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares. In addition, the firm was a party to a locked or crossed market condition prior to the market opening, received a Trade-or-Move message in each instance through SelectNet, and, within 30 seconds of receiving such messages, failed to fill the incoming message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. Furthermore, NASD found that the firm failed to display immediately customer limit orders in Nasdaq securities in its published quotation when each such order was at a price that would have improved the firm's bid or offer in each securities, or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each such security, and the size of the order represented more than a de minimis change in relation to the size associated with the firm's bid or offer in each such security. (NASD Case #CMS020104)

Pacific Growth Equities, Inc. (CRD #24835, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that orders were presented to the firm at the firm's published bid or published offer in an amount up to its published quotation size, failed to execute the orders upon presentment, and thereby failed to honor its published quotation. (NASD Case #CMS020111)

Pershing Trading Company, L.P. (CRD #36671, Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it caused a locked/crossed market condition prior to the market opening by entering a quotation that locked or crossed another market maker's quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quotes it locked or crossed a Trade-or-Move Message that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares. NASD found that the firm was a party to a locked or crossed market condition prior to the market opening, received a Trade-or-Move Message in each instance

through SelectNet, and, within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its quotation by an increment that would have unlocked or uncrossed the market. (NASD Case #CMS020102)

Scott & Stringfellow, Inc. (CRD #6255, Richmond, Virginia) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to pay \$4,861.13, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, in transactions for or with a customer, to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. (NASD Case #CMS020106)

Service Asset Management Company (CRD #47157, Austin, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening and received a Trade-or-Move Message in each instance through SelectNet, and, within 30 seconds of receiving such message, failed to fill the incoming Trade-or-Move Message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. (NASD Case #CMS020115)

Trident Securities, Inc. (CRD #566, Cleveland, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise the firm's written supervisory procedures with respect to firm quote rules. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a registered market maker in securities, it failed to execute the orders presented to the firm at its published bid or offer in an amount up to its published quotation size upon presentment, and thereby failed to honor its published quotation. The findings also stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities rules and regulations concerning firm quote compliance. (NASD Case #CMS020100)

WM Financial Services, Inc. (CRD #599, Irvine, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to disclose customer complaints and settlements on the Forms U-4 and/or Forms U-5 of registered representatives as required. The findings also stated that the firm failed to establish, maintain, and

enforce written procedures to ensure that the firm made required disclosures on Forms U-4 and U-5 concerning customer complaints and settlements. (NASD Case #C02020036)

Individuals Barred or Suspended

Seymour Isaac Abramowitz a/k/a Seymour Abrams (CRD #4412506, Associated Person, Tarzana, California), submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Abramowitz consented to the described sanction and to the entry of findings that he willfully misrepresented material facts on a Form U-4. (NASD Case #C02020033)

Kevin Eric Aizenshtat (CRD #2860587, Registered Representative, Naples, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,500 and suspended from association with any NASD member in any capacity for five business days. The fine must be paid before Aizenshtat reassociates with any NASD member in any capacity following the suspension or before requesting relief from any statutory disqualification. In light of Aizenshtat's payment of \$28,105.75 in restitution to the customer, no additional monetary sanction has been imposed. Without admitting or denying the allegations, Aizenshtat consented to the described sanctions and to the entry of findings that he exercised discretionary authority in the account of a public customer, pursuant to oral authority granted by the customer, without having that authority reduced to writing and without having the account accepted in writing by his member firm. The findings also stated that Aizenshtat negligently misrepresented that a bond purchased by a client was returning principal with its interest payments when, in fact, it was not, causing the client to sell the bond.

Aizenshtat's suspension began August 5, 2002, and concluded at the close of business August 9, 2002. (NASD Case #C07020056)

Brent Allen Atwood (CRD #2540982, Registered Principal, Durham, North Carolina) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Atwood consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing written notice to, or obtaining written approval from, his member firm. The findings stated that Atwood received \$20,000 from public customers to purchase Class A shares in a security that Atwood claimed to own although he did not, and failed to obtain such shares to fulfill his agreement with the customers. NASD found that Atwood made improper use of these funds or converted the funds to his own use before repaying \$19,500 to the customers. (NASD Case #C07020047)

Robert Wells Bailey (CRD #1622898, Registered Representative, Wayne, Michigan) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 40 days. The fine must be paid before Bailey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Bailey consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Bailey's suspension began July 15, 2002, and will conclude at the close of business August 23, 2002. (NASD Case #C8A020041)

Robert Joseph Borson (CRD #2828890, Registered Representative, Fullerton, California) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Borson consented to the described sanction and to the entry of findings that he received a check for \$2,000 from a public customer for investment purposes payable to Borson's member firm. The findings stated that Borson failed to apply the customer funds as instructed and, without the customer's authorization or consent, altered the payee line of the customer check to read "Robert Borson" and inserted the customer's initials above to make it appear as though the customer had authorized the alteration. In addition, the findings stated that Borson, without the customer's authorization or consent, added the notation, "Given to Rob Borson" next to the customer's notation on the memo portion of the check, to make it appear as though Borson was the authorized payee on the customer check. The findings further stated that after altering the customer check, Borson endorsed and deposited it into his personal checking account and held the funds for a period of time, without the customer's authorization or consent. (NASD Case #C02020022)

Donald Christopher Bowers (CRD #4291781, Associated Person, Long Beach, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Bowers failed to disclose material information on his Form U-4 and failed to respond to NASD requests for information. (NASD Case #C02020001)

Scott Michael Brown (CRD #2642492, Registered Representative, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$30,000 and suspended from association with any NASD member in any capacity for 12 months. The fine must be paid before Brown reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Brown further agrees to provide additional testimony to NASD and to appear personally and testify truthfully and completely in connection with its investigation or any disciplinary hearing conducted in connection with the

investigation. If Brown fails to appear or to testify truthfully and completely, he consents to a sanction including a bar from the securities industry. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests to provide on-the-record testimony.

Brown's suspension began April 1, 2002, and will conclude at the close of business March 31, 2003. (NASD Case #CAF020010)

Arthur Kenny Bryant (CRD #1827620, Registered Representative, Edmonds, Washington) was barred from association with any NASD member in any capacity. The sanction was based on findings that Bryant obtained a \$4,000 check drawn on a public customer's account at his member firm, altered the check to make himself the payee, deposited the check in the net amount of \$3,900 into his personal credit union savings account, and later withdrew the funds for his own purposes, thereby converting the funds to his own use. (NASD Case #C3B020002)

Allen Gene Davis (CRD #2783495, Registered Representative, Deer Lodge, Tennessee) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Davis consented to the described sanction and to the entry of findings that he received \$3,760.97 in checks from a public customer for investment purposes. The findings stated that Davis cashed the checks and neglected to purchase securities for the account of the public customer before remitting the funds to his member firm after a period of time. (NASD Case #C05020031)

Thomas Rayvon Daye (CRD #2596342, Registered Representative, Raleigh, North Carolina) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Daye consented to the described sanction and to the entry of findings that he submitted wire transfer instructions to his member firm, causing \$180,000 in funds to be transferred from client accounts to a bank account under his control without the authorization of the clients. The findings also stated that Daye failed to respond to NASD requests for information. (NASD Case #C07020055)

Paul DePasquale (CRD #2832113, Registered Representative, Miami Beach, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, DePasquale consented to the described sanctions and to the entry of findings that he acted in a registered capacity while his registration was inactive. In addition, NASD found that DePasquale provided false testimony during an NASD on-the-record interview.

DePasquale's suspension began July 15, 2002, and will conclude October 12, 2002. (NASD Case #C07020050)

Michael Scott Dreher (CRD #2701679, Registered Representative, Denver, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Dreher consented to the described sanction and to the entry of findings that he forged the name of a manager of his member firm on a letter sent to a prospective customer. (NASD Case #C3A020027)

Ernest Yoshitsugo Fukumoto (CRD #215511, Registered Representative, Pasadena, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Fukumoto consented to the described sanction and to the entry of findings that he engaged in private securities transactions, for compensation, without prior written notice to, and approval from, his member firm. (NASD Case #C02020029)

Roland Raymond Gaboury (CRD #1284789, Registered Representative, West Brookfield, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Gaboury consented to the described sanction and to the entry of findings that a public customer provided him with \$20,000 to invest in a high-yield account that Gaboury said would provide a fixed rate of return, failed to invest the customer's funds as directed, and, instead, misused the funds by purchasing for the customer a security offered by a friend. The findings also stated that Gaboury engaged in a private securities transaction without prior written notice to, or approval from, his member firm. NASD found that Gaboury created and sent fictitious account statements to the public customer that falsely indicated that the \$20,000 investment, plus accrued interest, was located in a firm account. In addition, NASD found that Gaboury had learned that the outside investment was a fraud and that someone had absconded with the customer's funds, but instead of informing the customer, Gaboury continued to create and send fictitious reports falsely indicating that the investment was at the firm and continuing to accrue interest. Moreover, NASD found that Gaboury created and provided to the customer a letter on firm stationery showing a fictitious policy number and account value for the customer's \$20,000 investment and forged a firm employee's signature on this document. (NASD Case #C11020025)

Matthew James Gervasio (CRD #2844164, Registered Representative, West Islip, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Gervasio received checks and silver bars from public customers for deposit in their accounts and in a

safe deposit box, respectively, at his member firm. The findings stated that Gervasio converted the checks and bars to his personal use and benefit without the authorization of the customers. NASD also found that Gervasio failed to respond to NASD requests for information. (NASD Case #C10010157)

Foster J. Gibbons (CRD #2766670, Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Gibbons consented to the described sanction and to the entry of findings that a member firm, acting through Gibbons, failed to implement, maintain, and enforce a reasonable supervisory system that would have enabled the firm to comply effectively with NASD Rules and federal securities laws and regulations by preventing and detecting violations by the firm regarding unauthorized transactions in the accounts of public customers; churning of accounts of public customers; and charging unreasonable, unfair, and excessive commissions in transactions effected on behalf of public customers. (NASD Case #C10020057)

Edward Hossein Haghani (CRD #3055635, Associated Person, King of Prussia, Pennsylvania) was barred from association with any NASD member in any capacity. The sanction was based on findings that Haghani caused an unauthorized withdrawal of \$650 from the bank account of a public customer for his own personal financial benefit and failed to respond to NASD requests for information. (NASD Case #C9A020003)

Kim Ione Halliburton (CRD #1058579, Registered Principal, Dunedin, Florida) and Carl Dominic Martellaro (CRD #320959, Registered Principal, Chico, California) submitted a Letter of Acceptance, Waiver, and Consent in which Halliburton was fined \$7,500, jointly and severally, suspended from association with any NASD member in a supervisory capacity for 90 days, and suspended from association with any NASD member as a financial and operations principal (FINOP) for 30 days. Martellaro was fined \$10,000 and barred from association with any NASD member in any principal or proprietary capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that a member firm, acting through Halliburton, failed to maintain properly adequate net capital while conducting a securities business. The findings also stated that a member firm, acting through Halliburton, failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with rules and regulations applicable to sales practices by registered representatives, and failed to supervise a branch office. NASD also found that Martellaro acted in a principal capacity while failing to be registered with NASD in any capacity, and the member firm, acting through Halliburton, permitted Martellaro to act in a principal capacity without registration as such with NASD.

Halliburton's suspension in a supervisory capacity began August 5, 2002, and will conclude November 2, 2002. Halliburton's suspension in a FINOP capacity began August 5, 2002, and will conclude at the close of business September 3, 2002. (NASD Case #C07020053)

Henry Joseph Jedziniak (CRD #1731003, Registered Representative, Bernardsville, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Jedziniak consented to the described sanction and to the entry of findings that he failed to respond to an NASD request to appear for an on-the-record interview. (NASD Case #C9B020044)

Tameka Darsaleik Johnson (CRD #2828002, Registered Representative, Philadelphia, Pennsylvania) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Johnson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Johnson consented to the described sanctions and to the entry of findings that she willfully failed to amend her Form U-4 to disclose a material fact.

Johnson's suspension began July 15, 2002, and will conclude at the close of business July 14, 2003. (NASD Case #C9A020026)

Daniel Steven Kippert (CRD #2327018, Registered Representative, Ogden, Utah) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kippert instructed a member firm sales assistant to transfer \$1,700 from a public customer's account maintained *at his member firm* to his personal bank account without the prior knowledge, authorization, or consent of the public customer. (NASD Case #C3A020011)

Victor Kozirovsky (CRD #2841043, Registered Representative, Woodmere, New York) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for four months. In light of the financial status of Kozirovsky, no monetary sanctions have been imposed. Without admitting or denying the allegations, Kozirovsky consented to the described sanction and to the entry of findings that he caused purchases of stock during the initial public offering of a security for persons who had not agreed to purchase stock or to open accounts with his member firm.

Kozirovsky's suspension began July 15, 2002, and will conclude at the close of business November 14, 2002. (NASD Case #CAF020004)

Gene Louis Lancour (CRD #3164906, Registered Representative, Hampton, Virginia) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lancour consented to the described sanction and to the entry of findings that he received a \$2,400.05 check from a public customer to be used for investment purposes, cashed the check, and failed to make the investment as directed. The findings also stated that Lancour held the customer's funds until he returned them with interest, but misused them in that he failed to make the investment as directed and held the funds for over two months before returning them to the customer. (NASD Case #C07020029)

Rebecca English Lantz (CRD #4250342, Registered Representative, Youngsville, Louisiana) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lantz consented to the described sanction and to the entry of findings that she processed credit entries totaling \$1,500 to her personal checking account, thereby converting the funds to her own use and benefit. The findings also stated that Lantz failed to respond to NASD requests for information. (NASD Case #C05020029)

Gregory Scott Long (CRD #2495123, Registered Representative, San Diego, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Long consented to the described sanction and to the entry of findings that he made recommendations to a public customer without having reasonable grounds for believing that such recommendations were suitable for the customer in light of the size and nature of the transactions, and the facts disclosed concerning the customer's other securities holdings, financial situation, investment objectives, circumstances, and needs.

Long's suspension began August 5, 2002, and will conclude at the close of business August 9, 2002. (NASD Case #C02020034)

James Hugh Long (CRD #1790073, Registered Principal, Plant City, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for 18 months. In light of the financial status of Long, no monetary sanctions have been imposed. Without admitting or denying the allegations, Long consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Long's suspension began July 15, 2002, and will conclude at the close of business January 14, 2003. (NASD Case #C07020052)

Robert David Luecke (CRD #1999585, Registered Principal, Bellevue, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Luecke consented to the described sanctions and to the entry of findings that broker/dealers he owned and operated posted misleading information on Web sites and made claims and comparisons that were unwarranted, exaggerated, and without support. The findings also stated that Luecke, through a Web site, promoted day trading without sufficiently disclosing the risks of that type of trading strategy, and discussed after-hours trading without sufficiently disclosing the risks of after-hours trading.

Luecke's suspension began July 15, 2002, and concluded on July 28, 2002; it will begin again August 19, 2002, and conclude at the close of business September 3, 2002. (NASD Case #CAF020019)

Tracie Lynn Mason (CRD #4041253, Registered Representative, Minot, North Dakota) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Mason consented to the described sanction and to the entry of findings that she altered incoming and outgoing insurance-related checks and converted the funds to her own personal use and benefit. (NASD Case #C04020017)

Jeffrey Henry Massey (CRD #2395900, Registered Representative, Cumberland, Rhode Island) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for nine months and required to disgorge \$20,000 in partial restitution to public customers. Restitution must be paid before Massey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. In light of the financial status of Massey, no monetary sanction has been imposed. Without admitting or denying the allegations, Massey consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm.

Massey's suspension began July 15, 2002, and will conclude at the close of business April 14, 2003. (NASD Case #C11020026)

Jack Alan Moloney (CRD #2190471, Registered Principal, Hoboken, New Jersey) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for one year and required to pay \$20,000 in disgorgement of commissions in partial restitution to public customers. In the light of the financial status of Moloney, no fine has been imposed and the restitution amount was reduced. Restitution must be paid before Moloney reassociates

with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Moloney consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm.

Moloney's suspension began August 5, 2002, and will conclude at the close of business August 4, 2003. (NASD Case #C9B020010)

William Benjamin Muller Jr. (CRD #1892075, Registered Representative, Novi, Michigan) was barred from association with any NASD member in any capacity. The sanction was based on findings that Muller failed to disclose a material fact on his Form U-4. NASD also found that Muller failed to respond to requests for information. (NASD Case #C8A010091)

David Bruce Novak (CRD #2700222, Registered Principal, Winnetka, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and required to pay \$96,898, plus interest, in restitution to a public customer. The restitution must be paid before Novak reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Novak consented to the described sanctions and to the entry of findings that he made improper use of approximately \$96,898 from the securities accounts of a public customer. The findings also stated that Novak failed to respond to an NASD request for information. (NASD Case #C8A020035)

Fred John Pascaris (CRD #2213626, Registered Representative, Dearborn Heights, Michigan) was barred from association with any NASD member in any capacity. The sanction was based on findings that Pascaris engaged in private securities transactions, for compensation, and failed to provide written notice to, and obtain prior written authorization from, his member firm to engage in the private securities transactions. The findings also stated that Pascaris willfully failed to timely update his Form U-4. (NASD Case #C8A010096)

Howard Charles Penn (CRD #811882, Registered Principal, Briarcliff Manor, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, suspended from association with any NASD member in any capacity for 10 business days, and required to disgorge \$6,270 in commissions received in partial restitution to a public customer. The restitution must be paid before Penn reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Penn consented to the described sanctions and to the entry of findings that he recommended and purchased limited partnership interests in businesses totaling approximately \$100,000 for a public customer without reasonable grounds for believing that these recommendations and resultant transactions were suitable for the customer on the

basis of the customer's financial situation, investment objectives, and needs.

Penn's suspension began August 5, 2002, and will conclude at the close of business August 16, 2002. (NASD Case #C11020027)

James Patrick Philbin (CRD #721998, Registered Representative, Dunellen, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in any capacity for six months, and required to disgorge \$25,000 in commissions in partial restitution to public customers. The fine and restitution must be paid before Philbin reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Philbin consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm.

Philbin's suspension began August 5, 2002, and will conclude at the close of business February 4, 2003. (NASD Case #C9B020045)

Paul Edison Renfroe, Jr. (CRD #2557149, Registered Representative, Collierville, Tennessee) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Renfroe consented to the described sanction and to the entry of findings that he received \$84,000 from a public customer for investment purposes, deposited the funds into his personal checking account, purchased contracts totaling \$80,000 in his own name, returned \$4,000 to the customer and, at a later date, transferred ownership of the contracts to the customer. The findings also stated that Renfroe participated in private securities transactions without providing prior written notice to his member firm. (NASD Case #C05020030)

James Eric Smartt (CRD #4195655, Associated Person, Inglewood, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Smartt consented to the described sanction and to the entry of findings that he received and converted a \$2,100 check payable to his member firm's proprietary account. The findings also stated that Smartt received and converted a \$3,000 check payable to a customer's investment account. (NASD Case #C02020035)

Patrick Hoell Smith (CRD #1821303, Registered Principal, Gastonia, North Carolina) was fined \$30,000, suspended from association with any NASD member in a general securities principal and FINOP capacities for two years, suspended from association with any NASD member in any capacity for three months, and ordered to requalify by exam as a general securities

principal and FINOP before he resumes those responsibilities. For one year following Smith's association with any NASD member, his firm shall review and pre-approve all transactions for his personal accounts (including all accounts in which he has a beneficial interest), and require that he have sufficient funds in his accounts to settle all transactions before they are executed. The sanctions were based on findings that Smith effected purchases of securities in his personal securities account for a total purchase price of \$11,593,471.98, running the account as if it were a proprietary trading account without paying for the purchases as required by Regulation T. The findings also stated that Smith netted out his short-term positions against other trades in his account because his member firm was self-clearing and his strategy was to sell each position before payment was due. NASD also found that Smith, as FINOP for his firm, arranged for extensions of credit because he was unable to pay for the purchases effected in his account, in violation of Regulation X.

Smith's suspension as a general securities principal and FINOP began July 1, 2002, and will conclude at the close of business June 30, 2004. Smith's suspension in any capacity began July 1, 2002, and will conclude at the close of business September 30, 2002. (NASD Case #C07010095)

Martin Ronald Sprenger (CRD #2200424, Registered Representative, Omaha, Nebraska) was barred from association with any NASD member in any capacity. The sanction was based on findings that Sprenger willfully failed to disclose material facts on his Form U-4. The findings also stated that Sprenger failed to respond to NASD requests for information. (NASD Case #C04010030)

Clarence Joe Susaeta (CRD #837418, Registered Principal, Park City, Utah) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity, with a right to reapply to become associated with an NASD member after three years from the date the AWC becomes final. Without admitting or denying the allegations, Susaeta consented to the described sanction and to the entry of findings that he received \$46,221 from a public customer, deposited the funds into a bank account he controlled, and paid the premiums on insurance policies owned by the customer in the total amount of \$54,134. The findings also stated that Susaeta's failure to segregate such funds from his own funds constituted an improper use of public customer funds. (NASD Case #C3A020028)

Dave Hung Trinh (CRD #2916910, Registered Representative, Renton, Washington) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Trinh consented to the described sanction and to the entry of findings that he affixed the signature of a public customer to an account application to open a securities account at a member firm other than his own without the customer's

knowledge or consent, and provided his telephone number and e-mail address, falsely representing that they were the customer's telephone number and e-mail address. The findings also stated that Trinh affixed the customer's signature to a margin agreement for the customer's account without the customer's knowledge or consent. In addition, Trinh affixed the customer's signature to a memorandum to the other member firm requesting the address on the account be changed, without the customer's knowledge or consent, and provided his own home address as the new address in the memorandum.

NASD also found that Trinh received a \$24,916.50 check from a public customer to purchase shares of stock; deposited the funds in a money market account linked to the customer's account but failed to purchase the stock; affixed the customer's signature to a \$24,000 check drawn on the money market account payable to Trinh without the customer's knowledge or consent; and deposited the check in his own checking account, thereby converting \$24,000 to his own use and benefit. Furthermore, NASD found that Trinh received a \$423 check from his member firm, payable to the employer of a public customer, to refund an excess contribution to the customer's qualified variable annuity contract; endorsed the check; and deposited it in his own checking account, thereby converting \$423 to his own use and benefit. Moreover, the findings stated that Trinh made false statements in response to an NASD request for information and delivered a false document concealing his conversion of \$423 to NASD to impede the investigation. (NASD Case #C3B020009)

Christopher Thomas Votta (CRD #2760656, Registered Representative, Ronkonkoma, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,222.50, including disgorgement of \$222.50 in commissions, and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Votta consented to the described sanctions and to the entry of findings that he effected an unauthorized sale transaction in the account of a public customer without the customer's prior knowledge, authorization, or consent.

Votta's suspension began July 15, 2002, and concluded at the close of business July 26, 2002. (NASD Case #C10020053)

Charles Eugene Williams (CRD #727212, Registered Principal, Macy, Indiana) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in any capacity for three months, and required to disgorge \$4,080 in commissions to public customers. Without admitting or denying the allegations, Williams consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without providing prior written notice to, and receiving written approval from, his member firm.

Williams' suspension began July 1, 2002, and will conclude at the close of business September 30, 2002. (NASD Case #C8A020043)

Mimy Wong (CRD #2284425, Registered Principal, La Canada, California) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$9,125 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Wong consented to the described sanctions and to the entry of findings that she participated in private securities transactions without providing prior written notice to her member firm.

Wong's suspension began August 5, 2002, and will conclude at the close of business August 16, 2002. (NASD Case #C02020031)

Decision Issued

The following default decision has been issued by the DBCC or the Office of Hearing Officers, and has been appealed to or called for review by the NAC as of July 5, 2002. The findings and sanctions imposed in the default decision may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notices to Members*.

Juan Gascot-Jimenez (CRD #1385156, Registered Representative, Rio Piedras, Puerto Rico) was barred from association with any NASD member in any capacity. The sanction was based on findings that Gascot-Jimenez possessed and reviewed unauthorized materials during his Series 7 qualification exam.

Gascot-Jimenez has appealed this decision to the NAC, and the sanction is not in effect pending consideration of the appeal. (NASD Case #C07020018)

Complaints Filed

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

Justin Edward Apgar (CRD #2770606, Registered Representative, Wall Township, New Jersey) was named as a respondent in an NASD complaint alleging that he recommended to a public customer that he invest money in a mutual fund rather than keeping the money in certificates of

deposit. The complaint also alleges that Apgar knowingly or recklessly guaranteed the customer against loss and knowingly or recklessly informed the customer that the fund would pay a guaranteed rate. In addition, the complaint alleges that Apgar forged, or caused to be forged, the signature of his supervisor on a letter sent to the customer, without the supervisor's knowledge or consent. (NASD Case #C9B020046)

John Oliver Edwards (CRD #1627812, Registered Representative, Cincinnati, Ohio) was named as a respondent in an NASD complaint alleging that he participated in private securities transactions for compensation without prior written notice to, or approval from, his firm. The complaint also alleges that Edwards, acting in his capacity as a trustee, caused a member firm to liquidate portions of the trusts' mutual fund investments and deliver the proceeds totaling approximately \$1,149,500 to him. The complaint further alleges that Edwards deposited these funds into a bank account that he controlled, and made improper use of approximately \$1,043,170 of customer funds for his personal benefit. In addition, the complaint alleges that Edwards failed to notify his member firm that he had a financial benefit in an outside securities account maintained in the name of a trust at a member firm, and failed to notify the member firm carrying the account of his association with his member firm. Furthermore, the complaint alleges that Edwards completed and provided to his member firm a firm document in which he falsely represented that he did not have any securities accounts at a broker/dealer other than his member firm when he knew, or should have known, that his financial interest and authority to direct the execution of transactions in the outside account was required to be disclosed to his member firm. The complaint also alleges that Edwards failed to respond, or respond completely, to NASD requests for information. (NASD Case #C3A020029)

Edward Paul Galvan (CRD #2124116, Registered Principal, Addison, Texas) was named as a respondent in an NASD complaint alleging that he executed an unauthorized transaction in the account of a public customer for \$5,393.75. The complaint also alleges that, without the prior knowledge or consent of his member firm, Galvan deposited \$2,000 into the public customer's account in partial payment for the loss incurred as a result of the unauthorized transaction. In addition, the complaint alleges that Galvan failed to respond to NASD requests for information. (NASD Case #C05020032)

Daniel Richard Schmidt (CRD #2652062, Registered Representative, Santa Barbara, California) was named as a respondent in an NASD complaint alleging that he signed public customers' names to Contribution Change Forms (CCF) without their authorization, knowledge, or consent, and submitted them to his member firm requesting an increase in the customer's monthly payroll deductions for which he received \$520 in commission advances. The proposed payroll deduction increases

were not effectuated because Schmidt failed to submit salary reduction agreements (SRAs) along with the forged CCFs. (NASD Case #C02020030)

Craig Frank Wisbiski (CRD #2711742, Registered Supervisor, Williamston, Michigan) was named as a respondent in an NASD complaint alleging that he caused at least \$160,970 to be withdrawn from the securities account of a public customer for which he was the broker, deposited the funds into his own securities account without the customer's knowledge or consent, and used the funds for his own personal benefit or for some purpose other than the benefit of the customer. The complaint also alleges that Wisbiski induced the purchase or sale of securities by means of manipulative, deceptive, or other fraudulent devices or contrivances by inducing public customers to invest funds which he represented would be placed with a "private investment group" and earn 15 percent tax-free annual interest, when, in fact, said investment was nonexistent and Wisbiski used the customer funds for his own purposes. (NASD Case #C8A020036)

Firm Expelled for Failing to Pay Fines and/or Costs in Accordance With NASD Rule 8320

All-Tech Direct, Inc.
Montvale, New Jersey
(June 14, 2002)

Individuals Barred Pursuant to NASD Rule 9544 for Failure to Provide Information Requested Under NASD Rule 8210. (The date the bar became effective is listed after the entry.)

Darlington, Douglas K.
Morristown, New Jersey
(June 11, 2002)

Dukes, Robert James
Charlotte, North Carolina
(June 18, 2002)

Farber, David I.
Cranbury, New Jersey
(June 14, 2002)

Flowers, Troy
Lemon Grove, California
(June 18, 2002)

Rooney, Patrick W.
Chula Vista, California
(June 24, 2002)

Individuals Suspended Pursuant to NASD Rule 9541(b) for Failure to Provide Information Requested Under NASD Rule 8210. (The date the suspension began is listed after the entry.)

Delosh, Rey A.
Clearwater, Florida
(June 14, 2002)

Frankfurter, Patrick N.
Commerce City, Colorado
(June 19, 2002)

Jacks, Roger W.
Kansas City, Missouri
(June 6, 2002)

Melton, Thomas
Visalia, California
(June 19, 2002)

Miranda, Nilsa M.
Chicago, Illinois
(June 19, 2002)

Travale, Stephen D.
Lauderhill, Florida
(June 11, 2002)

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

Aburas, Salam
Berwyn, Illinois
(June 14, 2002)

Blake, Richard A.
DeKalb, Illinois
(June 14, 2002)

Frydrych, Daniel J.
Schaumburg, Illinois
(June 14, 2002)

Green, James C.
Brooklyn, New York
(June 14, 2002)

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

The date the registration was suspended is included after the entry. If the individual has complied, the listing also includes the date the suspension was lifted.

Couch, Jr., Thomas M.
Houston, Texas
(June 14, 2002 – July 1, 2002)

NASD Charges Hornblower and Weeks with Violating Settlement by Issuing Research During NASD Ban

Report Found to Contain Misleading Information

NASD charged New York investment-banking firm Hornblower & Weeks with violating a recent NASD-imposed prohibition against issuing research reports. NASD also charged in its complaint that the research report issued by Hornblower contained exaggerated and misleading statements and failed to disclose material facts.

On May 7, 2002, Hornblower reached a settlement with NASD regarding charges related to a research report recommending the common stock of MyTurn.com. NASD found that the report contained baseless projections, misleading and exaggerated statements, and omitted to state important facts. As part of the settlement with NASD, Hornblower was suspended from issuing research reports for six months.

According to the current complaint, Hornblower violated the terms of the prior settlement by issuing a research report relating to American Diversified Group, Inc., in late May 2002. NASD charged that the research report was published on two Web sites, including that of American Diversified, a provider of telecommunication services.

NASD also charged that Hornblower failed to disclose material facts in the research report, including that American Diversified has experienced significant losses, the company has received an opinion from its auditors that there is substantial doubt about its ability to continue as a going concern, and the company has had to rely on loans from its executive officers or directors to pay certain operating expenses.

NASD further charged that the research report made exaggerated, unwarranted, and misleading statements about American Diversified, including that the company "is positioned as a premier provider of communication products and enhanced value-added services..." and "is positioned to exploit the upside potential of the vast expansion of the Internet."

NASD Suspends and Sanctions Trader for Marking the Close; Issues Cautionary Note Prior to Russell 2000 Rebalance

NASD suspended Alan M. Remer for four months for market manipulation by "marking the close" on three separate occasions. Remer was also fined \$7,500.

"Marking the close" is a form of market manipulation. The practice involves attempting to influence the closing price of a security by executing purchase or sale orders at or near the close of normal trading hours. Such activity can artificially inflate or depress the closing price for the security and can affect price of "market-on-close" orders. On three occasions, Remer received a market-on-close sell order that required him to purchase a block-sized order of a security at the price of the last trade executed during normal business hours. In each instance, Remer executed the last trade himself and did so at an artificially low price. As a result, Remer was able to purchase the market-on-close block from his customer at the artificially low price established by his last trade.

Effects on Index Rebalancing

The practice of "marking the close" will have a disproportionately adverse impact when it occurs on an expiration Friday or on an index rebalancing day, such as the Russell 2000 Index rebalancing, which takes place on June 28, 2002. On rebalancing days, securities are added to and deleted from an index. Market makers often receive large market-on-close orders on expiration Fridays and rebalancing days as customers adjust their portfolios to reflect the expiration of options, index options, futures, and the rebalanced index. Accurate pricing at and around the market's close on index rebalancing days is critically important to a fair and orderly rebalancing process.

NASD always monitors for manipulative activity and scrutinized market activity on June 28, 2002, for improper attempts to influence closing prices.

NASD Fines U.S. Bancorp Piper Jaffray and Managing Director \$300,000

Cites Threat to Drop Research Analyst Coverage and Cease Market Making Activities in Retaliation for Not Receiving Investment Banking Business

As part of its ongoing regulatory focus on investment banking and research analyst activities, NASD reached a settlement with U.S. Bancorp Piper Jaffray and a Piper Managing Director, Scott Beardsley, who is the senior banker in the firm's

biopharmaceutical investment banking practice. NASD found that Beardsley threatened Antigenics, Inc., a Nasdaq-listed company, by telling them that Piper would discontinue research coverage and stop making a market in the company's stock if it did not select Piper as lead underwriter for a planned secondary offering.

NASD found that the threats were made to force Antigenics to select Piper as lead underwriter. This type of conduct violates NASD's rule requiring all firms and associated persons to adhere to high standards of commercial honor and just and equitable principles of trade. It also has the potential to undermine competition for investment-banking services.

"Brokerage firms and their executives cannot use threats regarding research activities as a way to obtain investment banking business. The threat to drop research coverage if Piper was not selected as the lead underwriter for a secondary offering was totally inappropriate and undermines the integrity of the market," said Mary L. Schapiro, NASD's President of Regulatory Policy and Oversight. "It is essential that investors have confidence that decisions firms make about coverage of companies are based on merit and nothing else."

As part of their settlement with NASD, Piper was censured and fined \$250,000 and Beardsley was censured and fined \$50,000.

NASD found that, on Dec. 27, 2001, the CEO of Antigenics, Inc., informed Beardsley and another Piper investment banker that the company had chosen another firm to serve as lead manager of a planned secondary offering. After speaking with Piper's head of investment banking, Beardsley told the CEO that Piper would either serve as the lead underwriter for the planned secondary offering or would not participate. In the same conversation, Beardsley threatened the CEO that if Piper were not selected as lead underwriter, the firm would drop research coverage of Antigenics and would stop making a market in Antigenics stock. The next day, the CEO of Antigenics wrote a letter to the Chairman of the Board of Piper complaining about the threatened "retaliation." At this time, Piper rated Antigenics a "Strong Buy."

On Jan. 2, 2002, Antigenics announced that it planned to offer 4 million shares of stock to the public in a secondary offering, using another investment banking firm as lead underwriter. Piper did not serve in any capacity in that offering, which went effective on Jan. 11. On Jan. 4, two days after Antigenics's announcement of its proposed secondary offering, Piper discontinued its research coverage of Antigenics.

In settling this matter, Piper and Beardsley neither admitted nor denied NASD's findings.

For Your Information

Update to Web CRD Firm Notification Functionality

NASD, as part of its continuing efforts to assist member firms in fulfilling their compliance and registration-related requirements, is introducing an expanded e-mail notification service to all firms beginning August 22. The e-mail notifications, which are listed below, are intended to assist firms in identifying (1) material changes to a registered person's registration status and (2) critical dates relating to a registered person's CE requirements. NASD recognizes the significance of our member firms' efforts to ensure compliance with registration-related requirements; therefore, as an expanded service to all firms, beginning on August 22, NASD will automatically send the following five e-mail notifications to firm-designated contacts as the conditions occur:

- ◆ Notify when an individual's registration is Inactive Prints with the Firm-BD Only
- ◆ Notify when a registered individual enters Firm Temporary Registration Cancellation Queue
- ◆ Notify when a registered individual is within 30 days of the end of his or her CE Required window – BD Only
- ◆ Notify when a registered individual is within 90 days of the end of his or her CE Required window – BD Only
- ◆ Notify when a registered individual enters Firm CE Inactive Queue – BD Only

In order to ensure that these important e-mails are directed appropriately, NASD requests that all firms select and supply contact information for the five e-mail notifications. Detailed instructions on how to access the selection screens and supply new and/or updated e-mail address information for the receipt of Firm Notifications can be found at: http://www.nasdr.com/pdf-text/webcrd_nav_firmnot.pdf.

continued



For Your Information

Key Dates:

Monday, July 22

- ▶ 16 Firm Notifications available for firms to elect to receive. NASD is asking firms to select, at minimum, the 5 notifications listed in this article.
- ▶ Firms may choose to have one individual at the firm receive all of the e-mails selected, or, as of this date, firms can input a different e-mail address for each Firm Notification it selects.

Wednesday, August 14

- ▶ Deadline for member firms to select and input the appropriate e-mail address(es) for the five e-mail notifications listed.

Thursday, August 22

- ▶ On behalf of firms that do not input contact information by this date, NASD will run a script to automatically select the five e-mail notifications listed in this article and designate the firm's Primary Account Administrator as the recipient for all.
- ▶ If NASD does not have a Primary Account Administrator's e-mail address on file for a firm, the e-mail address of the firm's Executive Representative will be used, and he/she will then automatically receive those five e-mail notifications as the conditions occur.

Questions

If you have any questions regarding Firm Notifications, please contact the Gateway Call Center at 301-869-6699.