

# Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management  
Technology  
Trading And Market Making

## KEY TOPICS

Market Making  
OTC Securities  
Recording And Reporting Quotation Data

## INFORMATIONAL

### Quotation Reporting

SEC Approves NASD Rule Proposal Requiring Quotation Recording and Reporting for OTC Equity Securities;  
**Effective Date: June 27, 2003**

#### Executive Summary

On March 27, 2003, the Securities and Exchange Commission (SEC) approved proposed rule changes by NASD that require members to record and maintain their proprietary quotations in over-the-counter (OTC) Equity Securities displayed in certain automated inter-dealer quotations systems, such as the Electronic Pink Sheets (EPS), and to report such data to NASD upon request.<sup>1</sup> The new rule text is contained in Attachment A and becomes effective on June 27, 2003.

At this time, NASD is requiring that the quotation data described herein be submitted to NASD on a **weekly** basis. NASD may alter the frequency of the reporting of this data to NASD based on regulatory need. NASD will notify members of any changes in reporting frequency in a *Notice to Members* and will provide adequate time for members to adjust their systems or reporting arrangements accordingly.

#### Questions/Further Information

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

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## Background

In September 1999, the EPS began displaying real-time, online stock quotations for approximately 5,000 OTC Equity Securities.<sup>2</sup> Prior to the availability of EPS, the "pink sheets" consisted of printed weekly lists of quotes in each security. These non-binding quotations were updated by means of a daily facsimile to subscribers. Market participants could learn of changes to intra-day quotations only by telephone or similar means of communication to market makers in the security.

Because the EPS now displays quotations in OTC Equity Securities on a real-time basis, NASD staff requires access to this quotation data to assess member compliance with applicable rules and regulations and, when necessary, to reconstruct market activity. For example, member quotation activities in the EPS are subject to NASD Rule 3320, "Offers at Stated Prices," which requires that a member's priced quotations be "firm," *i.e.*, the member is expected to buy or sell at least a normal unit of trading in the quoted stock at its then-prevailing quotations, unless clearly designated otherwise. In addition, NASD Rule 6750 provides that every member firm that functions as a market maker in OTC Equity Securities on an inter-dealer quotation system that permits quotation updates on a real-time basis honor those quotations for the minimum size applicable to the market maker's firm bid or ask.

## Recording and Reporting Requirements

The new rule requires that members record and maintain their quotations displayed on an inter-dealer quotation system<sup>3</sup> that permits quotation updates on a real-time basis. Specifically, the rule change requires all members that publish quotations on the EPS or any other inter-dealer quotation system that meets the requirements under the rule to record and maintain their priced quotations and unpriced indications of interest data and to report such quotation data to NASD. Specifically, members must record and report the following items for all updates in quotations or quotation size:

- Submitting Firm Market Participant Identifier;
- Identification of the inter-dealer quotation system;
- Trade date;
- Time of the quotation display, expressed in hours, minutes and seconds;
- Bid and bid quotation size;
- Offer and offer quotation size; and
- Prevailing inside bid and offer in the inter-dealer quotation system at the time of the quotation.<sup>4</sup>

This information must be recorded for any trade date on which a member displays quotes, even if no quotation updates or changes are entered on that particular day. Members are required to record such information on a daily basis and maintain such records in accordance with Rule 17a-4(a) under the Exchange Act for a period of not less than six years, the first two years in an accessible place.

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In addition, members must report such information to NASD on a weekly basis.

The new requirements do not apply to quotations displayed on an inter-dealer quotation system that is operated by a registered securities association or national securities exchange because such quotation information will be available from and/or regulated by the system operator directly. This includes, for example, the OTC Bulletin Board, which is sponsored and regulated by NASD. In addition, the new requirements do not apply to an inter-dealer quotation system that is operated by an NASD member because NASD can obtain quotation data (or in some cases, the display of limit orders) directly from the member that operates the system.

Under the rule, members are permitted to use a Reporting Agent to provide the quotation data to NASD.<sup>5</sup> NASD believes that most, if not all, members will use the services of a Reporting Agent, which would likely be the operator of the system. The member must enter into a written agreement with the Reporting Agent to have the Reporting Agent fulfill the member's obligations under the rule. The member, however, remains ultimately responsible for compliance with all regulatory requirements, notwithstanding the use of a Reporting Agent.

If a member knows or has reason to believe that it or its Reporting Agent is not complying with the requirements of the rule, the member is required to withdraw its priced quotations or unpriced indications of interest until such time that the member is satisfied that the quotation data is being properly maintained and reported. In this regard, NASD would expect a member periodically to review or monitor a Reporting Agent's activities to ensure continued compliance.

## Impact of the New Reporting Requirements on the Three Quote Rule Recordkeeping Requirements

Rule 2320(g), the "Three Quote Rule," requires that a member or person associated with a member contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for an OTC Equity Security, unless two or more priced quotations are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis. Rule 3110(b)(2) currently requires that members indicate on the order ticket for each transaction in an OTC Equity Security the name of each dealer contacted and the quotations received to determine the best inter-dealer market. Rule 3110(b)(2), however, does not require members to note such information on the order ticket if two or more priced quotations are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis and NASD has access to historical quotation data from the system. As a result, members have been relieved of certain recordkeeping burdens relating to the Three Quote Rule in those instances where NASD can validate and confirm compliance with applicable requirements directly through its internal historical data.

Upon the implementation of the new requirements described herein, NASD will have access to historical quotation data with respect to the EPS and other inter-dealer quotation systems, as applicable. Therefore, members will not be required to annotate on the order ticket the names of the dealers and the quotations displayed when two or more priced quotations are displayed on the EPS or

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another inter-dealer quotation system that permits quotation updates on a real-time basis and for which NASD has access to historical quotation data.

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## Endnotes

- 1 Exchange Act Release No. 47587 (March 27, 2003) (File No. SR-NASD-2000-42), 68 Federal Register 16328 (April 3, 2003).
- 2 Rule 6610(d) defines "OTC Equity Security" as "any equity security not classified as a 'designated security,' for purposes of the Rule 4630 and 4640 Series. This term also includes certain exchange-listed securities that do not otherwise qualify for real-time trade reporting because they are not 'eligible securities' as defined in Rule 6410(d). The term 'OTC Equity Security' shall not include 'restricted securities,' as defined by SEC Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market, the Rule 5300 Series."
- 3 Rule 15c2-11(e) under the Exchange Act defines "inter-dealer quotation system" as "any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers."
- 4 Members should not consolidate quotation information from other systems or markets that are quoting the same security in calculating the prevailing inside bid or offer.
- 5 Under Rule 6630(e), "Reporting Agent" means a third party that enters into a written agreement with a member pursuant to which such third party agrees to fulfill the member's obligations under the Rule. The written agreement must specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of the rule.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 6600. [REPORTING TRANSACTIONS IN] OVER-THE-COUNTER EQUITY SECURITIES

This Rule 6600 Series sets forth recording and reporting requirements for certain quotations and unpriced indications of interest displayed on inter-dealer quotation systems and the trade reporting requirements applicable to members' transactions in equity securities for which real-time trade reporting is not otherwise required (hereinafter referred to as "OTC Equity Securities"). Members shall utilize the Automated Confirmation Transaction Service (ACT) for trade reporting in OTC Equity Securities.

**Rules 6610 and 6620 No Change.**

#### Rule 6630. Recording of Quotation Information

##### (a) Quotation Recording Requirements

(1) Subject to the terms and conditions contained herein, each OTC Market Maker that displays priced quotations (bid and/or offer) or unpriced indications of interest in OTC Equity Securities in an inter-dealer quotation system that permits quotation updates on a real-time basis shall record each item of information described in paragraph (b) of this Rule. This quote activity record must reflect all changes in an OTC Market Maker's priced quotation or quotation size displayed or unpriced indication of interest, and the time any such change was effected.

(2) Members shall record each item of information required to be recorded under this Rule in such form as is prescribed by the Association from time to time.

##### (3) Maintaining and Preserving Records

(A) Each member shall maintain and preserve records of the information required to be recorded under this Rule for the period of time and accessibility specified in SEC Rule 17a-4(a).

(B) The records required to be maintained and preserved under this Rule may be immediately produced or reproduced on "micrographic media" as defined in SEC Rule 17a-4(f)(1)(i) or by means of "electronic storage media" as defined in SEC Rule 17a-

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4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and may be maintained and preserved for the required time in that form.

(b) Information to be Recorded

The quotation activity record required pursuant to paragraph (a) of this Rule shall contain, at a minimum, the following information for every priced quotation (bid and/or offer) or unpriced indication of interest displayed by the member during the trading day:

- (1) Submitting firm;
- (2) Inter-dealer quotation system or medium;
- (3) Trade date;
- (4) Time quotation displayed (expressed in hours, minutes and seconds);
- (5) Security name and symbol;
- (6) Bid and bid quotation size (if applicable);
- (7) Offer and offer quotation size (if applicable);
- (8) Prevailing Inside Bid; and
- (9) Prevailing Inside Offer

If no updates were entered to an OTC Market Maker's quotation or quotation size for any given trading day, the member must record the information in subparagraphs (b)(1) through (7).

(c) Quotations Not Required To Be Recorded

The recording requirements contained in paragraphs (a) and (b) of this Rule shall not apply to quotations of OTC Equity Securities that are displayed on an inter-dealer quotation system that is:

- (1) operated by a registered securities association or a national securities exchange; or
- (2) operated by a member of the Association.

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**(d) Reporting Requirements**

**(1) General Requirement**

Members shall report information required to be recorded under this Rule to the Association upon its request.

**(2) Method of Transmitting Data**

Members shall transmit this information in such form prescribed by the Association.

**(e) Reporting Agent Agreements**

(1) "Reporting Agent" shall mean a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this Rule.

(2) Any member may enter into an agreement with a Reporting Agent pursuant to which the Reporting Agent agrees to fulfill the obligations of such member under this Rule. Any such agreement shall be evidenced in writing, which shall specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of this Rule.

(3) All written documents evidencing an agreement described in paragraph (e)(2) shall be maintained by each party to the agreement.

(4) Each member remains responsible for compliance with the requirements of this Rule, notwithstanding the existence of an agreement described in this paragraph.

**(f) Withdrawal of Quotations or Unpriced Indications of Interest**

If a member knows or has reason to believe that it or its Reporting Agent is not complying with the requirements of this Rule, the member must withdraw its quotations or unpriced indications of interest until such time that the member is satisfied that its quotation data is being properly recorded and reported.

# Special Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Executive Representative  
Legal & Compliance  
Senior Management

REQUEST FOR COMMENT

ACTION REQUESTED BY JULY 11, 2003

## Certification by Chief Executive Officer and Chief Compliance Officer

NASD Requests Comment on Proposal to Amend Rule 3010 and Adopt Interpretive Material 3010-1. **Comment Period Expires on July 11, 2003**

## KEY TOPICS

Compliance  
Supervision

### Executive Summary

NASD is proposing to amend Rule 3010 and adopt related interpretive material to require each member to designate a Chief Compliance Officer who, jointly with a member's Chief Executive Officer,<sup>1</sup> must certify annually that the member has in place adequate compliance and supervisory policies and procedures. The proposed rule changes are intended to enhance investor protection by encouraging senior management to focus increased attention to a member's compliance and supervisory systems and by fostering regular interaction between business and compliance officers. The proposal also would promote joint consideration by the Chief Compliance Officer and senior management of specific compliance problems or initiatives. This proposal is intended to foster greater investor protection by providing a strong consultative voice to Chief Compliance Officers in their dealings with other supervisors, managers, and officers of the member. The accompanying interpretive material makes it clear that the obligation of the Chief Executive Officer and Chief Compliance Officer is limited to executing the certification upon a reasonable basis that comports with the high standards of commercial honor and just and equitable principles of trade. Provided that the signatories execute upon such a basis, neither would incur any greater liability for the adequacy of supervisory and compliance policies and procedures than would otherwise be the case in the absence of this certification.

The text of the certification and proposed interpretive material are attached.

Questions or comments concerning this *Notice* may be directed to Philip Shaikun, Assistant General Counsel, Regulatory Policy and Oversight, at 202-728-8451.

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## Request for Comment

NASD is proposing an amendment and interpretive material to NASD Rule 3010 to require a member's Chief Executive Officer and Chief Compliance Officer to certify to the adequacy of the member's compliance and supervisory policies and procedures. Members wishing to comment must make a submission that is received by July 11, 2003. Members and interested persons can submit their comments using the following methods:

- ◆ mailing in written comments, or
- ◆ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com).

Written comments submitted via hard copy should be mailed to:

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

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

Before becoming effective, any rule change must be approved by the NASD Board of Governors and the Securities and Exchange Commission.

## Background and Discussion

Comprehensive compliance and supervisory systems constitute the bedrock of effective securities industry self-regulation and the primary strata of investor protection. As such, NASD believes that a member's senior management should regard the adequacy of its compliance and supervisory policies and procedures with the same seriousness

accorded to such fundamental operational prerequisites as, for example, net capital requirements. To develop this ethos, NASD further believes it is essential that regular and significant interaction occur between senior business and compliance officers. Moreover, those compliance officers must be empowered with sufficient leverage to oblige senior management to give meaningful consideration to the caliber of a member's compliance and supervisory systems.

To that end, NASD has developed a proposal to ensure that compliance – and by extension, investor protection – is given the highest priority by a member's senior executive officers. Specifically, the proposal would amend Rule 3010 to require each member to designate a Chief Compliance Officer and would further require that individual and a member's Chief Executive Officer jointly to certify annually that the member has in place compliance and supervisory policies and procedures reasonably designed to comport with applicable NASD rules, MSRB rules, and federal securities laws and rules. NASD recognizes that in certain instances the compliance function is undertaken by associated persons who have multiple areas of responsibility within the member, including the role of Chief Executive Officer. Consequently, it is possible that, at times, a single associated person would be executing the certification only once in the joint capacity of Chief Compliance Officer and Chief Executive Officer.

NASD further has proposed an accompanying interpretive material, IM-3010-1, that both articulates the philosophy behind the proposed rule amendment and delineates important limitations to the obligations and

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liabilities associated with the certification requirement. In particular, proposed IM-3010-1 makes three noteworthy interpretations.

First, the interpretive material limits the scope of the certification to the adequacy of compliance and supervisory policies and procedures commensurate with the nature of the member's business segments and its activities related thereto. Notably, although the rule proposal would require certification annually, it would not relieve a member of its current and ongoing obligation to periodically review the adequacy of its policies and procedures in light of business and regulatory developments.

Second, the interpretive material clarifies that the Chief Executive Officer and Chief Compliance Officer only must certify to the adequacy of the compliance and supervisory system – but not generally to the implementation or execution of that system. Nonetheless, the interpretive material notes that certification carries an implicit representation that implementation of the system has at least been audited and tested for efficacy.

Third, the interpretive material explains that no liability under the proposed rule or other NASD rule will attach to the signatories of the certification, provided there was a reasonable basis to certify at the time of execution. The touchstone of reasonableness would be whether the act of certification was consistent with high standards of commercial honor and just and equitable principles of trade. Provided that the signatories execute upon such a basis, neither would incur any greater liability for the adequacy of supervisory and compliance policies and procedures than would otherwise be the case in the absence of this certification.

Thus, it is not NASD's intent with this proposal to make the Chief Executive Officer and Chief Compliance Officer personally liable for every compliance or supervisory failure a firm might experience. Rather, the proposal seeks to facilitate development of an ethical culture of compliance within firms by elevating the status of the Chief Compliance Officer and by compelling periodic and significant consultation between senior business and compliance personnel.

In this respect, the proposed rule is analogous to the recently enacted provisions of the Sarbanes-Oxley Act of 2002 that require a company's principal executive and financial officers to certify the accuracy of financial reports and the existence of internal controls designed to ensure that accuracy. In addition, the SEC recently enacted Regulation AC, another certification-based regulation that requires research analysts to affirm that their research reports reflect their true opinions. NASD supports the rationale behind those initiatives and believes its certification proposal similarly will promote corporate ethics and public trust and also will enhance investor protection and bolster the integrity of our members and markets.

## Endnote

- 1 As used in this *Notice to Members*, the term "Chief Executive Officer" includes any other title utilized by the member connoting equivalent management status and seniority.

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## EXHIBIT A

### Annual Compliance And Supervision Certification

The undersigned are respectively the chief executive officer (or equivalent officer) and chief compliance officer of [name of member corporation/partnership/sole proprietorship] (the "Member"). As required by NASD Rule 3010 (c) [to be amended to include requirement] the undersigned makes the following certification:

1. The Member, based on the types of businesses in which it engages and the nature of its activities in connection with these types of businesses, has in place adequate compliance and supervisory policies and procedures reasonably designed to comport with applicable NASD rules, MSRB rules and federal securities laws and rules.
2. The undersigned senior executive officer/managing partner and chief compliance officer have consulted with or otherwise relied on those employees, officers, outside consultants, lawyers and accountants as they consider appropriate, in order to attest to the statements made in this certification.
3. Notwithstanding the requirement to make this certification annually, the Member has reviewed and will continue to review the adequacy of its compliance and supervisory policies and procedures on a periodic basis as necessitated by the types of businesses in which it engages and the nature of its activities in connection with these types of businesses, any changes or modification in such businesses and activities, or the promulgation of new laws or rules or any amendments to existing laws or rules.

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## **EXHIBIT B**

### **IM-3010-1 Annual Compliance And Supervision Certification**

The Board of Governors is issuing this interpretation to the requirement under Rule 3010(c) to have the member's chief executive officer (or equivalent officer) and the chief compliance officer execute a certification that the member has compliance and supervisory policies and procedures reasonably designed to comport with applicable NASD rules, MSRB rules and federal securities laws and rules.

The Board of Governors is concerned that each member understands the importance of employing adequate compliance and supervisory policies and procedures. Compliance with applicable NASD rules, MSRB rules, and federal securities laws and rules is the foundation of ensuring investor protection and market integrity, and is essential in promoting the efficacy of self-regulation. Consequently, the certification requirement is intended to require a regular review by each member of its compliance and supervisory policies and procedures in light of the nature of its businesses and the laws and rules that are applicable and to take such action as may be appropriate with respect thereto.

The execution of the certification by the chief compliance officer is intended to ensure that the person charged with managing the member's compliance program has regular and significant interaction with senior management concerning the subject matter of the certification. Furthermore, the Board of Governors understands that the chief compliance officer is not necessarily responsible for the execution of each compliance and supervisory policy and procedure and that the signatories to the certification are certifying as to adequacy, but not necessarily as to the implementation, of the member's compliance and supervisory policies and procedures. However, necessary components to ensure the adequacy of these policies and procedures are the auditing and testing of the implementation of the compliance and supervisory policies and procedures.

The scope of the requirement to have adequate compliance and supervisory policies and procedures for the business lines in which the member engages is defined by the nature and extent of regulation attendant to each line of business.

No liability will accrue to the signatories to the certification under this or any other NASD rule or interpretation as a consequence of their certification provided that at the time they execute the certification they have a reasonable basis for doing so and do so in a manner that comports with high standards of commercial honor and just and equitable principles of trade.

# Special Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Senior Management  
Legal and Compliance  
Operations Managers

## KEY TOPICS

Fees  
NASD By-Laws

## INFORMATIONAL

### Trading Activity Fee

SEC Approves Revisions to NASD By-Laws Regarding Trading Activity Fee

#### Executive Summary

On May 30, 2003, the Securities and Exchange Commission ("SEC" or "Commission") approved revisions to NASD By-Laws, eliminating the current Regulatory Fee assessed upon NASD members and instituting a new transaction-based Trading Activity Fee ("TAF").<sup>1</sup> Approval of the TAF, along with previously approved revisions to both the Gross Income Assessment ("GIA") and the Personnel Assessment ("PA"), completes NASD's restructuring of its member regulatory pricing structure. The By-Laws, as amended, are set forth in Attachment A.

#### Questions/Further Information

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

#### Discussion

On July 24, 2002, NASD filed a proposed rule change for immediate effectiveness to amend Section 8 of Schedule A to NASD's By-Laws to eliminate the Regulatory Fee and institute a new transaction-based TAF.<sup>2</sup> This rule filing was part of a proposed restructuring of NASD's member regulatory pricing structure composed of four components that: (1) eliminated the Regulatory Fee; (2) instituted a new transaction-based TAF similar to the SEC's Section 31 Fee;

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(3) increased the rates assessed to member firms under the PA; and (4) implemented a simplified, three-tiered flat rate for the GIA and eliminated current deductions and exclusions. The revisions to the GIA and PA were approved by the SEC in December 2002 and were reflected in the 2003 annual invoicing of both the GIA and PA.

On October 18, 2002, NASD filed a rule proposal sunsetting the TAF effective December 31, 2002,<sup>3</sup> and re-filed the proposal under Section 19(b)(2) of the Securities Exchange Act of 1934 ("Act") to allow for additional member comment.<sup>4</sup> On December 24, 2002, NASD extended the TAF in its current form as a pilot program through March 1, 2003.<sup>5</sup> NASD subsequently extended the pilot program through June 1, 2003.<sup>6</sup>

The SEC approved the TAF on a permanent basis on May 30, 2003. The TAF, as approved, is substantially similar to the TAF that has been in effect since October 1, 2002, with two notable exceptions. First, Section 1(b)(2) was amended to incorporate certain exemptions into the text of the rule.<sup>7</sup> Second, listed options transactions executed by broker/dealers for which NASD is not the primary regulator are exempted from the TAF, effective January 1, 2004.<sup>8</sup> The permanent TAF will continue to be self-reported in the same manner as during the pilot period.<sup>9</sup>

As noted in the original NASD rule filings and throughout the notice and comment period, NASD designed the overall effect of the revisions to its member regulatory pricing structure to be revenue neutral. Although the structure is fixed, TAF rates will be adjusted as necessary to adapt to the changing activity levels or NASD funding requirements. NASD analysis of the TAF results for the first half of the year suggests that the rates as applied to

actual volumes are inconsistent with the intended fee structure and that rate adjustments will be necessary shortly. Any proposed rate adjustments will be filed as rule changes with the SEC and will be subject to a notice and comment period, as well as SEC approval.

In connection with the approval of the TAF, NASD continues to receive questions regarding the application of the TAF to particular scenarios. The following questions and answers are published to address some of these scenarios and to provide additional guidance. NASD also has addressed questions raised in connection with its new fee structure in *Notices to Members 02-41, 02-63, and 02-75*. Members should consult these *Notices to Members* for further information. The guidance contained herein is not intended to provide an exhaustive analysis of all circumstances that could possibly arise under the new fee structure. Members should contact the NASD staff listed above in the event they have further questions.

## Questions and Answers

- Q1. If my firm purchases a covered security from a customer whose account is not held by my firm, such as a sponsored institution, will I be assessed a fee for those purchases?
- A1. No. Although the TAF is assessed on the buy side of member transactions where the counter party is not a broker/dealer, in transactions where a member purchases a covered security from a non-broker/dealer customer whose account is not carried by the member, such as a sponsored institution, a fee will not be assessed on the member.

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- Q2.** If my trader receives a buy order for 400,000 shares that will later be allocated among multiple accounts and sells the entire 400,000 shares as principal, which is reported as such to the tape, is the TAF assessed based on the 400,000 sale from the firm's trading account or on the individual allocations that make up the 400,000 share order?
- A2.** A member may choose to calculate the fee based on either the one 400,000 share sale from the firm's proprietary account or at the individual customer account level. However, the methodology chosen by the member to calculate the fee assessment must be consistently applied to all such transactions.
- Q3.** My firm clears for non-member broker/dealers that engage primarily in options transactions as exchange specialists. As part of our clearing services, we provide an electronic order delivery system that allows our correspondents to electronically access other market centers, such as SuperMontage, SuperDot, and a variety of ECNs. Our correspondents direct orders through the system to the market center of their choosing and control all aspects of how the order will be executed. However, when trades are executed through this electronic order delivery system, the counter party only sees the identity of the NASD clearing firm (not the non-member correspondent). Does NASD view the clearing firm as the executing broker for purposes of the TAF for executions occurring via these electronic order delivery systems?
- A3.** Yes. For TAF purposes, NASD views the clearing firm as the executing broker and will assess a fee on transactions effected through these types of electronic order delivery systems. Based upon these facts, neither NASD nor the contra party to these transactions knows the identity of the correspondent broker/dealer. Accordingly, the clearing firm is identified as the party to the trade and, as such, will be assessed a TAF. (NOTE: Any covered security traded through these electronic order delivery systems will be subject to the TAF unless otherwise exempted. See question 4 below regarding assessment of the TAF on listed options transactions.)
- Q4.** Is the TAF charged on listed options transactions?
- A4.** Yes. NASD members are assessed the TAF on listed options transactions, regardless of where they are executed, until January 1, 2004. Effective January 1, 2004, listed options transactions will be subject to the TAF only if NASD is that member firm's Designated Options Examining Authority (DOEA).<sup>9</sup> NASD proposed that the exemption regarding listed options transactions be effective starting January 1, 2004, to provide member firms with time to make necessary programming and billing changes and to synchronize with new, bi-annual DOEA allocations effective on that date. Prior to January 1, 2004, NASD will publish a list of those firms designated to NASD.

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## Endnotes

- 1 Securities Exchange Act Rel. No. 47946 (May 30, 2003).
- 2 Securities Exchange Act Rel. No. 46416 (Aug. 23, 2002), 67 FR 55901 (Aug. 30, 2002).
- 3 Securities Exchange Act Rel. No. 46818 (Nov. 12, 2002), 67 FR 69782 (Nov. 19, 2002) (SR-NASD-2002-147).
- 4 Securities Exchange Act Rel. No. 46817 (Nov. 12, 2002), 67 FR 69785 (Nov. 19, 2002) (SR-NASD-2002-148).
- 5 Securities Exchange Act Rel. No. 47112 (Dec. 31, 2002), 68 FR 824 (Jan. 7, 2003) (SR-NASD-2002-182).
- 6 Securities Exchange Act Rel. No. 47436 (March 4, 2003), 68 FR 11422 (March 10, 2003) (SR-NASD-2003-26) and Securities Exchange Act Rel. No. 47685 (April 16, 2003), 68 FR 20198 (April 24, 2003) (SR-NASD-2003-73).
- 7 See Attachment A, Section 1(b)(2) for a complete list of transactions exempt from the TAF.
- 8 See question 4 in this *Notice* for a discussion of the exemption for listed options transactions.
- 9 See *Notice to Members 02-75* for detailed submission/payment information, including the Self-Reporting Form that must be used when remitting payment to NASD.
- 10 Currently, approximately 70% of all broker/dealers that conduct a public options business are designated to NASD. Firms designated to any of the remaining six SROs that have regulatory responsibilities for options trading may be paying explicit or implicit regulatory fees to that SRO. See Securities Exchange Act Rel. No. 47577 (March 26, 2003), 68 FR 16109 (Apr. 2, 2003) (SR-PCX-2003-03) (Pacific Exchange rule filing establishing a DOEA fee).

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## ATTACHMENT A

### Schedule A to NASD By-Laws

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of NASD shall be determined on the following basis.

#### Section 1— Member Regulatory Fees

(a) Recovery of cost of services. NASD shall, in accordance with this section, collect member regulatory fees that are designed to recover the costs to NASD of the supervision and regulation of members, including performing examinations, processing of membership applications, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. NASD shall periodically review these revenues in conjunction with these costs to determine the applicable rate. NASD shall publish notices of the fees and adjustments to the assessment rates applicable under this section.

(b) Each member shall be assessed a Trading Activity Fee for the sale of covered securities.

(1) Covered Securities. For purposes of the rule, covered securities shall mean:

(i) All exchange registered securities wherever executed (other than bonds, debentures, and other evidence of indebtedness);

(ii) All other equity securities traded otherwise than on an exchange; and

(iii) All security futures wherever executed.

(2) Transactions exempt from the fee. The following shall be exempt from the Trading Activity Fee:

(i) Transactions in securities offered pursuant to an effective registration statement under the Securities Act of 1933 (except transactions in put or call options issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by Section 3(a) or 3(b) thereof, or a rule thereunder;

(ii) Transactions by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act of 1933;

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(iii) The purchase or sale of securities pursuant to and in consummation of a tender or exchange offer;

(iv) The purchase or sale of securities upon the exercise of a warrant or right (except a put or call), or upon the conversion of a convertible security;

(v) Transactions that are executed outside the United States and are not reported, or required to be reported, to a transaction reporting association as defined in Rule 11Aa3-1 and any approved plan filed thereunder;

(vi) Proprietary transactions by a firm that is a member of both NASD and a national securities exchange, effected in its capacity as an exchange specialist or market maker, that are subject to Securities Exchange Act of 1934, Section 11(a) and Rule 11a1-1(T)(a) thereunder; however this exemption does not apply to other transactions permitted by Section 11(a) such as bona fide arbitrage or hedge transactions;

(vii) Transactions by a firm that is a floor based broker and that is a member of both NASD and a national securities exchange provided that the floor based broker qualifies for exemption from NASD membership under Exchange Act Rule 15b9-1;

(viii) Transactions in conventional options;

(ix) Transactions in options and futures involving narrow and broad based indexes;

(x) Transactions in security futures held in futures accounts; and

(xi) Transactions in exchange listed options effected by a member when NASD is not the designated options examining authority for that member. *(exemption (xi) is effective beginning January 1, 2004; please see question 4 in the preceding Notice for a discussion of this exemption).*

NASD may exempt other securities and transactions as it deems appropriate.

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(3) Fee Rates\*

(i) Each member shall pay to NASD a fee per share for each sale of a covered equity security.

(ii) Each member shall pay to NASD a fee per contract for each sale of an option.

(iii) Each member shall pay to NASD a fee for each round turn transaction (treated as including one purchase and one sale of a contract of sale for future delivery) of a security future.

(4) Reporting of Transactions. Members shall report to NASD the aggregate share, contract, and/or round turn volume of sales of covered securities in a manner as prescribed by NASD from time to time.

(c) Each member shall pay an annual Gross Income Assessment equal to the greater of \$1,200.00 or the total of:

(1) 0.125% of annual gross revenue less than or equal to \$100,000,000.00;

(2) 0.029% of annual gross revenue greater than \$100,000,000.00 up to \$1,000,000,000.00; and

(3) 0.014% of annual gross revenue greater than \$1,000,000,000.00.

Each member is to report annual gross revenue as defined in Section 2 of this Schedule, for the preceding calendar year.

(d) Each member shall pay an annual Personnel Assessment equal to:

(1) \$75.00 per principal and each representative up to five principals and representatives as defined below;

(2) \$70.00 per principal and each representative for six principals and representatives up to twenty-five principals and representatives as defined below; or

(3) \$65.00 per principal and each representative for twenty-six or more principals and representatives as defined below.

A principal or representative is defined as a principal or representative in the member's organization who is registered with NASD as of December 31st of the prior fiscal year.

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## Section 2—Gross Revenue for Assessment Purposes

Gross revenue is defined for assessment purposes as total income as reported on FOCUS form Part II or IIA with the following exclusion: commodities income.

- \* Trading Activity Fee rates are as follows: Each member shall pay to NASD \$0.00005 per share for each sale of a covered equity security, with a maximum charge of \$5 per trade; \$0.002 per contract for each sale of an option; and \$0.04 per contract for each round turn transaction of a security future. In addition, if the execution price for a covered security is less than the Trading Activity Fee rate (\$0.00005 for covered equity securities, \$0.002 for covered option contracts, or \$0.04 for a security future) on a per share, per contract, or round-turn transaction basis, then no fee will be assessed.

# Special Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

District Elections

## INFORMATIONAL

### District Elections

NASD Informs Members of Upcoming District Committee and District Nominating Committee Elections

#### Executive Summary

The purpose of this *Special Notice to Members* is to inform members of the upcoming nomination and election process to fill forthcoming vacancies on the District Committees and the District Nominating Committees.

Information on District Committee and District Nominating Committee members serving through 2004, 2005, and 2006 is included in Attachment A. Information on District Election Procedures is included in Attachment B. A candidate profile sheet is included in Attachment C.

#### Nomination Process

Individuals from member firms of all sizes and segments of the industry are encouraged to submit names for consideration for membership on the 11 District Committees and District Nominating Committees. Members are requested to submit candidates' names to the appropriate District Nominating Committee Chairman or to the District Director by submitting a cover letter and the candidate profile sheet (Attachment C) by July 28.

Completed forms will be provided to all District Nominating Committee members for review. It is anticipated that the District Nominating Committees will certify their nominees to the District Committees on or about September 12.

03-31

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Members are reminded of the importance to accurately maintain their Executive Representative name and e-mail address information, as well as their firm's main postal address. This will ensure that member mailings, such as election information, will be properly directed. Failure to keep this information accurate may jeopardize the member's ability to participate in District elections as well as other member votes. To update the Executive Representative name and e-mail address, firms should access their NASD Member Firm Contact Questionnaire (NMFCQ) located on the NASD Web Site ([www.nasdr.com/disclaimer.asp](http://www.nasdr.com/disclaimer.asp)).

To update postal address information, the firm must file a Form BD Amendment via the Web CRD system. For assistance updating either of these systems, you may contact our Call Center at (301) 590-6500.

### Questions/Further Information

Questions concerning this *Special Notice* may be directed to the District Director noted or to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, at (202) 728-8062 or via e-mail at [barbara.sweeney@nasd.com](mailto:barbara.sweeney@nasd.com).

©2003. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

## ATTACHMENT A

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### District 1 Committee And District Nominating Committee Members

#### Elisabeth P. Owens, District Director

525 Market Street, Suite 300, San Francisco, CA 94105 (415) 882-1201

#### District 1 Committee — Chair: S. Katherine Campbell

Members to be elected to terms expiring January 2007: 3

#### Committee members to serve until January 2004

Steven R. Aaron	J.P. Morgan Securities	San Francisco, CA
S. Katherine Campbell	Protected Investors of America	Kensington, CA
Carol Van Bruggen	Financial Telesis, Inc.	Sacramento, CA

#### Committee members to serve until January 2005

Gerard P. Gloisten	GBS Financial Corporation	Santa Rosa, CA
Allan L. Herzog	Prudential Securities, Inc.	San Francisco, CA
Robert A. Muh	Sutter Securities, Inc.	San Francisco, CA

#### Committee members to serve until January 2006

Warren E. Gordon	Charles Schwab & Co., Inc.	San Francisco, CA
William P. Hayes	Wells Fargo Investments, LLC	San Francisco, CA
Francis X. Roche, II	RBC Dain Rauscher, Inc.	San Francisco, CA

#### District 1 Nominating Committee — Chair: Glenn M. Colacurci

Committee members to be elected to terms expiring January 2004: 5

#### Committee members

Sally G. Aelion	Emmett A. Larkin Company, Inc.	San Francisco, CA
Glenn M. Colacurci	Salomon Smith Barney	San Francisco, CA
James D. Klein	UBS PaineWebber, Inc.	San Francisco, CA
Jerry D. Phillips	RBC Dain Rauscher, Inc.	San Francisco, CA
William A. Svoboda	Morgan Stanley Dean Witter, Inc.	Palo Alto, CA

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## District 2 Committee And District Nominating Committee Members

### Lani M.Sen Woltmann, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071 (213) 613-2601

### District 2 Committee — Chair: Steven K. McGinnis

Members to be elected to terms expiring January 2007: 3

#### Committee members to serve until January 2004

James E. Biddle	The Securities Center Incorporated	Chula Vista, CA
Chris M. Kanoff	Jefferies and Co., Inc.	Los Angeles, CA
Steven K. McGinnis	National Planning Holdings	Santa Monica, CA
Neal E. Nakagiri	Associated Securities Corporation	Los Angeles, CA

#### Committee members to serve until January 2005

Joan A. Payden	Payden & Rygel	Los Angeles, CA
Joel H. Ravitz	Quincy Cass Associates	Los Angeles, CA
Guy W. Williams	Merrill Lynch Pierce Fenner & Smith, Inc.	Costa Mesa, CA

#### Committee members to serve until January 2006

A. William Cohen	Integrated Trading and Investments, Inc.	Las Vegas, NV
Don S. Dalis	UBS PaineWebber Inc.	Newport Beach, CA
Donna Bartlett Lawson	First Allied Securities, Inc.	San Diego, CA

### District 2 Nominating Committee — Chair: Robert L. Winston

Committee members to be elected to terms expiring January 2004: 5

#### Committee members

Margaret M. Black	Morgan Stanley Dean Witter	Los Angeles, CA
George H. Casey	Crowell Weedon & Co.	Los Angeles, CA
Miles Z. Gordon	Financial Network Investment Corp.	Torrance, CA
Dean A. Holmes	Valic Financial Advisors, Inc.	Glendale, CA
Robert L. Winston	American Funds Distributors, Inc.	Los Angeles, CA



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**District 3 Committee And District Nominating Committee Members**

**Joseph M. McCarthy, District Director**

370 17th Street, Suite 2900, Denver, CO 80202

(303) 446-3100

**James G. Dawson, District Director**

Two Union Square, 601 Union, Suite 1616, Seattle, WA 98101-2327

(206) 624-0790

**District 3 Committee — Chair: Kathryn A. Supko**

Members to be elected to terms expiring January 2007: 3

**Committee members to serve until January 2004**

George T. Diachok	Geneos Wealth Management, Inc.	Denver, CO
John M. Rose	Seattle-Northwest Securities Corporation	Seattle, WA
Kathryn A. Supko	Northwestern Mutual Investment Services, LLC	Boise, ID

**Committee members to serve until January 2005**

Gregory R. Anderson	TIAA/CREF Individual & Institutional Services, Inc.	Denver, CO
Robert E. Frey, Jr.	KMS Financial Services, Inc.	Seattle, WA
John F. York	Strand, Atkinson, Williams & York, Inc.	Portland, OR

**Committee members to serve until January 2006**

Gene G. Branson	Partners Investment Network, Inc.	Spokane, WA
Bridget M. Gaughan	SunAmerica Financial Network, Inc.	Phoenix, AZ
John W. Goodwin	Goodwin Browning & Luna Securities, Inc.	Albuquerque, NM

**District 3 Nominating Committee — Chair: Martin O. Nelson, Jr.**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

L. Hoyt DeMers	Wells Fargo Investments, LLC	Seattle, WA
J. David Griswold	Frank Russell Securities, Inc.	Tacoma, WA
Martin O. Nelson, Jr.	Martin Nelson & Co., Inc.	Seattle, WA
William G. Papesh	WM Funds Distributor, Inc.	Seattle, WA
Anthony B. Petrelli	Neidiger, Tucker, Bruner, Inc.	Denver, CO

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**District 4 Committee And District Nominating Committee Member**

**Thomas D. Clough, District Director**

120 West 12th Street, Suite 900, Kansas City, MO 64105 (816) 802-4708

**District 4 Committee — Chair: Timothy J. Lyle**

Members to be elected to terms expiring January 2007: 3

Member to be elected to term expiring January 2006: 1

**Committee members to serve until January 2004**

Gene M. Diederich	A.G. Edwards & Sons, Inc.	Overland Park, KS
Timothy J. Lyle	Trusted Securities Advisors Corp.	Minneapolis, MN
Pamela R. Ziermann	Dougherty & Company LLC	Minneapolis, MN

**Committee members to serve until January 2005**

William R. Giovanni	Ameritas Investment Corp.	Lincoln, NE
Frank H. Kirk	Wachovia Securities, Inc.	Kansas City, MO
James H. Warner	The Warner Group	Sioux City, IA

**Committee members to serve until January 2006**

Deborah M. Castiglioni	Cutter & Company, Inc.	Chesterfield, MO
Terry L. Lister	Cambridge Investment Research, Inc.	Fairfield, IA

Vacancy\*

\* This vacancy was created by the resignation of Richard J. Miller.

**District 4 Nominating Committee — Chair: Norman Frager**

Committee members to be elected to terms expiring January 2004: 5

**Committee Members**

Norman Frager	Flagstone Securities, LLC	St. Louis, MO
E. John Moloney	Moloney Securities Co., Inc.	St. Louis, MO
Rodger O. Riney	Scottrade, Inc.	St. Louis, MO
Jeffrey A. Schuh	Wells Fargo Investment Services	Minneapolis, MN
Gail Werner-Robertson	GWR Investments, Inc.	Omaha, NE

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**District 5 Committee And District Nominating Committee Members**

**Warren A. Butler, Jr., District Director**

1100 Poydras Street, Energy Centre, Suite 850, New Orleans, LA 70163 (504) 522-6527

**District 5 Committee — Chair: David W. Wiley, III**

Members to be elected to terms expiring January 2007: 3

**Committee members to serve until January 2004**

David A. Knight	Stephens Inc.	Little Rock, AR
Lawrence J. Sisung, Jr.	Sisung Securities Corporation	New Orleans, LA
David W. Wiley, III	Wiley Bros., Aintree Capital, LLC	Nashville, TN

**Committee members to serve until January 2005**

John J. Dardis	Jack Dardis & Associates, Ltd.	Metairie, LA
J. Timothy Rice	Rice, Voelker, LLC	Covington, LA
James T. Ritt	Morgan Keegan & Company, Inc.	Memphis, TN

**Committee members to serve until January 2006**

Victor E. Blaylock	BancorpSouth Investment Service, Inc.	Jackson, MS
Carolyn R. May	Benchmark Investments, Inc.	Arkadelphia, AR
F. Eugene Woodham	Sterne, Agee & Leach, Inc.	Birmingham, AL

**District 5 Nominating Committee — Chair: Duncan F. Williams**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

Carl W. Busch	Prudential Securities Incorporated	Edmond, OK
E. Douglas Johnson, Jr.	Johnson Rice & Company	New Orleans, LA
James M. Rogers	J.J.B. Hilliard, W.L. Lyons, Inc.	Louisville, KY
William L. Tedford, Jr.	Stephens Inc.	Little Rock, AR
Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN

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**District 6 Committee And District Nominating Committee Members**

**Virginia F.M. Jans, District Director**

12801 N. Central Expressway, Suite 1050, Dallas, TX 75243 (972) 701-8554

**District 6 Committee — Chair: R. Dwayne Whitehead**

Members to be elected to terms expiring January 2007: 3

**Committee members to serve until January 2004**

Christopher R. Allison	M.E. Allison & Co., Inc.	San Antonio, TX
David W. Turner	Wachovia Securities, Inc.	Ft. Worth, TX
R. Dwayne Whitehead	Coastal Securities L.P.	Houston, TX

**Committee members to serve until January 2005**

Donaldson D. Frizzell	First Command Educational Foundation	Fort Worth, TX
Sennett Kirk, III	Kirk Securities Corporation	Denton, TX
V. Keith Roberts	VALIC Financial Advisors	Houston, TX

**Committee members to serve until January 2006**

Brent T. Johnson	IFG Network Securities, Inc.	Houston, TX
John R. Muschalek	First Southwest Company	Dallas, TX
Robert L. Nash	SWS Securities, Inc.	Dallas, TX

**District 6 Nominating Committee — Chair: Frederick W. McGinnis**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

C. Ronald Baker	Williams Financial Group	Lubbock, TX
Robert A. Estrada	Estrada Hinojosa & Company, Inc.	Dallas, TX
Fredrick W. McGinnis	UBS PaineWebber, Inc.	Houston, TX
Edward M. Milkie	Milkie/Ferguson Investments, Inc.	Dallas, TX
Jim G. Rhodes	Rhodes Securities, Inc.	Fort Worth, TX

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**District 7 Committee And District Nominating Committee Members**

**Alan M. Wolper, District Director**

One Securities Centre, Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305 (404) 239-6128

**District 7 Committee — Chair: Kenneth W. McGrath**

Members to be elected to terms expiring January 2007: 3

Member to be elected to terms expiring January 2005: 1

**Committee members to serve until January 2004**

Kenneth W. McGrath	Popular Securities, Inc.	Hato Rey, PR
C. John O'Bryant, III	Legg Mason Wood Walker, Inc.	Raleigh, NC
Charles R. Roberts	RBC Dain Rauscher, Inc.	Richmond, VA

**Committee members to serve until January 2005**

Jeffrey P. Adams	Balentine & Company	Atlanta, GA
Richard G. Averitt, III	Raymond James Financial Services, Inc.	St. Petersburg, FL
Roark A. Young*	Young, Stovall and Company	Miami, FL

\* Term expires January 2004—appointed to fill vacancy created by the resignation of Harold F. Corrigan.

**Committee members to serve until January 2006**

Joseph B. Gruber	FSC Securities Corporation	Atlanta, GA
Dennis S. Kaminski	Mutual Service Corporation	West Palm Beach, FL
James A. Klotz	First Miami Securities, Inc.	North Miami Beach, FL

**District 7 Nominating Committee — Chair: Edward R. Hipp, III**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

James W. Hamilton	Morgan Keegan & Co.	Atlanta, GA
Michael D. Hearn, Esq.	Banc of America Investment Services, Inc.	Charlotte, NC
Edward R. Hipp, III	Legg Mason Wood Walker, Inc.	Norfolk, VA
J. Lee Keiger, III	Davenort & Company, LLC	Richmond, VA
John W. Waechter	William R. Hough & Co.	St. Petersburg, FL

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### District 8 Committee And District Nominating Committee Members

#### Carla A. Romano, District Director

55 West Monroe Street, Suite 2700, Chicago, IL 60603 (312) 899-4324

#### William Jackson, Jr., District Director

1350 Euclid Avenue, Suite 650, Cleveland, OH 44115 (216) 592-2951

### District 8 Committee — Chair: Gregory W. Goelzer

Members to be elected to terms expiring January 2007: 3

#### Committee members to serve until January 2004

George E. Bates	Bates Securities, Inc.	Rockford, IL
Gregory W. Goelzer	Goelzer Investment Management, Inc.	Indianapolis, IN
Jay B. MacKenzie	Prudential Securities Incorporated	Grand Rapids, MI

#### Committee members to serve until January 2005

Bernard A. Breton	Carillon Investments, Inc.	Cincinnati, OH
Donald A. Carlson	B.C. Ziegler and Company	Chicago, IL
William K. Curtis	M & I Brokerage Services, Inc.	Milwaukee, WI
Gerald L. Oaks	Legg Mason Wood Walker, Inc.	Cincinnati, OH
Jill R. Powers	Oberlin Financial Corporation	Bryan, OH

#### Committee members to serve until January 2006

Wilbur H. Burch	J.B. Hanauer & Co.	Chicago, IL
Thomas M. McDonald	Wayne Hummer Investments, LLC	Chicago, IL
James J. Roth	Pershing Division of Donaldson, Lufkin & Jenrette Securities Corporation	Oak Brook, IL

### District 8 Nominating Committee — Chair: Wallen L. Crane

Committee members to be elected to terms expiring January 2004: 5

#### Committee members

Wallen L. Crane	Citigroup Global Markets, Inc.	Toledo, OH
Mary D. Esser	Cressman Esser Securities, Inc.	Naperville, IL
Wayne F. Holly	Sage, Ruttly & Co., Inc.	Rochester, NY
L. Gene Tanner	NatCity Investments, Inc.	Indianapolis, IN
Rodney Trautvetter	Harris Investor Services, LLC	Chicago, IL

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**District 9 Committee And District Nominating Committee Members**

**John P. Nocella, District Director**      1835 Market Street, Suite 1900, Philadelphia, PA 19103      (215) 963-1992  
**Gary K. Liebowitz, District Director**      581 Main Street, 7th Floor, Woodbridge, NJ 07095      (732) 596-2025

**District 9 Committee — Chair: Jerry V. Duhovic**

Members to be elected to terms expiring January 2007      3  
Member to be elected to terms expiring January 2005      1

**Committee members to serve until January 2004**

Jerry V. Duhovic	Ameritrade, Inc.	Bellevue, NE
Kimberly Tillotson Fleming	Hefren-Tillotson, Inc.	Pittsburgh, PA
Howard B. Scherer	Janney Montgomery Scott LLC	Philadelphia, PA
Mark Thomas Whaley	RBC Dain Rauscher Inc.	Florham Park, NJ

**Committee members to serve until January 2005**

James E. Bickley	Cresap, Inc.	Radnor, PA
Michael B. Row	Pershing Division of Donaldson, Lufkin & Jenrette Securities Corporation	Jersey City, NJ
Michael S. Mortensen*	PNC Investments	Pittsburgh, PA

\* Term expires January 2004—appointed to fill vacancy created by the resignation of Frank D. Ruscetti.

**Committee members to serve until January 2006**

Robert M. Berson	Ryan, Beck & Co., LLC	Livingston, NJ
Richard Grobman	Fahnestock & Co., Inc.	Philadelphia, PA
W. Dean Karrash	Rutherford, Brown & Catherwood, LLC	Philadelphia, PA

**District 9 Nominating Committee — Chair: A. Louis Denton**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

A. Louis Denton	Philadelphia Corporation for Investment Services	Philadelphia, PA
James D. Lambe	Spear, Leeds & Kellogg	New York, NY
Lance A. Reihl	1717 Capital Management Co.	Berwyn, PA
Lenda P. Washington	GRW Capital Corporation	Washington, DC
Gregory R. Zappala	J.P. Morgan Securities	Cranberry Township, PA

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## District 10 Committee And District Nominating Committee Members

**Cathleen F. Shine, District Director**     One Liberty Plaza, 49th Floor, 165 Broadway, New York, NY 10006  
(212) 858-4180

### District 10 Committee — Chair: Charles V. Senatore

Members to be elected to terms expiring January 2007:     4

Member to be elected to terms expiring January 2005:     1

#### Committee members to serve until January 2004

Ruth S. Goodstein	UBS PaineWebber Inc.	New York, NY
Patrick Remmert	Credit Suisse First Boston Corporation	New York, NY
Charles V. Senatore	Fidelity Risk Oversight Group, FMR Corporation	New York, NY
Jeffrey R. Zuckerman	Salomon Smith Barney Inc.	New York, NY

#### Committee members to serve until January 2005

Jennifer A. Connors	ITG Inc.	New York, NY
Christopher R. Franke*	J.P. Morgan Securities Inc.	New York, NY
Joan E. Hoffman	Deutsche Banc A.G.	New York, NY
Bertram J. Riley Sr.	Petersen Investments, Inc.	New York, NY
Mark W. Ronda	Fahnestock & Co. Inc.	New York, NY

\* Term expires January 2004—appointed to fill vacancy created by the resignation of Nathalie P. Maio.

#### Committee members to serve until January 2006

Raymond C. Holland, Sr.	Triad Securities Corp.	New York, NY
Vicki Z. Holleman	Loeb Partners Corporation	New York, NY
Andrew H. Madoff	Bernard L. Madoff Investment Services LLC	New York, NY
Richard J. Paley	Fox-Pitt, Kelton Inc.	New York, NY

### District 10 Nominating Committee — Chair: Tom M. Wirtshafter

Committee members to be elected to terms expiring January 2004:     5

#### Committee members

Kevin J. Browne	Banc of America Securities	New York, NY
Judith R. MacDonald	Rothschild, Inc.	New York, NY
Eugene A. Schlanger	Nomura Holding America, Inc.	New York, NY
Stephen C. Strombelline	Barclays Capital Inc.	New York, NY
Tom M. Wirtshafter	AXA Advisors, LLC	New York, NY



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**District 11 Committee And District Nominating Committee Members**

**Frederick F. McDonald, District Director**

260 Franklin Street, Suite 1600, Boston, MA 02110

(617) 261-0805

**District 11 Committee — Chair: John I. Fitzgerald**

Members to be elected to terms expiring January 2007: 3

**Committee members to serve until January 2004**

John I. Fitzgerald	Leerink Swann & Company	Boston, MA
Robert V. Rodia	People's Securities, Inc.	Bridgeport, CT
Gregory D. Teese	Equity Services, Inc.	Montpelier, VT

**Committee members to serve until January 2005**

Michael C. Braun	Moors & Cabot, Inc.	Boston, MA
Andrew F. Detwiler	Vandham Securities Corp.	Plymouth, MA
Thomas J. Horack	John Hancock Life Insurance Company	Boston, MA

**Committee members to serve until January 2006**

Mark R. Hansen	State Street Global Markets, LLC	Boston, MA
Gregg A. Kidd	Pinnacle Investments, Inc.	East Syracuse, NY
Lee G. Kuckro	Advest, Inc.	Hartford, CT

**District 11 Nominating Committee — Chair: Stephen O. Buff**

Committee members to be elected to terms expiring January 2004: 5

**Committee members**

Stephen O. Buff	Fleet Securities, Inc.	Boston, MA
Richard J. DeAgazio	Boston Capital Services, Inc.	Boston, MA
John D. Lane	Lane Capital Markets LLC	Fairfield, CT
Dennis R. Surprenant	Cantella & Co., Inc.	Boston, MA
Peter T. Wheeler	Commonwealth Financial Network	Waltham, MA

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## ATTACHMENT B

### District Election Procedures for District Committees and District Nominating Committees

#### Regular Election

1. Each NASD District shall maintain a District Nominating Committee in the manner specified in Article VIII of the By-Laws of NASD Regulation, Inc.
2. The Secretary of NASD Regulation will notify in writing the Chairman of each District Committee and the Chairman of the District Nominating Committee of the upcoming vacancies on both the District Committee and the District Nominating Committee, and the procedures to follow to fill the vacancies. A copy of these letters will be provided to the District Directors.

The District Nominating Committee will be provided by NASD Regulation staff with information considered relevant to the nominating process, including statistical data pertaining to the District membership.

3. The Secretary of NASD Regulation will remind all members of their responsibility and obligation to keep current and accurate information on their Executive Representatives and branch office addresses. This reminder will contain a reference to the NASDR Web Site ([www.nasdr.com](http://www.nasdr.com)) and detail the process for changing a firm's Executive Representative. Please note that failure to keep this information accurate may jeopardize the member's ability to participate in District elections as well as other member votes.
4. The Secretary of NASD Regulation on behalf of the District Committee Chairmen will send a Notice to Members announcing the forthcoming elections to the Executive Representative and each branch office of all members eligible to vote in that District. The Notice to Members will contain: a) the number of vacancies for each District; and b) the remaining members of each District Committee. Members interested in serving on the District Committee or District Nominating Committee will be requested to complete the candidate profile sheet and submit it to the District Nominating Committee Chairman or the District Director. The completed candidate profile sheet will be provided to all Nominating Committee members for review.
5. The District Nominating Committee will endeavor to secure appropriate and fair representation on the District Committee and on the District Nominating Committee of the various sizes and types of NASD members engaged in the investment banking or securities business within the District.
6. The District Nominating Committee will review the background and qualifications of the proposed candidates and the profile information provided by staff, and will determine its slate of candidates for the election.

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7. On or about September 12, 2003, the District Nominating Committee will certify to the District Committee each candidate nominated by the District Nominating Committee.
  8. Within five (5) calendar days after this certification, a Notice to Members shall be sent to Executive Representatives communicating the nominees for the vacancies on the District Committees and District Nominating Committees.
  9. If an officer, director, or employee of an NASD member is interested in being considered as an additional candidate by contesting the election, he/she must indicate his/her interest to the District Director within fourteen (14) calendar days of the date of the Notice to Members referenced in #8 above. The District Director shall make a written record of the time and date of such notification and the process will continue as described in #10 - #13.

If an additional candidate does not come forward within 14 days, the election of committee members is complete.

10. The Secretary of NASD Regulation shall provide a list of all NASD members eligible to vote in the District and their Executive Representatives to the additional candidate(s) immediately following receipt of the additional candidate's notice by the District Director.
11. Additional candidate(s) may be nominated if a petition signed by the Executive Representative of at least 10 percent of the members eligible to vote in the District is filed with the District Nominating Committee within 30 calendar days from the mailing date of the list referenced in #10 to the additional candidate(s).
12. If no additional candidate(s) are nominated within the 30-calendar day period, then the candidates nominated by the District Nominating Committee shall be considered duly elected, and the District Committee shall certify the election to the Board of Directors of NASD Regulation.
13. If any additional candidate(s) are nominated, the procedures outlined in the Contested Election Procedures will apply.

Additional information pertaining to the District Election Procedures can be found in Article VIII of the By-Laws of NASD Regulation.

**Candidate Profile Sheet****Current Employment**

Name: \_\_\_\_\_ CRD#: \_\_\_\_\_

Firm: \_\_\_\_\_ #RRs at Firm: \_\_\_\_\_

Title/Primary Responsibility: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ State: \_\_\_\_\_ Zip: \_\_\_\_\_

Phone: \_\_\_\_\_ Fax: \_\_\_\_\_

E-mail: \_\_\_\_\_

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

Firm: \_\_\_\_\_

Title/Primary Responsibility: \_\_\_\_\_

Firm: \_\_\_\_\_

Title/Primary Responsibility: \_\_\_\_\_

**General Areas of Expertise** (please check all that apply)

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

**Product Expertise** (please check all that apply)

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

**Memberships/Positions Held in Trade or Business Organizations**

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Past NASD Experience and Dates of Service** (please check all that apply)
 Committee Member (Identify committee: \_\_\_\_\_ ) Approx. Dates: \_\_\_\_\_

 Arbitrator Approx. Dates: \_\_\_\_\_

 Mediator Approx. Dates: \_\_\_\_\_

 Expert Witness (arbitrations; disciplinary proceedings): Approx. Dates: \_\_\_\_\_

 Other: Approx. Dates: \_\_\_\_\_
**Educational Background**

School: \_\_\_\_\_ Degree: \_\_\_\_\_

School: \_\_\_\_\_ Degree: \_\_\_\_\_

# Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management

## KEY TOPICS

Consultative Committees  
District Committees  
Enforcement Actions  
Market Regulation Committee

## INFORMATIONAL

### NASD Consultative Committees

Clarification of NASD Establishment of Consultative Committees

#### Executive Summary

NASD is issuing this *Notice* to replace and supersede *Notice to Members 03-10*, which discussed the establishment of Consultative Committees. This *Notice* repeats the information in *Notice to Members 03-10*, and clarifies that materials arising out of staff discussions with Consultative Committee members are protected from discovery in NASD proceedings.

NASD regulatory staff believes that greater industry input into its investigatory process would be particularly valuable in responding to emerging regulatory issues, particularly given the technological and marketplace developments that have taken place over the past few years. To provide staff with a resource for obtaining the benefits of industry expertise during the course of an investigation, NASD has established Consultative Committees, on a pilot basis. NASD also has developed procedures for the operation of these committees that provide staff with flexibility to obtain information from industry representatives without compromising the staff's autonomy in performing its regulatory obligations.

#### Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Jeffrey S. Holik, Senior Vice President, Member Regulation, at (202) 728-8387; or Katherine A. Malfa, Vice President, Enforcement, at (202) 974-2853.

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## Background

During the course of an investigation, NASD staff may encounter situations where industry expertise would be a useful resource. Such situations may arise, for example, as the result of new or complex securities products, technological developments, or industry practices. In these instances, NASD staff could benefit from industry experience to provide information on the background, operation, or scope of these products, developments or practices so that the staff can heighten its understanding regarding the extent to which the product, development, or practice raises regulatory concern. NASD believes consultation with industry representatives for this purpose produces more informed regulation.

It is critical that consultations by NASD staff with industry representatives do not impinge on the staff's independence and autonomy in deciding whether and how to investigate or prosecute any particular matter. To ensure that the staff has the ability to obtain information on industry practices and developments in connection with an investigation without raising concerns about the staff's independence, NASD has established, on a pilot basis, Consultative Committees that will be available to the staff as a source of industry-related information. NASD also has developed guidelines concerning the operation of these committees to ensure that the committees are consulted and provide services in an appropriate manner.<sup>1</sup>

## Consultative Committees

NASD has established one Consultative Committee for each NASD region that will be responsible for providing information to NASD staff on issues arising out of investigations. Each Consultative Committee will be composed of former District Committee members from the Committees in their region. Former District 10 Committee members and former Market Regulation Committee industry members together will be treated as representatives of one region for these purposes and will comprise one Consultative Committee.<sup>2</sup>

Former District Committee members eligible to serve on Consultative Committees are those who have just completed their third year of a three-year term and are not being reappointed to the District Committee. These representatives will be invited to serve two-year terms on the Consultative Committee for their region, and may continue to participate beyond the two years as necessary to complete the consultation process on a matter that was pending before the two-year term expired. Each Consultative Committee will range in size from approximately six to nine members during the first year of operation, and contain between approximately twelve and eighteen members thereafter.

Consultative Committee members will be required to sign, at the beginning of their term, an agreement that contains provisions regarding confidentiality and conflicts of interest. In addition, members will be advised at each meeting of the confidential nature of the matters presented to them. Members also will

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be reminded at each meeting that their function is strictly advisory and they will have no role in determining whether a regulatory proceeding will be initiated in any matter. Further, staff will be advised that there are no circumstances in which it may ask Consultative Committee members whether NASD should initiate a proceeding.

NASD has adopted internal procedures to ensure that this program does not impinge upon the independence of NASD staff and to coordinate this program with NASD's other regulatory operations. For example, NASD staff will be permitted to seek information from a Consultative Committee only when authorized to do so by a District Director or the Executive Vice President from Market Regulation or Enforcement (or their designees). Further, if the appropriate staff authorizes a consultation with a Consultative Committee, the staff will maintain careful records of the consultation with the Consultative Committee and will provide this information to the relevant departments of NASD. These procedures maintain the staff's independence and ensure that the Consultative Committees will not influence inappropriately determinations to bring disciplinary actions. The procedures also ensure that the staff responsible for assigning hearing panelists to disciplinary matters is aware of those potential panelists who may be recused from a particular matter because they participated in a Consultative Committee meeting where the matter was discussed.

## Endnotes

- 1 In response to a report issued by the SEC in 1996 pursuant to Section 21(a) of the Securities Exchange Act of 1934 (Section 21(a) Report), NASD undertook, among other things, to provide for the autonomy and independence of its staff with respect to disciplinary matters where the commercial interests of NASD's members could be inappropriately asserted. See Undertaking No. 4, Section 21(a) Report. The internal procedures established for the operation of Consultative Committees are consistent with the undertakings and principles of independence articulated in the Section 21(a) Report.
- 2 Information and documents presented to or discussed with members of the District Committees, Market Regulation Committee, Consultative Committees, and other NASD standing committees, as well as discussions concerning the information and documents, are protected from discovery in NASD disciplinary proceedings pursuant to Rule 9251(b)(1) of the NASD Code of Procedure and other applicable privileges.

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## Disciplinary and Other NASD Actions

### REPORTED FOR JUNE

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 May 2003.

### Firm Expelled

**Millennium Securities Corp. (CRD #31695, New York, New York)** submitted an Offer of Settlement in which the firm was expelled from NASD membership. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it employed a statutorily disqualified person in various capacities and entered into a consulting agreement with the individual. The findings also stated that the firm sold penny stocks without obtaining a signed and dated statement from each customer acknowledging receipt of the required penny stock transaction risk disclosure statement; without disclosing the bid and ask price prior to the transactions; without disclosing prior to, and at the time of confirmation, compensation to the firm and registered representative; without obtaining a written suitability statement; and without obtaining a trade agreement and a signed and dated written statement from each purchaser relating to the purchaser's financial condition, investment experience, and investment objectives prior to effecting transactions. In addition, NASD found that the firm, acting through an employee, executed unauthorized transactions in the accounts of public customers without the customers' prior knowledge, authorization, or consent. (NASD Case #C04020030)

### Firms Fined

**Acument Securities, Inc. (CRD #7661, San Francisco, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, acting through its securities division, it advertised on the World Wide Web that it would effect retail customer transactions for market orders at certain prices, and failed to disclose that in some cases, where multiple executions at different prices were required to fill a market order, it charged a commission for each execution. (NASD Case #C01030009)

**Briarcliff Capital Corp. (CRD #14178, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000, jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report customer complaints to NASD. The findings also stated that the firm



failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations in that it had no supervisory system or written procedures relating to compliance with NASD customer complaint reporting requirements. (NASD Case #C07030023)

**Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney, Inc. (CRD #7059, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$225,000, including disgorgement of profits of \$125,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, as managing underwriter or syndicate member in hot initial public offerings (IPOs), placed an aggregate of shares of cancelled customer orders into proprietary branch error accounts after secondary trading commenced, and sold those shares at a profit. The findings also stated that the firm failed to have an adequate system in place to ensure that customer cancellations of IPO allocations were properly handled in compliance with NASD's Free-Riding and Withholding Rule. (NASD Case #C05030021)

**Domestic Securities, Inc. (CRD #34721, Montvale, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$22,500, and required to revise its written supervisory procedures concerning the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) rule within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it transmitted to OATS execution reports that contained inaccurate, incomplete, or improperly formatted data that failed to match to an Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) trade report, or contained inaccurate timestamps. The findings also stated that the firm failed to timely report to OATS Reportable Order Events (ROE) and re-submitted repaired ROEs that were previously rejected without making these ROEs with the Rejected ROE Resubmit Flag, "Y."

In addition, NASD found that the firm submitted to OATS reports with respect to equity securities traded on The NASDAQ Stock Market that were not in the electronic form prescribed by NASD. The subject reports were rejected by the OATS system, and notice of such rejection was made available to the firm on the OATS Web Site. Furthermore, NASD found that the firm failed to correct or replace the subject reports representing 100 percent of all rejected ROEs. NASD also found that the firm transmitted to OATS reports for preferenced SelectNet<sup>®</sup> orders that the firm was not required to submit. Moreover, NASD found that the firm made available a report on the covered orders in national market system securities that it received for execution from any person that included incorrect information as to at least six security/size/type categories. NASD also found that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning OATS. (NASD Case #CMS030101)

**Intersecurities, Inc. (CRD #16164, St. Petersburg, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$125,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that its procedures failed to adequately provide for identification of correspondence as customer complaints and, therefore, failed to report certain customer complaints; and that the firm failed to maintain and preserve in each office of supervisory jurisdiction all written customer complaints in either a separate file of customer complaints and action taken by the firm, if any, or a separate record of such complaints, and a clear reference to the files containing the correspondence connected with such complaints as maintained in each office. In addition, NASD found that the firm failed to conduct adequate supervisory reviews of the complaint-handling process and did not provide adequate guidelines for conducting, tracking, and documenting customer complaint investigations.

NASD also found that the firm failed to provide adequate suitability guidance on variable universal life insurance transactions for registered representatives in connection with making recommendations for purchases or exchanges, allocating premium payments to sub-accounts, and recording and documenting the suitability of the transaction. Furthermore, NASD found that the firm failed to demonstrate that it made reasonable efforts to obtain information critical in making a determination of suitability and conducting related supervisory reviews, and information required for its books and records to be in conformity with applicable laws, rules, regulations, and statements of policy prescribed by the Securities and Exchange Commission (SEC) and NASD. Moreover, NASD found that the firm failed to obtain information regarding prior investment experience, liquid net worth, risk tolerance, time horizon, and investment objectives. NASD also found that the firm failed to establish procedures for the periodic review of customer account activity through surveillance of transactions in variable products to identify possible sale practice abuses. (NASD Case #C05030020)

**McDonald Investments, Inc. (CRD #566, Cleveland, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to the Fixed Income Pricing System<sup>SM</sup> (FIPS<sup>SM</sup>) transactions in FIPS securities within five minutes after execution. The findings also stated that the firm incorrectly reported to FIPS transactions in FIPS securities that the firm should not have reported to FIPS under the FIPS rules. NASD also found that the firm incorrectly reported to FIPS transactions in high-yield securities that the firm should not have reported to FIPS under the FIPS rules. (NASD Case #CMS030089)

**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 and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening, received a Trade-or-Move message in each instance through SelectNet, and within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. (NASD Case #CMS030090)

**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 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 reported to OATS execution reports that contained inaccurate, incomplete, or improperly formatted data that failed to match to an ACT trade report. The findings also stated that the firm transmitted to OATS reports containing inaccurate data as to the receiving terminal ID, receiving department ID, and originating department ID. (NASD Case #CMS030093)

**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 \$10,000, and required to revise its written supervisory procedures concerning SEC Rule 15c2-11 and NASD Marketplace Rule 6740 within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published quotations for an OTC Equity Security or, directly or indirectly, submitted such quotations for publication in a quotation medium and did not have in its records the documentation required by SEC Rule 15c2-11(a); did not have a reasonable basis under the circumstances for believing that the information was accurate in all material respects; or did not have a reasonable basis under the circumstances for believing that the sources of the information were reliable. NASD found that the quotations did not represent a customer's indication of unsolicited interest. The findings also stated that the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotations medium. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning SEC Rule 15c2-11 and NASD Marketplace Rule 6740. (NASD Case #CMS030108)

**National Financial Services, LLC (CRD #13041, Boston, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,000. Without admitting or denying the allegations, the firm

consented to the described sanctions and to the entry of findings that it failed to correctly report trades with the ".PRP" modifier. The findings also stated that the firm failed to display immediately customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer 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. In addition, NASD found that the firm failed to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities in a principal or agency capacity. NASD also found that the firm failed to report to ACT the correct designation indicating whether the firm executed transactions in eligible securities as riskless principal transactions. (NASD Case #CMS030104)

**NexTrade, Inc. (CRD #41087, Clearwater, 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 submit OATS data relating to the execution of customer limit orders. The findings also stated that the firm incorrectly identified market orders as limit orders when submitting new order reports to OATS. In addition, NASD found that the firm transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data that failed to match to an ACT trade report. (NASD Case #CMS030091)

**Southwest Securities, Inc. (CRD #6220, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to pay \$356.95, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, in transactions for or with a customer, to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. (NASD Case #CMS030110)

**Susquehanna Capital Group (CRD #29337, Bala Cynwyd, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$35,000, and required to revise its written supervisory procedures concerning the OATS rule within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening, received a Trade-or-Move message in each instance through SelectNet, and within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have

unlocked/uncrossed the market. The findings also stated that the firm transmitted to OATS reports that contained improperly formatted data, in that the reports contained timestamps using a standard 12-hour clock rather than 24-hour clock. In addition, NASD found that the firm transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data, in that the reports contained inaccurate Account Type Codes and Routed Order IDs. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning reporting to OATS with a timestamp using a 24-hour clock. (NASD Case #CMS030087)

**Terra Nova Trading, LLC (CRD #37761, Chicago, Illinois)** 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 short-sale rules within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short-sale transactions in NASDAQ National Market® (NNM®) securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. The findings also stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning short sales. (NASD Case #CMS030102)

**Track Data Securities Corporation (CRD #103802, Brooklyn, New Jersey)** 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 the OATS rule within 30 business days. 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 126 business days. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning OATS. (NASD Case #CMS030084)

## Firm Fined, Individuals Sanctioned

**Investors Capital Corporation (CRD #30613, Lynnfield, Massachusetts), Timothy Boyle Murphy (CRD #2132822, Registered Representative, Quincy, Massachusetts), and C. David Weller (CRD #1004604, Registered Representative, Dover, New Hampshire)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$250,000, jointly and severally. Murphy was fined \$175,000, jointly and severally, and suspended from association with any NASD member in a principal capacity for 30 days. Weller was

fined \$75,000, jointly and severally, and suspended from association with any NASD member in a principal capacity for nine months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm's written supervisory procedures and policies and its supervisory system were deficient in several areas, including branch office inspections, heightened supervision, outside business activities, review of customer transactions, designation of principals, representatives' outside brokerage accounts, anti-money laundering, and advertising. The findings stated that the firm failed to enforce its written supervisory procedures on a consistent basis in several of those areas and that the firm, acting through Murphy, failed to commit sufficient resources to its supervisory system. Furthermore, the findings stated that Weller failed to ensure that the firm's written supervisory procedures were adequately updated, maintained, and enforced; that they were reasonably designed to achieve compliance with applicable rules and regulations; and that the firm maintained reasonable and adequate supervisory systems. NASD also found that Weller failed to ensure that the compliance staff performed their delegated duties in several areas, such as advertising/sales literature and periodic transactions review of registered individuals' business. Moreover, the findings stated that Weller failed to supervise adequately the firm's registered representatives engaged in private securities transactions.

NASD also determined that the firm, acting through Weller, failed to approve the use of advertising and sales literature that violated NASD advertising rules. In addition, the findings stated that the firm's own Web site omitted material information and contained misleading and unwarranted statements, and that registered individuals posted items on an online bulletin board about the firm's parent company recommending its stock. Furthermore, NASD found that the firm, acting through Weller, failed to make and/or preserve certain books and records and failed to ensure that all customers were afforded with the appropriate "pre-dispute arbitration clause" when opening an account. The findings also stated that the firm, acting through Weller, failed to make and/or preserve certain books and records showing approval and review of Plan business. The firm, acting through Weller, also failed to timely report customer complaints. The firm, acting through Murphy, used the instrumentalities of interstate commerce to conduct a securities business while failing to maintain minimum required net capital.

Murphy's suspension began June 16, 2003, and will conclude at the close of business July 15, 2003. Weller's suspension began June 16, 2003, and will conclude at the close of business March 15, 2004. (NASD Case #C11030012)

## Individuals Barred or Suspended

**Iqbal Ashraf (CRD #1158662, Registered Principal, San Gabriel, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, jointly and severally, suspended from association with any NASD member as a financial and operations principal for 30 days, and ordered to requalify by exam as a financial and operations principal before becoming reassociated with any NASD member. Without admitting or denying the allegations, Ashraf consented to the described sanctions and to the entry of findings that, acting on behalf of his member firm, he utilized the instrumentalities of interstate commerce to engage in the securities business while failing to have and maintain sufficient net capital.

Ashraf's suspension began June 2, 2003, and will conclude at the close of business July 1, 2003. (NASD Case #C02030022)

**Craig Stuart Balsam (CRD #2680237, Registered Representative, Spring Valley, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Balsam consented to the described sanctions and to the entry of findings that he participated in a securities transaction away from his member firm and failed to provide prior written notification to, or obtain written approval from, his member firm.

Balsam's suspension began June 2, 2003, and will conclude at the close of business July 1, 2003. (NASD Case #C10030025)

**Richard Andrew Baumel (CRD #2837559, Registered Representative, Lawrence, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Baumel created a false bank document and altered bank data as to addresses and other details in an effort to gain control over and convert the funds in the dormant account of a deceased public customer. The findings also stated that, in an attempt to gain control over the account, Baumel forged the deceased customer's signature on the back of the bank signature card that he had created. (NASD Case #C10020099)

**Kenneth Ray Bell (CRD #2191634, Registered Representative, Memphis, Tennessee)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Bell effected unauthorized sales in, and cash withdrawals from, a public customer's variable annuity totaling \$124,900, and converted the funds to his own use and benefit without the customer's knowledge or consent. The findings also stated that Bell changed the address on the customer's account to his own home address, received the checks from the unauthorized sales at his own address, added his name as an additional payee on the checks, and deposited

the checks into his personal checking account. NASD also found that Bell admitted receiving the funds to his member firm but asserted that the funds were used for options trading on the customer's behalf. (NASD Case #C05020053)

**Christopher John Benz (CRD #1633349, Registered Principal, Santa Monica, California)** was fined \$25,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Benz reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. The sanctions were based on findings that Benz, acting on behalf of his member firm, utilized the instrumentalities of interstate commerce to engage in the securities business while the firm failed to have and maintain sufficient net capital. The findings also stated that Benz failed to respond to NASD requests for information.

Benz's suspension began May 19, 2003, and will conclude at the close of business November 18, 2003. (NASD Case #C01020014)

**Rakesh Bhakta (CRD #4421133, Associated Person, The Colony, Texas)** 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, Bhakta consented to the described sanction and to the entry of findings that he willfully failed to disclose material information on his Uniform Application for Securities Industry Registration or Transfer Form (Form U-4). The findings also stated that Bhakta failed to respond to NASD requests for information. (NASD Case #C06020015)

**Rex A. Blanton (CRD #4287584, Registered Representative, Connersville, Indiana)** 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, Blanton consented to the described sanction and to the entry of findings that he received an \$84,820 check from a public customer for the payment of insurance premiums, and without the knowledge or consent of the customer, altered the check by adding his name as payee and made it payable to the insurance company and himself. The findings also stated that Blanton endorsed the check and cashed it, applying \$409 of the proceeds toward the payment of the customer's auto insurance and misappropriating the balance for his own use and benefit. (NASD Case #C8A030030)

**Robert James D'Andria (CRD #1916172, Registered Representative, Manasquan, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 days. Without admitting or denying the allegations, D'Andria consented to the described sanctions and to the entry of findings that he failed to disclose material information on his Form U-4.

D'Andria's suspension began June 2, 2003, and concluded at the close of business June 11, 2003. (NASD Case #C9B030023)

**Anthony Lucas DeBenedictis (CRD #2326689, Registered Representative, White Plains, New York)** 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 30 days, and ordered to pay disgorgement of \$381.43, plus interest, in unjust profits in partial restitution to public customers. Without admitting or denying the allegations, DeBenedictis consented to the described sanctions and to the entry of findings that he effected transactions in the joint trust account of public customers without their prior knowledge, authorization, or consent.

DeBenedictis' suspension began May 19, 2003, and will conclude at the close of business June 17, 2003. (NASD Case #C10030028)

**John Oliver Edwards (CRD #1627812, Registered Representative, Cincinnati, Ohio)** 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, Edwards consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing prior written notice to his member firm. The findings also stated that Edwards made improper use of customer funds and caused \$106,000 of charitable remainder trusts, for which he was trustee, to be placed with an entity that purchased a residence in which he resided. In addition, Edwards had a financial benefit in a securities account at an NASD member firm other than his employer, also a NASD member, but did not notify his member firm of the account or notify the member firm carrying the account of his association with another NASD member firm. The findings further stated that Edwards failed to respond to NASD requests for information. (NASD Case #C3A020029)

**David Eugene (CRD #4487526, Associated Person, Miramar, Florida)** was barred from association with any NASD member in any capacity. The sanction is based on findings that Eugene failed to respond to NASD requests for information. The findings also stated that Eugene willfully failed to disclose material information on his Form U-4. (NASD Case #C07020097)

**Joseph Charles Ferragamo (CRD #2868601, Registered Representative, Staten Island, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Ferragamo failed to respond to an NASD request to appear for an on-the-record interview. (NASD Case #CMS020208)

**David Paul Folino (CRD #1371813, Registered Principal, Camarillo, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended

from association with any NASD member in any capacity for three months, and required to disgorge \$17,250, plus interest, in commissions received to be paid as restitution to public customers. Without admitting or denying the allegations, Folino consented to the described sanctions and to the entry of findings that he participated in private securities transactions and failed to provide prior notice, written or otherwise, to his member firm describing the proposed transactions, his role therein, and whether he had received, or might receive, selling compensation in connection with the transactions.

Folino's suspension began June 2, 2003, and will conclude at the close of business September 1, 2003. (NASD Case #C06030006)

**Colby Daniel Furlong (CRD #2755002, Registered Representative, West Liberty, Ohio)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for eight weeks and ordered to pay \$53,000 in restitution to public customers. Without admitting or denying the allegations, Furlong consented to the described sanctions and to the entry of findings that directly and/or indirectly, singly and in concert, by use of the means or instrumentalities of interstate commerce or of the mails, and in connection with the purchase and sale of securities, he knowingly or recklessly engaged in, and/or induced others to engage in a device, scheme, or artifice to defraud; the use of an untrue statement of material fact and/or the omission of material facts necessary to make statements made, in light of the circumstances, not misleading; and acts, practices, or courses of business that operated as a fraud or deceit upon persons. The findings also stated that Furlong solicited and recommended investments to public customers and omitted discussion or disclosure of material negative information and risk.

Furlong's suspension began June 2, 2003, and will conclude July 27, 2003. (NASD Case #CAF020023)

**Maria Teresa Gonzalez (CRD #4441307, Associated Person, Aliso Viejo, California)** submitted an Offer of Settlement in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Gonzalez consented to the described sanction and to the entry of findings that she willfully failed to disclose a material fact on her Form U-4. (NASD Case #C02030006)

**John Goodish (CRD #1411721, Registered Representative, Oakland Park, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Goodish received a \$6,050.18 check from a public customer to purchase a variable universal life insurance policy, endorsed the check, and used the funds for his own purposes. The findings also stated that Goodish failed to respond to NASD requests for information. (NASD Case #C07020098)

**Machella Lavern Graham (CRD #3074650, Associated Person, Sacramento, California)** 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, Graham consented to the described sanction and to the entry of findings that she converted \$7,915.59 belonging to her member firm to her own use and benefit. **(NASD Case #C01030010)**

**Matthew Patrick Green (CRD #4464386, Registered Representative, St. Petersburg, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Green consented to the described sanction and to the entry of findings that he completed an account service form for the account of a public customer that requested his member firm to change the customer's address of record and to liquidate \$7,500 from the customer's account. The findings also stated that Green forged, or caused to be forged, the signature of the customer on the form. NASD also found that a \$7,500 check was sent to an entity under Green's control and that he obtained and used the funds for his own benefit, without the authorization from the customer to change the account address, to sign the customer's name to the form, or to withdraw funds from the account and use them for his own purposes. **(NASD Case #C07030027)**

**Jack Benjamin Grubman (CRD #1505636, Registered Representative, New York, New York)** submitted an Offer of Settlement in which he was fined \$7,500,000, barred from association with any NASD member in any capacity, and ordered to disgorge \$7,500,000. Without admitting or denying the allegations, Grubman consented to the described sanctions and to the entry of findings that he wrote reports regarding a stock that were not based on principles of fair dealing and good faith, and did not provide a sound basis for evaluating facts regarding the stock issuer's business prospects and the risks of investing. The findings also stated that Grubman prepared reports that contained exaggerated, unwarranted, or misleading statements or claims for which there was no reasonable basis while omitting material facts or qualifications, causing the reports to be misleading and not adequately balanced. NASD also found that Grubman's reports contained exaggerated, unwarranted, or misleading statements or claims about a stock's target price, and opinions for which there were no reasonable basis while omitting material facts or qualifications, causing the target price to be unreasonable. In addition, NASD found that Grubman publicly recommended a stock while privately expressing doubts and discussing risk. Moreover, NASD found that Grubman made misrepresentations and omissions of fact in a blast voicemail message regarding the financial situation of a stock issuer, providing exaggerated, unwarranted, or misleading statements or claims and omitting material facts or qualifications causing the statement to be unreasonable. **(NASD Case #CAF020042)**

**Kathryn Lynn Hartley (CRD #3198918, Registered Representative, Mishawaka, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Hartley reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hartley consented to the described sanctions and to the entry of findings that she affixed the signature of a public customer on a policy and illustration acknowledgement receipt form without the customer's knowledge or consent. The findings also stated that Hartley affixed the signature of a public customer on a contract receipt form without the customer's knowledge or consent.

Hartley's suspension began June 2, 2003, and will conclude at the close of business June 1, 2004. **(NASD Case #C8A030031)**

**William John Henderson, III (CRD #1665525, Registered Principal, Rochester, New Hampshire)** 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, Henderson consented to the described sanction and to the entry of findings that he engaged in private securities transactions, for compensation, without providing prior written notice to, and receiving prior written approval from, his member firm. **(NASD Case #C11030015)**

**Douglas John Hershey (CRD #1079473, Registered Representative, Charlotte, North Carolina)** and **Claude William Johnson, III (CRD #1427025, Registered Representative, Charlotte, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which they were each fined \$55,000, which includes disgorgement of \$102,105 in earned commissions, and suspended from association with any NASD member in any capacity for 12 months. The fine must be paid before Hershey or Johnson reassociates with any NASD member following his suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hershey and Johnson consented to the described sanctions and to the entry of findings that they participated in an outside business activity for compensation without providing prompt written notice to their member firm.

Hershey's and Johnson's suspensions began June 2, 2003, and will conclude at the close of business June 1, 2004. **(NASD Case #C07030022)**

**Scott Bradley Hollenbeck (CRD #2097674, Registered Representative, Kernersville, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid

before Hollenbeck reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hollenbeck consented to the described sanctions and to the entry of findings that he participated in private securities transactions, for compensation, and failed to give his member firm prior written notice of his intentions and to receive prior approval from his member firm.

Hollenbeck's suspension began May 19, 2003, and will conclude at the close of business June 17, 2003. (NASD Case #C07030021)

**Christian Johnson (CRD #4218744, Registered Representative, Chicago, Illinois)** 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, Johnson consented to the described sanction and to the entry of findings that he signed the names of public customers to various forms without authorization. The findings also stated that Johnson failed to respond to NASD requests for information. (NASD Case #C8A030029)

**Adam Peter Klein (CRD #2686322, Registered Representative, Staten Island, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Klein failed to respond to an NASD request to appear for an on-the-record interview. (NASD Case #CMS020207)

**Robert Joseph Krause (CRD #2445175, Registered Supervisor, Warwick, 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, Krause consented to the described sanction and to the entry of findings that he, without authorization, reversed margin interest charges of \$1,379.72 in a personal account that he maintained with his member firm. (NASD Case #C9B030020)

**Nicholas John Lomax (CRD #4026204, Registered Representative, Lansing, Michigan)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Lomax received \$778 from a public customer to purchase car insurance, failed to use the funds to purchase insurance, and, instead, used the funds for other purposes thereby misusing the customer's funds. The findings also stated that Lomax failed to respond to an NASD request for information. (NASD Case #C8A020083)

**Miguel Angel Martinez, Sr. (CRD #1018292, Registered Principal, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for nine months. The fine must be paid before Martinez reassociates with any NASD member following

the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Martinez consented to the described sanctions and to the entry of findings that he effected a private securities transaction and failed to provide prior written notification to his member firm.

Martinez' suspension began June 2, 2003, and will conclude at the close of business March 1, 2004. (NASD Case #C10030026)

**Colleen Margaret McLaughlin (CRD #1605063, Registered Representative, Whitinsville, Massachusetts)** 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, McLaughlin consented to the described sanction and to the entry of findings that she photocopied a check from a public customer that had been previously submitted to her member firm; altered the date, the check number, and the amount on the customer's check; and submitted the altered check to her member firm for credit to the customer's account. (NASD Case #C11030016)

**Richard Francis McNally (CRD #329959, Registered Representative, Apopka, Florida)** 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 \$16,592.21, plus interest, in restitution to public customers. The restitution must be paid before McNally requests relief from any statutory disqualification. Without admitting or denying the allegations, McNally consented to the described sanctions and to the entry of findings that he recommended and initiated transactions in the joint securities account of public customers without having reasonable grounds for believing that the recommendations and resulting transactions were suitable for them. The finding also stated that, as a result of McNally's recommendations, the customers' account incurred losses of \$16,592.21. NASD also found that McNally entered into an arrangement with a registered principal at his member firm whose registration had been denied in the State of Rhode Island to use McNally's name and commission number to actively trade the customer's account, receiving approximately \$65,000 in commissions. In addition, NASD found that the customer's account record at the firm had been falsified to reflect McNally as the registered representative. (NASD Case #C11030013)

**Joel Curtis Morgan (CRD #3124059, Registered Representative, Chino, 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, Morgan consented to the described sanction and to the entry of findings that, in an attempt to extricate himself from a controversy between another representative and a public customer, and without his member firm's knowledge or consent, he created a fictitious memorandum and a fictitious trade report on firm letterhead

which misrepresented that the controversy had been resolved in favor of the customer. The findings also stated that Morgan forged the name of another firm employee on the memorandum who was purportedly a "trade desk supervisor" without the employee's knowledge or consent. In addition, NASD found that Morgan submitted the fictitious documents to the firm's representative he was assisting who then gave the false documents to the public customer. (NASD Case #C02030020)

**Robert Dickson Mosby (CRD #1791036, Registered Supervisor, Kirkwood, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$24,350, including disgorgement of \$14,350 in profits, and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Mosby reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Mosby consented to the described sanctions and to the entry of findings that he effected securities transactions for the accounts of public customers and shared in the profits earned on the subsequent sales of the securities without obtaining prior written authorization from his member firm. The findings also stated that Mosby's purchases involved allocations of IPOs that were "hot" and immediately traded in the aftermarket at a premium, violating NASD's Free Riding and Withholding Interpretation.

Mosby's suspension began June 2, 2003, and will conclude at the close of business September 1, 2003. (NASD Case #C05030022)

**Bryan Edward Muller (CRD #2449729, Registered Representative, Seaford, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 90 days. The fine must be paid before Muller reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Muller consented to the described sanctions and to the entry of findings that he solicited individuals to purchase shares of stock and misrepresented and/or omitted material facts and made baseless statements regarding the prospective performance of the stock and the risks involved in investing in the stock.

Muller's suspension began June 2, 2003, and will conclude August 30, 2003. (NASD Case #C10030027)

**Kelly Anderson Penley, III (CRD #4396942, Registered Representative, Belmont, North Carolina)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Penley willfully failed to disclose material facts on his Form U-4. (NASD Case #C07020089)

**Michael Donovan Puls (CRD #2671882, Registered Representative, Lincoln, Nebraska)** 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 three months. The fine must be paid before Puls reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Puls consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, and failed to provide prompt written notice to his member firm.

Puls' suspension began May 19, 2003, and will conclude at the close of business August 18, 2003. (NASD Case #C04030020)

**Rodney Wade Ratcliff (CRD #2587341, Registered Representative, Wesley Chapel, Florida)** 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 Ratcliff reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ratcliff consented to the described sanctions and to the entry of findings that he negotiated and entered into a settlement agreement with a public customer to pay him \$850 to resolve the customer's complaint about a sales charge on a variable universal life product for which Ratcliff was the customer's representative, without the knowledge or consent of his member firms.

Ratcliff's suspension began May 19, 2003, and concluded at the close of business June 2, 2003. (NASD Case #C8B030009)

**Kenneth Wayne Robinson (CRD #1886846, Registered Representative, Houston, Texas)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Robinson engaged in free riding by purchasing and selling securities in the form of put and call options in his personal cash and margin account at his member firm without having the ability or intent to pay for the purchases. The findings stated that Robinson caused his member firm to defer the deposit of cash and securities beyond the time when such transactions would normally be settled or to meet the margin requirements by the liquidation of securities in his margin account. In addition, NASD determined that Robinson intentionally or recklessly misrepresented or omitted to disclose the material facts to his member firm that he could not, or did not, intend to pay for his securities transactions, thereby causing his firm to unwittingly assume the risk of his trading activities. The findings also stated that Robinson failed to respond to NASD requests for information. (NASD Case #C06020020)



**Richard David Russell, Sr. (CRD #1464018, Registered Representative, Wheaton, Illinois)** 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, Russell consented to the described sanction and to the entry of findings that he converted customer funds to his own use that were sent to him for investment purposes. (NASD Case #C8A030033)

**Lionel James Sanchez (CRD #1782052, Registered Principal, Albuquerque, New Mexico)** was barred from association with any NASD member in any capacity and ordered to pay \$341,136 in restitution to public customers. The sanctions were based on findings that Sanchez made unsuitable recommendations to public customers for products issued by entities that he founded, operated, owned, or controlled, or with which he was affiliated, without having reasonable grounds for believing that the recommendations were suitable for the customers based on their other security holdings, financial situation, and needs. The findings also stated that Sanchez failed to respond to NASD requests to appear for an NASD on-the-record interview. (NASD Case #C3A020052)

**Emanuel Louis Sarris, Sr. (CRD #1363059, Registered Representative, New Hope, Pennsylvania)** was fined \$10,000, ordered to requalify by exam before re-entering the securities industry in any capacity, and suspended from association with any NASD member in any capacity for one year. The sanctions were based on findings that Sarris willfully failed to disclose material facts on his Form U-4.

Sarris' suspension began May 5, 2003, and will conclude at the close of business May 4, 2004. (NASD Case #C9A020017)

**Barton Garland Saunders (CRD #2252112, Registered Principal, Lafayette, Indiana)** 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, Saunders consented to the described sanction and to the entry of findings that he created and sent a fictitious account statement to a public customer that falsely indicated the value of the customer's investments in his account. (NASD Case #C8A030027)

**Michael Murray Scott (CRD #2332480, Registered Representative, Willis, Texas)** 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, Scott consented to the described sanction and to the entry of findings that he engaged in an outside business activity, for compensation, and failed to give any notice to his member firm. The findings also stated that Scott failed to respond to NASD requests for information. (NASD Case #C06020022)

**Jackson J. Short (CRD #1879026, Registered Representative, Bryan, 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, Short consented to the described sanction and to the entry of findings that he affixed the signature of a public customer on forms needed to transfer variable annuity policies held in the customer's retirement plan to a separate variable annuity contract. (NASD Case #C8B030010)

**Jack Harry Stein (CRD #1233359, Registered Representative, West Palm Beach, Florida)** was fined \$25,000 and suspended from association with any NASD member in any capacity for three months. The SEC affirmed the sanctions imposed by the National Adjudicatory Council (NAC). The sanctions were based on findings that Stein made unsuitable recommendations and engaged in excessive trading in the account of a public customer. The findings also stated that Stein sold the customer's conservative investments; purchased speculative oil, gas, and mining stocks; and began trading the customer's account on margin.

Stein's suspension began June 2, 2003, and will conclude at the close of business September 1, 2003. (NASD Case #C07000003)

**Clifford Jean St. Simon (CRD #2701335, Registered Principal, Uniondale, New York)** submitted a Letter of Acceptance, Waiver, or Consent in which he was fined \$5,100, including disgorgement of \$100 in commissions, and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, St. Simon consented to the described sanctions and to the entry of findings that he effected transactions in the accounts of public customers without their prior knowledge, authorization, or consent.

St. Simon's suspension began May 19, 2003, and will conclude at the close of business June 17, 2003. (NASD Case #CL1030009)

**John Valentino Tito (CRD #3215150, Associated Person, Brooklyn, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Tito willfully failed to disclose a material fact on his Form U-4. The findings also stated that Tito failed to respond to NASD requests for information. (NASD Case #C10010146)

## 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.

**Theodore Sanidad Alvia (CRD #3086395, Registered Representative, Schaumburg, Illinois)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in the account of public customers without the knowledge or consent of the customers, and in the absence of written or oral authorization to Alvia to exercise discretion in the accounts. The complaint also alleges that Alvia failed to respond to NASD requests for documents and information. (NASD Case #C8A030028)

**Michael Frederick Flannigan (CRD #1135700, Registered Principal, Excelsior, Minnesota), Richard James Cochrane (CRD #1924141, Registered Principal, Edina, Minnesota), Larry Laverne Nelson (CRD #1378197, Registered Principal, Coral Springs, Florida), and Stephen Frank Molinari (CRD #1845773, Registered Principal, Pompano Beach, Florida)** were named as respondents in an NASD complaint alleging that a member firm, acting through Flannigan and Cochrane, employed Molinari as a general securities representative at a firm's branch office and knew, or should have known, that he had not successfully completed the series 24 exam and was not registered as a general securities principal with NASD. The complaint also alleges that Flannigan and Cochrane knew, or should have known, that Molinari was not properly licensed as a general securities principal and allowed, aided, and assisted Molinari to perform the functions of a registered principal. The complaint further alleges that Flannigan, Nelson, and Cochrane failed to establish and maintain a system to supervise the activities of each registered representative and associated person that was reasonably designed to achieve compliance with applicable laws, rules, and regulations related to obtaining customer account information for customers.

In addition, the complaint alleges that a member firm, acting through Flannigan, Cochrane, and Nelson, failed to obtain vital customer information and to transcribe it upon the new account forms relating to the firm's participation in an offering, and failed to obtain suitability information regarding customers who purchased shares in the offering. Furthermore, the complaint alleges that Nelson permitted, aided, and assisted an individual in performing the functions of a registered representative when he was not registered with NASD. Moreover, the complaint alleges that Flannigan, Nelson, and Cochrane participated in an offering and failed to comply with SEC penny stock rules. Furthermore, the complaint alleges

that Molinari acted in a supervisory capacity without proper registration, and permitted and assisted an individual in engaging in the securities business and/or functioning as a representative prior to properly qualifying and/or registering in the appropriate capacity with NASD. In addition, the complaint alleges that Molinari failed to respond to NASD requests for information and engaged in private securities transactions, for compensation, without providing written notice to, and obtaining written authorization from, his member firm. Moreover, the complaint alleges that Molinari, by the use or instrumentalities of interstate commerce or the mails, participated in securities transactions through accounts for which he was account representative, and intentionally or recklessly misrepresented and failed to disclose material facts. (NASD Case #C04030024)

**Ralph Timothy Grubb (CRD #1528906, Registered Representative, Johnson City, Tennessee)** was named as a respondent in an NASD complaint alleging that he recommended and effected the sale of deferred variable annuity contracts to public customers without having a reasonable basis for believing that the transactions were suitable for the customers based on their financial situations and needs. (NASD Case #C05030019)

**David William Haburjak (CRD #2233093, Registered Representative, W. Gastonia, North Carolina)** was named as a respondent in an NASD complaint alleging that he failed to follow the instructions of a public customer and change the sub-account investments of the customer from the existing growth mutual funds to other growth mutual funds. The complaint also alleges that Haburjak changed the address of record on the account of a public customer without her knowledge or consent, and prepared written statements to his member firm that falsely represented that he did not change the customer's address. In addition, the complaint alleges that Haburjak misrepresented to a public customer the current value and interest percentage paid on her account. Moreover, the complaint alleges that Haburjak failed to respond to NASD requests to appear and give testimony. (NASD Case #C07030028)

**Jeffrey John Miller (CRD #2576559, Registered Principal, Onalaska, Wisconsin)** was named as a respondent in an NASD complaint alleging that he recommended to, and effected securities transactions for, public customers without having reasonable grounds for believing that the recommendations and resulting transactions were suitable for the customers based on their financial situation, investment objectives, and needs. The complaint also alleges that Miller induced the offer and sale of the securities to public customers by making untrue statements of material fact or omitting to state material facts necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading.

In addition, the complaint alleges that Miller received approximately \$53,643 in commissions for the sale of the variable life insurance policies and sent a \$50,000 check to an insurance company to pay the premiums and fund the policies, moved the money out of his checking account so that the check would not clear, and failed to return the commissions and cancel the policies but used the commission for his own benefit. Furthermore, the complaint alleges that Miller failed to respond completely to NASD requests to provide documents and information. (NASD Case #C8A030026)

**Wayne Richardson (CRD #2074676, Registered Principal, Smithtown, New York)** was named as a respondent in an NASD complaint alleging that he executed transactions in the account of a public customer that were excessive in volume and frequency in view of the customer's financial circumstances, investment objectives, and needs. The complaint also alleges that Richardson's trading strategy involved substantial use of margin and aggressive options trading. (NASD Case #C10030021)

**Donald Gene Schuster (CRD #2598174, Registered Representative, Tigard, Oregon)** was named as a respondent in a complaint alleging that, while he was the treasurer of a company, he issued checks drawn on the company's bank account for \$27,198.60 that were made payable to an account that the respondent controlled. The complaint also alleges that, by endorsing the checks, Schuster converted the funds to his own use and benefit without the company's prior knowledge, authorization, or consent. In addition, the complaint alleges that, in order to conceal his conversion of funds, Schuster created and presented to the company's Board of Directors a false account statement from his member firm, although no account was actually maintained in the company's name at Schuster's member firm. Furthermore, the complaint alleges that Schuster failed to respond to NASD requests for information. (NASD Case #C3B030008)

**Linda Joan Shenko (CRD #2324137, Registered Representative, Whitesboro, New York)** was named as a respondent in an NASD complaint alleging that she instructed a public customer to remit employee contributions directly to her and not to her member firm. The complaint also alleges that the customer, on behalf of a defined distributor plan, issued a \$14,699.97 check, payable to Shenko, for investment in the plan; Shenko misappropriated the proceeds to her own use and benefit without the knowledge or consent of the customer and/or plan participants. (NASD Case #C11030014)

## **Firms Suspended for Failure to File Annual Audit Report**

The following firms were 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 8221. 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.

**Berg Faircloth Investment Advisors, LLC**  
Vienna, Virginia  
(April 23, 2003)

**Business and Individual Insurance Services, Inc.**  
Hawthorne, California  
(April 23, 2003)

**Clarity Securities, Inc.**  
Miami, Florida  
(April 23, 2003)

**Clements Company Investment Advisors**  
San Diego, California  
(April 23, 2003)

**Dynasty Capital Corporation**  
Portland, Oregon  
(April 23, 2003)

**PVR Securities, Inc.**  
Princeton, New Jersey  
(April 23, 2003)

**Wealthsource Financial Services, Inc.**  
Seminole, Florida  
(April 23, 2003)

## **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.)

**Bealman, Vicki D.**  
Virginia Beach, Virginia  
(March 21, 2003)

**Berry, Daniel J.**  
Bronx, New York  
(April 28, 2003)

**Brush, Bryan R.**  
Garden City, New York  
(April 28, 2003)

**Lemieux, Charles J.**  
Levittown, New York  
(April 9, 2003)

**Neiswender, John**  
Scottsdale, Arizona  
(April 28, 2003)

**Patterson, Jr., Melvin**  
San Jose, California  
(April 28, 2003)

**Weiss, Barry**  
Marietta, Georgia  
(April 25, 2003)

**Weston, Robert T.**  
New Canaan, Connecticut  
(April 25, 2003)

### **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. If the suspension has been lifted, the date follows the suspension date.)

**Angelou, Morris**  
Rego Park, New York  
(May 8, 2003)

**Avella, Jr., Michael**  
Remsenburg, New York  
(April 21, 2003)

**Davidson, Michael**  
Brooklyn, New York  
(April 21, 2003)

**Pagano, Brian Joseph**  
West Islip, New York  
(May 8, 2003)

**Peters, Troy M.**  
Solana Beach, California  
(April 9, 2003)

**Spear, James B.**  
Evansville, Indiana  
(April 21, 2003)

**Starominski, Yevgeny**  
Forest Hills, New York  
(April 15, 2003)

**Stewart, Stephen R.**  
Cary, North Carolina  
(April 25, 2003)

**Tanner, Jr., Thomas**  
Hartselle, Alabama  
(May 5, 2003)

**Thalheim, David**  
Old Westbury, New York  
(April 21, 2003)

### **NASD's NAC Bars Tony Elgindy and Expels Key West Securities, Inc., For Manipulative Short Selling Scheme**

NASD's National Adjudicatory Council (NAC) ruled that Amr (Tony) Elgindy and his firm, Key West Securities, Inc., engaged in a manipulative scheme in 1997 to inflate artificially the share price of Saf T Lok, Inc., by entering fraudulent quotations in the NASDAQ system, selling the stock short at the artificially high prices, and then taking active steps to depress the share price of Saf T Lok through the dissemination of negative research comments. The NAC ruling reversed that portion of a December 2001 NASD Hearing Panel decision that dismissed the charge of manipulation, while affirming the Hearing Panel's findings regarding other violations. The NAC barred Elgindy from associating with any NASD member in any capacity, expelled Key West Securities from NASD membership, and fined Elgindy and Key West Securities \$51,000, jointly and severally.

NASD filed the original complaint in March 2000. It charged that from Oct. 9, 1997, to Nov. 11, 1997, Key West Securities and Elgindy engaged in a manipulative short selling scheme involving the common shares of Saf T Lok, Inc. NASD charged that Elgindy entered quotes in Saf T Lok designed to artificially increase the inside bid, failed to honor the firm's quotes, and published negative research comments about the company to support the fraudulent scheme. The complaint also alleged that Key West Securities and Elgindy violated NASD's advertising rule by disseminating a negative report about Saf T Lok that failed to disclose that Key West Securities was a registered market maker and held a proprietary short position in the stock. At the time of the manipulation in October 1997, Saf T Lok was listed on the NASDAQ SmallCap Market.

In reversing the Hearing Panel's dismissal of the market manipulation charges, the NAC found that the conduct of Elgindy and Key West Securities was fraudulent and violated NASD rules and federal securities laws. The NAC concluded that the Hearing Panel incorrectly required NASD to prove that Elgindy and Key West Securities controlled the market for Saf T Lok shares to reach a finding of manipulation. Rather, the NAC ruled that Elgindy's actions violated NASD fraud rules because he took steps to artificially influence the market price for Saf T Lok shares.

The NAC also overruled the Hearing Panel's conclusion that the evidence did not prove manipulation because it did not have certain "hallmarks" of a classic "pump and dump" manipulation. The NAC pointed out that there is no one exclusive blueprint for market manipulation, and emphasized that the securities laws contain a catch-all provision that may be applied flexibly to allow regulators to deal with unique manipulative schemes.

Elgindy has appealed the NAC's decision to the SEC. The NAC's order that Elgindy be barred and Key West Securities be expelled is in effect pending consideration of the appeal. (NASD Case #CMS000015)

## **Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking**

### ***Historic Settlement Requires Payments of Penalties of \$487.5 Million, Disgorgement of \$387.5 Million, Payments of \$432.5 Million to Fund Independent Research, and Payments of \$80 Million to Fund Investor Education And Mandates Sweeping Structural Reforms***

Securities and Exchange Commission Chairman William H. Donaldson, New York Attorney General Eliot Spitzer, North American Securities Administrators Association President Christine Bruenn, NASD Chairman and CEO Robert Glauber, New York Stock Exchange Chairman and CEO Dick Grasso, and state securities regulators have announced that enforcement actions against ten of the nation's top investment firms have been completed, thereby finalizing the global settlement in principle reached and announced by regulators last December. That settlement followed joint investigations by the regulators of allegations of undue influence of investment banking interests on securities research at brokerage firms, and the enforcement actions announced today track the provisions of the December global settlement in principle.

The ten firms against which enforcement actions are being announced today are:

- ◆ Bear, Stearns & Co. Inc. (Bear Stearns)
- ◆ Credit Suisse First Boston LLC (CSFB)
- ◆ Goldman, Sachs & Co. (Goldman)
- ◆ Lehman Brothers Inc. (Lehman)
- ◆ J.P. Morgan Securities Inc. (J.P. Morgan)
- ◆ Merrill Lynch, Pierce, Fenner & Smith, Incorporated (Merrill Lynch)

- ◆ Morgan Stanley & Co. Incorporated (Morgan Stanley)
- ◆ Citigroup Global Markets Inc. f/k/a Salomon Smith Barney Inc. (SSB)
- ◆ UBS Warburg LLC (UBS Warburg)
- ◆ U.S. Bancorp Piper Jaffray Inc. (Piper Jaffray)

### ***Penalties, Disgorgement and Funds for Independent Research and Investor Education***

Pursuant to the enforcement actions, the ten firms will pay a total of \$875 million in penalties and disgorgement, consisting of \$387.5 million in disgorgement and \$487.5 million in penalties (which includes Merrill Lynch's previous payment of \$100 million in connection with its prior settlement with the states relating to research analyst conflicts of interest). Under the settlement agreements, half of the \$775 million payment by the firms other than Merrill Lynch will be paid in resolution of actions brought by the SEC, NYSE, and NASD, and will be put into a fund to benefit customers of the firms. The remainder of the funds will be paid to the states. In addition, the firms will make payments totaling \$432.5 million to fund independent research, and payments of \$80 million from seven of the firms will fund and promote investor education. The total of all payments is roughly \$1.4 billion.

Under the terms of the settlement, the firms will not seek reimbursement or indemnification for any penalties that they pay. In addition, the firms will not seek a tax deduction or tax credit with regard to any federal, state or local tax for any penalty amounts that they pay under the settlement.

Below is a list of how much each firm is paying pursuant to the settlement. The individual penalties include some of the highest ever imposed in civil enforcement actions under the securities laws.

### ***Summary of the Enforcement Actions***

In addition to the monetary payments, the firms are also required to comply with significant requirements that dramatically reform their future practices, including separating the research and investment banking departments at the firms, how research is reviewed and supervised, and making independent research available to investors. The changes that the firms will be required to make are discussed below.

The enforcement actions allege that, from approximately mid-1999 through mid-2001 or later, all of the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner. In addition, the regulators found supervisory deficiencies at

every firm. The enforcement actions, the allegations of which were neither admitted nor denied by the firms, also included additional charges:

- ◆ CSFB, Merrill Lynch, and SSB issued fraudulent research reports in violation of Section 15(c) of the Securities Exchange Act of 1934 as well as various state statutes;
- ◆ Bear Stearns, CSFB, Goldman, Lehman, Merrill Lynch, Piper Jaffray, SSB, and UBS Warburg issued research reports that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about the covered companies, and/or contained opinions for which there were no reasonable bases in violation of NYSE Rules 401, 472 and 476(a)(6), NASD Rules 2110 and 2210, as well as state ethics statutes;
- ◆ UBS Warburg and Piper Jaffray received payments for research without disclosing such payments in violation of Section 17(b) of the Securities Act of 1933, as well as NYSE Rules 476(a)(6), 401 and 472 and NASD Rules 2210 and 2110. Those two firms, as well as Bear Stearns, J.P. Morgan, and Morgan Stanley, made undisclosed payments for research in violation of NYSE Rules 476(a)(6), 401 and 472 and NASD Rules 2210 and 2110 and state statutes; and
- ◆ CSFB and SSB engaged in inappropriate spinning of "hot" Initial Public Offering (IPO) allocations in violation of SRO rules requiring adherence to high business standards and just and equitable principles of trade, and the firms' books and records relating to certain transactions violated the broker/dealer recordkeeping provisions of Section 17(a) of the Securities Exchange Act of 1934 and SRO rules (NYSE Rule 440 and NASD Rule 3110).

Under the terms of the settlement, an injunction will be entered against each of the firms, enjoining it from violating the statutes and rules that it is alleged to have violated.

Today's enforcement actions will also reform industry practices regarding the relationship between investment banking and research and will bolster the integrity of equity research. Among other significant reforms included in these actions are the following:

- ◆ To ensure that stock recommendations are not tainted by efforts to obtain investment-banking fees, research analysts will be insulated from investment banking pressure. The firms will be required to sever the links between research and investment banking, including prohibiting analysts from receiving compensation for investment banking activities, and prohibiting analysts' involvement in investment banking "pitches" and "roadshows." Among the more important reforms:

- ◆ The firms will physically separate their research and investment banking departments to prevent the flow of information between the two groups.
- ◆ The firms' senior management will determine the research department's budget without input from investment banking and without regard to specific revenues derived from investment banking.
- ◆ Research analysts' compensation may not be based, directly or indirectly, on investment banking revenues or input from investment banking personnel, and investment bankers will have no role in evaluating analysts' job performance.
- ◆ Research management will make all company-specific decisions to terminate coverage, and investment bankers will have no role in company-specific coverage decisions.
- ◆ Research analysts will be prohibited from participating in efforts to solicit investment-banking business, including pitches and roadshows. During the offering period for an investment-banking transaction, research analysts may not participate in roadshows or other efforts to market the transaction.
- ◆ The firms will create and enforce firewalls restricting interaction between investment banking and research except in specifically designated circumstances.
- ◆ To ensure that individual investors get access to objective investment advice, the firms will be obligated to furnish independent research. For a five-year period, each of the firms will be required to contract with no fewer than three independent research firms that will make available independent research to the firm's customers. An independent consultant for each firm will have final authority to procure independent research.
- ◆ To enable investors to evaluate and compare the performance of analysts, research analysts' historical ratings will be disclosed. Each firm will make its analysts' historical ratings and price target forecasts publicly available.

Further, seven of the firms will collectively pay \$80 million for investor education. The SEC, NYSE, and NASD have authorized that \$52.5 million of these funds be put into an Investor Education Fund that will develop and support programs designed to equip investors with the knowledge and skills necessary to make informed decisions. The remaining \$27.5 million will be paid to state securities regulators and will be used by them for investor education purposes.

In addition to the other restrictions and requirements imposed by the enforcement actions, the ten firms have collectively

entered into a voluntary agreement restricting allocations of securities in hot IPOs — offerings that begin trading in the aftermarket at a premium — to certain company executive officers and directors, a practice known as “spinning.” This will promote fairness in the allocation of IPO shares and prevent firms from using these shares to attract investment-banking business.

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Remarking on the historic settlement, SEC Chairman Donaldson said, “The hallmark of our business and financial system is that the rule of law must prevail and when wrongdoing occurs, it must be confronted and punished. Today we do just that.” Mr. Donaldson went on to say that, “These cases reflect a sad chapter in the history of American business — a chapter in which those who reaped enormous benefits from the trust of investors profoundly betrayed that trust. These cases also represent an important new chapter in our ongoing efforts to restore investors’ faith in the fairness and integrity of our markets.”

New York Attorney General Eliot Spitzer said, “This global settlement is one of the largest effected by securities regulators to date. It fulfills our promise to help restore integrity to the marketplace and investor confidence in our system. The wide-ranging structural reforms to firms’ research operations will empower investors to use securities research in a practical and meaningful way when making investment decisions.”

“This case was a model for state-federal regulatory cooperation to benefit investors. As they did with microcap fraud and day trading, the states helped to spotlight a problem and worked with national regulators on enforcement actions and market-wide rule changes,” said NASAA President Christine Bruenn. “We’re hopeful that the settlement announced today will help restore the faith and trust of wary and cynical investors.” Ms. Bruenn added that, “If the Street follows both the spirit and the letter of this settlement, it will change the way business is done on Wall Street. Investors — not investment banking fees — will come first. And analysts will be beholden to the truth, not the IPO business.”

NASD Chairman and CEO Robert Glauber said, “Today marks an ending, but even more, a beginning. Because in finalizing this settlement, we take a giant step on the road to restoring and renewing investor confidence. The final resolution we announce today is a good one for everyone, everywhere, who has a stake in the integrity of the U.S. capital markets.”

“This historic settlement establishes a clear bright line — a banker is a banker and an analyst is an analyst. The two shall never cross,” said NYSE Chairman and CEO Dick Grasso. “The partnership between the SEC, state regulators, the SROs, and our lawmakers remains the best and most effective system of market regulation and the global settlement reflects that. Our capital markets model is the most successful in the world and I

am absolutely certain that we will come out of this period with a stronger system that puts the interests of the investing public first.”

### **The Securities and Exchange Commission, NASD, and the New York Stock Exchange Permanently Bar Henry Blodget From the Securities Industry and Require \$4 Million Payment**

The Securities and Exchange Commission, NASD, and the New York Stock Exchange — following a coordinated investigation of allegations of undue influence of investment banking interests on research analysts at brokerage firms — announced that Henry Blodget, a former managing director at Merrill Lynch, Pierce, Fenner & Smith, Incorporated, and the senior research analyst and group head for the Internet sector at the firm, will be censured and permanently barred from the securities industry, and will make a total payment of \$4 million to settle the charges against him.

The regulators charged that, among other things, Blodget, of New York City, issued fraudulent research under Merrill Lynch’s name, as well as research in which he expressed views that were inconsistent with privately expressed negative views. Blodget’s conduct constituted violations of the federal securities laws and NASD and NYSE rules, which require that, among other things, published research reports have a reasonable basis, present a fair picture of the investment risks and benefits, and not make exaggerated or unwarranted claims.

In particular, the SEC alleges, and the NASD and NYSE found that, during 1999-2001, Blodget:

- ◆ aided and abetted violations of antifraud provisions of the federal securities laws and violated SRO rules by issuing research reports on one Internet company (GoTo.com) that were materially misleading because they were contrary to privately expressed negative views; and
- ◆ issued research reports on six other Internet companies (InfoSpace, Inc., 24/7 Media, Inc., Lifeminders, Inc., Homestore.com, Inc., Excite@Home, and Internet Capital Group, Inc.) that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts regarding those companies, contained exaggerated or unwarranted claims about those companies, and/or contained opinions for which there was no reasonable basis.

Blodget neither admits nor denies these allegations, facts, conclusions, and findings.

Of Blodget’s \$4 million total payment, \$2 million constitutes a penalty and \$2 million constitutes disgorgement. Blodget’s \$4 million payment is specified in a Final Judgment that, if

approved by the Court, will be entered in an action filed by the SEC in Federal District Court in New York City. The entire \$4 million will be put into a distribution fund for the benefit of Merrill Lynch customers. Blodget has agreed that he will not seek reimbursement or indemnification for the penalties he pays. In addition, he has agreed that he will not seek a tax deduction or tax credit with regard to any federal, state or local tax for any penalty amounts he pays under the settlement.

Under the terms of the settlement, the Final Judgment in the SEC's Federal Court action will enjoin Blodget from violating the statutes and rules he is alleged to have violated.

### **The Securities and Exchange Commission, New York Attorney General's Office, NASD, and the New York Stock Exchange Permanently Bar Jack Grubman and Require \$15 Million Payment**

The Securities and Exchange Commission, the New York Attorney General's Office, NASD, and the New York Stock Exchange — following a coordinated investigation of allegations of undue influence of investment banking interests on research analysts at brokerage firms — announced that Jack Grubman will be censured and permanently barred from the securities industry, and will pay a total of \$15 million to settle their charges against him. The regulators charged that Grubman, of New York City, a former managing director of Salomon Smith Barney Inc. (SSB), the lead research analyst for SSB's telecommunications (telecom) sector and the linchpin for SSB's investment banking efforts in the telecom sector, issued fraudulent, misleading, and otherwise flawed research reports under SSB's name. As a result, Grubman aided and abetted SSB's violations of antifraud provisions of the federal securities laws and violated NASD and NYSE rules as well as New York State law.

In particular, the regulators found that, during 1999-2001, Grubman:

- ◆ issued several fraudulent research reports on two telecom stocks (Focal Communications and Metromedia Fiber) that contained misstatements and omissions of material facts about the companies, contained recommendations contrary to the actual views regarding the companies, overlooked or minimized the risk of investing in these companies, and predicted substantial growth in the companies' revenues and earnings without a reasonable basis;
- ◆ issued numerous research reports on six telecom stocks (Focal Communications, RCN Communications, Level 3 Communications, XO Communications, Adelphia Business Solutions, and Williams Communications Group) that were not based on principles of fair dealing and good faith, and did not provide a sound basis for evaluating facts regarding these companies' business prospects, contained

exaggerated and unwarranted claims about these companies, and/or contained opinions for which there was no reasonable basis; and

- ◆ published a research report in November 1999 upgrading AT&T that contained omissions of material facts and was misleading.

Grubman neither admits nor denies these allegations, facts, conclusions, and findings.

Grubman's \$15 million payment is specified in a Final Judgment that, if approved by the Court, will be entered in an action filed by the SEC in Federal District Court in New York City. Of the \$15 million total payment, half (\$7.5 million) will be authorized by the SEC, NYSE, and NASD to be added to a distribution fund for the benefit of SSB customers; that fund will be created in a separate action brought against SSB. The remaining \$7.5 million penalty will be paid to the New York Attorney General.

Under the terms of the settlement, Grubman agrees that he will not seek reimbursement or indemnification for any amounts he pays under the settlement. In addition, he agrees that he will not seek a tax deduction or tax credit with regard to any federal, state, or local tax for any penalty amounts he pays under the settlement.

Under the terms of the settlement, the Final Judgment in the SEC's Federal Court action will enjoin Grubman from violating the statutes and rules he is alleged to have violated.

### **NASD Fines Altegris Investments for Hedge Fund Sales Violations**

#### *Firm Failed to Adequately Disclose Risks of Investing in Hedge Funds*

NASD announced that it has censured and fined Altegris Investments, Inc., of La Jolla, California, \$175,000 for failing to disclose the risks associated with hedge funds when marketing them to investors. Some of the firm's sales literature also contained exaggerated and unwarranted statements about these products. NASD also censured and fined Altegris' Chief Compliance Officer, Robert Amedeo, \$20,000 for failing to adequately supervise the firm's advertising practices in this area.

NASD found that between October 2002 and February 2003, Altegris distributed 26 different pieces of hedge fund sales literature to its customers. Each of these marketing pieces failed to include important disclosures regarding specific risks of investing in hedge funds and made unbalanced presentations about the particular hedge funds that failed to provide investors with a sound basis for evaluating whether to invest in these hedge fund products.



"Communications by our members with the investing public must provide a sound basis for evaluating an investment and must adequately disclose the risks," said Mary L. Schapiro, NASD's Vice Chairman and President Regulatory Oversight. "This is no less true for hedge funds than for any other investment product. Today's enforcement action is part of NASD's broader review of hedge fund sales practices and reinforces NASD's commitment to ensuring adherence to the highest standards of good faith and fair dealing."

Among the items that Altegris failed to disclose about the specific hedge funds were the following:

- ◆ The fund is speculative and involves a high degree of risk.
- ◆ The fund may be leveraged.
- ◆ The fund's performance can be volatile.
- ◆ An investor could lose all or a substantial amount of his or her investment.
- ◆ The fund manager has total trading authority over the fund. The use of a single advisor applying generally similar trading programs could mean lack of diversification and, consequentially, higher risk.
- ◆ There is no secondary market for the investor's interest in the fund and none is expected to develop.
- ◆ There may be restrictions on transferring interests in the fund.
- ◆ The fund's high fees and expenses may offset the fund's trading profits.
- ◆ A substantial portion of the trades executed for the fund takes place on foreign exchanges.

Although some or all of these risks may have been described in offering documents to investors, such disclosure did not cure these violations of NASD's advertising rules. These rules require that each piece of sales literature independently comply with the rules' standards.

Two of the pieces of sales literature distributed by Altegris were research reports on specific hedge funds that were written by a registered representative at another member firm. These research reports contained several exaggerated and unwarranted statements and claims. For example:

- ◆ The first research report characterized the hedge fund as "an ideal fund for conservative investors." However, the Offering Memorandum indicated that the fund has a limited operating history, is speculative, and involves a high degree of risk.

- ◆ In the second research report, the author made the following unwarranted projection of future performance: "Is he likely to continue to give us 12-14% years over the next 4-5 years? In my opinion, I think it is likely he will."
- ◆ The second research report inaccurately stated that the hedge fund was "subject to NASD inspection" and that "the NASD will audit the fund as well." The research report went on to say, "For some, this layer of regulatory oversight is comforting." The statement is false since NASD does not and will not audit the hedge fund.

A hedge fund can be described generally as a private and unregistered investment pool that accepts investors' money and employs hedging and arbitrage techniques using long and short positions, leverage and derivatives, and investments in many markets. This enforcement action is NASD's first in its recent and ongoing focus on hedge funds. As a result of a recent review of members that sell hedge funds and registered products (closed-end funds) that invest in hedge funds, NASD has become concerned that some members may not be fulfilling their sales-practice obligations when selling and marketing these instruments, especially to retail customers. As part of this focus, NASD issued an Investor Alert in August of 2002 and a *Notice to Members* in February of 2003 advising members of their suitability obligation to investors whenever recommending or selling hedge.

In settling this matter, Altegris and Amedeo neither admitted nor denied the allegations, but consented to the entry of findings. Altegris also agreed to obtain pre-approval from NASD's Department of Advertising Regulation before distributing future advertisements and sales literature.