

# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Legal and Compliance  
Operations  
Senior Management  
Trading

## KEY TOPICS

NASD Rule 2315  
OTC Equity Securities

## INFORMATIONAL

### OTC Equity Securities

SEC Approves NASD Rule 2315; Recommendations to Customers in OTC Equity Securities

#### Executive Summary

On August 22, 2002, the Securities and Exchange Commission (SEC) approved new NASD Rule 2315, Recommendations to Customers in OTC Equity Securities (Recommendation Rule). The Rule generally requires a member to review current financial statements and material business information before recommending transactions in low-priced over-the-counter equity securities.<sup>1</sup> The Rule supplements the federal securities laws and existing NASD rules, including suitability obligations and the requirement that any recommendation to a customer have a reasonable basis. The Rule also exempts certain transactions.

The *Notice* provides a general overview of the Rule. Members should carefully read the text of the Rule (Attachment A). The SEC Approval Order also appears with this *Notice* (Attachment B).

#### Question/Further Information

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 2315 is intended to address abuses in transactions involving thinly capitalized ("microcap") securities. The Rule mandates that a member conduct a due diligence review of an issuer's current financial and business information before recommending that issuer's microcap securities. Since the Rule does not supercede existing member obligations when recommending a security – e.g., suitability determination – compliance does not provide a safe harbor for recommendations of microcap securities.

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## Requirements

The Rule requires a member to review "current financial statements" and "current material business information" before it recommends the purchase or short sale of microcap securities. The Rule does not apply to recommendations to sell long positions.

The Rule applies to those securities that are published in a "quotation medium" and are either (1) not listed on NASDAQ or a national securities exchange or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape. The Rule defines "quotation medium" as (1) any system of general circulation to brokers or dealers that regularly disseminates quotation or indications of interest of identified brokers or dealers or (2) any publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations or indication of interest to others.<sup>2</sup>

The Rule defines "current financial statements" to include balance sheets, statements of profit and loss and publicly available financial statements and reports. The Rule makes distinctions in the definition as applied to foreign private issuers and all other issuers. For example, the Rule recognizes that the customary accounting periods and filing requirements of foreign issuers differ from domestic issuers. Accordingly, the Rule imposes different review periods for those foreign issuers. The Rule also limits review of financial filings to those that are publicly available and filed with the issuer's principal financial or securities regulatory authority in its home jurisdiction.

The term "current material business information" has been interpreted to mean information that is available or relates to events that have occurred in the 12 months prior to the recommendation.

The requisite review must be conducted by a Series 24 principal or someone supervised by a Series 24 principal. Members are required to keep a written record of the information reviewed, the date of the review, and the name of the person who conducted the review.

## Exemptions

The Rule provides NASD with general exemptive authority. Furthermore, the Rule expressly exempts the following transactions:

- ◆ Transactions that meet the requirements of Rule 504 of Regulation D under the Securities Act of 1933 (Securities Act) and transactions with an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act.
- ◆ Transactions with an "institutional account" under Rule 3110(c)(4), a "qualified institutional buyer" under Rule 144A of the Securities Act, or a "qualified purchaser" under Section 2(a)(51) of the Investment Company Act of 1940.
- ◆ Transaction in the securities of issuers with at least \$50 million in assets and \$10 million in shareholder equity as reflected in the issuer's most recent audited "current financial statements."

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- ◆ Transactions in securities of a bank or insurance company that is subject to regulation by a state or federal bank or insurance authority.
  - ◆ Transactions in securities of an issuer that have had an average daily volume of \$100,000 during each of the preceding 6 calendar months and any convertible security based on an underlying security that meets this requirement.
  - ◆ Transactions in securities that have a bid of at least \$50 per share, as published in a quotation medium.

#### **Effective Date**

The Rule becomes effective on October 30, 2002.

#### **Endnotes**

- 1 NASD originally had intended to make the Recommendation Rule consistent with the SEC's repropoed Exchange Act Rule 15c2-11. The SEC has not yet acted on that repropoal, which published for comment on March 5, 1999. NASD will consider amending the Recommendation Rule after any Commission action on the repropoal.
- 2 The Rule's definition of "quotation medium" is consistent with the definition of that term in the SEC's repropoed Exchange Act Rule 15c2-11. The SEC's repropoal does not expressly include indications of interest, but incorporates them through its definition of "quotation." The Recommendation Rule does not define "quotation."

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## ATTACHMENT A

New text is underlined.

### 2315. Recommendations to Customers in OTC Equity Securities

Preliminary Note: The requirements of this Rule are in addition to other existing member obligations under NASD rules and the federal securities laws, including obligations to determine suitability of particular securities transactions with customers and to have a reasonable basis for any recommendation made to a customer. This Rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal obligation or requirement imposed under NASD rules or the federal securities laws.

#### (a) Review Requirement

No member or person associated with a member shall recommend that a customer purchase or sell short any equity security that is published or quoted in a quotation medium and that either (1) is not listed on Nasdaq or on a national securities exchange or (2) is listed on a regional securities exchange and does not qualify for dissemination of transaction reports via the Consolidated Tape, unless the member has reviewed the current financial statements of the issuer, current material business information about the issuer, and made a determination that such information, and any other information available, provides a reasonable basis under the circumstances for making the recommendation.

#### (b) Definitions

(1) For purposes of this Rule, the term "current financial statements" shall include:

(A) For issuers that are not foreign private issuers,

(i) a balance sheet as of a date less than 15 months before the date of the recommendation;

(ii) a statement of profit and loss for the 12 months preceding the date of the balance sheet;

(iii) if the balance sheet is not as of a date less than 6 months before the date of the recommendation, additional statements of profit and loss for the period from the date of the balance sheet to a date less than 6 months before the date of the recommendation;

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(iv) publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, bank and insurance regulators; and

(v) all publicly available financial information filed with the Commission during the 12 months preceding the date of the recommendation contained in registration statements or Regulation A filings.

(B) For foreign private issuers,

(i) a balance sheet as of a date less than 18 months before the date of the recommendation;

(ii) a statement of profit and loss for the 12 months preceding the date of the balance sheet;

(iii) if the balance sheet is not as of a date less than 9 months before the date of the recommendation, additional statements of profit and loss for the period from the date of the balance sheet to a date less than 9 months before the date of the recommendation, if any such statements have been prepared by the issuer; and

(iv) publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, bank and insurance regulators.

(2) For purposes of this Rule, the term "quotation medium" shall mean any:

(A) System of general circulation to brokers or dealers that regularly disseminates quotations or indications of interest of identified brokers or dealers; or

(B) Publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations or indications of interest to others.

(c) Compliance Requirements

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(1) A member shall designate a registered person to conduct the review required by this Rule. In making such designation, the member must ensure that:

(A) Either the person is registered as a Series 24 principal, or the person's conduct in complying with the provisions of this Rule is appropriately supervised by a Series 24 principal; and

(B) Such designated person has the requisite skills, background and knowledge to conduct the review required under this Rule.

(2) The member shall document the information reviewed, the date of the review, and the name of the person performing the review of the required information.

**(d) Additional Review Requirement for Delinquent Filers**

If an issuer has not made current filings required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, or bank and insurance regulators, such review must include an inquiry into the circumstances concerning the failure to make current filings, and a determination, based on all the facts and circumstances, that the recommendation is appropriate under the circumstances. Such a determination must be made in writing and maintained by the member.

**(e) Exemptions**

(1) The requirements of this Rule shall not apply to:

(A) Transactions that meet the requirements of Rule 504 of Regulation D under the Securities Act of 1933 ("Securities Act") and transactions with an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act;

(B) Transactions with or for an account that qualifies as an "institutional account" under Rule 3110(c)(4) or with a customer that is a "qualified institutional buyer" under Rule 144A promulgated under the Securities Act or "qualified purchaser" under Section 2(a)(51) of the Investment Company Act of 1940;

(C) Transactions in an issuer's securities if the issuer has at least \$50 million in total assets and \$10 million in shareholder's equity as stated in the issuer's most recent audited current financial statements, as defined in this Rule;

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(D) Transactions in securities of a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934 and/or insurance company subject to regulation by a state or federal bank or insurance regulatory authority;

(E) A security with a worldwide average daily trading volume value of at least \$100,000 during each month of the six full calendar months immediately before the date of the recommendation;

(F) A convertible security, if the underlying security meets the requirement of Section (e)(1)(E) of this Rule;

(G) A security that has a bid price, as published in a quotation medium, of at least \$50 per share. If the security is a unit composed of one or more securities, the bid price of the unit divided by the number of shares of the unit that are not warrants, options, rights, or similar securities must be at least \$50; or

(2) Pursuant to the Rule 9600 Series, NASD, for good cause shown after taking into consideration all relevant factors, may exempt any person, security or transaction, or any class or classes of persons, securities or transactions, either unconditionally or on specified terms, from any or all of the requirements of this Rule if it determines that such exemption is consistent with the purpose of this Rule, the protection of investors, and the public interest.

## PROCEDURES FOR EXEMPTIONS

### 9610. Application

#### (a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1070, 2210, 2315, 2320, 2340, 2520, 2710, 2720, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3210, 3230, 3350, 8211, 8212, 8213, 11870, or 11900, Interpretive Material 2110-1, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of the Association and provide a copy of the application to the Office of General Counsel of NASD Regulation.

(b) through (c) No change.

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## ATTACHMENT B

### Securities and Exchange Commission

(Release No. 34-46376; File No. SR-NASD-99-04)

August 19, 2002

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to the Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Microcap Initiative - Recommendation Rule

#### I. Introduction

On February 19, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change that would require members to review current financial statements of, and current material business information about, an issuer prior to recommending a transaction to a customer in an over-the-counter ("OTC") equity security.

The proposed rule change was published for comment in the Federal Register on March 1, 1999.<sup>3</sup> The Commission received six comment letters on the Original Proposal. On January 11, 2002, the NASD filed Amendment No. 1 to the proposed rule change, which among other things addressed the issues raised by commenters.<sup>4</sup> Amendment No. 1 was published for comment in the Federal Register on January 22, 2002.<sup>5</sup> On July 26, 2002, the NASD filed Amendment No. 2 to the proposed rule change.<sup>6</sup>

The Commission received no comments regarding the proposal as amended. This order approves the proposed rule change, as amended.

#### II. Description of Proposal

To respond to concerns about abuses in the trading and sales of thinly traded, thinly capitalized securities (i.e., microcap securities) quoted in the OTC market, NASD Regulation has proposed to amend NASD rules to include new NASD Rule 2315, entitled "Recommendations to Customers in OTC Equity Securities" ("Recommendation Rule" or "Rule"). In the view of NASD Regulation, the lack of reliable and current financial information about issuers of microcap securities can create the potential for fraud and manipulation.



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The proposed rule would be limited to equity securities that are published or quoted in a quotation medium and that either: (1) are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape (“covered securities”).<sup>7</sup> The requirements in the Recommendation Rule is intended to supplement requirements under the federal securities laws and under NASD rules that a broker-dealer that recommends securities to its customers is required to have a reasonable basis for those recommendations.<sup>8</sup> In addition, the proposed rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal obligation or requirement imposed under NASD rules or the federal securities laws.

A. Review Requirements

Proposed NASD Rule 2315 would require a member and its associated persons to review the current financial statements of an issuer and current material business information about an issuer prior to recommending the purchase or short sale of any OTC equity security to a customer.<sup>9</sup> Under the proposed rule, members must designate a person who is registered as a Series 24 principal, or who is supervised by a Series 24 principal, to conduct the required review. The person designated by the member must have the requisite skills, background and knowledge to conduct the review. Members are also required to document the information reviewed, the date of the review, and the name of the person performing the review of the required information.

B. Information to be Reviewed

As stated above, members must review the “current financial statements” of the issuer, as well as “current material business information” about the issuer, before recommending the purchase or short sale of an OTC security. NASD Regulation has stated that current material business information includes material information that is available or relates to events that have occurred within the last 12 months prior to the recommendation. Under the Recommendation Rule, because of differences in accounting practices, what constitutes “current financial statements” depends on whether the issuer is or is not a foreign private issuer.

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1. Issuers that are not foreign private issuers

The current financial statements of issuers that are not foreign private issuers that must be reviewed prior to a recommendation to purchase or sell short a covered security are as follows:

- publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction;
- all publicly available financial information filed with the Commission during the 12 months preceding the date of the recommendation contained in registration statements or Regulation A filings;
- a balance sheet as of a date less than 15 months before the date of recommendation; and
- a statement of profit and loss for the 12 months preceding the date of the balance sheet.

However, if the balance sheet is not as of a date less than 6 months before the date of the recommendation, the member must review additional statements of profit and loss for the period from the date of the balance sheet to a date less than 6 months before the date of the recommendation.

2. Issuers that are foreign private issuers

The current financial statements of issuers who are foreign private issuers that must be reviewed prior to a recommendation for purchase or short sale are as follows:

- publicly available financial statements and other financial reports filed during the 12 months preceding the date of the recommendation and up to the date of the recommendation with the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, bank and insurance regulators;
- a balance sheet as of a date less than 18 months before the date of the recommendation; and
- a statement of profit and loss for the 12 months preceding the date of the balance sheet.

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However, if the balance sheet is not as of a date less than 9 months before the date of the recommendation, the member must review additional statements of profit and loss for the period from the date of the balance sheet to a date less than 9 months before the date of the recommendation, if any such statements have been prepared by the issuer.

In addition, if any issuer has not made current filings required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, or bank and insurance regulators, the required review must include an inquiry into the circumstances concerning the failure to make current filings, and a determination, based on all the facts and circumstances, that a recommendation is appropriate under the circumstances. Such a determination must be made in writing and maintained by the member.

#### C. Exemptions

Under the Recommendation Rule, there are several transactions that are not subject to the Rule. Broker-dealers are not required to comply with the Recommendation Rule when effecting the following transactions:

- transactions that meet the requirements of Rule 504 of Regulation D of the Securities Act of 1933 ("Securities Act")<sup>10</sup> and transactions by<sup>11</sup> an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act;<sup>12</sup>
- transactions with or for an account that qualifies as an "institutional account" under NASD Rule 3110(c)(4) or with a customer that is a "qualified institutional buyer" under Rule 144A of the Securities Act<sup>13</sup> or "qualified purchaser" under Section 2(a)(51) of the Investment Company Act of 1940;<sup>14</sup>
- transactions in an issuer's securities if the issuer has at least \$50 million in total assets and \$10 million in shareholder's equity are exempt;
- transactions in securities of a bank as defined in Section 3(a)(6) of the Act<sup>15</sup> and/or insurance company subject to regulation by a state or federal bank or insurance regulatory authority are exempt;
- transactions involving securities with a worldwide daily trading volume value of at least \$100,000 during each month of the six full calendar months immediately before the date of the recommendation, and transactions involving any convertible security based on a security meeting this requirement are exempt;<sup>16</sup> and

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- transactions involving securities that have a bid price, as published in a quotation medium, of at least \$50 per share.<sup>17</sup>

In addition, under the proposed rule the NASD may, for good cause shown, exempt any person, security or transaction, or any class or classes of person, securities or transactions, either unconditionally or on specified terms, from any or all of the requirements of the Rule if it determines that such exemption is consistent with the purpose of the rule, the protection of investors and the public interest.<sup>18</sup>

### III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>19</sup> which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

#### A. Review Requirements

Manipulative and fraudulent schemes often have involved infrequently-traded securities of little-known issuers. Unscrupulous broker-dealers have recommended that customers purchase the securities of unseasoned issuers whose securities do not trade in a listed market, without giving due regard to the fundamentals regarding these issuers. Among the most critical pieces of information that a broker-dealer should have before making a recommendation regarding a security are the financial condition of, and business information about, the issuer, particularly with respect to those issuers whose securities are not listed on a national securities exchange or Nasdaq. Therefore, the Commission finds that the NASD's proposal to require broker-dealers to independently review current financial and business information about these issuers prior to making a recommendation to purchase or sell short covered securities is consistent with the Act, particularly its mandate that the Association's rules be designed to prevent fraudulent and manipulative acts.<sup>20</sup>

While the Commission considers the review requirement to be appropriate, it also believes that the requirement is properly tailored to meet the Rule's objectives without over-burdening members. Under the Recommendation Rule, broker-dealers are required to review publicly available current financial statements and material business information. The Commission believes that the Recommendation Rule establishes appropriate parameters regarding what constitutes "current financial information" and "current material business information" that

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members and their sales personnel must review before making a recommendation as a means to lessen the opportunity for abusive practices when broker-dealers recommend covered securities to investors.

1. Foreign private issuers vs. non-foreign private issuers

Further, as detailed above, these definitions also distinguish between information that must be reviewed for issuers that are foreign private issuers and those that are not. The Commission believes that this is an important distinction because the customary accounting periods for foreign issuers are often different from those for domestic issuers. Foreign issuers maybe permitted to report financial information on a semi-annual basis, rather than on a quarterly basis, as is required for domestic issuers. Therefore, the Commission believes that it is appropriate to establish different time parameters regarding when financial information should be considered "current" for foreign private issuers in order to address this difference in accounting practices.

2. Delinquent issuers

The Commission notes that the Recommendation Rule contains a provision covering the situation when the issuer has not made current filings as required by the issuer's principal financial or securities regulatory authority in its home jurisdiction, including the Commission, foreign regulatory authorities, and bank and insurance regulators. In the event the issuer is delinquent with its filings, the Recommendation Rule requires that the member make an inquiry into the circumstances concerning the failure to make current filings and make a determination that a recommendation is appropriate under the circumstances.

The Commission believes that the Rule is appropriately limited in that it does not prohibit recommendations in the event the issuer's filings are delinquent, nor does it require that a member confirm that the issuer is not delinquent in its filings with any regulatory authority prior to making a recommendation. Rather, the Rule requires that a member conduct an inquiry in the event that an issuer has been delinquent in its filings with its principal financial or securities regulatory authority in its home jurisdiction and then determine whether the recommendation is appropriate. The Commission believes that this requirement strikes a proper balance in those cases where the issuer has failed to make current filings.

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3. Persons responsible for review

The Commission believes that it is appropriate to require that the person responsible for conducting the financial information review be registered as a Series 24 principal or be someone who is supervised by a Series 24 principal, as these individuals are under the jurisdiction of the NASD. Registered Series 24 principals are persons who are associated with a member and are permitted to manage or supervise the member's investment banking or securities business for corporate securities, direct participation programs, and investment company products/variable contracts. Therefore, the Commission believes that this requirement will ensure that financial information is reviewed by individuals who have the proper skills, background and knowledge to conduct a thorough analysis of the information prior to the firm or its associated persons making a recommendation.

B. Exemptions from Recommendation Rule

As indicated above, the Recommendation Rule lists several transactions that are exempt from the Rule and provides the Association with the authority, for good cause, to grant additional exemptions from its provisions. The Commission believes that these provisions are appropriately tailored to serve the purposes of the Rule so that only those transactions that are more likely to raise risks for retail investors are subject to the Rule, and that those transactions that are less likely to be the subject of fraudulent sales practices are not covered by the Rule.

C. Interaction with other NASD Rules and Federal Securities Laws

Finally, as noted in the Preliminary Note to the Recommendation Rule, the Commission emphasizes that the requirements of the Rule are in addition to other existing broker-dealer obligations under NASD rules and the federal securities laws, including obligations to determine the suitability of particular securities transactions with customers and to have a reasonable basis for any recommendation made to a customer. The Commission reiterates that the Recommendation Rule is not intended to act or operate as a presumption or as a safe harbor for purposes of determining suitability or for any other legal obligation or requirement imposed under NASD rule or the federal securities laws.

D. Operational Date

The Commission notes that the NASD will announce the operational date of the proposed rule change in a Notice to Members to be published no later than 60 days following the date of approval by the Commission. The operational date will be 30 days following the date of publication of the Notice to Members announcing Commission approval.

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#### IV. Amendment No. 2

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. In Amendment No. 2, the NASD amended NASD Rule 2315(a) to add a category of equity securities that, pursuant to NASD Rule 6530(b)(2), are eligible for quotation on the OTCBB. This change provides that members conducting transactions in securities that are listed on a regional securities exchange, but do not qualify for dissemination of transaction reports via the Consolidated Tape, must comply with the review requirements of the Recommendation Rule if such securities are published or quoted in a quotation medium.

Because securities that are listed on a regional securities exchange but not eligible for the reporting of transactions to the Consolidated Tape are eligible for quotation on the OTCBB, and thus fall within the category of securities contemplated to be covered by the Recommendation Rule, the Commission believes that it is appropriate for these securities to be covered by the Recommendation Rule.

In Amendment No. 2, the NASD also amended NASD Rule 2315(e)(1)(G)(2) to substitute "NASD" for the reference to "the Association" contained in the Rule. The Commission believes that this is a technical, non-substantive change to the proposal.

In sum, the Commission finds that the NASD's proposed changes in Amendment No. 2 further strengthen and clarify the proposed rule change and raise no new regulatory issues. Further, the Commission believes that Amendment No. 2 does not significantly alter the original proposal, which was subject to a full notice and comment period. Therefore, the Commission finds that granting accelerated approval to Amendment No. 2 is appropriate and consistent with Section 19(b)(2) of the Act.<sup>21</sup>

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the proposed amendment is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed amendment that are filed with the Commission, and all written communications relating to the

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amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-99-04 and should be submitted by [insert date 21 days from date of publication].

VI. Conclusion

For all of the aforementioned reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-NASD-99-04), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Margaret H. McFarland**

**Deputy Secretary**



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## Endnotes

- 1 15 U.S.C. 78s(b)(1).
- 2 17 CFR 240.19b-4.
- 3 See Securities Exchange Act Release No. 41075 (February 19, 1999), 64 FR 10037 ("Original Proposal").
- 4 In the Original Proposal, the NASD proposed subparagraph (e) to NASD Rule 6740. That provision would have permitted a member to submit a certification to the NASD stating that the firm complied with the requirements of SEC Rule 15c2-11, 17 CFR 240.15c2-11, including the member's review obligation, if the documents the firm was required to review were contained in the Commission's Electronic Data Gathering and Retrieval System, in lieu of submitting a copy of the documents reviewed. This proposed rule text was deleted as part of Amendment No. 1, although the change was not reflected in the narrative portion of the Amendment.
- 5 See Securities Exchange Act Release No. 45277 (January 14, 2002), 67 FR 2937.
- 6 See Letter from Marc Menchel, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 26, 2002 ("Amendment No. 2). In Amendment No. 2, the NASD amended proposed NASD Rule 2315(a) to clarify that members conducting transactions in securities that are listed on a regional securities exchange, but do not qualify for dissemination of transaction reports via the Consolidated Tape, must comply with the review requirements of the Recommendation Rule if such securities are published or quoted in a quotation medium. The NASD also amended NASD Rule 2315(e)(1)(G)(2) to substitute "NASD" for the reference to "the Association" contained in the Rule.
- 7 "Quotation medium" is defined as a system of general circulation to brokers or dealers that regularly disseminates quotations or indications of interest of identified brokers or dealers; or a publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations or indications of interest to others. The Recommendation Rule is intended to cover equity securities that are published or quoted in a quotation medium and that either: (1) are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape.
- 8 See NASD Rule 2310 (Suitability Rule), which requires a member to have reasonable grounds for believing that a recommendation to a customer is suitable based on facts disclosed, other security holdings and financial situation and needs.
- 9 The current financial and business information that a broker-dealer must review prior to recommending the purchase or short sale of a covered security is similar to that required by Rule 15c2-11 under the Act for those broker-dealers initiating or resuming quotations for securities covered by that rule. 17 CFR 240.15c2-11.
- 10 17 CFR 230.504.
- 11 Proposed NASD Rule 2315(e)(1)(A) contained a typographical error. In pertinent part, the Rule should read "transactions by an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act" instead of "transactions with an issuer not involving any public offering pursuant to Section 4(2) of the Securities Act." (Emphasis added.) Telephone conversation between Phil Shaikun, Associate General Counsel, NASD Regulation, and Jennifer Colihan, Special Counsel, Division, Commission, on August 12, 2002.
- 12 15 U.S.C. 77d(2).
- 13 15 U.S.C. 77(a).
- 14 15 U.S.C. 80a-2(a)(51).
- 15 15 U.S.C. 78c(a)(6).
- 16 See Securities Exchange Act Release No. 41110 (February 25, 1999), 64 FR 11124 (March 8, 1999) ("Rule 15c2-11 Reproposing Release"). This exemption is consistent with exemptions contained proposed Rules 15c2-11(h)(6) and (7).
- 17 This exemption is consistent with an exemption contained in proposed Rule 15c2-11(h)(8). See Rule 15c2-11 Reproposing Release, supra note 16.

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18 As part of this proposed rule change, the NASD has added the Recommendation Rule to NASD Rule 9610, which provides the procedures for requesting exemptive relief from various Association rules.

19 15 U.S.C. 78o-3(b)(6).

20 The Recommendation Rule will apply to equity securities that are quoted on the OTCBB, in The Pink Sheets, or in any other system that regularly disseminates indications of interest and quotation information among broker-dealers and those securities either: (1) are not listed on Nasdaq or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape. See Proposed NASD Rule 2315(a). As part of its application to become a national securities exchange, Nasdaq has filed rules to operate the OTCBB, which is expected to be renamed the Bulletin Board Service ("BBS"). NASD Regulation has advised the Commission that the Recommendation Rule will apply to BBS securities when Nasdaq operates the BBS. The Commission is also aware that Nasdaq intends to develop the OTCBB/BBS into a listed market, which will be called the Bulletin Board Exchange ("BBX"). See NASD-2001-82, pending before the Commission. Securities trading on the BBX would be listed securities, and therefore would not be covered under the current wording of the Recommendation Rule. NASD Regulation has advised the Commission that it will amend the Recommendation Rule at the appropriate time to ensure that securities listed on the BBX are covered by the Rule.

21 15 U.S.C. 78s(b)(2).

22 15 U.S.C. 78s(b)(2).

23 17 CFR 200.30-3(a)(12).

# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Operations  
Registered Representative  
Registration  
Senior Management

## KEY TOPICS

IARD<sup>SM</sup>  
Maintenance Fees  
Renewals  
Registration  
Web CRD<sup>SM</sup>

## ACTION REQUIRED

### Broker/Dealer and Investment Adviser Renewal Program

Broker/Dealer, Investment Adviser Firm, Agent and  
Investment Adviser Representative Renewals for 2003  
**Payment Deadline: December 6, 2002**

#### Executive Summary

The 2003 NASD Broker/Dealer and Investment Adviser Registration Renewal Program begins on November 4, 2002, when online Preliminary Renewal Statements are made available to all firms on Web CRD<sup>SM</sup>/IARD<sup>SM</sup>. This annual program simplifies the registration renewal process for more than 21,000 Broker/Dealer (BD) and Investment Adviser (IA) firms and approximately 700,000 registered representatives and 100,000 investment adviser representatives by allowing the payment of one amount to NASD by the published deadline. There are two significant changes to the program this year. This is the first year that NASD will collect investment adviser representative (RA) Renewal Fees on behalf of participating state regulators. Also, NASD will assess a Late Payment Fee to all NASD members that do not pay by the 2003 Renewal payment deadline of December 6, 2002.

Renewal Statements will include the following fees: NASD Web CRD/IARD System Processing Fees, NASD Branch Office Fees, as well as New York Stock Exchange (NYSE), American Stock Exchange (Amex), Chicago Board Options Exchange (CBOE), International Securities Exchange (ISE), Pacific Exchange (PCX) and Philadelphia Stock Exchange (PHLX) Maintenance Fees. The statement will also include state Agent, state Broker/Dealer, and if applicable, state Investment Adviser Firm and Representative Renewal Fees.

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Members should read this *Notice to Members*; any instructions posted to the NASD Web Site, [www.nasd.com](http://www.nasd.com); the Investment Adviser Web Site (where applicable), [www.iard.com](http://www.iard.com); *The Bulletin*; and any other mailed information to ensure continued eligibility to do business in the states effective January 1, 2003. Any Renewal processing changes subsequent to the publishing of this *Notice to Members* will be provided to you in a *Special Notice to Members*.

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

### Preliminary Renewal Statements

Beginning November 4, 2002, Preliminary Renewal Statements will be available for viewing and printing for all firms on Web CRD/IARD. The statements will include the following fees: Web CRD/IARD System Processing Fees, NASD Branch Office Fees, NYSE, Amex, CBOE, ISE, PCX and PHLX Maintenance Fees, state Agent Renewal Fees, state Broker/Dealer, and if applicable, Investment Adviser Firm and Representative Renewal Fees. NASD must receive full payment of the November Preliminary Renewal Statement amount **no later than December 6, 2002**.

If payment is NOT received by the December 6, 2002, Payment Due Date, NASD member firms will be assessed a **RENEWAL LATE PAYMENT FEE**. This Renewal Late Payment Fee will be included as part of the member firm's Final Renewal Statement and will be calculated as follows: 10% of a member firm's cumulative Final Renewal Assessment or \$100, whichever is greater, with a cap of \$5,000. Please see *Notice to Members 02-48* for details.

### Fees

Beginning with this 2003 Renewal Program, NASD Personnel Assessment Fees will **no longer** be assessed through the annual Renewal Program. NASD will mail all NASD member firms a separate billing during the 1st quarter of 2003. Please see *Notice to Members 02-41* for more details.

A fee of \$30.00 will be assessed for each person who renews his/her registration with any regulator through Web CRD.

The *RA Renewal System Processing Fee* of \$45.00 will be assessed for every Investment Adviser Representative who renews through the IARD Program.

The *IARD Firm System Fee* of \$100.00 will be assessed for every state-registered Investment Adviser firm that renews through the IARD.

The NASD *Branch Office Assessment Fee* of \$75 per branch, based on the number of active NASD branches as of December 31, 2002, will be assessed.

Renewal Fees for NYSE, Amex, CBOE, PCX, ISE, PHLX, and state affiliations are also assessed in the Preliminary Renewal Statement on Web CRD. NYSE, Amex, CBOE, PCX, ISE and PHLX and state Maintenance Fees collected by NASD for firms that are registered with those exchanges, as well as NASD, are based on the number of NYSE, Amex, CBOE, PCX, ISE and PHLX and state-registered personnel employed by the member firm.

Beginning this year with the 2003 Renewal Program, the State of California will collect its firm Broker/Dealer Renewal Fees through Web CRD. However, California will not collect its Agent (AG) Renewal Fees through the Renewal Program. Firms registered in California should contact the state directly to

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ensure compliance with Renewal requirements. In addition, some participating states may require steps beyond the payment of Renewal Fees to NASD to complete the Broker/Dealer or Investment Adviser Renewal process. Firms should contact each jurisdiction directly for further information on state renewal requirements. See the NASD Web Site for an SRO/State Directory.

For detailed information regarding Investment Adviser renewals, you may also visit the Investment Adviser Web Site, [www.iard.com](http://www.iard.com). A matrix that includes a list of Investment Adviser Renewal Fees for states that participate in the 2003 IARD Investment Adviser Renewal Program is posted at [www.iard.com/pdf/reg\\_directory.pdf](http://www.iard.com/pdf/reg_directory.pdf).

### Renewal Payment

Beginning with this Renewal Program, firms will be able to submit electronic payments through a Web-based application known as Web CRD/IARD E-Pay. The E-Payment application is accessible from either the NASD ([www.nasdr.com/3400.asp](http://www.nasdr.com/3400.asp)) or IARD ([www.iard.com](http://www.iard.com)) Web Sites and allows firms to make an ACH payment from a designated bank account to their Web CRD/IARD Renewal Account. In order for funds to be posted to your firm's **Renewal** account by **December 6, 2002**, payment must be submitted electronically, **no later than 8:30 p.m.**, Eastern Time (ET), on December 4, 2002.

Payment of the Preliminary Renewal Statement may also be made either in the form of a check made payable to NASD, or by bank wire transfer. The check should be drawn on the firm's account, with the firm's CRD Number included on the front of the check, along with the word "Renewals."

Submit all Renewal Payments, along with a printout of the first page of your online Preliminary Renewal Statement directly to:

#### **U.S. Mail**

NASD, CRD-IARD  
P.O. Box 7777-W8705  
Philadelphia, PA 19175-8705  
(Note: This P.O. Box will not accept courier or overnight deliveries)

or

#### **Express/Overnight Delivery**

NASD, CRD-IARD  
W8705  
c/o Mellon Bank, Rm 3490  
701 Market Street  
Philadelphia, PA 19106  
Telephone No: (301) 869-6699

Use the full address, including the "W8705" number in either address to ensure prompt processing.

**Please note: The addresses for Renewal Payments are *different* from the addresses for funding your firm's CRD or IARD Daily Account.**

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### Check Instructions:

To ensure prompt processing of your Renewal Payment check:

- ◆ Include a printout of the first page of your Preliminary Renewal Statement with payment.
- ◆ Do not include any other forms or fee submissions.
- ◆ Write your firm's CRD Number and the word "Renewals" on the check memo line.
- ◆ Be sure to send your payment either in the blue, pre-addressed Renewal envelope that will be mailed to you, or write the address on an envelope exactly as noted in this *Notice*.

### Wire Payment Instructions:

Firms may wire full payment of the Preliminary Renewal Statement by requesting their bank to initiate the wire transfer to: "The Riggs National Bank in Washington, DC". You will need to provide your bank the following information:

Transfer funds to:	<b>Riggs National Bank in Washington, DC</b>
ABA Number:	<b>054-000030</b>
Beneficiary:	<b>NASD</b>
NASD Account Number:	<b>086-761-52</b>
Reference Number:	<b>Firm CRD Number and the word "Renewals"</b>

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

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

Members are advised that failure to return full payment of their Preliminary Renewal Statement to NASD by the December 6, 2002, deadline could cause a member to become ineligible to do business in the jurisdictions effective January 1, 2003.

### Renewal Reports

Beginning November 4, 2002, the Renewal Reports are available to request, print, and/or download via Web CRD and IARD. There will be three reports available for reconciliation with the Preliminary Renewal Statement. All three reports will also be available as downloads:

- ◆ *Firm Renewal Report* - applicable to Broker/Dealer and Investment Adviser Firms. This report lists individuals included in the 2003 Renewal processing and includes Billing Codes (if they have been supplied by the firm).
- ◆ *Branches Renewal Report* - applicable to NASD members. This report lists each branch registered with NASD and lists branch offices for which the firm is being assessed a fee. Firms should use this report to reconcile their records for Renewal purposes.

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- ◆ *Approved AG Reg Without NASD Approval Report* - applicable to NASD members. This report contains all individuals who are not registered with NASD but are registered with one or more jurisdictions. This roster should be used to determine if any NASD registrations should be requested or jurisdictions terminated.

### Filing Form U-5

If Forms U-5 (either Full or Partial) are filed electronically via Web CRD by 11:00 p.m., ET, November 1, for Agents (AGs)/Investment Adviser Representatives (RAs) terminating in one or more jurisdiction affiliations, for 2002, those individuals' Renewal Fees will not be included on the Preliminary Renewal Statement.

The deadline for electronic filing of Forms U-5 for firms that want to terminate an Agent affiliation before year-end 2002 is 6:00 p.m., ET, on December 21, 2002. Firms may file both Partial and Full Forms U-5 with a post-dated **termination date of December 31, 2002**. (This is the only date that can be used for a post-dated Form U-5.) For more detailed information on post-dated Forms U-5, see the section titled "Post-Dated Form Filings" below.

### Filing Form BDW

The CRD Phase II Program allows firms requesting Broker/Dealer termination (either full or partial) to electronically file their Forms BDW via Web CRD. Firms that file either a Full or Partial Form BDW by 11:00 p.m., ET, November 1, 2002, will avoid the assessment of the applicable

Renewal Fees on the Preliminary Renewal Statement, provided that the regulator is a CRD Phase II participant. Currently, there are four regulators that participate in Web CRD Renewals for agent fees but do not participate in CRD Phase II:

- ◆ American Stock Exchange
- ◆ New York Stock Exchange
- ◆ Pacific Exchange
- ◆ Philadelphia Stock Exchange

Firms requesting termination with any of the above-listed regulators must submit a paper Form BDW directly to the regulator, as well as submit one electronically to Web CRD.

The deadline for electronic filing of Forms BDW for firms that want to terminate an affiliation before year-end 2002 is 6:00 p.m., ET, December 21, 2002. This same date applies to the filing of Forms BDW with regulators that are not Phase II participants. For information regarding the post-dating of Forms BDW with the termination date of December 31, 2002, see the section below titled "Post-Dated Form Filings."

### Filing Forms ADV to Cancel Notice Filings or Forms ADV-W to Terminate Registrations

Firms that file either a Form ADV Amendment, unmarking a state, (generating the Status of "Removal Requested at End of Year") or a Full or Partial Form ADV-W by 11:00 p.m., ET, November 1, 2002, will avoid the assessment of the applicable Renewal Fees on their Preliminary Renewal Statement.

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The deadline for electronic filing of Form ADV Amendments or Forms ADV-W for firms that want to cancel a Notice Filing or terminate a state registration before year-end 2002 is 6:00 p.m., ET, December 21, 2002. For information regarding post-dating Form ADV-W with the termination date of December 31, 2002, for state registrations, see the following section.

### Post-Dated Form Filings

Firms can begin electronically filing post-dated Forms U-5, BDW, Schedule E, and ADV-W via Web CRD/IARD on November 1, 2002. This program allows firms to file a termination form on, or after, November 1, with a termination date of **December 31, 2002**. Firms that submit post-dated termination filings will not be assessed Renewal Fees for the terminated jurisdictions on the Final Renewal Statement in January 2003.

Between November 1 and December 21, 2002, firms may process Forms U-5, BDW, Schedule E, and ADV-W (both partial and full terminations) with a post-dated termination date of **December 31, 2002**. (This is the only date that can be used for a post-dated form filing.) If a Form U-5, BDW, Schedule E, or ADV-W indicates a termination date of December 31, 2002, an agent, Broker/Dealer and/or Investment Adviser (firm) and investment adviser representative (RA) may continue doing business in the jurisdiction until the end of the calendar year without being assessed 2003 Renewal Fees. Please ensure that electronic Forms U-5, BDW, Schedule E, and ADV-W are filed by the Renewal filing deadline date of 6:00 p.m., ET, on December 21, 2002.

Members should exercise care when submitting post-dated Forms U-5, BDW, Schedule E, and ADV-W. NASD will systematically process these forms as they are submitted and cannot withdraw a post-dated termination once submitted and processed. A member that files a post-dated termination in error would have to file, electronically, a new Form U-4, BD Amendment or ADV when Web CRD/IARD resumes filing processing on January 2, 2003. New registration fees would be assessed as a result.

### Removing Open Registrations

Beginning November 4, 2002, member firms will be able to request, via Web CRD, the "Approved AG Reg Without NASD Approval" Report. This report identifies agents whose NASD registration is either terminated or has been changed to a "purged" status due to the existence of a deficient condition (*i.e.*, Exams or Fingerprints) but maintain an approved registration with a state. Member firms should use this roster to terminate obsolete state registrations through the submission of Forms U-5 or reinstate the NASD licenses through the filing of a Form U-4 Amendment. This roster should aid in the reconciliation of personnel registrations prior to year's end. The "Approved AG Reg Without NASD Approval" Report will also advise a firm if there are no agents within this category.



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## Final Renewal Statements

Beginning January 2, 2003, NASD will make available Final Renewal Statements via Web CRD and IARD. These statements will reflect the final status of Broker/Dealer, Registered Representative (AG), Investment Adviser Firm and Investment Adviser Representative (RA) registrations and/or Notice Filings as of December 31, 2002. Any adjustments in fees owed as a result of registration terminations, approvals, Notice Filings or Transitions, subsequent to the processing/posting of the Preliminary Renewal Statement will be made in the Final Renewal Statement on Web CRD.

- ◆ If a firm has more agents, branch offices, or jurisdictions registered and/or Notice Filed on Web CRD and IARD at year's end than it did when the Preliminary Renewal Statement was generated, additional fees will be assessed.
- ◆ If a firm has fewer agents, branch offices, or jurisdictions registered and/or Notice Filed at year end than it did when the Preliminary Renewal Statement was generated, a credit/refund will be issued. Beginning this 2003 Renewal Program, all 2003 Renewal overpayments will be systemically transferred to firms' Daily Accounts on January 6, 2003. Refund requests will be made from this account.

After January 2, 2003, NASD member firms and "Joint" firms should access the Web CRD Reports function for the **Firm Renewal Report**, which will list all renewed personnel with the NASD, NYSE, Amex, CBOE, PCX, ISE, PHLX, and each

jurisdiction. Agents and RAs whose registrations are "Approved" in any of these jurisdictions during November and December will be included in this roster. Registrations that are "Pending Approval" or are "Deficient" at year's end will not be included in the Renewal Program. Member firms will also be able to request the **Branches Renewal Report** that lists all NASD branches for which they have been assessed. Download versions of these reports will also be available.

Firms have until March 14, 2003, to report any discrepancies on the Renewal Reports. Firms should contact all jurisdictions directly in writing. Specific information and instructions concerning the Final Renewal Statements and Renewal Reports will appear in the January 2003 issue of *Notices to Members*. Firms may also refer to the Fall *Bulletin*, which is devoted entirely to Renewals and will be mailed to all firms. The blue Renewal payment envelope will be included with *The Bulletin* that will be sent to firms. *The Bulletin* will also be available for viewing on the CRD Page of the NASD Web Site.

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# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Legal & Compliance  
Registered Representatives  
Registered Principals  
Senior Management

## KEY TOPICS

Arbitration  
Associated Persons  
California Disclosure Standards  
Members

## INFORMATIONAL

### SEC Approves Rule Change to IM-10100

Industry parties in California arbitration proceedings must waive contested California arbitrator disclosure standards if all parties who are investors, or associated persons with claims of statutory employment discrimination, have executed waiver agreements

#### Executive Summary

The Securities and Exchange Commission (SEC or Commission) has approved amendments to IM-10100 of the NASD Code of Arbitration Procedure (Code) governing Failure to Act Under Provisions of Code of Arbitration Procedure.<sup>1</sup> The amendments provide that members and associated persons involved in NASD arbitration proceedings in the State of California are required to waive application of California Ethics Standards for Neutral Arbitrators in Contractual Arbitration (the "California Standards") to their arbitration proceedings upon the request of investors or, in industry cases, of associated persons with claims of statutory employment discrimination, for a six-month pilot period (or until the conclusion of pending litigation contesting application of the standards to NASD).

The new procedures will apply to the appointment of arbitrators on or after September 30, 2002, to serve in California arbitrations.

The text of the rule change described in this *Notice* is included as Attachment A. A sample Memorandum to Parties and Counsel of Record and Waiver Agreement are included as Attachment B.

#### Questions/Further Information

Questions regarding this *Notice* may be directed to Jean I. Feeney, Chief Counsel and Associate Vice President, NASD Dispute Resolution, at (202) 728-6959, or e-mail, [jean.feeney@nasd.com](mailto:jean.feeney@nasd.com).

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## Discussion

For several months, NASD has taken many steps to address concerns raised by the California Standards, which NASD believes to be in conflict with the Code of Arbitration Procedure. Since July 1, 2002, NASD has postponed appointing arbitrators in arbitration proceedings scheduled to take place in California. Additional information on the history of this issue, and the measures NASD has taken to provide alternatives for parties, can be found in NASD's rule proposal, SR-NASD-2002-126,<sup>2</sup> which was approved on an accelerated basis by the SEC on September 26, 2002.

Effective September 30, 2002, NASD is implementing a six-month pilot amendment to IM-10100, "Failure to Act Under Provisions of Code of Arbitration Procedure," for cases that are affected by the new California Standards. The amendment requires industry parties to waive the California Standards in all cases in which all the parties in the case who are investors (referred to as "customers" in the Code) or associated persons with claims of statutory employment discrimination agree to waive application of the California Standards. Under such a waiver, the case would proceed in California under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

NASD has resumed issuing lists of proposed arbitrators in California cases from which the parties select their panels under the current Neutral List Selection System (NLSS). NASD will send memoranda to investors and to associated persons with claims of statutory employment discrimination, giving them the option of waiving the

California Standards and providing them with waiver forms. A sample of such a memorandum is attached to this *Notice*.

NASD is also notifying industry parties in all pending California cases that they must waive the California Standards where the investors agree to a waiver (or associated persons, in the circumstances described above). Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the new rule will be referred for disciplinary action.

Upon receipt of completed waiver forms signed by investors and their counsel, or by associated persons with claims of statutory employment discrimination and their counsel, NASD will immediately commence the arbitrator appointment process under existing NASD rules, and current NASD disclosure requirements.

## Effective Date

The new procedures will apply to the appointment of arbitrators on or after September 30, 2002, to serve in California arbitrations.

## Endnotes

1. Exchange Act Release No. 46562 (September 26, 2002) (File No. SR-NASD-2002-126).
2. This rule filing may be found on the NASD Web site at: [www.nasdadr.com/app\\_orders\\_index.asp#02-126](http://www.nasdadr.com/app_orders_index.asp#02-126).

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## **ATTACHMENT A**

### **Code of Arbitration Procedure**

\* \* \*

#### **IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure**

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) – (e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers have waived application of the California Standards in that case; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.

(Remainder unchanged.)

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## ATTACHMENT B

### NEW WAIVER OPTION EFFECTIVE SEPTEMBER 30, 2002

#### MEMORANDUM

TO: Parties and Counsel of Record  
FROM: NASD Dispute Resolution  
RE: New Waiver Option re: Appointment of Arbitrators In California  
DATE: September 30, 2002

**Effective September 30, 2002, customers in all cases and associated persons in cases involving employment discrimination claims may waive all rights and remedies they might otherwise be entitled to under the California Standards. Industry parties in such cases are required to execute waiver agreements. Upon receipt of the completed waiver form signed by all of the customers and their counsel, arbitrators will be appointed under existing NASD rules, and current NASD disclosure requirements.**

Since July 1, 2002, NASD has not appointed arbitrators in arbitration proceedings scheduled to take place in California. On that date, the state enacted Ethics Standards for Neutral Arbitrators ("California Standards"), which NASD and the Securities and Exchange Commission ("SEC") believe to be in conflict with the SEC-approved Code of Arbitration Procedure. These standards require significantly more disclosure by arbitrators of their financial and personal relationships; include provisions for arbitrators to be removed from a case on demand of a single party to the case; and also provide that an arbitrator's failure to provide the required disclosure is a basis for challenging the arbitration award in court. Trying to implement these standards would require NASD to violate its own SEC-approved rules, increase costs of arbitrations, reduce the number of arbitrators willing to serve on cases, and reduce the speed and certainty of arbitration proceedings. For these reasons, NASD and the New York Stock Exchange are challenging the California Standards in federal court in California.

In July, NASD announced that it was taking steps to help investors deal with the delay in California cases. Specifically, we said we would provide venue changes for arbitration cases and absorb the extra administrative costs associated with the change of venue, using non-California arbitrators when appropriate. To accommodate cases being heard outside of California, we added Reno, Nevada as a new hearing location to the existing sites in Portland, Oregon; Seattle, Washington; Phoenix, Arizona; and Las Vegas, Nevada. On September 3, we further enhanced the venue selection for investors by announcing that cases would be moved outside of California at the request of an investor; industry party acquiescence is no longer required.

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We also encouraged parties to mediate their disputes by waiving our administrative fees for NASD-sponsored mediations, and assigning mediators who agreed to reduce their usual hourly rate. Finally, we assigned arbitrators from outside of California to all simplified arbitration cases, that is, claims involving under \$25,000 that are decided by a single arbitrator without a hearing.

In a further effort to provide arbitration hearings to parties who do not wish to travel outside of California or mediate, NASD has adopted a rule permitting arbitrators to be appointed in cases in California where customers waive the application of the California Standards to their arbitration proceedings. This rule was approved by the Securities and Exchange Commission on September 26, 2002, and is effective on Monday, September 30, 2002.

The new rule provides that arbitrators will be appointed under existing NASD rules, and current NASD disclosure requirements, in cases where all of the customers and their counsel agree to waive all rights and remedies they might otherwise be entitled to under the California Standards. If all of the customers agree to waive the California Standards, then the rule *requires* industry parties (securities firms and their associated persons, a technical term for securities industry employees) to do the same. This rule applies to customers, whether they are the claimants or the respondents in an arbitration.

In intra-industry cases involving claims of statutory employment discrimination, the rule provides that if associated persons and their counsel waive the California Standards, then the firms they are suing must also waive them. The rule does not apply to associated persons bringing non-statutory employment claims or other claims against firms or other associated persons; and it does not apply to associated persons who are respondents in a claim brought by a customer or another associated person.

Customers and associated persons who want to have arbitrators appointed under current NASD rules must execute the attached Waiver Form and return it to NASD. Customers and associated persons who execute the waiver form acknowledge that the arbitrator disclosure requirements under NASD rules are different from and not as expansive as the disclosure requirements under the California Standards. They agree that they are arbitrating their cases under NASD rules and the Federal Arbitration Act, and not under the California Standards, and they agree that they will not seek to challenge the arbitration or arbitrators for failure to comply with the California Standards. *Customers and associated persons should seek the advice of counsel before executing this waiver form, and counsel must also sign the form for the waiver to be effective.*

Industry parties in all pending California cases must waive the California Standards where the investor (or associated person, in the circumstances described above) agrees to a waiver. Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the proposed rule change will be referred for disciplinary action to the NASD Regulatory Policy and Oversight Division.

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**NASD will start the arbitrator appointment process immediately for customers (in all cases) or associated persons (in employment discrimination cases) who execute and return the enclosed Waiver Forms.**

This procedure is available for customers (or associated persons with employment discrimination claims) who:

- ◆ Have filed claims, but have not yet received arbitrator ranking forms;
- ◆ Have received arbitrator ranking forms that are not yet due to be returned;
- ◆ Have timely returned their arbitrator ranking forms, but have not been provided the names of the selected arbitrators;
- ◆ Have received the names of their arbitrators, but a replacement arbitrator is needed; and
- ◆ Have agreed to a non-California hearing location, but would prefer to have the case heard in California, with California arbitrators, now that this option is available (submission of the waiver form will render the agreement to use a non-California hearing location null and void).

Completed forms should be mailed or faxed to:

NASD Dispute Resolution  
300 South Grand Avenue  
Suite 900  
Los Angeles, CA 90071  
Facsimile: 213-613-2677

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## WAIVER AGREEMENT

The undersigned parties hereby agree that this arbitration shall be governed by the NASD Code of Arbitration Procedure and the Federal Arbitration Act, notwithstanding any contrary federal or state substantive or procedural law. In particular, the parties agree that the provisions of the NASD Code of Arbitration Procedure, specifically including its arbitrator disclosure requirements, arbitrator selection procedures, and arbitrator disqualification provisions, and not any provisions of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration in California ("California Standards"), will apply in this arbitration. The California Standards shall have no application whatsoever to any aspect of this arbitration, including without limitation any proceedings to obtain judicial review or judicial enforcement of any arbitration award that may be entered in this arbitration.

The parties accept the disclosures required under the NASD Code of Arbitration Procedure as fully sufficient for purposes of this case, notwithstanding the fact that such disclosures may be less extensive than those required by the California Standards in cases to which those Standards apply. The parties further accept that the NASD Code of Arbitration Procedure's disqualification procedures vest the ultimate authority in the Director of Arbitration to determine whether to disqualify an arbitrator, whereas the California Standards purport to eliminate the Director of Arbitration's discretion in determining whether to disqualify arbitrators. In recognition of these, and other, variances between the NASD Code of Arbitration Procedure and the California Standards, the parties hereby expressly waive any and all rights, obligations, and/or benefits that might be conferred on them by the California Standards in this arbitration, expressly agree that they will not seek to enforce any rights or claim any remedies under or pursuant to the California Standards in any court, proceeding or forum in any matter relating to this arbitration, and expressly and irrevocably release any claim or claims that they may have based on the California Standards in connection with this arbitration or any proceedings relating thereto.

In addition, and without limiting in any way the scope of the waiver and release set forth in the foregoing paragraph, the parties specifically agree not to assert, in any forum, that non-compliance with the California Standards is a basis for challenging the validity of any arbitrator or of any arbitration award, whether asserted during the arbitration proceeding or after an arbitration award has been issued. The parties also specifically agree not to seek any relief against NASD Dispute Resolution or NASD, or any arbitrator, for any failure to comply with the Standards.

The parties understand and acknowledge that this waiver and release applies to and includes all unknown or unsuspected consequences or results arising from or relating to the parties' waiver of any and all rights under the California Standards in connection with this arbitration. The parties represent and warrant that they have read the contents of California Civil Code section 1542, which provides as follows:

*"A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected this settlement with the debtor."*



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**The Parties Expressly Waive Any and All Rights and Benefits Under California Civil Code Section 1542.**

The parties hereby agree that this agreement may be signed in counterparts.

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**Date:**  
Claimant(s):

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**Date:**  
Respondent(s): (Print here)

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Claimant (print name and sign above)

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Counsel for Respondent

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Claimant (print name and sign above)

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Counsel for Respondent

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Claimant (print name and sign above)

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Counsel for Respondent

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**Counsel for Claimant**  
(add signature lines if additional space needed)

# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Trading  
Operations  
Senior Management

## KEY TOPICS

Certificates of Deposit

## INFORMATIONAL

### Certificates of Deposit

Clarification of Member Obligations Regarding Brokered  
Certificates of Deposit **Effective Date: October 8, 2002**

#### Executive Summary

NASD is issuing this *Notice* to supersede *NASD Notice to Members 02-28 (Notice or Notice 02-28)* and replace the guidance offered in *Notice to Members 02-28*, which addressed issues applicable to members offering "brokered" certificates of deposit (CDs). Accordingly, this *Notice* repeats pertinent information from *Notice to Members 02-28*. However, it also provides additional guidance not included in *Notice to Members 02-28*. First, the *Notice* gives a more detailed description of the characteristics of brokered CDs, the mechanics of the brokered CD market, and the circumstances in which brokered CDs may be considered securities. Second, the *Notice* harmonizes NASD's disclosure and sales practice requirements with the New York Stock Exchange's (NYSE's) disclosure and sales practice obligations applicable to its members offering brokered CDs. Finally, the *Notice* recommends the appropriate pricing that members should use in reporting the value of brokered CDs on customers' account statements and the appropriate disclosures that should appear in customers' account statements.

#### Questions/Further Information

Members may direct questions about this *Notice* to Patricia Albrecht, Assistant General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8206.

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## Characteristics of Brokered CD and Brokered CD Market

CDs that typically are issued by a bank directly to a customer carry a fixed interest rate over a fixed duration of time and are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000 against insolvency by the depository institution. As such, they are generally considered by the investing public to be simple, conservative products that carry few risks.

However, some members have been soliciting customers with "brokered" CDs. As explained below, brokered CDs may have a longer holding period until maturity date, be more complex, and carry more risk than "traditional" CDs. Brokered CDs are CDs issued by banks via a "master CD" to deposit brokers, which in turn sell interests in the master certificate to individual retail investors. Any broker/dealer that sells brokered CDs is a deposit broker.

The master CD is a negotiable instrument that represents a certain number of individual CDs, each with the same denomination. FDIC insurance attaches to the individual CDs represented in the master CD.<sup>1</sup> The master CDs are held by a deposit broker as a custodian or by a sub-custodian appointed by the deposit broker. Either the deposit broker or the sub-custodian keeps the records of its customers' ownership interests in the CDs.<sup>2</sup>

In general, brokered CDs have longer maturity dates (in some cases, 20 years from the date of issuance), than traditional CDs. The interest rate terms of brokered CDs can also differ significantly from the simple interest rate terms usually used by traditional CDs. For example, some brokered CDs have their

interest rates tied to a market index, such as the S&P 500. Brokered CDs also may have special call features that allow the issuing bank to terminate the CD after a specified period of time if interest rates drop. In this respect, the CD is similar to a callable, fixed-rate bond. To compensate for these additional features, brokered CDs frequently pay a higher interest rate than traditional CDs.

Because issuing banks may impose penalties on investors for withdrawing their funds before the maturity date of the CD or may not allow withdrawal prior to the maturity date, some deposit brokers (usually broker/dealers) may maintain a limited secondary market for customers who have purchased brokered CDs by buying back the CDs to resell to other customers. The deposit brokers maintain these markets to create some liquidity for the investment. However, the market conditions do not always favor the customer. For instance, if interest rates are high and a customer wants to trade in a low interest brokered CD for another CD with a higher interest rate, the customer might have to realize a loss on the principal of the CD in order to sell the CD. In addition, deposit brokers are not obligated to maintain a secondary market for brokered CDs sold to customers.

## Circumstances that May Make a Brokered CD a Security

Although brokered CDs may have certain features that traditional CDs do not have, it is important to remember that, as long as a banking institution issues the brokered CDs, sets all of their features, and FDIC insurance applies to them, brokered CDs are generally considered bank products, not securities. However, there are several circumstances under

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which a brokered CD may be considered a security. For example, if a deposit broker materially alters the terms and features of a brokered CD (e.g., offering a different interest rate than the interest rate set by the issuing depository institution), the brokered CD is arguably a different investment vehicle that could be considered a security. Additionally, if a deposit broker buys for itself a large-denomination CD, fractionalizes it, and sells the fractions to investors, these actions could make the fractionalized CDs securities. Also, if a deposit broker affirmatively offers to customers certain expertise and skills that go beyond the sale of brokered CDs as incentives to purchase the brokered CDs, such as marketing and the ability to identify attractive CDs, these features may make the brokered CDs securities.<sup>3</sup> As noted above, some deposit brokers maintain a limited secondary market for customers who have bought brokered CDs. If a deposit broker, as an incentive to purchase brokered CDs, offers and/or maintains a secondary market for customers to rely upon to provide additional liquidity to their brokered CDs, this feature may make brokered CDs securities.

### Training

NASD expects registered persons to understand the characteristics and risk factors associated with all investment products, including each type of brokered CD offered by the member with which the registered persons are associated, before soliciting customers. NASD recommends that firms review their compliance programs, supervisory procedures, and continuing education offerings to ensure that registered persons are properly trained and educated about these products. Audits,

compliance meetings, and continuing education programs should include a discussion of these products.

### Appropriate Disclosures and Sales Practices

The NYSE has also provided guidance on the appropriate disclosures and sales practices for members selling brokered CDs to customers.<sup>4</sup> As noted above, this *Notice* serves in part to harmonize NASD's disclosure and sales practice requirements applicable to members offering brokered CDs with those of the NYSE. Accordingly, the *Notice* recommends amended disclosure and sales practice requirements in the following areas: (1) loss of principal; (2) secondary market; (3) call features; and (4) "step-rate" CDs. The following disclosures should be provided sufficiently in advance of the transaction date in any brokered CD in order to provide customers with meaningful notice of the terms, conditions, and risks in connection with such a transaction.

#### 1. Loss of Principal

If a member buys a brokered CD from a customer prior to the CD's maturity date, the member should disclose to the customer that, if the customer chooses to sell the CD prior to the maturity date, the pre-maturity sales price of the brokered CD may be less than its original purchase price. This will be particularly true if interest rates have risen since the time of the original sale. Buyers, including members, will not generally be interested in buying a lower interest rate CD in the secondary market if they can purchase a higher rate CD in the primary market. In addition, a member should not use the term "no penalty for early withdrawal" unless the issuer guarantees redemption

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of the full face value of the brokered CD in the event the owner decides to sell before the maturity date.

## 2. Secondary Market

Members should inform customers that the secondary market for brokered CDs may be limited. The following types of disclosures may be used to describe an organization's post-distribution intentions:

"Upon completion of the distribution, the firm may not make a market in this CD."

or

"Upon completion of the distribution the firm may, as an accommodation to customers, make a market in this CD."

or

"The firm, though not obligated to do so, may maintain a secondary market in this CD upon completion of the distribution."

## 3. Call Features

Brokered CDs may include a provision that allows the issuing bank or other depository institution to "call" or redeem the CD prior to maturity at a given price. Call features typically are exercised when a brokered CD is trading at a premium to its call price in the secondary market. The call option is solely at the discretion of the issuer. Members should inform customers that the brokered CD they are purchasing is callable at the sole discretion of the issuing depository institution and that if the CD is "called," investors seeking to reinvest their

redeemed funds will be subject to reinvestment risk because interest rates may have fallen since the time they first purchased the brokered CD. Also, in marketing callable brokered CDs, members should be careful not to predict the likelihood that the CDs will be called.

## 4. "Step Rate" CDs

Brokered CDs may also have "step-up" or "step-down" features. A "step-down" CD will pay an above-market interest rate for a defined period of time but will then "step-down" to a lower, predetermined rate that will be paid until maturity. Similarly, a "step-up" CD will generally pay a below market interest rate for a defined period of time and will "step-up" to a higher, predetermined rate that will be paid until maturity. Members should inform customers that the "step rate" on a brokered CD may be below or above then-prevailing market rates and that the CDs are also subject to secondary market risk and often will include a call provision by the issuing depository institution that would likewise subject them to reinvestment risk. Members should also remind customers that the initial rate cannot be used to calculate the yield to maturity.

## Written Communications

Members should provide customers with written materials that describe the characteristics and risks of purchasing brokered CDs or prepare such material for distribution if not made available by the issuer. Any such written materials must also comply with Rule 2210 ("Communications With The Public").

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## Account Statements

NASD has observed that some members continue to price brokered CDs at par value on account statements. Carrying CDs at par value could be materially misleading if values have significantly eroded, and members are advised to diligently endeavor to price accurately the brokered CDs on customer account statements.

There is no single method to determine the market value of brokered CDs. Members can obtain estimated values from several sources, including commercial pricing services. Some members rely on their fixed-income trading desks to determine a market value, while others have developed computerized valuation models or matrices to ascertain a theoretical market price. NASD recommends that when disclosing in account statements the more accurate values of brokered CDs held by customers, members should also disclose to customers that the value of brokered CDs on account statements are estimated and that their actual value may differ if customers elect to sell their brokered CDs in the secondary market. In addition, NASD recommends that members disclose the pricing method used to determine the market value of the brokered CDs. If market value is not provided as described above, NASD recommends that brokered CDs be reflected on customer statements as unpriced.

The *Notice* also recommends including other disclosures on the account statement, covering the following points:

- (1) the secondary market for CDs is generally illiquid;
- (2) an accurate market value could not be determined by the member firm;
- (3) the actual value of the CDs may be different from their purchase price; and
- (4) a significant loss of principal could result if brokered CDs are sold prior to maturity. If the disclosure documents initially provided to customers purchasing brokered CDs provides information on these points, NASD does not believe that the disclosures, while preferable, need to appear in customers' account statements.

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## Endnotes

- 1 Federal deposit insurance generally covers deposits of up to \$100,000 in the aggregate for each depositor in each bank, thrift, or credit union. A customer should ensure that purchasing any insured CD will not bring his or her aggregate deposit over the \$100,000 FDIC insurance limit.
  - 2 For FDIC insurance protection to apply to the owner of the brokered CD, it is important that deposit brokers keep accurate records of the ownership interest in the brokered CD. However, the FDIC does not have to rely solely upon the records of the bank and/or the deposit broker to establish ownership. Under the FDIC's rules, if the brokered CDs are being held by a custodian, which is usually the case in sales by broker/dealers, the FDIC may also look to the records of a custodian to establish a relationship that permits deposit insurance to pass through the custodian to the purchaser. In addition, if the FDIC has reason to believe that the insured depository institution's deposit account records misrepresent the actual ownership of deposited funds and such misrepresentation would increase deposit insurance coverage, the FDIC may consider other available evidence of ownership and pay claims for insured deposits on the basis of the actual rather than the misrepresented ownership. See 12 C.F.R. § 330.5. Accordingly, firms should suggest to their customers that the customers keep records of their brokered CDs in the event the FDIC needs to look beyond the custodian's or deposit institution's records to establish ownership.
  - 3 See *Gary Plastic v. Merrill Lynch, Pierce, Fenner & Smith*, 756 F.2d 230 (2d Cir. 1985).
  - 4 See NYSE Information Memo No. 01-5 (March 7, 2001) and NYSE Information Memo No. 01-19 (July 20, 2001).
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# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Continuing Education  
Firm Element

## INFORMATIONAL

### Continuing Education

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

#### Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued the annual *Firm Element Advisory*, a guide for firms to use when developing their continuing education Firm Element training plans. The attached *Firm Element Advisory* lists topics that the Council considers to be particularly relevant to the industry at this time. The list is based on a review of recent regulatory events, as well as advisories issued by self-regulatory organizations (SROs) since the last Firm Element Advisory of November 2001. Firms should review the training topics listed in the *Firm Element Advisory* in conjunction with their annual Firm Element Needs Analysis in which firms identify training issues to be addressed by their written Firm Element training plan(s).

Also, please note that the Council has two additional resources available on its Web Site to assist firms with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application in which the user identifies specific investment products or services and selects training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources like those listed in the *Firm Element Advisory*, and provides a report of relevant resources. The report can then be edited into a Firm Element training plan using a word processing program. A tutorial on the Web Site demonstrates this process. The second Firm Element resource comprises scenarios taken from the Regulatory Element computer-based training that may be suitable for Firm Element training. For more information, to use the *Firm Element Organizer*, or to order Regulatory Element scenarios, log on to [www.securitiescep.com](http://www.securitiescep.com).

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## Questions/Further Information

Questions concerning this *Notice* may be directed to John Linnehan, Director, NASD Continuing Education, at (240) 386-4684.

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The Securities Industry Continuing Education Program

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## Securities Industry Continuing Education Program Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (Council) publishes the *Firm Element Advisory* to identify pertinent regulatory and sales practice issues for possible inclusion in Firm Element training plans. This year's topics have been taken from a review of industry regulatory and self-regulatory organization (SRO) publications issued since the last *Firm Element Advisory* of November 2001.

The Council recommends that firms use the *Firm Element Advisory* when they undertake their annual Firm Element Needs Analysis. Begin by reviewing the training topics listed in the *Firm Element Advisory* that are most relevant to the firm's business as it exists today, including training for supervisors. Then, consider training topics prompted by new products or services the firm plans to offer, such as security futures, where training is mandated before a registered person can conduct business in this area. Other training topics may address issues raised by new rules, customer complaints, or regulatory examination findings.

In addition to the training resources listed next to each topic in the *Firm Element Advisory*, there are two additional resources on the Council Web Site ([www.securitiescep.com](http://www.securitiescep.com)) to assist with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application. Just identify specific investment products or services and training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources similar to those listed in the *Firm Element Advisory*, and provides a report of relevant resources. The report can then be edited into a Firm Element training plan using a word processing program. A tutorial on the Web Site demonstrates how to use the *Firm Element Organizer*. The second Firm Element resource comprises scenarios taken from the Regulatory Element computer-based training that may be suitable for Firm Element training. For more information, log on to [www.securitiescep.com](http://www.securitiescep.com), or phone Roni Meikle, Continuing Education Manager, the New York Stock Exchange (212-656-2156), or John Linnehan, Director, NASD Continuing Education, (240-386-4684).

## Training Topics and Relevant Training Points and References

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### **Anti-Money Laundering**

The SROs adopted rules, pursuant to amendments to Section 352 of USA PATRIOT Act, that every broker/dealer member must establish an anti-money laundering compliance program by April 24, 2002 that included certain specified minimum requirements:

- ◆ the development of internal policies, procedures, and controls;
- ◆ the designation of a compliance officer;
- ◆ an ongoing employee training program; and
- ◆ an independent audit function to test programs.

Anti-money laundering is an evolving topic that places additional due diligence and reporting responsibilities on firms, supervisors, and registered representatives. Many SROs and government agencies maintain Web Sites on anti-money laundering, including the SEC ([www.sec.gov](http://www.sec.gov)), the U.S. Treasury ([www.ustreas.gov](http://www.ustreas.gov) => *Bureaus=>Financial Crimes Enforcement Network (FinCen)*), NASD (<http://www.nasdr.com/money.asp>) and the SIA ([www.sia.com](http://www.sia.com) => *Reference Materials => Anti-Money Laundering Guidance*). See also, *NASD Notice To Members 02-21, NASD Provides Guidance To Member Firms Concerning Anti-Money Laundering Compliance Programs Required By Federal Law*, April 2002; *NYSE Information Memoranda Nos. 02-16*, (April 12, 2002) *Anti-Money Laundering Compliance Program Requirements, 02-21* (May 6, 2002), *Approval of New Rule 445 – Anti-Money Laundering Compliance Program and 02-34* (August 1, 2002), *Special Due Diligence for Correspondent Accounts and Private Banking Account*; *CBOE Rule 4.20, Anti-Money Laundering Compliance Program*, and *CBOE Regulatory Circular RG-02-69, Anti-Money Laundering Programs*, August 19, 2002; *Philadelphia Stock Exchange Rule 757 – Anti-Money Laundering Compliance Program*.

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### **Business Conduct**

#### *Outside Business Activities and Private Securities Transactions*

A registered person who sells a security away from his or her firm without first obtaining written approval from the firm violates NASD Rule 3040, and a registered person who engages in an outside business activity without prior notice to his or her firm, including the sale of non-securities products, violates NASD Rule 3030. Broker/dealers must have supervisory procedures to make sure that they are complying with NASD Rules 3030 and 3040 regarding outside business activities and private securities transactions. Broker/dealers must also appropriately educate their associated persons regarding the requirements of Rules 3030 and 3040. Registered persons are advised to provide written notice to their firms before they engage in the sale of any financial instrument that is not approved by their firm.

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NYSE Rule 407 amendment codifies the requirement that associated persons obtain their employers' written approval prior to establishing or monitoring securities or commodities accounts or entry into private securities transactions (rather than notification) and clarifies the terms "account," "private securities transactions," and "other financial institutions."

See *NYSE Information Memo No. 02-40*, August 28, 2001, Amendments to Rule 407 Relating to Private Securities Transactions and NYSE Interpretation Memo 02-08, August 28, 2002, Interpretation to Rule 407 Transactions – Employees of Members, Member Organizations and the Exchange.

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*Charitable Gift Annuities*

A Charitable Gift Annuity (CGA) enables an individual to transfer cash or marketable securities to charitable organizations that then issue gift annuities in exchange for a current income tax deduction and the organization's promise to make fixed annual payments for life. Registered persons may be told that CGAs do not require federal or state securities registration or licensing. This is false, however, if representatives will receive a commission.

See NASD Regulatory & Compliance Alert, *Regulatory Short Takes — Charitable Gift Annuities*, Summer 2002.

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*Short Term Promissory Notes*

Short-term promissory notes are often marketed to registered representatives by issuers, promoters, and marketing agents who misrepresent these products as non-securities products that do not have to be sold by a broker/dealer or by a registered person. See, *NASD Notice To Members 01-79, Selling Away And Outside Business Activities, NASD Reminds Members Of Their Responsibilities Regarding Private Securities Transactions Involving Notes And Other Securities And Outside Business Activities*, December 2001.

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*Viatical Investments*

Viatical investments are structured to provide an insured with a percentage of a life insurance death benefit before his or her death, while the investors get a share of the death benefit when the insured dies. Originated as a way to help the gravely ill pay their bills, these interests in the death benefits of terminally ill patients are always risky and sometimes fraudulent. Because of uncertainties associated with predicting an insured's death, these investments are extremely speculative, and unscrupulous promoters misrepresent or fail to disclose the risks of viatical investments.

Almost all state securities regulators consider viatical investments as securities under their respective laws, but a circuit court of appeals ruling in 1996 found that they were not securities under federal securities laws. The North American Securities Administrators

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## Communications with the Public

### *Disclosure and Reporting Requirements — Research Analysts and Research Reports*

Association (NASAA) has developed Guidelines regarding viatical investments (see [http://www.nasaa.org/nasaa/Files/File\\_Uploads/viaticalfinal.37534-67899.pdf](http://www.nasaa.org/nasaa/Files/File_Uploads/viaticalfinal.37534-67899.pdf)). Broker/dealers must appropriately educate themselves and their associated persons before venturing into offering viatical investments to clients.

See also *Risky 'death futures' draw warning from state securities regulators, congressional scrutiny*; [http://www.nasaa.org/nasaa/labtnasaa/display\\_top\\_story.asp?stid=245](http://www.nasaa.org/nasaa/labtnasaa/display_top_story.asp?stid=245)

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On May 10, 2002, the SEC, in order to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions, approved new NASD Rule 2711, *Research Analysts and Research Reports*, as well as amendments to NYSE Rule 472, *Communications With The Public and Rule 351, Reporting Requirements*. Rule 2711 and the NYSE rule amendments:

- ◆ Place restrictions on relationships between a firm's investment banking department and its research department.
- ◆ Restrict review of a research report by the subject company.
- ◆ Prohibit certain forms of research analyst compensation.
- ◆ Prohibit the promise of favorable research.
- ◆ Impose Quiet or Blackout Periods.
- ◆ Restrict trading by research analysts and firms.
- ◆ Require new disclosures in research reports and public appearances.

See *NASD Notice to Members 02-39, SEC Approves Rule Governing Research Analysts' Conflicts of Interest*, July 2002; and *NYSE Information Memos re: Disclosure and Reporting Requirements Nos. 02-24*, May 20, 2002; *02-26*, June 26, 2002; and *02-30*, July 9, 2002. Included therein is a Joint Memorandum that provides interpretive guidance for NASD and NYSE rules governing research reports and analysts.

NASD also maintains a Web Site on this evolving topic that is continuously updated, see [http://www.nasdr.com/analyst\\_guide.htm](http://www.nasdr.com/analyst_guide.htm).

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*Electronic  
Communications  
— Suitability and  
Online  
Communications*

In light of the dramatic increase in the use of the Internet for communication between broker/dealers and their customers, NASD has issued a Policy Statement to provide guidance concerning a firm's obligations under the NASD general suitability rule, Rule 2310, in this electronic environment.

The Policy Statement briefly discusses some of the issues created by the intersection of online activity and the suitability rule, and it provides examples of electronic communications that NASD considers to be either within or outside the definition of "recommendation" for purposes of the suitability rule. In addition, the Policy Statement sets forth guidelines to assist members in evaluating whether a particular communication could be viewed as a "recommendation," thereby triggering application of the suitability rule.

See *Notice to Members 01-23, Suitability Rule And Online Communications*, April 2001. See also *Internet Guide for Registered Representatives*, at <http://www.nasdr.com/4040.asp>.

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**Customer  
Accounts, Trade  
and Settlement  
Practices**

*Errors and  
Erroneous  
Transactions*

The NYSE gave notice to its members and member organizations of new NYSE Rule 407A, and amendments to NYSE Rules 134 and 411, addressing situations involving erroneous transactions and reports. In addition, there is a new requirement that all members maintain an error account, as well as a new requirement that members report to the Exchange any account in which the member has a direct or indirect financial interest or over which the member has discretionary authority.

In addition these amendments to NYSE Rules 134 and 411 and new Rule 407A dealing with erroneous transactions, erroneous reports and member account disclosure announced in *Information Memo 01-38* (November 6, 2001), gave rise to a number of questions concerning the application of these rules which the NYSE addressed in two separate *Information Memos* (Nos. 02-19 and 02-07).

The NYSE also advised its members and member organizations regarding amendments to NYSE Rule 134.40 of the requirement to report profitable error transactions.

See *NYSE Information Memoranda 01-38, Mandatory Error Account Requirement, Error Transaction Procedures, Recordkeeping Requirements, Disclosure of All Member Accounts, and Procedures for Handling Erroneous Reports/Rules 134, 407A, and 411*, November 6, 2001; 02-07, *Mandatory Error Account Requirement and Error Transaction Procedures – Rules 134, 407A and 411*, February 5, 2002; 02-10, *Rule 134.10 – Reporting Profitable Error Transactions*, March 5, 2002; and 02-19, *Errors, Erroneous Reports and Error Accounts – Rules 134, 411 and 407A*, April 29, 2002.

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*Gifts and  
Gratuities*

NYSE restated and reminded its members and member organizations of the Exchange's policy on gifts and gratuities which prohibits most Exchange employees from accepting gifts and gratuities from members, allied members, and member organizations. Limited exceptions are provided for Exchange Operational/Clerical Trading Floor employees who may accept usual and customary gratuities, not in excess of \$50 per year. The memo also references NYSE Rule 350 ("Compensation or Gratuities to Employees of Others").

See *NYSE Information Memo No. 01-49*, December 19, 2001, *Exchange Guidelines on Gifts and Gratuities*.

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*Margin Disclosure  
and Day-Trading  
Risk Disclosure  
Statements*

NASD has adopted amendments to (1) Rule 2341 (Margin Disclosure Statement) to require firms that permit customers to open accounts online or to engage in transactions in securities online to post the margin disclosure statement on their Web Sites and (2) NASD Rule 2362 (Day-Trading Risk Disclosure Statement) to require firms that promote a day-trading strategy to post the day-trading risk disclosure statement on their Web Sites.

See *NASD Notice to Members 02-35, Margin Disclosure and Day-Trading Risk Disclosure Statements*, June 2002.

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*Options*  
  
*AM-Settled  
Index Options*

Expiring AM-settled index options should be considered exercised, assigned or purged at the point the securities that comprise the index open for trading on the business day immediately preceding Saturday expiration. In the case of an AM-settled index option carried short and treated as "covered," the writing of a new index option on Friday, after the opening to replace the assigned or expiring option, will not be deemed to constitute an "uncovered" transaction.

See *CBOE Regulatory Circular RG02-46, Time at Which Expiring AM-Settled Index Options are Considered Exercised, Assigned or Purged*.

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*Alerting  
Customers to  
Adjustments  
to Option  
Contracts*

SROs reminded member organizations of the need to review their policies and procedures to ensure that customers are provided with relevant information concerning adjustments to option contracts as the result of corporate actions.

See *CBOE Regulatory Circular RG02-41, Alerting Customers to Adjustments to Options Contracts. NASD Notice to Members 02-17, Alerting Customers to Adjustments to Options Contracts*, March 2002; *NYSE Information Memo No. 02-42*, September 19, 2002, *Alerting Customers To Adjustments To Options Contracts Resulting From Corporate Actions*.

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**Municipal  
Securities**

*Consultants*

MSRB Rule G-38 defines a consultant as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of, receiving payment from the dealer or any other person. Dealers must disclose to issuers certain information about their consultants and report certain information about their consultants to the MSRB on Form G-37/G-38, including certain of their consultants' political contributions to issuer officials and payments to state and local political parties.

See MSRB Rule G-38: Consultants, *MSRB Rule Book*.

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*Disclosure of  
Material Facts*

The SEC approved an interpretive notice regarding Rule G-17, on disclosure of material facts. The first prong of Rule G-17 is essentially an anti-fraud prohibition; the second prong of the rule imposes a duty on dealers to deal fairly. As part of a dealer's obligation to deal fairly, the dealer is required to disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security. These affirmative disclosure obligations apply even when a dealer is acting as an order taker and effecting non-recommended secondary market transactions.

See "Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts" (<http://www1.msrb.org/msrb1/archive/G-17NOTICE32002.htm>).

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*Municipal Fund  
Securities,  
Including 529  
Plans*

A municipal fund security (e.g., 529 Plans and local government investment pools) is defined in MSRB Rule D-12 as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company thereunder.

The MSRB recognizes that the market for municipal fund securities continues to evolve rapidly, particularly with respect to the 529 College Savings Plans. Many dealers active in this market have no other experience effecting municipal securities transactions and therefore may not be familiar with the rules of the MSRB. Other dealers that do have a sound understanding of MSRB rules as they relate to traditional debt securities have discovered that familiar rules are applied in unfamiliar ways due to the unique nature of municipal fund securities. All dealers are reminded that all activities in municipal fund securities are subject to MSRB rules. Dealers are required by MSRB Rule G-17 to deal fairly with all persons and that they not engage in any deceptive, dishonest, or unfair practice. In some cases, certain sales-related activities are governed by MSRB, e.g., Rule G-19, on suitability of recommendations and transactions,



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Rule G-21, on advertising, and Rule G-30, on prices and commissions. Other activities may not be explicitly addressed by a specific MSRB rule; however, the general principles of Rule G-17 always apply.

The MSRB has amended Rule G-3, on professional qualifications, to provide a temporary alternative method for qualification of municipal securities principals in connection with municipal fund securities. Until March 31, 2003, a dealer may designate an investment company/variable contracts limited principal or a general securities principal to act as a municipal fund securities limited principal. A designated municipal fund securities limited principal will have all of the powers and responsibilities of a municipal securities principal under MSRB rules with respect to transactions in municipal fund securities and, under certain circumstances, may be counted toward the dealer's numerical requirement with regard to municipal securities principals.

See "Municipal Fund Securities Limited Principal Qualification Examination: Filing of Test Specifications, Study Outline and Extension of Transition Period (<http://www1.msrb.org/msrb1/archive/Series51Notice.htm>)

"Application of Fair Practice and Advertising Rules to Municipal Fund Securities" (<http://www1.msrb.org/msrb1/archive/MFS-FairPracticeNotice—5-02.htm>).

Also, see NASD's *Smart Saving for College – Better By Degrees, 529 Plans and Other Savings Options*, [http://www.nasdr.com/529\\_saving.asp](http://www.nasdr.com/529_saving.asp), and "Saving for Education: A Long-Term Investment Guide to Understanding 529 Plans," prepared by the College Savings Plans Network, the North American Securities Administrators Association, and the Investment Company Institute, [http://www.nasaa.org/nasaa/Files/Top\\_Stories/529%20brochure1.37536-62599.pdf](http://www.nasaa.org/nasaa/Files/Top_Stories/529%20brochure1.37536-62599.pdf)

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*Political  
Contributions  
and Prohibitions  
on Municipal  
Securities Business*

Dealers are prohibited from engaging in municipal securities business with a municipal securities issuer within two years after any contribution to an official of such issuer made by the dealer, any municipal finance professional associated with such dealer, or any political action committee controlled by the dealer or any municipal finance professional. The only exception to this absolute prohibition on municipal securities business is for certain contributions made to issuer officials by municipal finance professionals, but only if the municipal finance professional is entitled to vote for such official and provided any contributions do not exceed, in total, \$250 to each official, per election. Dealers must report certain information about political contributions, political party payments, municipal securities business, and consultants to the MSRB on Form G-37/G-38 or, if appropriate, dealers may file a Form G-37x with the MSRB.

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The definition of "municipal finance professional" includes any associated person of the dealer who solicits municipal securities business. "Associated person" is defined in Section 3(a)(18) of the Securities Exchange Act of 1934. See SEC order *In the Matter of Fifth Third Securities, Inc.*, Exchange Act Release No. 46087, June 18, 2002; MSRB Rule G-37: Political Contributions and Prohibitions on Municipal Securities Business, *MSRB Rule Book*.

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*Transactions in  
Securities with  
Minimum  
Denominations*

Dealers are prohibited from effecting transactions with customers in below-minimum denomination amounts for securities issued after June 1, 2002. There are two limited exceptions to this rule. First, dealers may purchase a below-minimum denomination position from a customer provided that the customer liquidates his or her entire position. Second, dealers may sell such a liquidated position to another customer but would be required to provide written disclosure, either on the confirmation or separately, to the effect that the security position is below the minimum denomination and that liquidity may be adversely affected by this fact. The MSRB issued an interpretation of Rule G-17, on fair practice, that states that any time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer's failure to disclose such a material fact to the customer, and to explain how this could affect the liquidity of the customer's position, generally would constitute a violation of the dealer's duty under Rule G-17 to disclose all material facts about the transaction to the customer.

See "Approval of Amendments Concerning Minimum Denominations" (<http://www1.msrb.org/msrb1/archive/approvalnotice.htm>).

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*Transactions with  
Sophisticated  
Municipal Market  
Professionals*

The SEC approved an interpretive notice concerning the application of MSRB rules to transactions with sophisticated municipal market professionals ("SMMP"). An institutional customer can be considered an SMMP if the dealer has reasonable grounds for concluding that the customer (i) has timely access to the to all publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and, (iii) is making independent investment decisions about its investment in municipal securities. The notice addresses the manner in which a dealer has determined that it has met its fair practice obligations to certain institutional customers; it does not alter the basic duty of the dealer to deal fairly in all transactions and with all customers.

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See "Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals" (<http://www1.msrb.org/msrb1/archive/SMMPAPPROVAL0502.htm>).

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**Registration and Reporting Requirements**

*Reportable Criminal Offenses*

The NYSE narrowed the scope of reportable criminal offenses to incidents which are more germane to the conduct of a securities-related business minimizing the number of less material filings and maximizing the efficient use of resources committed to fulfilling self-regulatory responsibilities at both the Exchange and member organizations. The rule amendment captures the reporting of arrests for which any subsequent conviction or plea of no contest or guilty, would subject the individual to a statutory disqualification from securities industry employment or association.

See *NYSE Information Memo No. 02-31, Update Regarding Exchange Rule 351 – Reporting Requirements*, July 15, 2002, and *NYSE Information Memo No. 02-29, Exchange Rule 351 – Reporting Requirements*, July 8, 2002.

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**Registration and Reporting**

*Trading Floor*

The NYSE has prepared an Information Memo that outlines requirements for conducting a public business from the Floor. Registration topics addressed include the distinction between dealing with the "public" as distinguished from "professional customers"; the registration requirements of sole proprietors; and the registration, disclosure, and supervisory requirements specifically applicable to dual employees.

A general outline is included that references several prerequisites for conducting a public business including supervisory requirements, state registration, capital requirements, fidelity bond coverage, documentation requirements, and carrying agreements. The Memo also outlines policies and procedures related to permissible and restricted means of telephonic/electronic means of Floor communications.

See *NYSE Information Memo No. 01-41*, November 21, 2001, *Conducting a Public Business on the Floor*.

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**Security Futures (also known as Single Stock Futures)**

The Commodity Futures Modernization Act lifted the ban on the trading of security futures (i.e., futures on narrow-based indices, single stocks, and options on security futures). Because security futures have different characteristics and requirements than existing securities, the SROs have adopted rules that require any currently registered securities professional that intends to engage in a security futures business to complete a training program covering security futures, which may be included as Firm Element training for the pertinent registered persons. The SROs have also developed a content outline for use in the development of the training program,

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which focuses on the essential information individuals and supervisors should know before conducting a security futures business. The content outline has five modules:

1. Stocks and Stock Options
2. Futures Contracts
3. Security Futures
4. Regulatory Requirements for Security Futures
5. Supervision of the Offer and Sale of Security Futures.

An individual's current registration category will determine which of these modules must be completed before engaging in a security futures business. Series 7 registrants, for example, may not need to participate in the training on Stocks and Stock Options. Therefore, a member firm must consider the registration category and qualifications of persons in determining the nature and scope of his or her training.

Firms may develop their own security futures training program or may engage a third-party provider to deliver the training program, so long as the training provided encompasses all appropriate subjects in the SRO-developed content outline. Firms remain responsible for compliance with SRO rules in all respects where training is developed and or administered by outside parties. NASD and the NFA have developed a Web-based security futures training program that, if completed in the prescribed manner, would satisfy the required training requirement. Information regarding this training program can be obtained at <http://www.nasdr.com/futures.asp>.

Finally, members are reminded of the need to maintain records of the completion of any security futures training program designed to satisfy the requirement. Members may be required during an examination or investigation to demonstrate that individuals who are engaged in a security futures business have completed the required training.

Please monitor the following SRO Web Sites as well as the NASD Web Site above for additional information:

<http://www.nqlx.com>

<http://www.onechicago.com>

<http://www.nfa.futures.org>

<http://www.cboe.com>

<http://www.nyse.com>

<http://www.amextrader.com>

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**Supervision****Books and Records**

Branch office managers and other supervisory personnel should be aware of SEC-approved amendments to the broker/dealer books and records rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934 that become effective on May 2, 2003. The amendments clarify and expand record-keeping requirements in connection with purchase and sale documents, customer records, associated person records, customer complaint records, and certain other matters. The amendments also require broker/dealers to maintain or promptly produce certain records at each office to which those records relate.

Some of the more significant changes to the books and records rules are:

- ◆ The definition of "office."
- ◆ Updating Customer Account Records.
- ◆ Additional Information Annotated on Order Tickets.
- ◆ Additional Records Related to Associated Persons.
- ◆ Retention of Communications With the Public.

For more information, see *Amendments To Broker/Dealer Books And Records Rules Under The Securities Exchange Act Of 1934, NASD Notice to Members 01-80, December 2001, <http://www.nasdr.com/pdf-text/0180ntm.pdf>.*

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**Supervision****General Topics**

Industry SRO continuing education rules require a broker/dealer to include supervisory training for supervisors if its Firm Element Needs Analysis establishes the need for it. Supervisors should be trained on new rules with general application, e.g., anti-money laundering, as well as new rules relating to new products, such as security futures, if applicable. Firms should reiterate with supervisors the importance of internal controls as they relate to areas such as changing customer addresses, Letters of Authorization, mail directed to customer post office boxes, time and price discretionary orders, and supervision of producing managers.

Broker/dealers may also find it helpful to periodically review with their supervisors various examples of conduct that violates SRO rules, such as

- ◆ Exercising discretion without prior written authority
- ◆ Failing to respond to SRO information requests
- ◆ Failing to take advantage of mutual fund discounts

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- ◆ Falsifying documents
  - ◆ Forgery
  - ◆ Misrepresentations to customers
  - ◆ Selling away
  - ◆ Unsuitable recommendations
  - ◆ Unauthorized trading

Supervisors in turn may wish to share this information with the registered persons they supervise. Many industry SROs publish information on their Web Sites that illustrate improper conduct and the disciplinary action taken by regulators. For example: NASD's quarterly Disciplinary Update at [http://www.nasdr.com/disc\\_update\\_index.asp](http://www.nasdr.com/disc_update_index.asp), and the NYSE's Disciplinary Actions at <http://www.nyse.com/regulation/regulation.html>.

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## **Variable Annuities**

### *Bonus Annuities*

Bonus annuities offer credits equal to a percentage of the amount invested in the variable annuity contract. The investment is usually from a 1031 exchange from another variable annuity contract. Bonus credits generally range from 3 percent to 5 percent of the money invested. In order to fund these bonus credits, the bonus contracts typically impose high mortality and expense charges and lengthy surrender charge periods. Registered persons recommending bonus annuities must be careful to comply with applicable SRO suitability rules. Communications promoting bonus annuities must disclose fees, expenses and surrender periods with the same prominence as the bonus feature of the new variable annuity contract.

See *NASD Regulation Cautions Firms For Deficient Variable Annuity Communications, Regulatory & Compliance Alert, Spring 2002* ([http://www.nasdr.com/lrca\\_spring02\\_adv.htm](http://www.nasdr.com/lrca_spring02_adv.htm)); *Advertising Of Bonus Credit Variable Annuities, Regulatory & Compliance Alert, Summer 2000* ([http://www.nasdr.com/lrca\\_summer00.htm](http://www.nasdr.com/lrca_summer00.htm)); and the NASD Regulation Investor Alert on exchanging variable annuities ([http://www.nasdr.com/alert\\_02-01.htm](http://www.nasdr.com/alert_02-01.htm))

See also:

- ◆ *Notice to Members 99-35, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Annuities, May 1999*, (<http://www.nasdr.com/pdf-text/9935ntm.pdf>).

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## To Obtain More Information

For more information about publications contact the SROs at these addresses:

<b>Self-Regulatory Organization</b>	<b>Address and Phone Number</b>	<b>On-line Address</b>
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	<a href="http://www.amex.com">www.amex.com</a> <a href="http://www.amextrader.com">www.amextrader.com</a>
Chicago Board Options Exchange	Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 877-843-2263 e-mail: <a href="mailto:help@cboe.com">help@cboe.com</a>	<a href="http://www.cboe.com">www.cboe.com</a>
Municipal Securities Rulemaking Board MSRB	Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	<a href="http://www.msrb.org">www.msrb.org</a>
NASD	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 301-590-6142	<a href="http://www.nasd.com">www.nasd.com</a>
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street 18th Floor New York, NY 10005 212-656-5273, or 212-656-2089	<a href="http://www.nyse.com">www.nyse.com</a>
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX, or 215-496-5158	<a href="http://www.phlx.com">www.phlx.com</a> or <a href="mailto:info@phlx.com">info@phlx.com</a>

# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management

## KEY TOPICS

SuperMontage

## SuperMontage

NASDAQ Provides Guidance on Recent Amendments to "Trade-or-Move" Rule and SuperMontage Opening Process

### Executive Summary

On May 28, 2002, the Securities and Exchange Commission (SEC) approved amendments made by The Nasdaq Stock Market, Inc. (NASDAQ®) to NASD Rule 4613(e), the Trade-or-Move Rule.<sup>1</sup> The amendments change three aspects of the Trade-or-Move Rule as it operates today between 9:20 and 9:29:59 a.m., Eastern Time (ET).

- (1) **Sequence of messaging:** Electronic communications networks (ECNs) will now be required to send Trade-or-Move Directed Orders prior to entering locking/crossing quotes, and market makers will continue to be required to send Trade-or-Move Directed Orders after entering locking/crossing quotes;
- (2) **Response Time:** The time to respond to a Trade-or-Move Directed Order will be reduced from 30 seconds to 10 seconds; and
- (3) **Minimum Share Requirement:** The amendment creates a 10,000-share minimum requirement for Trade-or-Move Directed Orders for NASDAQ-100 Index® (NASDAQ-100) and S&P MidCap 400 Index (S&P-400) issues, while preserving the 5,000-share requirement for all other securities. The rule filing also preserves the existing exception for agency orders.

As a result of these changes, ECNs will be required to send a Trade-or-Move Directed Order and then wait 10 seconds before entering a locking/crossing quotation. If the ECN receives no response, it may then cancel the Trade-or-Move Directed Order and enter a locking/crossing quote. If the recipient trades in full, the ECN will be required to send another Trade-or-Move Directed Order prior to entering a lock/cross.

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Market makers will adhere to the Rule as they do today, taking into account the modified minimum share and response time requirements. The Trade-or-Move requirements apply only to the markets that participate in NASDAQ market systems. Currently, those markets are NASDAQ and the Chicago Stock Exchange, Inc.

On August 23, 2002, the SEC approved the new SuperMontage<sup>SM</sup> opening process.<sup>2</sup> Beginning at 9:29:30 a.m., ET, the system will resolve any outstanding locked/crossed markets through a matching process that will continue until all locked/crossed orders are cleared.

As members are aware, NASDAQ started to implement SuperMontage, including the new opening process, beginning on October 14, 2002, on a security-by-security basis. NASDAQ has decided to implement both the Trade-or-Move Rule changes as well as the SuperMontage opening process changes as NASDAQ rolls out SuperMontage in a particular security. **In other words, the new Rule amendments will be implemented on a security-by-security basis, as soon as each NASDAQ security begins to trade on SuperMontage.** The current Trade-or-Move Rule obligations will continue to apply to all securities continuing to trade through SuperSoes<sup>SM</sup>.

Attachment A includes a question and answer section that explains the major points of the rule changes. Attachment B includes the text of the amended rule.

## Questions/Further Information

Legal questions regarding this *Notice* may be directed to Jeffrey Davis, Associate General Counsel, or Thomas Moran, Associate Vice President, Office of General Counsel, NASDAQ, at (202) 728-8088. General trading questions may be directed to John Malitzis, Vice President; Karen Peterson, Associate Vice President; or Mary Revell, Associate Vice President; NASDAQ Transaction Services, at (212) 858-4322. Questions about market operations or the Clearly Erroneous Trade Rule may be directed to Dan Franks, Senior Vice President, NASDAQ Market Operations, NASDAQ, at (800) 219-4861.

## Background and Explanation

To address ongoing concerns with locked/crossed markets prior to the open, NASDAQ proposed, and the SEC approved (on May 28, 2002), changes to NASD Rule 4613(e). The rule change alters three aspects of the Trade-or-Move Rule as it operates today between 9:20 and 9:29:59 a.m., ET. First, ECNs will be required to send Trade-or-Move Directed Orders prior to entering locking or crossing quotes, while market makers will continue to be required to send Trade-or-Move Directed Orders after entering locking or crossing quotes. Second, the time to respond to a Trade-or-Move Directed Order will be reduced from 30 seconds to 10 seconds. Third, the amendment creates a 10,000-share minimum requirement for Trade-or-Move Directed Orders for NASDAQ-100 and S&P 400 issues, while preserving the 5,000-share minimum requirement for all other securities. The rule filing preserves the existing exception to the minimum share requirement of 5,000 or 10,000 shares for agency orders.

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## Sequence of Messages

Under the new Trade-or-Move Rule, the sequence of Trade-or-Move Directed Orders will differ by market participant business model. The Rule has been changed to require ECNs to send a Trade-or-Move Directed Order before entering a locking/crossing quotation. The sequence procedures applicable to market makers will remain unchanged from the requirements under the current Rule: they are required to send a Trade-or-Move Directed Order immediately after entering a locking or crossing quote. The revised sequence applicable to ECNs, combined with the requirement to respond to a Trade-or-Move Directed Order within 10 seconds, should help ECNs avoid dual liability. The revised Rule will allow an ECN to send a Trade-or-Move Directed Order for the actual size of an agency order, wait 10 seconds for a response, and, assuming it receives no response, cancel the Trade-or-Move Directed Order and enter the agency order as a locking or crossing quote.

## Response Time

The time for responding to a Trade-or-Move Directed Order has been reduced to 10 seconds from 30 seconds. This reduced response time should help facilitate the prompt resolution of locked and crossed markets when they occur.

## Minimum Share Requirement

Under the current Trade-or-Move Rule, the aggregate size of the Trade-or-Move Directed Order must be for either at least 5,000 shares (*i.e.*, the market participant must send a total of 5,000 shares to all parties it is locking or crossing) in the case of a proprietary quote or the actual size of the agency order if that is the basis for the locking or crossing quote (the "agency exception"). The amended Rule will require a market participant handling a proprietary order to send a Trade-or-Move Directed Order for a minimum of 10,000 shares in the case of NASDAQ-100 and S&P-400 issues and will retain the 5,000-share minimum requirement for all other issues. The "agency exception" will continue to operate as it does today. This means that if a market participant is representing agency interest that locks or crosses the market, it is required to send a Trade-or-Move Directed Order for the size of the agency interest (not the full 5,000 or 10,000 shares). This new size requirement may deter the entering of locking or crossing quotations in securities that are characterized by higher liquidity and faster trading.

## SuperMontage Opening Process; How Trade-or-Move Interacts with New Opening Process

The SEC approved the new SuperMontage opening process on August 23, 2002. The new rules (1) permit the entry of market orders prior to 9:30 a.m., ET; (2) revise the time frame for the entry of Trade-or-Move Directed Orders to between 9:20 a.m. and 9:29:29 a.m., ET (from 9:29:59 a.m., ET); and (3) modify the SuperMontage opening process.

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Under the new opening process, starting at 9:29:30 a.m., ET, NASDAQ will resolve any outstanding locked and crossed markets. The system will pair off the most aggressively priced buy quote/order against the most aggressively priced sell quote/order. Once this "best-priced pair" is determined, the system will execute the two identified orders at the price of the newer order until the older order is fully satisfied. If the displayed size becomes exhausted at that price level, SuperMontage will continue to execute against available reserve size at that price level. This process will be repeated until an unlocked and uncrossed market results. After the initial locks/crosses are cleared, any additional locking or crossing quotes/orders entered between 9:29:30 and 9:29:59 a.m., ET, will be cleared consistent with the SuperMontage process for clearing locks and crosses applicable during regular market hours.

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## ATTACHMENT A

### Questions and Answers

Outlined below are a series of Questions and Answers. These Questions and Answers supplement the guidance provided in *NASD Notice to Members 00-29*.

#### General Obligations

1. **Q. When will the Trade-or-Move (“Trade-or-Move”) Rule amendments be implemented?**

A. The amendments will be implemented on a security-by-security basis at the same time that a security begins trading on SuperMontage<sup>SM</sup>. The current Trade-or-Move Rule obligations will continue to apply to all securities continuing to trade through SuperSoes<sup>SM</sup>.

2. **Q. After the launch of SuperMontage, must market participants still use SelectNet® to deliver Trade-or-Move Directed Orders during the 9:20 to 9:29:29 a.m., Eastern Time (ET), period?**

A. Market participants must use SuperMontage “Directed Orders” to deliver Trade-or-Move Directed Orders; they may not use any other system to comply with the Trade-or-Move Rule. (Note that the SuperMontage Directed Order Process is an enhanced version of SelectNet, and the Directed Order windows and messages on the NASDAQ Workstation II are still labeled as SelectNet.) Market participants will format Directed Orders in the same manner they format SelectNet Trade-or-Move Directed Orders. See Question 3 in *NASD Notice to Members 00-29* for further guidance.

3. **Q. What is the relationship between the rule amendments and the rule that currently governs pre-opening locks or crosses?**

A. The rule amendments will modify the current rule only as described in this *Notice*. Unless otherwise noted, all current obligations imposed under the rule will remain the same as described in *NASD Notice to Members 00-29* and related *NASDAQ Head Trader Alerts*.

4. **Q. What is the relationship between the approved rule amendments and the approved amendments to the SuperMontage opening?**

A. The amendments to the SuperMontage opening process revise the time frame for the entry of Trade-or-Move Directed Orders to conform to the changes in the opening process. The time frame for entering Trade-or-Move Directed Orders is now between 9:20 and 9:29:29 a.m., ET (as opposed to 9:29:59 a.m., ET). See discussion of the relationship between the Trade-or-Move Rule and the SuperMontage opening process, below.

5. **Q. How long does a market participant have to respond to a Trade-or-Move Directed Order?**

A. 10 seconds. The rule amendments reduce the response time from the current 30 seconds to 10 seconds.

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6. **Q. Must a Trade-or-Move Directed Order always include a minimum of 5,000 shares?**

A. No. For stocks included in the NASDAQ-100 Index® and the S&P MidCap 400 Index, a market maker or electronic communication network (ECN) must send a Trade-or-Move Directed Order(s) for at least 10,000 shares, unless the quote/order represents an agency order. Trade-or-Move Directed Orders for all other stocks must include a minimum of 5,000 shares, unless the quote/order represents an agency order. The "agency exception" contained in the Trade-or-Move Rule, which states that a market participant that is representing an agency order (as defined in the Rule) is required to send a Trade-or-Move Directed Order in an amount equal to the agency order, even if that order is less than 5,000/10,000 shares, will continue to operate as it does today.

7. **Q. How will market makers and ECNs know which securities are in the NASDAQ 100 and the S&P MidCap 400 Index?**

A. NASDAQ will post on *NASDAQtrader.com* a list of securities included in these indices and for which the obligation to send 10,000 shares exists. That list will be the official source of information with respect to this obligation, and will be published on the first day of every month. The list is available on *NASDAQtrader.com* under SuperMontage Hot Topics (General Section).

8. **Q. Can a market participant satisfy the minimum share requirement by sending two or more Trade-or-Move Directed Orders to two or more different quotes/orders?**

A. Yes, as long as the aggregate size of all Trade-or-Move Directed Orders equals the minimum share requirement.

9. **Q. If a market participant receives a Trade-or-Move Directed Order from an ECN, what are its options?**

A. The recipient can trade in full (i.e., fill the incoming Directed Order for the full size of the order), in which case it is not required to move its quote. Alternatively, if the recipient of a Trade-or-Move Directed Order does not trade in full, it is required to move to a price that would **both** not lock or cross the market, and is at a minimum \$0.01 away from the price of the inbound Trade-or-Move Directed Order from the ECN, because the ECN's quote has not yet been posted.

10. **Q. If a market participant receives a Trade-or-Move Directed Order from a market maker, what are its options?**

A. The recipient can trade in full, in which case it is not required to move its quote. Alternatively, if the recipient of a Trade-or-Move Directed Order does not trade in full, it is required to move to a price that would not lock or cross the market.

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## ECN Obligations

11. **Q. What are an ECN's options for entering a quote/order between 9:20:00 a.m. and 9:29:29 a.m., ET, that would lock/cross the market if displayed in NASDAQ during that period?**

A. **Before** entering a quote/order that would lock or cross the market, the ECN must send a Trade-or-Move Directed Order and wait **10** seconds for a response to that message. This requirement applies regardless of the type of locking/crossing quote or order (agency or principal) entered.

12. **Q. What are an ECN's obligations if, after it has sent a Trade-or-Move Directed Order and has waited 10 seconds, the recipient of the Trade-or-Move Directed Order has not traded in full or moved its quotation?**

A. If the recipient of a Trade-or-Move Directed Order does not respond properly and in a timely manner to a Trade-or-Move Directed Order sent by an ECN, the ECN must immediately enter its locking/crossing quote or order. After posting its locking/crossing quote or order, the ECN may then cancel the Trade-or-Move Directed Order. It would be inconsistent with the rule for an ECN to send a Trade-or-Move Directed Order and then fail to enter a locking/crossing quote in an attempt to manipulate the market.

13. **Q. What are an ECN's options after it has sent a Trade-or-Move Directed Order?**

A. If **all** the recipients of a Trade-or-Move Directed Order sent by an ECN

trade in full or move their quotes, an ECN may enter a new quote or order, but it would not be a locking/crossing quote or order. If **all** the recipients of a Trade-or-Move Directed Order sent by an ECN trade in full and do not move their quotes, and the ECN still wants to lock/cross the market, the ECN must send another Trade-or-Move Directed Order. If after 10 seconds fewer than all recipients trade in full, the ECN must enter its locking or crossing quotation.

## Market Maker Obligations

14. **Q. What are a market maker's obligations for entering a quote or order between 9:20:00 a.m. and 9:29:29 a.m., ET, that would lock or cross the market if displayed in NASDAQ during that period?**

A. Except as specified above (with respect to the aggregate size of a Trade-or-Move Directed Order[s]), market makers' obligations with respect to Trade-or-Move will not change. If a market maker wishes to enter a quote/order that would lock or cross the market, it must enter the locking or crossing quote/order and then immediately send a Trade-or-Move Directed Order for the appropriate number of shares.

15. **Q. If a market maker sends a Trade-or-Move Directed Order and the recipient does not respond to the message within 10 seconds, can the market maker cancel the Trade-or-Move Directed Order?**

A. Yes. A market maker may cancel a Trade-or-Move Directed Order it sends if it has waited the full 10 seconds and the receiving market participant has

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not responded. (Refer to Question 20 below for further discussion.) A market maker also may cancel a Trade-or-Move Directed Order before 10 seconds elapse if the recipient moves its quote to a non-locking/non-crossing price or the market otherwise unlocks.

### **Trade-or-Move Obligations to Orders Below a Market Maker's or an ECN's Top of File in a Multiple Order Environment**

The following two questions address a market participant's obligations where a market participant is displaying multiple levels of attributable orders below the market participant's top of file. These questions address how Trade-or-Move operates in an environment where a market maker may have several levels of orders in the system that could be locked or crossed.

16. **Q. If a market maker has orders in the SuperMontage book and receives a Trade-or-Move Directed Order at its quoted price and it executes all shares at that price, what obligations does the market maker have?**

A. The market maker must do one of two things:

(1) If the market maker has orders or summary quotes at multiple price levels (*i.e.*, orders below its top of file), and the actively crossing market maker sends a Trade-or-Move Directed Order priced **at** the passively crossed market maker's top of file, the passively crossed market maker does not have to cancel or move those summary quotes or orders against which the Trade-or-Move Directed Order is **not** marketable; it only has to execute at the price and quantity of the inbound Trade-or-Move Directed Order or it has

to move. Thus, if a market maker receives a Trade-or-Move Directed Order priced at its top of file, it only has to trade in full with the Trade-or-Move Directed Order, even though the system will publish its next best quote or order that is then locked or crossed, once the order(s) at the top of file is(are) exhausted.

For example, MMB wants to cross at \$19.95, so it enters the \$19.95 quote and sends MMA a Trade-or-Move Directed Order to sell at \$20.00 for 10,000 shares. MMA has the following buy orders on its book: 1,000 shares at \$20.00; 5,000 shares at \$19.99; and 6,000 shares at \$19.98. The shares at \$19.99 and \$19.98 are attributable but not displayed because they are below the top of its file. MMB is only obligated to send a sell order for 10,000 shares to the quoted price it sees: MMA at \$20.00. MMA must execute the full 10,000 shares of the Trade-or-Move Directed Order to maintain its \$20 bid. If MMA does not fully execute the Trade-or-Move Directed Order, it may partially execute the order at \$20 and remove its trading interest at \$20, or it may remove its trading interest at \$20 altogether. MMA will re-appear at \$19.99 for 5,000 shares, but it has no obligation to send a Trade-or-Move Directed Order. At this point, either party to the cross can (but is not obligated to) send a Trade-or-Move Directed Order.

(2) If the market maker has orders or summary quotes at multiple price levels (*i.e.*, orders below its top of file) and the actively crossing market maker sends a Trade-or-Move Directed Order priced **better than** the passively crossed market maker's top of file, then the passively crossed market maker is

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obligated to trade in full against the incoming Trade-or-Move Directed Order **or** move to a price that is not locking/crossing.

For example, MMB wants to cross at \$19.95, so it enters the \$19.95 quote and sends MMA a Trade-or-Move Directed Order to sell at \$19.95 for 10,000 shares. MMA has the following buy orders on its book: 1,000 shares at \$20.00; 5,000 shares at \$19.99; and 6,000 shares at \$19.98. The shares at \$19.99 and \$19.98 are attributable but not displayed because they are below the top of its file. MMA is **obligated** to execute 1,000 shares at \$20.00; 5,000 shares at \$19.99; and 4,000 shares at \$19.98, *i.e.*, all prices against which the inbound Trade-or-Move Directed Order is marketable, up to the size of the inbound Trade-or-Move Directed Order (here, 10,000 shares). If MMA does not trade in full, MMA must cancel all orders and quotes that are crossed and move its quote to (or establish a new quote at) \$19.94 (an uncrossed/unlocked price).

17. **Q. If a market maker is quoting only one price and does not have orders in the book and receives a Trade-or-Move Directed Order at its quoted price and it executes all shares at that price, what obligations does the market maker have?**

A. Nothing changes under this scenario. For example, MMA is quoting at \$20.00 for 1,000 shares and MMC is quoting at \$19.99 for 1,000 shares. MMB wants to cross at \$19.95, and MMB sends MMA a Trade-or-Move Directed Order at \$20.00 for 5,000

shares and MMC a Trade-or-Move Directed Order at \$19.99 for 5,000 shares. Here both MMA and MMC would be required to trade 5,000 shares at \$20.00 and \$19.99 respectively **or** move their quotes to a price below \$19.95.

### **Interaction Between Trade-or-Move, SIZE, and the SuperMontage Open**

18. **Q. If a market maker or ECN receives a Trade-or-Move Directed Order within the last 10 seconds before 9:29:30, ET (*i.e.*, at or after 9:29:20 a.m., ET), does the market maker or ECN still have the obligation to trade or move within 10 seconds?**

A. A market participant continues to have an obligation to respond timely to a Trade-or-Move Directed Order sent after 9:29:20 a.m. and before 9:29:29 a.m., ET. As noted in Question 21 below, however, at and after 9:29:30 a.m., ET, the receiving market participant should not accept the Trade-or-Move Directed Order.

19. **Q. How long is a market participant obligated to leave a Trade-or-Move Directed Order live before it may be cancelled?**

A. A market participant generally is required to leave a Trade-or-Move Directed Order live for 10 seconds. As noted in Question 20 below, a market participant may cancel a Trade-or-Move Directed Order at any time after 9:29:30 a.m., ET.



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20. **Q. May a market maker or ECN cancel a Trade-or-Move Directed Order at or after 9:29:30 a.m., ET, that is still “open”?**

A. Yes. Once the 9:29:30 a.m., ET, opening process begins, a market participant may cancel outstanding Trade-or-Move Directed Orders. Note, however, that a Trade-or-Move Directed Order—by system operation—cannot be canceled for 5 seconds (*i.e.*, the NASDAQ system will reject the cancellation unless the order has been live for 5 seconds). Thus, a market participant will have to wait 5 seconds after sending a Trade-or-Move Directed Order before a cancellation will be successfully processed by NASDAQ systems.

21. **Q. If a market maker locks or crosses the market at or after 9:29:25, ET, is the market maker required to send a Trade-or-Move Directed Order?**

A. Yes. However, since the SuperMontage opening process will unlock or uncross the market beginning at 9:29:30 a.m., ET, the recipient of a Trade-or-Move Directed Order may NOT accept a Trade-or-Move Directed Order at or after 9:29:30 a.m., ET. This is to ensure that the sender of a Trade-or-Move Directed Order does not receive an execution of the outstanding Trade-or-Move Directed Order while simultaneously receiving an execution of its locking/crossing quote through the SuperMontage opening process. (Note that this amends the guidance set forth in Question 2 to *NASD Notice to Members 00-29*, where NASD and NASDAQ explicitly state that an obligation to a Trade-or-Move Message carries over after the open; this will no longer be the case given the changes

to the SuperMontage Opening Process.) NASDAQ has submitted a proposed rule change to the SEC to establish that any trade executed after 9:29:30 a.m., ET, as a result of the receipt of a Trade-or-Move Directed Order may be broken (declared null and void) pursuant to the Clearly Erroneous Trade Rule (NASD Rule 11890) if a party submits an erroneous trade complaint.<sup>3</sup>

22. **Q. If an ECN wishes to lock or cross the market at or after 9:29:20 a.m., ET, what are its Trade-or-Move obligations?**

A. An ECN is required to send a Trade-or-Move Directed Order first, and wait 10 seconds before entering a locking or crossing quote. If the ECN does not receive a response by 9:29:29 a.m., ET, it may cancel the Trade-or-Move Directed Order and thereafter initiate a lock/cross. The system would resolve the resulting locked or crossed market at 9:29:30 a.m., ET (or thereafter) pursuant to the SuperMontage opening process.

23. **Q. If a market maker wishes to enter a quote or order into “SIZE” that would lock or cross another market participant between 9:20:00 a.m. and 9:29:29 a.m., ET, what are the market maker’s Trade-or-Move obligations? (See Question 25 for an ECN’s obligations.)**

A. A market maker that wishes to enter a locking or crossing quote or order into SIZE, must follow all rules that would be applicable to the entry of a locking or crossing quote or order under its own market participant identifier (MPID). Thus, a market maker wishing to lock or cross the market via SIZE during the Trade-or-Move period

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must, immediately after entering the locking or crossing quote/order into SIZE, send a Trade-or-Move Directed Order for the appropriate share amount to the market participant(s) it has locked or crossed or will lock or cross.

24. **Q. Does a market maker incur additional obligations by entering a locking or crossing quote or order into SIZE as opposed to its own MPID?**

A. Due to the anonymous nature of the SIZE MPID, and the resulting inability of other market participants to identify the entity with which to resolve a locked or crossed market, a market maker that elects to represent its trading interest in SIZE must comply with the following. If the market maker has locked/crossed the market using SIZE, it must send out the required Trade-or-Move Directed Order(s). If all recipients of a Trade-or-Move Directed Order trade in full and do not move their quotes to an unlocking/uncrossing position, a market maker that still wants to lock or cross the market via SIZE must send another Trade-or-Move Directed Order to the parties it has locked or crossed. A market maker that continues to actively lock or cross the market via SIZE must continue sending Trade-or-Move Directed Orders (every 10 seconds) until the locked or crossed market is resolved.

25. **Q. If an ECN wishes to enter a quote/order into SIZE that would lock or cross another market participant(s) between 9:20:00 a.m. and 9:29:29 a.m., ET, what are the ECN's Trade-or-Move obligations? (See Question 23 for a market maker's obligations.)**

A. An ECN wishing to actively lock or cross using the SIZE MPID during the Trade-or-Move period must, before entering a locking or crossing quote or order into SIZE, send a Trade-or-Move Directed Order to the market participant(s) it will lock or cross. If the recipient trades in full with the message and does not move its quote to an unlocking or uncrossing position, the ECN that wishes to actively lock or cross the market via SIZE must continue to send Trade-or-Move Directed Orders every 10 seconds to the parties it wishes to lock or cross. The ECN must continue to send Trade-or-Move Directed Orders until the potential locked or crossed market is resolved.

26. **Q. What are the Trade-or-Move obligations of a market participant that wishes to lock or cross the SIZE MPID?**

A. Since SuperMontage does not currently have the capability to route Trade-or-Move Directed Orders to individual entities represented in SIZE, a market participant that wishes to lock or cross the SIZE MPID has no obligation under the Trade-or-Move Rule with respect to orders that reside in SIZE. The market participant retains all other Trade-or-Move obligations to interact with attributed quotes or orders that it has locked or crossed or that it will lock or cross.

27. **Q. What are the Trade-or-Move obligations of a market participant that has entered a quote or order into SIZE that is thereafter locked or crossed by another market participant?**

A. The Trade-or-Move Rule does not require the market participant whose

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quote or order is locked to send a Trade-or-Move Directed Order. Similarly, if a market participant enters an order into SIZE prior to 9:20 that locks/crosses, there is no obligation to send a Trade-or-Move Directed Order either before or after 9:20 a.m., E.T.

NASDAQ does believe, however, that parties have an ongoing responsibility to monitor those orders and take reasonable steps to attempt to interact with displayed quotes/orders that lock/cross those orders. NASDAQ will closely monitor, and refer for regulatory review, market participants that routinely enter orders in SIZE and take no action to attempt to execute such orders despite clear indicia that other market participants are willing to execute at prices that would satisfy them.

## Endnotes

- 1 Securities Exchange Act Release No. 45990 (May 28, 2002), 67 FR 38535 (June 4, 2002) (File No. SR-NASD-2000-76).
- 2 Securities Exchange Act Release No. 46410 (August 23, 2002), 67 FR 55897 (August 30, 2002) (File No. SR-NASD-2002-56).
- 3 File No. SR-NASD-2002-123 (filed September 18, 2002).

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## ATTACHMENT B

### Text of Amended Rule (reflecting amendments to the Trade-or-Move Rule and the SuperMontage Opening Process)

#### 4613. Character of Quotations

(a) through (d) No Change.

#### (e) Locked and Crossed Markets

(1) A market maker shall not, except under extraordinary circumstances, enter or maintain quotations in NASDAQ during normal business hours if:

(A) through (B) No Change.

(C) Obligations Regarding Locked/Crossed Market Conditions Prior to Market Opening

(i) Locked/Crossed Market Prior to 9:20 a.m. — For locks/crosses that occur prior to 9:20 a.m. Eastern Time, a market maker that is a party to a lock/cross because the market maker either has entered a bid (ask) quotation that locks/crosses another market maker's quotation(s) or has had its quotation(s) locked/crossed by another market maker ("party to a lock/cross") may, beginning at 9:20 a.m. Eastern Time, send a Directed Order of any size that is at the receiving market maker's quoted price ("Trade-or-Move Directed Order"). Exception: A market maker that is a party to a lock/cross may not send such an order to the SIZE MPID.

(ii) Locked/Crossed Market Between 9:20 and 9:29:29 a.m. —

(a) Before an ECN enters a quote that would lock or cross the market between 9:20 and 9:29:29 a.m. Eastern Time, the ECN must first send a Trade-or-Move Directed Order to the market maker or ECN whose quote it would lock or cross that is at or superior to the receiving market maker's or ECN's quoted price. An ECN that sends a Trade-or-Move Directed Order during these periods must then wait at least 10 seconds before entering a quote that would lock or cross the market. Exception: An ECN is not required to send such an order to the SIZE MPID.

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(b) If a market maker enters a quote that would lock or cross the market between 9:20 and 9:29:29 a.m. Eastern Time, the market maker must then immediately send a Trade-or-Move Directed Order to the market maker or ECN whose quote it would lock or cross that is at or superior to the receiving market maker's or ECN's quoted price. Exception: A market maker is not required to send such an order to the SIZE MPID.

(c) If any market participant enters a quote that would lock or cross the market between 9:29:30 and 9:29:59, that quote will be processed as set forth in Rule 4710(b)(3)(B).

(iii) (a) In the case of securities included in the Nasdaq 100 Index or the S&P 400 Index, a Trade-or-Move Directed Order must be for at least 10,000 shares (if multiple market makers would be locked/crossed, each one must receive a Trade-or-Move Directed Order and the aggregate size of all such messages must be for at least 10,000 shares); provided, however, that if a market participant is representing an agency order (as defined in subparagraph (vi) of this rule), the market participant shall be required to send a Trade-or-Move Directed Order(s) in an amount equal to the agency order, even if that order is for less than 10,000 shares.

(b) In the case of all other securities, a Trade-or-Move Directed Order must be for at least 5,000 shares (if multiple market makers would be locked/crossed, each one must receive a Trade-or-Move Directed Order and the aggregate size of all such orders must be for at least 5,000 shares); provided, however, that if a market participant is representing an agency order (as defined in subparagraph (vi) of this rule), the market participant shall be required to send a Trade-or-Move Directed Order(s) in an amount equal to the agency order, even if that order is for less than 5,000 shares.

(iv) A market maker that receives a Trade-or-Move Directed Order must, within 10 seconds of receiving such message, either fill the incoming Trade-or-Move Directed Order for the full size of the order, or move its bid down (offer up) by a quotation increment that restores or maintains an unlocked/uncrossed market.

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(v) A market maker that sends a Trade-or-Move Directed Order pursuant to subparagraphs (e)(1)(C)(i) or (e)(1)(C)(ii)(b) of this rule, or an ECN that sends a Trade-or-Move Directed Order pursuant to subparagraph (e)(1)(C)(ii)(a) of this rule, must append to the order a NASDAQ-provided symbol indicating that it is a Trade-or-Move Directed Order.

(vi) No Change.

(2) No Change.

(3) Except as indicated in subsection (1)(C)(ii), for purposes of this rule, the term "market maker" shall include:

(A) through (D) No Change.

# Notice to Members

OCTOBER 2002

## SUGGESTED ROUTING

Internal Audit  
Legal & Compliance  
Municipal/Government Securities  
Operations  
Trading & Market Making

## KEY TOPICS

Holiday Trade Date—  
Settlement Date Schedule

## Trade Date—Settlement Date Schedule Veterans' Day and Thanksgiving Day

The schedule of trade dates-settlement dates below reflects the observance of the financial community of Veterans' Day, Monday, November 11, 2002, and Thanksgiving Day, Thursday, November 28, 2002. On Monday, November 11, The NASDAQ Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans Day. All securities markets will be closed on Thursday, November 28, 2002, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Reg. T Date*
Nov. 5	Nov. 8	Nov. 12
6	12	13
7	13	14
8	14	15
11	14	18
12	15	19
22	27	Dec. 2
25	29	3
26	Dec. 2	4
27	3	5
28	Markets Closed	—
29	4	6

02-72

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Note: November 11, 2002, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Transactions made on November 11 will be combined with transactions made on the previous business day, November 8, for settlement on November 14. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.



## Disciplinary Actions

### REPORTED FOR OCTOBER

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 September 2002.

### Firms and Individuals Fined

**Conseco Securities, Inc. (CRD #29367, Carmel, Indiana) and Carlos Guevera (CRD #1697335, Registered Principal, Hillsborough, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000 jointly and severally. The firm was also fined \$65,000. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Guevera, failed to establish, maintain, and enforce adequate written supervisory procedures regarding variable annuity transactions. The findings also stated that the firm failed to ensure that its offices of supervisory jurisdiction were subject to annual inspections, and a review of variable annuity sales revealed where there was no written evidence that a principal had reviewed the transaction. Furthermore, NASD found that the firm failed to maintain customer files for all of its variable annuity business and was unable to provide documentation for variable annuity sales. In addition, NASD found that the firm failed to obtain customer information concerning financial status, tax status, investment objectives, and other similar information necessary for making a suitability determination and conducting related supervisory reviews. **(NASD Case #C9B020058)**

**Elite Investments, LLC (CRD #42794, Greeley, Colorado) and John Brady Guyette (CRD #1711681, Registered Principal, Greeley Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm received customer complaints that were required to be reported to NASD but were not reported. The findings also stated that the firm, acting through Guyette, failed to establish, maintain, and enforce procedures reasonably designed to result in the tape recording of all conversations required to be taped and reviewed pursuant to NASD Rule 3010(b)(2). **(NASD Case #C3A020042)**

**First Montauk Securities Corp. (CRD #13755, Red Bank, New Jersey) and Herbert Kurinsky (CRD #276776, Registered Representative, Long Branch, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$25,000 jointly and severally. The firm was also fined \$20,000, required to pay \$17,293 in restitution to public customers, and required to update its written supervisory procedures to address deficiencies regarding its mutual fund procedures. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that

the firm, acting through Kurinsky, failed to establish, maintain, and enforce an adequate supervisory system and written supervisory procedures regarding its mutual fund business. The findings stated that the firm failed to reasonably supervise a former registered representative who was engaged in a pattern of unsuitable mutual fund recommendations to public customers. NASD found that the firm incorrectly reported the trader in National Market Securities (NMS), NASDAQ SmallCap<sup>SM</sup> and OTC securities to the Automated Confirmation Transaction<sup>SM</sup> service (ACT<sup>SM</sup>) and reported the incorrect modifier, incorrect price, incorrect volume, and incorrect capacity. Furthermore, NASD found that the firm failed to report trades to the Fixed Income Pricing System<sup>SM</sup> (FIPS<sup>SM</sup>) as required, and executed a customer order without using reasonable diligence to determine the best inter-dealer market for the relevant security so that the resultant price to the customer was as favorable as possible under prevailing market conditions. In addition, the findings stated that the firm failed to comply with Securities and Exchange Commission (SEC) Rule 17a-3, in that order tickets processed by the firm were not properly time-stamped. (NASD Case #C9B020053)

**Liss Financial Services (CRD #21950, Milwaukee, Wisconsin) and Jerome Edward Liss (CRD #310709, Registered Representative, Belgium, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$20,000 jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Liss, failed to timely file an amended Uniform Application for Securities Industry Registration or Transfer (Form U-4) on 30 separate occasions for nine registered representatives to report customer complaints, arbitration settlements, and arbitration awards. The findings stated that the firm, acting through Liss, failed to comply with the firm's reporting requirements, in that it failed to promptly report to NASD that the firm and persons associated with the firm were respondents in arbitrations which had been disposed of by awards and settlements in amounts exceeding \$25,000 against the firm, exceeding \$15,000 against the associated person, and were reported late. NASD found that the firm, acting through Liss, failed to timely report to NASD a customer complaint. In addition, the findings stated that the firm, acting through Liss, failed to timely report terminations and failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable rules of NASD in that the procedures failed to state the supervisory steps to ensure that amendments to Forms U-4 and Uniform Termination Notices for Security Industry Registration (Forms U-5) were timely and accurately filed, stated how often supervisory procedures should be performed, and stated how such supervisory procedures should be evidenced by the firm. (NASD Case #C8A020062)

## Firms Fined

**CIBC World Markets Corp. (CRD #630, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. 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 orders presented to the firm at its published bid or published 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, as a market maker in securities, locked/crossed the market during the pre-opening market period and failed to send immediately thereafter a Trade-or-Move message through SelectNet<sup>®</sup> to the market participant whose quote it locked or crossed that was priced at the receiving market participant's quoted price, and/or failed to send a Trade-or-Move message through SelectNet with an aggregate size of at least 5,000 shares to all market participants whose quotes it locked/crossed. NASD also found that the firm, as a market maker in securities, 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 #CMS020146)

**Divine Capital Markets LLC, f/n/a Level Jump Trading, Inc. (CRD #118212, 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 it failed to report the correct price of the transactions through ACT in last-sale reports of transactions in NASDAQ National Market<sup>®</sup> (NNM<sup>®</sup>), NASDAQ SmallCap, and OTC Equity Securities. In addition, NASD found that the firm failed to transmit through ACT last-sale reports of transactions in NNM and OTC Equity securities, and failed to display immediately customer limit orders in NASDAQ securities in its public quotation when each order was at a price that would have improved the firm's bid or offer in each security, or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each 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 security. The findings also stated that the firm reported customer short-sale transactions through ACT without a short-sale modifier, and executed short-sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. NASD also found that the firm, acting as principal, failed to disclose to customers that it was a market maker in the security, and failed to disclose the

reported trade price and the difference between the reported trade price and the price to a customer. (NASD Case #C06020010)

**GVR Company LLC (CRD #111528, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$75,000; required to pay \$1,644.20, plus interest, in restitution to public customers; and required to revise its written supervisory procedures concerning trade reporting, ACT compliance, best execution, Limit Order Protection Interpretation, books and records, SEC Order Execution Rules, One Percent Rule, 21(a) Report issues, transaction reporting, recordkeeping, locked and crossed markets, short sales, front running, anti-competitive practices, registration of traders and supervisors, and the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>). Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it 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 the firm's bid or offer in each such security. NASD also found that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NNM, NASDAQ SmallCap, OTC Equity and eligible securities, and failed to designate through ACT such last-sale reports as late. NASD also determined that the firm incorrectly designated as ".T" through ACT last-sale reports of transactions in OTC Equity, NNM, and SmallCap securities executed during normal market hours.

The findings also stated that the firm failed to accept or decline in ACT transactions in eligible securities within 20 minutes after execution; and as a market maker in securities, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market participants whose quotations would be locked or crossed, entered a bid or ask quotation in the NASDAQ Stock Market, Inc., which caused a locked or crossed market condition to occur in each instance. In addition, NASD determined 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. Furthermore, the findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations and the rules of NASD concerning trade reporting, ACT compliance, best execution, Limit Order Protection Interpretation, books and records, SEC Order Execution Rules, One Percent Rule, 21(a) Report issues, transaction reporting, recordkeeping, locked and crossed markets, short sales, front running, anti-competitive practices, registration of traders and supervisors, and OATS. (NASD Case #CMS020139)

**Hill, Thompson, Magid & Co., Inc. (CRD #2202, Jersey City, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$21,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it 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 also found that the firm incorrectly designated as ".PRP" through ACT last-sale reports of transactions in NNM and OTC Equity securities. The findings stated that the firm also failed to report to ACT transactions in NNM, NASDAQ SmallCap, and OTC equity securities with the correct media volume and the correct symbol indicating whether such transactions were effected as principal, riskless principal, or agency. In addition, NASD found that the firm executed short-sale transactions and failed to report each of these transactions to ACT with a short-sale modifier. Furthermore, the findings stated that the firm incorrectly accepted transactions in eligible securities in ACT without correcting the reporting firm's report to ACT that included an incorrect symbol indicating whether the firm executed the transactions in a principal or agency capacity. (NASD Case #CMS020157)

**HSBC Securities Inc. (CRD #19585, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures concerning firm quotations. 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 the securities, it failed to execute orders upon presentment and thereby failed to honor its published quotation. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning firm quotations. (NASD Case #CMS020140)

**Merrill Lynch, Pierce, Fenner & Smith, Inc. (CRD #7691, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$65,000, and required to provide to NASD within 60 days a copy of the firm's written procedures regarding the accurate and prompt submission of all Form U-5 filings pertaining to the termination of persons for whom the firm has maintained a registration with NASD, indicating the name and title of the principals responsible. The firm is also required for one year to continue the firm's ongoing review of its current policies and procedures relevant to the reporting of terminations on Forms U-5, and to prepare and submit semi-annual reports to NASD that set forth the findings of the review and any corrective actions implemented. In addition, the firm will submit to NASD for one

year semi-annual summary reports outlining the details of every late Form U-5 filing pertaining to the termination of a person for whom the firm maintained a registration, if any, made within the prior six months with an explanation of the cause of delay, the principal responsible for ensuring the timely filing of the Forms U-5 in question, and any corrective action taken. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm failed to file Forms U-5 within 30 days of termination of the associated person. (NASD Case #C10020077)

**Murphy & Durieu (CRD #6292, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NNM securities. (NASD Case #CMS020148)

**Phillip Louis Trading, Inc. (CRD #19378, Red Bank, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$20,000, and required to revise its written supervisory procedures concerning SEC and NASD firm quote and trade-reporting 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 orders upon presentment and thereby failed to honor its published quotation. NASD also found that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NNM, NASDAQ SmallCap, and OTC equity securities, and failed to designate through ACT such last-sale reports as late. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning SEC and NASD firm quote and trade-reporting rules. (NASD Case #CMS020149)

**ProTrader Securities Corporation (CRD #35233, Austin, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000, and required to revise its written supervisory procedures concerning OATS. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to submit to OATS required information on 19 business days during the review period. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and the rules of NASD concerning OATS. (NASD Case #CMS020152)

**Raymond James Financial Services, Inc. (CRD #6694, St. Petersburg, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm

consented to the described sanctions and to the entry of findings that it failed to report statistical and summary information concerning customer complaints. (NASD Case #C07020068)

**RBC Dain Rauscher Inc. (CRD #31194, Minneapolis, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$35,000. 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 caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation that locked/crossed another market maker's quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quote(s) it locked or crossed a Trade-or-Move Message(s) 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, as a market maker in securities, 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. The findings also stated that the firm, as a registered market maker in securities, failed to execute orders upon presentment and thereby failed to honor its published quotation. (NASD Case #CMS020138)

**SWS Securities, Inc. (CRD #6220, Dallas, Texas)** 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, as a market maker in securities, it locked/crossed the market during the pre-opening market period and failed to immediately thereafter send a Trade-or-Move Message through SelectNet to the market participant whose quote it locked or crossed that was priced at the receiving market participant's quoted price; and/or failed to send a Trade-or-Move Message(s) through SelectNet with an aggregate size of at least 5,000 shares to all market participants whose quotes it locked/crossed. (NASD Case #CMS020155)

## Individuals Barred or Suspended

**Harry Michael Anthony (CRD #2356706, Registered Representative, Belle Vernon, Pennsylvania)** 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 10 business days, required to pay \$1,600 in disgorgement of commissions, and required to pay \$1,375 in restitution to public customers. In addition, Anthony will attend sales-practice training with an emphasis on mutual fund-related issues. The fine must be paid before Anthony

reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Anthony consented to the described sanctions and to the entry of findings that he made unsuitable mutual fund recommendations to his member firm's customers and engaged in short-term trading in a customer's account. The findings also stated that Anthony engaged in unsuitable switching by recommending that a customer switch from Class A shares to Class B shares in different fund families. NASD determined that these recommendations were unsuitable because there were funds within a family of funds that were sold with investment objectives and holdings comparable to the funds that were purchased. The findings stated that the customer could have taken advantage of "free exchanges" within his existing funds at no additional cost. Instead, the customer incurred higher fees and a contingent deferred sales charge period while Anthony received a full commission on each new purchase. In addition, NASD determined that Anthony effected transactions in the account of a public customer without obtaining prior written authorization from the customer and written acceptance of the account as discretionary by his member firm.

Anthony's suspension began October 7, 2002, and will conclude at the close of business October 18, 2002. (NASD Case #C9B020057)

**Chad Michael Arnholt (CRD #2632682, Registered Representative, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for six months. In light of the financial status of Arnholt, no monetary sanctions have been imposed. Without admitting or denying the allegations, Arnholt consented to the described sanction and to the entry of findings that he engaged in outside business activities and failed to provide prompt written notice to his member firm.

Arnholt's suspension began September 16, 2002, and will conclude March 15, 2003. (NASD Case #C8A020059)

**Connie Jenkins Baker (CRD #4347863, Associated Person, Villa Rica, Georgia)** submitted an Offer of Settlement in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid immediately upon reassociation with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Baker consented to the described sanctions and to the entry of findings that she willfully failed to disclose material facts on a Form U-4. The findings also stated that Baker failed to respond timely to NASD requests for documents and information.

Baker's suspension began September 16, 2002, and will conclude March 15, 2003. (NASD Case #C07020048)

**Rebecca Susan Barnard (CRD #1342721, Registered Representative, Tucson, Arizona)** 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, Barnard consented to the described sanction and to the entry of findings that she obtained \$566,000 by borrowing funds against insurance policies in the name of another person and retaining such funds for her personal benefit. (NASD Case #C3A020045)

**Jordan Robert Belkin (CRD #2955234, Registered Representative, New York, New York)** 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 requalify by exam as a general securities representative. In light of the bankruptcy filing, no monetary sanction has been imposed. Without admitting or denying the allegations, Belkin consented to the described sanctions and to the entry of findings that he engaged in a pattern of unsuitable mutual fund recommendations to public customers. NASD found that Belkin failed to ensure that his customers obtained the benefit of breakpoints, mutual fund promotions, and rights of accumulations to lower transaction costs; engaged in unsuitable switching by failing to utilize free exchanges; and engaged in unsuitable short-term trading in customer accounts. The findings also stated that Belkin failed to disclose to certain customers cost-savings available through letters of intent, breakpoints, and rights of accumulation. NASD determined that as a result of Belkin's recommendations, the customers incurred unnecessary charges totaling \$35,000, while Belkin generated an additional \$20,000 in commissions for himself.

Belkin's suspension began September 16, 2002, and will conclude June 15, 2003. (NASD Case #C9B020054)

**Gary Wilson Brown (CRD #1923682, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Brown reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he solicited a \$15,000 loan from a public customer and entered into a written loan agreement with the customer without having a reasonable basis for believing that he could repay the loan pursuant to the terms of the loan agreement. The findings also stated that Brown completed a form entitled "Annual Regulatory Field Instruction" wherein he represented to his member firm that he had not borrowed money from a customer, but such representation was false.

Brown's suspension began September 16, 2002, and will conclude at the close of business September 15, 2004. (NASD Case #C05020041)

**David Richard Carey (CRD #2077949, Registered Principal, Oglesby, Illinois)** 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, Carey consented to the described sanction and to the entry of findings that he received \$5,700 from public customers to purchase shares of a fund for custodial securities accounts. NASD found that Carey failed to follow the customers' instructions and used the funds for some purpose other than the benefit of the custodial customers. The findings also stated that Carey failed to respond fully to NASD requests for documents and information. (NASD Case #C8A020024)

**Cathy Lynn Cerullo (CRD #1923993, Registered Representative, Tampa, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Cerullo forged the signature of a public customer in order to effect the unauthorized disbursement of the customer's variable annuity account and failed to respond to NASD requests for information. The findings also stated that Cerullo engaged in the unauthorized disbursement of the account of a public customer by submitting a request to her member firm to close a customer's annuity account and disburse the funds to the customer, without the consent of the customer. NASD found that the customer negotiated the check and sent a new check to Cerullo who used the funds to open a new mutual fund IRA account for the customer rather than restoring the original account, thereby receiving \$13,986.07 in commissions, but causing the customer to lose the annuity benefits associated with his original annuity and to be subject to a new contingent deferred sales charge. (NASD Case #C07020010)

**Fanglun Michael Chai (CRD #3093902, Registered Representative, Bronx, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Chai made unsuitable recommendations to a public customer and engaged in excessive trading in the customer's account based on the customer's financial situation. The findings also stated that Chai executed discretionary transactions in the account of a public customer without obtaining the customer's written authorization or his member firm's written acceptance of the account as discretionary. (NASD Case #C10020010)

**Yenden Ann Chan (CRD #2237797, Registered Representative, Potomac, Maryland)** 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, Chan consented to the described sanction and to the entry of findings that she failed to respond to an NASD request to testify. (NASD Case #C9A020037)

**Lawrence Paul Chielli (CRD #2835012, Registered Representative, Middletown, 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, Chielli consented to the described sanction and to the entry of findings that he received a \$2,000 check from a public customer with instructions to purchase various shares of a common stock, and subsequently, the customer instructed Chielli to sell such shares. The findings stated that Chielli misrepresented to the customer that he had effected such transactions, although he was aware that no such transactions had ever occurred. In furtherance of the foregoing misrepresentations, Chielli provided the customer with fictitious account statements that reflected transactions that had never occurred. Subsequently, when the customer requested that some of the profits be forwarded to him, Chielli sold shares of a mutual fund that the customer owned without the customer's prior knowledge, authorization, or consent. In addition, NASD found that Chielli failed to respond to NASD requests for information. (NASD Case #C9B020059)

**Ronald Jay Clifton (CRD #1637760, Registered Principal, Odessa, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Clifton consented to the described sanction and to the entry of findings that he participated in a private securities transaction without providing prior notice, written or otherwise, to his member firm, and that he did not notify his member firm whether he had received, or might receive, selling compensation in connection with this transaction. The findings also stated that Clifton failed to respond to NASD requests for information and to appear for testimony. (NASD Case #C06020009)

**Ted Frederick Cook (CRD #852995, Registered Representative, Buffalo, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Cook received a \$7,000 check from an insurance customer for the purchase of a long-term care insurance policy and converted the funds for his own purposes. The findings also stated that Cook failed to respond to NASD requests for information. (NASD Case #C8B020010)

**Michael Coyle (CRD #2728846, Registered Representative, Brooklyn, New York)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Coyle consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U-4.

Coyle's suspension began September 3, 2002, and will conclude March 2, 2003. (NASD Case #C10020078)

**Cornelius L. Cu (CRD #2639850, Registered Principal, Hillsborough, California)** was barred from association with any NASD member in any capacity. The sanction is based on findings that Cu failed to respond to NASD requests for information. NASD also found that Cu opened a joint securities account, failed to provide written notice to his member firm of the existence of an account at another member firm, and failed to provide written notice to the other member firm of his registration with a member firm. The findings also stated that Cu purchased shares of an initial public offering (IPO) that traded at a premium in the secondary market and was considered a "hot issue" in violation of the Free-Riding and Withholding Interpretation. (NASD Case #C10020028)

**Gary Lewis Davis (CRD #2547665, Registered Representative, Bella Vista, Arkansas)** 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, Davis consented to the described sanctions and to the entry of findings that he maintained an account with a member firm over which he had discretionary authority without providing written notification to his member firm.

Davis' suspension began October 7, 2002, and concluded at the close of business October 11, 2002. (NASD Case #C05020043)

**Robert Andrew DiCarlo, Jr. (CRD #2837475, Registered Representative, Boca Raton, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that DiCarlo failed to respond to NASD requests for information. The findings also stated that DiCarlo executed trades in the accounts of public customers without obtaining authorization from the customers. (NASD Case #C07020012)

**Alfred Ward Dietrich (CRD #2137806, Registered Representative, Tampa, Florida)** 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, Dietrich consented to the described sanction and to the entry of findings that he forged the signature of a public customer on documents. (NASD Case #C07020057)

**Richard E. Dirickson, Jr. (CRD #68537, Registered Representative, San Francisco, California)** 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. The fine must be paid before Dirickson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Dirickson consented to the described sanctions and to the entry of findings that he executed transactions in a security, at or near the close of the market, for the purpose of affecting the reported closing last-sale price in the security.

Dirickson's suspension began September 16, 2002, and will conclude at the close of business October 15, 2002. (NASD Case #CMS020145)

**Edward Allan Fennell (CRD #3126627, Registered Representative, Dublin, Ohio)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Fennell received \$4,901.53 from public customers for the purchase of a variable annuity and a mutual fund, failed to use the funds as directed, and, instead, used the funds for his own benefit. The findings also stated that Fennell failed to respond to NASD requests for information. (NASD Case #C8B020009)

**Demetrius Donnell Ford (CRD #2540188, Registered Principal, Margate, Florida)** submitted an Offer of Settlement in which she was fined \$5,000, suspended from association with any NASD member in any capacity for 30 days, suspended from association with any NASD member in all principal capacities for one year, and ordered to requalify by exam prior to being registered in any principal capacity. The fine must be paid immediately upon reassociation with a member firm following the 30-day suspension in any capacity or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ford consented to the described sanctions and to the entry of findings that she supervised the sales force of her member firm in connection with private placement offerings, and distributed lead cards to the firm's representatives to enable them to sell the offerings in general solicitation although it was prohibited in the offerings. The findings stated that Ford failed to supervise the firm's representatives with a view to preventing violations of Section 5 of the Securities Act of 1933.

Ford's suspension in any capacity began September 16, 2002, and will conclude at the close of business October 15, 2002. Ford's suspension in any principal capacity began September 16, 2002, and will conclude at the close of business September 15, 2003. (NASD Case #C07020044)

**Wanda Teresa Foster (CRD #2261834, Registered Supervisor, Tacoma, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Foster consented to the described sanction and to the entry of findings that she received customer checks sent to her member firm for deposit to their brokerage accounts, deposited the checks in the firm's bank account, and failed to credit the appropriate amounts to the customers' accounts. The findings also stated that Foster diverted a portion of the customers' funds into her own account at the firm, thereby converting the customers' funds to her own use and benefit, without the customers' knowledge, authorization, or consent. (NASD Case #C3B020016)

**Brian Abraham Fried (CRD #2659427, Registered Representative, Smithtown, New York)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Fried consented to the described sanctions and to the entry of findings that he exercised discretionary authority in the joint account of public customers without obtaining their prior written authorization and without his member firm's prior written acceptance of the account as discretionary. The findings also stated that Fried prepared a letter and submitted it to his member firm that requested an address change for a public customer that the customer did not authorize, sign or authorize Fried to sign on his behalf. In addition, the findings stated that Fried forged the customer's signature on the letter, provided the falsified letter to his member firm, and had the customer's account documentation forwarded to a post office box without the customer's knowledge, authorization, or consent. NASD also found that Fried failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C10020066)

**Jianqiang Jeffrey Fu (CRD #3190303, Registered Representative, Silver Spring, Maryland)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Fu altered a monthly accounting statement of a public customer by changing the account number, tax ID number, name, and address to reflect his own account number, tax ID number, name, and address, and submitted the altered statement to a bank in connection with a personal loan application. The findings also stated that Fu failed to respond to NASD requests for information. (NASD Case #C07020008)

**Peter Jonathan Glaser (CRD #2504182, Registered Representative, Halandale, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and ordered to pay \$21,400, plus interest, in restitution to public customers. Restitution must be paid before Glaser requests any relief from any statutory disqualification. Without admitting or denying the allegations, Glaser consented to the described sanctions and to the entry of findings that, in connection with solicitations to public customers, he intentionally and/or recklessly made representations that were material, false, and made without any reasonable basis. The findings also stated that Glaser effected securities transactions away from his member firm and failed to provide written notification to, or obtain written approval from, his member firm. (NASD Case #C10020080)

**Dale Edward Groce (CRD #2869325, Registered Representative, Glenshaw, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500, suspended from association with any NASD member in any capacity for 10 business days, and required to pay \$18,800 in disgorgement of commissions. Groce also will attend sales practice training. Without admitting or denying the allegations, Groce consented to the described sanctions and to the entry of

findings that he made unsuitable mutual fund recommendations to his member firm's customers. NASD found that Groce recommended that customers switch from Class A to Class B shares in different fund families. The findings stated that these recommendations were unsuitable because there were funds within the family of funds that were sold with investment objectives and holdings comparable to the funds that were purchased. As a result, customers could have taken advantage of "free exchanges" within their existing funds at no additional cost. Instead, the customers incurred higher fees and a contingent deferred sales charge period, while Groce received a full commission on each new purchase. In addition, NASD found that Groce also failed to take advantage of a promotion by one mutual fund family that was offering discounted sales charges and lower contingent deferred sales charges on certain shares, and received additional commissions through the unsuitable recommendations.

Groce's suspension began September 16, 2002, and concluded at the close of business September 27, 2002. (NASD Case #C9B020056)

**William Augusta Hardy (CRD #1283999, Registered Representative, Delaware, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hardy consented to the described sanction and to the entry of findings that he engaged in private securities transactions away from his member firm, and failed to provide his firm with detailed written notice of the transactions and his role therein and to receive permission from the firm to engage in the transactions. (NASD Case #C8B020017)

**Jeffrey Joseph Hiser (CRD #2750883, Registered Principal, Las Vegas, Nevada)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from acting as a financial and operations principal with any NASD member for nine months, and required to requalify by examination as a financial and operations principal. In light of the financial status of Hiser, the fine imposed is \$10,000. Without admitting or denying the allegations, Hiser consented to the described sanctions and to the entry of findings that acting on behalf of a member firm, he used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities when they failed to maintain the minimum required net capital. The findings stated that Hiser, acting on behalf of a member firm, prepared inaccurate trial balances and net capital computations. NASD also found that Hiser, acting on behalf of a member firm, filed NASD FOCUS Part IIA reports, which were inaccurate in that, among other things, the reports overstated the firm's net capital.

Hiser's suspension began October 7, 2002, and will conclude July 6, 2003. (NASD Case #C8A020058)



**Sarah Jean Howard (CRD #2468812, Registered Representative, Detroit, Michigan)** 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, Howard consented to the described sanction and to the entry of findings that she willfully failed to disclose material facts on a Form U-4. (NASD Case #C8A020055)

**James Calvin Hulsey, III (CRD #1401945, Registered Representative, Tuscaloosa, Alabama)** 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, Hulsey consented to the described sanction and to the entry of findings that he executed unauthorized stock transactions in the accounts of public customers without the customers' knowledge or consent. The findings also stated that Hulsey failed to respond to NASD requests for information. (NASD Case #C05020040)

**Darryl Spencer Johnson (CRD #4308064, Registered Representative, Prairie View, Texas)** was fined \$2,500 and suspended from association with any NASD member in any capacity for 30 business days. The sanctions were based on findings that Johnson failed to disclose a material fact on his Form U-4.

Johnson's suspension began August 19, 2002, and concluded at the close of business September 30, 2002. (NASD Case #C05020009)

**Howard Michael Johnson (CRD #1353976, Registered Representative, Philomath, Oregon)** was barred from association with any NASD members in any capacity. The sanction was based on findings that, at Johnson's request, a public customer wrote checks on his account totaling approximately \$130,000 to third parties designated by Johnson, including relatives, other customers that had loaned money to Johnson, and other creditors. The findings also stated that Johnson forged the signature of a public customer on letters of authorization submitted to his member firm that purportedly authorized his firm to transfer funds totaling approximately \$150,000 from the customer's account to the account of another public customer. In addition, NASD found that Johnson failed to respond to NASD requests for information. (NASD Case #C3B020008)

**Phung M. Le (CRD #3274440, Registered Representative, Springfield, Massachusetts)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Le forged public customers' signatures on traditional life insurance death benefit checks and deposited the checks into bank accounts for his own use and benefit. (NASD Case #C11020011)

**Lawrence Ronald Legind (CRD #2830571, Registered Representative, Corona Del Mar, California)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Legind engaged in private securities transactions and failed to provide prior written notice to, and receive written permission from, his member firm. The findings also stated that Legind guaranteed customers against loss. (NASD Case #C02010062)

**Alfred Milton Lemcke, III (CRD #2404501, Registered Representative, Hingham, Massachusetts)** 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 \$775,000, plus interest, in restitution to public customers. The restitution amount must be paid before Lemcke reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lemcke consented to the described sanctions and to the entry of findings that he received \$775,000 from public customers, which, without their knowledge or consent, he misappropriated for his own use and benefit. The findings stated that Lemcke obtained the aforementioned customers' funds by falsely representing to customers that he would invest their money in various stocks, mutual funds, and other securities through a purported financial services company, and subsequently provided the customers with periodic false statements reflecting that their investments were generating substantial returns. (NASD Case #C11020034)

**George Michael Loughry (CRD #1241921, Registered Representative, Greensburg, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500, suspended from association with any NASD member in any capacity for 10 business days, and required to disgorge \$4,250 in commissions received. In addition, Loughry will attend sales practice training with an emphasis on mutual fund issues. The fine must be paid before Loughry reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Loughry consented to the described sanctions and to the entry of findings that he made unsuitable mutual fund recommendations to his member firm's customers. NASD found that Loughry recommended that customers switch from Class A shares to Class B shares in different fund families. NASD determined that these recommendations were unsuitable because there were funds within a family of funds that were sold with investment objectives and holdings comparable to the funds that were purchased. The findings stated that, as a result, the customers could have taken advantage of "free exchanges" within their existing funds at no additional cost; instead, the customers incurred higher fees and a contingent deferred sales charge period while Loughry received a full commission.

Loughry's suspension began September 16, 2002, and concluded at the close of business September 27, 2002. (NASD Case #C9B020055)

**Reza H. Mahini (CRD #2040798, Registered Representative, Bell Canyon, 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, Mahini consented to the described sanction and to the entry of findings that he obtained possession of \$581,734.66 in checks payable to a public customer and, without the customer's approval, knowledge, or consent, forged the customer's signature endorsement to each check and deposited the same into his own personal bank account, thereby converting the funds to his own use and benefit. (NASD Case #C02020042)

**Todd Andrew Marley (CRD #2392933, Registered Representative, Lawrence, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Marley consented to the described sanction and to the entry of findings that he engaged in securities transactions outside the normal course or scope of his association with his member firm and failed to provide prior written notice to his member firm.

Marley's suspension began October 7, 2002, and will conclude at the close of business January 6, 2003. (NASD Case #C9A020038)

**Paulette Marlene McDermott (CRD #2410863, Registered Representative, Cincinnati, Ohio)** 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, McDermott consented to the described sanction and to the entry of findings that she signed the names of members of the public to life insurance policy change application forms without their knowledge or consent. (NASD Case #C8B020016)

**Robin Bruce McNabb (CRD #1016598, Registered Principal, San Jose, California)** was censured, fined \$50,000, and barred from association with any NASD member in any capacity. The United States Court of Appeals affirmed the sanctions following appeal of an October 2000 SEC decision. The sanctions were based on findings that McNabb participated in private securities transactions without giving prior written notification to his member firm. In addition, McNabb recommended to public customers the purchase of securities without having reasonable grounds for believing that the investments were suitable for the customers in light of the facts disclosed by the customers as to their other securities holdings, financial situation, and needs. (NASD Case #C01970021)

**Richard Joseph Monello (CRD #1644006, Registered Principal, Irving, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association in a principal or supervisory capacity for two weeks. Without admitting or denying the allegations, Monello consented to the described sanction and to the entry of findings

that, as the direct supervisor of a branch office of a member firm, he failed to supervise a representative with regard to materials posted on Web sites, and failed to approve, before use, the material posted on the Web sites.

Monello's suspension began October 7, 2002, and will conclude October 20, 2002. (NASD Case #CAF020031)

**Louis Michael Montaino (CRD #2570300, Registered Representative, Middle Village, New York) and Michael Robert Marcus (CRD #2291751, Brooklyn, New York)** submitted an Offer of Settlement in which Marcus was fined \$20,000 and suspended from association with any NASD member in any capacity for eight months. Montaino was suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange, knowingly or recklessly employed manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities; knowingly or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent devices or contrivances; or made untrue statements of material fact and omitted to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

The findings also stated that Marcus arranged for his girlfriend to purchase shares of stock for her account at a steep discount to the prevailing market price, began placing day limit purchase orders for shares of stock with a market maker to create the appearance of interest and activity in the stock, and placed all stock purchased into the firm's proprietary account. NASD also found that Marcus knew he was participating in the manipulation of the stock; knew, or was reckless in not knowing, that the inside bid was increasing during the time he placed his limit orders; and knew that the market maker with whom he was placing the limit orders held the inside bid most of the time and that there was virtually no volume passing over the ticker in this security other than that created by the limit orders. In addition, NASD found that Montaino and another broker with whom he shared a registered representative number solicited public customers to purchase the stock, failed to disclose material risks, and fraudulently misled investors in connection with their decision to purchase and sell the common stock. Furthermore, the findings stated that Montaino solicited and obtained customer orders for purchases of the stock and held the orders for execution without authorization from the customers until Marcus filled the orders with shares held in inventory by their member firm, thereby realizing approximately \$1,900,000 in illicit profits for the firm. Moreover the findings stated that Marcus sold the shares of stock in his girlfriend's account, realizing approximately \$29,000 in illicit profits for the account.

Montaino's suspension began September 16, 2002, and will conclude March 15, 2003. Marcus' suspension began September 16, 2002, and will conclude at the close of business May 15, 2003. (NASD Case #CAF010025)

**James Brian Moran (CRD #1180416, Registered Representative, Basking Ridge, New Jersey)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. The sanctions were based on findings that Moran engaged in outside business activity without providing his member firm with prompt written notice.

Moran's suspension began September 16, 2002, and concluded at the close of business September 27, 2002. (NASD Case #C9B010041)

**Martin P. O'Malley (CRD #4417124, Registered Representative, Fitchburg, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before O'Malley reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, O'Malley consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U-4.

O'Malley's suspension began September 16, 2002, and will conclude December 15, 2002. (NASD Case #C11020033)

**Alexander Osterneck (CRD #1663321, Registered Representative, Palm Beach, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Osterneck failed to respond timely to NASD requests for information and to appear for an on-the-record interview. (NASD Case #C9A010006)

**Jonathan Goodwin Page (CRD #1054190, Registered Representative, Memphis, 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, Page consented to the described sanction and to the entry of findings that he engaged in outside business activities without providing written notice to, and obtaining proper approval from, his member firm. (NASD Case #C05020045)

**Peter Faris Peck (CRD #1019018, Registered Representative, Heyworth, Illinois)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and required to offer, in restitution to a public customer, to repurchase the customer's membership interest in the amount of \$25,000. Without admitting or denying the allegations, Peck consented to the described sanctions and to the entry of findings that he engaged in outside business activities and failed and neglected to provide prompt written

notice to his member firm. The findings stated that Peck participated in private securities transactions, and failed and neglected to provide prior written notice to, and obtain prior written authorization from, his member firm to engage in such transactions. NASD also found that Peck, by the use of instrumentalities of interstate commerce or the mails, intentionally or recklessly employed devices to defraud public customers and engaged in a course of business that operated as a fraud or deceit upon the customers by making untrue statements of material facts and/or omitting to state material facts necessary to make untrue statements made in light of the circumstances in which they were made not misleading, in connection with the purchase of a security that he sold to customers. In addition, the findings stated that Peck wrote, or caused to be issued checks totaling \$68,100 from the bank account of a company, deposited the checks into his personal bank account, and converted the funds for his own use and benefit without the knowledge or consent of the company. Furthermore, NASD found that Peck, without prior notice to his member firm, accepted \$14,349 in funds from public customers to be invested but instead used such funds to purchase shares of stock for his own personal securities account maintained at his member firm, thereby converting the funds to his own use and benefit, and failed to respond to NASD requests for information. (NASD Case #C04020010)

**Bill Plakos a/k/a William Plagianakos (CRD #3221829, Registered Representative, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Plakos reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Plakos consented to the described sanctions and to the entry of findings that he effected transactions in the account of a public customer without obtaining prior written authorization from the customer to exercise discretion or without having the account accepted in writing as a discretionary account by his member firm.

Plakos' suspension began October 7, 2002, and will conclude at the close of business October 18, 2002. (NASD Case #C10020086)

**Todd Michael Rome (CRD #2082803, 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, Rome consented to the described sanction and to the entry of findings that acting on behalf of his member firm, he employed a statutorily disqualified person in various capacities and after being informed by NASD of the person's disqualification, entered into a Consulting Agreement with the person knowing that the person was a statutorily disqualified person. The findings stated that Rome, acting on

behalf of his member firm, permitted a registered individual to be employed in capacities and perform functions that required registration with NASD. In addition, NASD found that Rome, in the exercise of reasonable supervision, failed to take appropriate steps to detect and prevent the conduct of registered representatives concerning customer claims and/or complaints alleging unauthorized transactions. (NASD Case #C04020029)

**Stanley Lynn Scanlon (CRD #1171669, Registered Representative, Edinboro, Pennsylvania)** 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, Scanlon consented to the described sanction and to the entry of findings that he engaged in securities transactions outside the scope of his employment with his member firm and failed to provide his member firm with prior written notice of his participation in the transactions. The findings also stated that Scanlon failed to respond, and to respond timely and completely, to NASD requests for information and documents. (NASD Case #C9A020036)

**Daniel Richard Schmidt (CRD #2652062, Registered Representative, Newport Beach, 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, Schmidt consented to the described sanction and to the entry of findings that he signed public customers' names to Contribution Change Forms (CCFs) without their authorization, knowledge, or consent, and submitted them to his member firm requesting an increase in the customers' 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)

**Trevor Douglas Seffren (CRD #2410677, Registered Representative, Aventura, Florida)** submitted an Offer of Settlement in which he was fined \$10,000, suspended from association with any NASD member in any capacity for one year, and required to requalify by exam as a general securities representative prior to acting in any capacity requiring that registration. The fine must be paid before Seffren reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Seffren consented to the described sanctions and to the entry of findings that he failed to respond timely to NASD requests for information.

Seffren's suspension began August 6, 2001, and concluded at the close of business August 5, 2002. (NASD Case #C07010005)

**Patricia Ann Schaffer (CRD #3171723, Registered Representative, Middletown, Delaware)** submitted a Letter

of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Schaffer consented to the described sanction and to the entry of findings that, while working as a teller with an affiliate bank of her member firm, she issued a \$1,500 cashier's check payable to herself without providing funds to pay for the check. The findings also stated that to later fund the check, Schaffer withdrew \$1,500 from a public customer's bank account without the customer's authorization or consent. (NASD Case #C9A020040)

**Michelle Stephanie Sias (CRD #1214291, Registered Representative, Ft. Lauderdale, Florida)** 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, Sias consented to the described sanction and to the entry of findings that, in response to a public customer who had demanded the cancellation of an allegedly unauthorized trade, she falsified an internal memorandum, a computer printout, and a customer account statement and provided them to the customer to create the appearance that the trade had been canceled when in fact it had not been canceled. (NASD Case #C07020069)

**VictoriaAnn Sperbeck (CRD #1413447, Registered Principal, Stockton, California)** was barred from association with any NASD member in any capacity for failure to respond to NASD requests for information. Sperbeck also failed to disclose material information on an amended Form U-4. (NASD Case #C01020008)

**Scott Donald Sprandel (CRD #2291857, Registered Representative, Flossmoor, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Sprandel consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in the securities accounts of public customers and exercised discretionary power in the accounts without prior written authorization from the customers or acceptance in writing by his member firm of the account as discretionary.

Sprandel's suspension began September 16, 2002, and concluded at the close of business September 20, 2002. (NASD Case #C8A020051)

**Jason Blaine Stevens (CRD #2802938, Registered Representative, Scottsdale, Arizona)** was fined \$25,000 and suspended from association with any NASD member in any capacity for six months. The sanctions were based on findings that Stevens made unsuitable recommendations to public customers. The findings also stated that Stevens made baseless price predictions regarding a speculative security to public

customers without any reasonable basis for the predictions, and made material omissions of fact in his recommendations of securities to public customers.

Stevens' suspension began September 16, 2002, and will conclude March 16, 2003. (NASD Case #C3A010039)

**Douglas Lumir Stolba (CRD #1153617, Registered Representative, Plymouth, Minnesota)** 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, Stolba consented to the described sanction and to the entry of findings that he received \$100,685.55 from public customers to be invested, but instead, without the knowledge or consent of the customers, deposited the funds into his personal bank account for his own personal use and benefit. (NASD Case #C04020031)

**Lisa June Strong (CRD #1837281, Registered Principal, Peoria, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and barred from association with any NASD member in any principal or managerial capacity. In light of the financial status of Strong, a \$5,000 fine was imposed. The fine must be paid upon reassociation with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Strong consented to the described sanctions and to the entry of findings that a member firm, acting through Strong, received notice of customer complaints or arbitration proceedings against registered representatives, sanctions imposed by NASD against representatives, the suspension of a representative, and the settlement of arbitration proceedings against representatives, and failed to cause amendments to be filed to Forms U-5 and U-4 on behalf of the representatives after learning of the reportable events and facts and circumstances giving rise to the requirement to amend. The findings also stated that a member firm, acting through Strong, received notice of disciplinary actions taken by NASD against registered representatives and settlements of arbitration claims against representatives and the firm and failed to report such incidents to NASD after becoming aware of the incidents. (NASD Case #C8A020056)

**Christopher Allen Wagner (CRD #3081539, Registered Representative, Belleville, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 15 business days. The fine must be paid before Wagner reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Wagner consented to the described sanctions and to the entry of findings that he failed to disclose information on his Form U-4.

Wagner's suspension began October 7, 2002, and will conclude at the close of business October 25, 2002. (NASD Case #C8A020033)

**Craig Frank Wisbiski (CRD #2711742, Registered Supervisor, Williamston, Michigan)** 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, Wisbiski consented to the described sanctions and to the entry of findings that he caused \$169,970 to be withdrawn from the securities account of a public customer, 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 findings also stated 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)

## Individual Fined

**Charles Francis Kirby (CRD #863916, Registered Principal, Littleton, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$7,500, jointly and severally. Kirby was also fined \$5,000 individually. Without admitting or denying the allegations, Kirby consented to the described sanctions and to the entry of findings that order tickets executed by his member firm contained an order execution time that was subsequent to the respective trade report, an order entry time that was subsequent to the related trade report, and illegible time stamps making it impossible to determine when the order was received and executed. The findings also stated that Kirby failed to enforce his member firm's supervisory procedures thereby causing order ticket violations. (NASD Case #C3A020043)

## Decisions Issued

The following decisions have been issued by the DBCC or the Office of Hearing Officers and have been appealed to or called for review by the NAC as of September 6, 2002. The findings and sanctions imposed in the 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*.

**Luis Guillermo Sarmiento (CRD #828824, Registered Principal, Miami, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Sarmiento acted as an imposter and took the Series 7 and Series 24 qualification exams for his employer.

Sarmiento has appealed this action to the NAC and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C07010091)

**U.S. Rica Financial, Inc. (CRD #38742, San Jose, California) and Vinh Huu Nguyen (CRD #2374393, Registered Principal, San Jose, California)** were fined \$133,579.83 jointly and severally, the firm was expelled from NASD membership, and Nguyen was barred from association with any NASD member in any capacity. The sanctions were based on findings that the firm, acting through Nguyen, represented to customers on the firm's Web site and on trade confirmations that they would be, or had been, charged commissions in accordance with the firm's published commissions schedule, or that trades would be, or had been, effected for "free," when in fact the firm effected customer trades on a riskless principal basis through the firm's proprietary account and charged the customers undisclosed markups and markdowns, thereby earning and retaining "secret profits" of \$58,579.83 as well as commissions on these trades. In addition, the firm, acting through Nguyen, failed to make appropriate memoranda of brokerage orders reflecting time of entry and time of execution of purchases of securities from other broker/dealers into the firm's inventory account and sales of securities to other broker/dealers from the firm's inventory account.

The firm and Nguyen have appealed this action to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C01000003)

## 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.

**Salvatore Clark (CRD #2580477, Registered Representative, Deer Park, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in public customers' accounts. (NASD Case #C3A020039)

**Joseph Alphonso Engerman, Jr. (CRD #2707877, Registered Representative, Upper Marlboro, Maryland)** was named as a respondent in an NASD complaint alleging that he received a \$25,000 check from a public customer to establish a securities trading account and to purchase a money market fund and/or municipal securities fund, deposited the check into a business checking account registered in his name, caused \$10,000 to be deposited in a securities account in the name of the customer, and converted the balance to his own use and purposes. The complaint also alleges that Engerman provided the customer with a statement that falsely listed a municipal securities fund and a money market fund as positions in the customer's securities account when, in fact, no such securities had been

purchased. In addition, the complaint alleges that Engerman received \$64,850 from a public customer for investment purposes in conformity with a recommended asset plan developed for the customer by Engerman to invest her monies in a variety of types of securities, but he retained the funds and converted them to his own use and purposes by failing to apply them to the intended investment purposes. Furthermore, the complaint alleges that Engerman failed to respond to NASD requests for information and documents. (NASD Case #C9A020039)

**Connie Fox, Jr. (CRD #1843462, Registered Representative, Navasota, Texas)** was named as a respondent in an NASD complaint alleging that he received a \$3,000 check from a public customer for investment purchases and, instead, deposited the check into a bank account he controlled, withdrew the \$3,000 from his bank account, and used these funds together with other funds to purchase a Certificate of Deposit in his own name, thereby converting the customer's funds to his own use and benefit without the customer's authorization, knowledge, or consent. The complaint also alleges that Fox failed to respond to NASD requests for information. (NASD Case #C06020011)

**J. Craig Hili (CRD #2531966, Registered Representative, Miami Beach, Florida)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in public customers' accounts. (NASD Case #C3A020040)

**Amy Lynn Martin (CRD #3204695, Registered Principal, Memphis, Tennessee)** was named as a respondent in an NASD complaint alleging that she transferred \$128,000 from the accounts of public customers to the checking account of another public customer for a purpose not directed by the customers and without their knowledge or consent. (NASD Case #C05020018)

**Stephen Nicholas McConnell (CRD #2689307, Registered Representative, West Orange, New Jersey)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in the accounts of public customers without their prior knowledge, authorization, or consent. The complaint also alleges that McConnell maintained a joint securities account at his member firm, purchased and sold various option contracts in the account, and failed to have sufficient funds in the account to cover the cost of options exercised on McConnell's behalf in the account by his member firm. In addition, the complaint alleges that McConnell's failure to deposit cash or securities against the unsecured debit balance in his account willfully caused his member firm to make an extension of credit to him in violation of Regulation T promulgated by the Board of Governors of the Federal Reserve System. The complaint further alleges that McConnell failed to respond to NASD requests for information and documents. (NASD Case #C10020082)

**Samuel Earl Miller, II (CRD #2479590, Registered Representative, Louisville, Kentucky)** was named as a respondent in an NASD complaint alleging that he received \$1,000 in cash from a public customer to be invested, failed and neglected to remit these funds to his member firm, and failed to invest the funds as directed by the customer. The complaint also alleges that Miller created and sent to a public customer a false account statement reflecting a fictitious mutual fund purchase and failed to respond to NASD requests for information. (NASD Case #C05020042)

**Adam Mosslih (CRD #2601978, Registered Representative, Syosset, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in public customers' accounts. (NASD Case #C3A020041)

**Vincent Ribortone (CRD #2614091, Registered Representative, Freeport, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in public customers' accounts. The complaint also alleges that Ribortone made baseless price predictions concerning the future performance of a stock. (NASD Case #C3A020044)

**Robby Don Schumacher (CRD #2714791, Registered Representative, East Islip, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in public customers' accounts. (NASD Case #C3A020038)

**Joseph Brian Shevlin, Jr. (CRD #2125060, Registered Representative, Bayonne, New Jersey)** was named as a respondent in an NASD complaint alleging that, in connection with the sale of common stock to retail customers, Shevlin, by the use of the instrumentalities of interstate commerce or of the mails, knowingly or recklessly made material misrepresentations and omitted to state material facts; effected transactions in, or induced the purchase or sale of, securities by means of a manipulative, deceptive, or fraudulent device. The complaint also alleges that Shevlin solicited public customers to purchase common stock and made baseless and improper price predictions. In addition, the complaint alleges that Shevlin purchased securities in the accounts of public customers without the customers' written or oral authorization. (NASD Case #C10020075)

**Gregory James Toth (CRD #2620359, Registered Representative, White Plains, New York)** was named as a respondent in an NASD complaint alleging that he used high-pressure sales tactics and knowingly made numerous baseless predictions of substantial price increases and misrepresentations of fact to customers and potential customers in connection with the solicitation of orders to purchase a common stock. (NASD Case #C07020067)

**Colin Eric Whittle (CRD #3131319, Registered Representative, Brooklyn, New York)** was named as a respondent in an NASD complaint alleging that he effected transactions in the account of a public customer without the customer's prior knowledge, authorization, or consent. The complaint also alleges that Whittle failed to respond to NASD requests for information and documents. (NASD Case #C10020085)

**Kevin Dacosta Worrell (CRD #2884901, Registered Representative, Queens Village, New York)** was named as a respondent in an NASD complaint alleging that he engaged in an unauthorized transaction in the account of a public customer without the customer's prior knowledge, authorization, or consent. (NASD Case #C10020074)

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

The following firm was suspended from membership in NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 8210 and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

**Russo Securities, Inc.**  
Staten Island, New York  
(September 4, 2002)

### **Suspensions Lifted**

NASD has lifted the suspension from membership on the date shown for the following firms because they have complied with formal written requests to submit financial information.

**Diamond Funding, LLC**  
Greenville, South Carolina  
(August 13, 2002)

**GFN.COM Securities, Inc.**  
New York, New York  
(August 21, 2002)

**Firm 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 firm has complied, the listing also includes the date the suspension was lifted.

**Interacciones Global, Inc.**  
New York, New York  
(August 20, 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.)

**Ambrosio, Jeffrey M.**  
Cleveland, Ohio  
(August 19, 2002)

**Hengst, Allen L., a/k/a Scott J. McKay Wolas**  
Orlando, Florida  
(August 12, 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.)

**Allen, Terrisa Marie**  
Citrus Heights, California  
(August 16, 2002)

**Bagwill, Jeremy B.**  
New Port Richey, Florida  
(August 15, 2002)

**DeMuth, Jean L.**  
Harrisburg, Pennsylvania  
(August 15, 2002)

**Feldman, Wendy P.**  
Rancho Sante Fe, California  
(August 22, 2002)

**Fiesta, Lorenzo E.**  
Honolulu, Hawaii  
(August 15, 2002)

**Leone, Christopher M.**  
Coconut Creek, Florida  
(September 4, 2002)

**Luu, Trong H.**  
Santa Ana, California  
(August 9, 2002)

**Peterson, James**  
St. Louis, Missouri  
(August 8, 2002)

**Prentice, Edward E.**  
Sacramento, California  
(September 4, 2002)

**Rau, Neal F.**  
San Diego, California  
(August 8, 2002)

**Rice, Kenneth P.**  
San Jose, California  
(August 16, 2002)

**Subhan, Philip J.**  
Lawrenceville, New Jersey  
(August 7, 2002)

**Techera, Daniel M.**  
Miami, Florida  
(August 8, 2002)

**Walder, Hanspeter A.**  
Tarrytown, New York  
(August 14, 2002)

**Weigand, Dale**  
Florence, Kentucky  
(August 27, 2002)

**Weis, Andrew P.**  
Golden, Colorado  
(August 1, 2002)

**Individuals 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.

**Becker, Gregg Mathew**  
Hicksville, New York  
(July 3, 2002)

**John, Dexter Kirnon**  
Cambria Heights, New York  
(August 28, 2002)



**Leon, Howard**  
Dahrland, Florida  
(August 15, 2002 – August 23, 2002)

**Schiro, Patrick Morgan**  
Bayshore, New York  
(August 26, 2002 – September 5, 2002)

### **NASD'S NAC Fines and Suspends Broker and Orders Restitution for Unsuitable Sales of Over \$2.1 Million of Class B Mutual Fund Shares**

NASD's National Adjudicatory Council (NAC) upheld an NASD Hearing Panel's decision that Wendell D. Belden made unsuitable sales of Class B mutual fund shares. Belden is the sole owner of Southmark, Inc. based in Tulsa, OK. He was fined \$40,000, suspended in all capacities for one year, and ordered to pay restitution of \$55,567, plus interest. Belden was also ordered to requalify as a principal by examination and assessed costs of the proceeding.

The NAC determined that a registered representative's suitability obligation includes the requirement to minimize the sales charges paid for mutual fund shares, when consistent with the customer's investment objectives. In this case, the NAC found that the recommendations were unsuitable because the purchase of Class B shares instead of Class A shares of the same fund resulted in significantly higher commission costs, including the payment of a contingent deferred sales charge upon the sale of the shares.

Specifically, Belden recommended and sold more than \$2.1 million in Class B shares rather than A shares to his customer, a retired individual. While Class A shares typically involve a front-end sales charge, these fund shares incur lower ongoing charges and there is no contingent deferred sales charge upon the sale of the shares. Class B mutual fund shares generally do not incur a front-end sales charge, but are subject to higher ongoing charges and a contingent deferred sales charge upon the sale of shares. In this case, the customer purchased shares in two mutual fund families. The amount invested in one fund family was more than \$1 million dollars, which would have entitled the customer to purchase Class A shares with no front-end sales charge. The customer's investment in the second fund family was over \$800,000, which would have entitled the customer to receive the largest discount on the front-end sales charge offered by the fund.

The NAC stated that over an eight-year period the ongoing fund charges for Class B shares would have been 64 percent higher than the same charge for Class A shares. The NAC also found that Belden placed his customer in Class B shares to generate higher commissions for himself and explained that its finding was bolstered by Belden's statement that he could not stay in business if he had to rely on the lower commissions from the sale of Class A shares. In this case, Belden and his employer firm earned commissions on the sale of B shares of \$84,000. The commissions on the sale of A shares would have only been \$28,000.

Belden appealed a Nov. 12, 2001, hearing panel decision that imposed a 90-day suspension along with the monetary sanctions affirmed by the NAC. The NAC increased the suspension because "Belden intentionally favored his financial interest to the detriment of one customer." Belden has since appealed the NAC decision to the SEC, and the sanction is not in effect pending consideration of the appeal. (NASD Case #C05010012)

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## For Your Information

### Important Information Regarding Annual Audited Report

Under Securities and Exchange Commission (SEC) Rule 17a-5, NASD members must file with NASD an Annual Audited Report not more than 60-calendar days after the date selected for their fiscal year end.

For the convenience of member firms, NASD has posted information to the Regulation section of the NASD Web Site listing essential information needed to complete the Annual Audited Reports.

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