

## INFORMATIONAL

### Weighted Average And Special Pricing Formula Trades

SEC Approves Changes To Transaction Reporting Procedures For Weighted Average And Special Pricing Formula Trades; **Effective Date: July 17, 2000**

#### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Trading & Market Making
- Training

#### KEY TOPICS

- Transaction Reporting

#### Executive Summary

On May 31, 2000, the Securities and Exchange Commission (SEC) approved changes to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) regarding transaction reporting procedures for weighted average and other special pricing formula trades.

NASD Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6), as now amended, require all transactions, not just agency crosses, in Nasdaq<sup>®</sup>-listed and exchange-listed securities that are traded on a weighted-average basis or effected based on other special pricing formula, to be reported with the .W modifier. Prior to the rule change, only agency cross transactions – not principal or riskless principal transactions – that were effected at an average price or based on a special pricing formula were required to be reported with the .W modifier.

The rule changes are included with this *Notice* in Attachment A. These changes will go into effect on July 17, 2000.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to: Nasdaq MarketWatch at (800) 211-4953; John F. Malitzis, Nasdaq Office of General Counsel, at (202) 728-8245; Thomas P. Moran, Nasdaq Office of General Counsel, at (202) 728-8401; or Legal Section, Market Regulation Department, NASD Regulation<sup>SM</sup>, at (301) 590-6410.

#### Background

NASD Rule 6420 sets forth NASD member reporting obligations for transactions in exchange-listed

securities effected in the over-the-counter market (*i.e.*, third market transactions). NASD Rules 4632 and 4642 set forth NASD reporting obligations for transactions in Nasdaq-listed securities. These three rules require members to append a special indicator (.W) to a trade report when a member is effecting an agency cross transaction at prices based on a weighted-average price or other special pricing formula. The NASD adopted these rules, in part, because these weighted-average trades were being effected in the third market and Nasdaq at a price that did not relate to the closing price on the primary exchange or Nasdaq, but such trades affected the reporting of the last sale in the exchange-listed security to the media and vendors. Pursuant to Rules 4632, 4642, and 6420, these weighted average or special pricing formula trades, when reported with the .W modifier, do not affect the last sale price.

When adopted, the scope of Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) were limited to agency cross trades effected on a weighted-average basis or other special pricing formula because a majority of the trades at the time were being effected on an agency cross basis. Since these rules were adopted, the market has changed in many ways. In particular, a number of NASD rules have been amended recently to allow Nasdaq, including the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>), to stay open until 6:30 p.m., Eastern Time, to facilitate after hours trading. As part of this initiative, Nasdaq amended Rules 4632, 4642, and 6420 to require members to report transactions effected between 9:30 a.m. and 6:30 p.m., ET, within 90 seconds. One effect of this rule change has been to subject transactions that

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previously were reported on an “as of” basis T+1 — because they were effected between 5:15 p.m. and 6:30 p.m. — to 90-second trade reporting requirements. The NASD and Nasdaq have learned that a number of trades effected during the 5:15 p.m. and 6:30 p.m. time period are volume-weighted transactions, which are effected on a principal and riskless principal basis. These volume-weighted trades are often effected at a price unrelated to the close — or, if effected during the trading day, the

last sale — on the primary exchange. Because these trades are not done as agency crosses and thus not subject to the .W reporting requirement in Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6), they are reported without a modifier and may affect the reporting to the media and vendors of the last sale in the exchange-listed security. As a result, there is a potential for investor confusion and disorderly markets. In light of this, the NASD and Nasdaq recently proposed —

and the SEC approved — amendments to NASD Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) to require all transactions, not just agency crosses, in Nasdaq and exchange-listed securities that are based on a weighted average or other special pricing formula, to be reported with the .W modifier. Note that the price does not necessarily have to be away from the prevailing market when using the .W modifier.

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## ATTACHMENT A

### Text Of Amendments

(Note: Deletions are bracketed.)

#### Rule 4632. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions occurring at prices based on average-weighting or other special-pricing formulae to Nasdaq using a special indicator, as designated by the Association and set out in the Symbol Directory.

(7) - (8) No Change

(b) - (f) No Change

#### Rule 4642. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions occurring at prices based on average-weighting or other special-pricing formulae to Nasdaq using a special indicator, as designated by the Association and set out in the Symbol Directory.

(7) - (8) No Change

(b) - (f) No Change

#### Rule 6420. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions at prices based on average-weighting or other special pricing formulae unrelated to the current or closing price of the security on the primary market to Nasdaq using a special indicator, as designated by the Association.

(b) - (e) No Change

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## NASD Notice to Members 00-44

### INFORMATIONAL

## Variable Contracts

### The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Life Insurance

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Insurance
- Internal Audit
- Legal & Compliance
- Operations
- Registered Representatives
- Senior Management
- Variable Contracts

### KEY TOPICS

- Suitability
- Supervision
- Variable Contracts

### Executive Summary

Due to the growth in sales and the popularity of variable life insurance products, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) has published this *Notice to Members*, which focuses on retail sales to individuals of variable life insurance. This *Notice* provides a set of guidelines to help members in developing supervisory procedures relating to the sales of variable life insurance. The guidelines identify areas of concern that NASD Regulation would expect to be considered in these procedures.

### Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, at (202) 728-8330; Lawrence Kosciulek, Associate Director, Advertising/Investment Companies Regulation, NASD Regulation, at (202) 728-8329; or Robert J. Smith, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8451.

### Background

Variable life insurance and variable annuity contracts (Variable Contracts) are securities, and accordingly, their distribution is subject to National Association of Securities Dealers, Inc. (NASD<sup>SM</sup>) rules. Of particular importance are:

- Rule 3010 (Supervision), which requires each member to establish and maintain systems to supervise the activities of each registered representative and associated person in order to achieve compliance with the securities laws, regulations, and NASD rules; and

- Rule 2310 (Suitability), which requires that a member, when recommending the purchase, sale, or exchange of any security to a customer, have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts disclosed by the customer.

NASD has published other *Notices to Members* regarding Variable Contracts, including *Notice to Members 99-35* (May 1999) which provides guidance to assist members in developing appropriate procedures relating to deferred variable annuity sales to customers, and *Notice to Members 96-86* (December 1996) which reminds members that sales of Variable Contracts are subject to NASD suitability requirements.

This *Notice* focuses on retail sales of variable life insurance, including both scheduled premium and flexible premium products. The *Notice* provides a set of guidelines to assist members in developing sales-related supervisory procedures.

### Description Of Variable Life Insurance

Variable life insurance is an insurance policy that is subject to regulation under state insurance and federal securities laws (unless otherwise indicated, references to variable life insurance include both scheduled premium variable life insurance and flexible premium variable universal life insurance).

Similar to traditional life insurance, variable life insurance offers a death benefit that represents the amount the life insurance company is obligated to pay upon the death of the insured. In addition to the death benefit, variable life

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insurance generates an investment element usually termed the “cash value.” However, the insurance company that issues the variable life insurance policy does not guarantee the cash value. The cash value and in some cases, the death benefit, can fluctuate based on the performance of investment portfolios maintained by the insurance company in a segregated or separate account, and the interest earned on balances in general account options, if any. Generally, the insurance company guarantees the original face amount of the policy as a death benefit as long as the policy holder’s premiums are paid on schedule or the cash value is sufficient to meet each fee deduction.

A customer’s variable life insurance premium payments typically are invested in an insurance company’s separate account, though in some cases, premiums may also be allocated to one or more general account options. The separate account is distinct from the insurance company’s general account, which comprises the assets of the insurance company that issues the policy.

The investment portfolios or investment divisions underlying the separate account are often called “subaccounts.” The subaccounts are divisions of the separate account that invest in distinct underlying fund portfolios. A customer’s policy premium payments, after deductions for any sales expense charges or premium tax charges, are applied to the subaccounts and any general account options in accordance with the customer’s allocation election. The value of the subaccounts will fluctuate in accordance with the investment experience of the underlying funds. Because the

policy owners assume investment risks, variable life insurance policies are securities within the meaning of the federal securities laws and must be registered under the Securities Act of 1933, and the separate account and the underlying funds must generally register as investment companies under the Investment Company Act of 1940.

The issuer of the variable life insurance policy is an insurance company. The wholesale or retail distributor of individual variable life insurance policies, which may or may not be related to the insurance company, must register as a broker/dealer under the Securities Exchange Act of 1934 and become a member of the NASD. A person selling individual variable life insurance, in addition to maintaining current life insurance licenses under applicable state laws, must be a registered broker/dealer or a registered representative of a broker/dealer.

Typically the main charges associated with a variable life insurance policy are front-end sales loads, back-end sales loads, administrative charges, cost of insurance charges, mortality and expense risk charges, and various fees associated with each underlying fund option. The cost of insurance charges can vary significantly depending on the individual’s personal circumstances (e.g., age, sex, health, smoker/non-smoker, face amount of policy).

### Recent Disciplinary Action

In a recent NASD Regulation disciplinary action, an NASD member was found to have violated NASD Rule 3010 (Supervision) for failing to establish, maintain, and enforce reasonable supervisory procedures. The member’s procedures failed to adequately

differentiate between fixed and variable life insurance products. In addition, the member was found to have violated NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade) for engaging in material misrepresentations and omissions, NASD Rule 2210 (Communications with the Public) for the use of misleading sales literature, and NASD Rule 2310 (Suitability Rule) for unsuitable recommendations and sales. (*See Pruco Securities Corp. Letter of Acceptance Waiver and Consent*<sup>1</sup>.) The violations included:

- Various misrepresentations, including statements that:
  - New policies could be acquired by customers already owning the firm’s life insurance by using cash values or future dividends from customers’ existing policies, for little or no additional cash payment;
  - Premium payments would end, or “vanish,” after a certain number of years; and
  - Variable life policies were not insurance but were an investment, savings, or retirement plan.
- Unsuitable sales to customers, including retirees and persons who did not know that they were purchasing insurance or did not want life insurance.
- Failure to establish, maintain, and enforce adequate procedures with respect to the review of variable life insurance purchases to determine whether sales were suitable for customers and failure to obtain the customer information necessary to make suitability determinations.

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- Use of misleading sales literature.
- Failure to establish, maintain, and enforce reasonable supervisory procedures.
- Failure to register representatives and principals and permitting unregistered persons to sell securities.

### Guidelines For Supervision Of Variable Life Insurance Sales

Variable life insurance may be appropriate for a customer with a need for life insurance and an ability to pay for permanent life insurance protection. Nevertheless, since the cash value and death benefit may fluctuate due to the performance of the investments in the separate account, a variable life insurance customer should also be able to assume investment risk and understand the implications of adverse investment performance.

The following guidelines represent a collection of industry practices regarding the supervision of the sale of variable life insurance. Although these are only guidelines, members are encouraged to refer to them in developing their own policies and procedures relating to variable life insurance sales practices.

#### A. Customer Information

NASD Rule 2310 requires that members and their registered representatives, prior to the execution of a recommended transaction, make reasonable efforts to obtain information concerning a customer's financial and tax status, investment objectives, and such other information used or considered to be reasonable in making recommendations to the customer. The NASD has recognized that

members have developed various practices and procedures in order to comply with this rule.

When recommending a variable life insurance policy, members and their registered representatives should make reasonable efforts to obtain comprehensive customer information, such as the customer's age, annual income, net worth, liquid net worth, number of dependents, investment objective, sources of funds for investment, investment experience, existing investments and life insurance, time horizon, and risk tolerance.

The registered representative should document this type of information in a customer account information form and should submit it with every variable life insurance application. A registered principal should review the account information form and verify that the recommendation of both the policy and the subaccount allocation is consistent with the customer's investment objectives and risk tolerance. Some members have designed policy applications that also contain comprehensive customer background information. Whatever the means by which a member collects customer account information (*e.g.*, in paper or electronic form), appropriate customer account information should be reviewed and retained.

#### B. Review Of Customer Information

The member should consider whether the customer desires and needs life insurance and whether the customer can afford the premiums likely needed to keep the policy in force.

A member may wish to establish internal percentage ratio guidelines, such as the ratio of scheduled or target premium to income or

household income, or percentage scheduled or target premium to liquid net worth. While these ratio guidelines are no substitute for proper supervision, they may assist in the review for variable life insurance affordability and excessive amounts of coverage. If the ratio exceeds the member's parameters, an extra level of supervision and review may be warranted. If parameters are exceeded, the registered representative should submit additional supporting documentation or a written explanation. To assist principals in their review of variable life insurance applications, members may wish to provide a checklist of items for the principal to review.

Members may choose at the point of sale to utilize allocation percentage guidelines when underlying fund allocations are made.

Members may wish to establish special supervision requirements for sales to older customers. Life insurance is often appropriately purchased by older investors. However, variable life insurance may not be suitable for an older investor who is primarily seeking an investment rather than an insurance product. Additionally, members should carefully consider whether an older investor has the financial means to sustain the likely amount of policy premium payments.

#### C. Product Information

Registered representatives should be thoroughly familiar with the features and costs associated with each recommended variable life insurance policy, including surrender charges, premium and cash value charges, separate account charges, underlying fund fees, subaccount investment

options, loan provisions, free-look periods, and policy premium lapse periods. The registered representative also should be able to clearly convey such information to the customer so that the customer can make an informed investment decision regarding the recommendation.

Variable life insurance policies have features of both traditional insurance products and securities. Accordingly, members may provide their registered representatives with examples, such as lifestyle case studies, to illustrate what the member considers to be potentially unsuitable recommendations and what type of activity would warrant an extra level of supervisory review.

Members may also wish to provide customers with member-approved product information brochures, in addition to any required disclosure documents, that explain the features and principal risks associated with variable life insurance.

To the extent practical, registered representatives should provide customers with a current prospectus when recommending a variable life insurance policy. Registered representatives should be available to discuss with customers the information that is contained in the prospectus.

### **D. Variable Life Insurance Replacements**

Various states have issued rules governing variable life insurance replacement activity. While the definitions vary, the term "replacement" generally refers to the activity of a customer surrendering or altering existing insurance coverage in order to purchase a new variable life insurance policy. A replacement may not be in the best interests of a customer. For example, a customer

may incur new fees, extended surrender charge periods, a possible higher insurance risk rating due to ill health, and new suicide and incontestability periods. There may also be unfavorable tax consequences. Registered representatives should carefully consider whether a replacement is in the best interests of the customer.

Members should adopt procedures for the review of replacement recommendations to ensure that they are suitable. Members should either develop a replacement disclosure form or use an existing form authorized by a state insurance commission or other regulatory body. Consistent with any state requirements, the appropriate form should be completed for each replacement involving variable life insurance.

The form should include the signatures of the customer and the registered representative. Members should provide their registered representatives and registered principals with appropriate procedures on replacements. Members should determine that the proposed replacement transaction is suitable and that the registered representative has complied with firm procedures and applicable state regulations regarding disclosure requirements.

A member should review a variable life insurance application to determine that any replacement question is answered. For example, if questions on whether the proposed policy replaces any existing annuity or policy are not completed, then the registered principal should request that the registered representative obtain a completed application.

The member may create a compliance report that tracks replacement activity by each

registered representative. Replacement activity exceeding a certain percentage of the registered representative's total activity could trigger further review. The member may also decide to design a compliance system to flag unacknowledged replacement activity by utilizing background information such as surrenders, reduced face amounts, lapses, and modified surrenders. To assist in this review, a member could use quarterly 1035 exchange reports or other reports that may be provided by a number of insurance companies. Upon reasonable request and to the extent practical, wholesale members should also assist retail broker/dealers in monitoring the replacement activity of their customers.

### **E. Life Insurance Financing**

Members should not recommend that a customer finance a variable life insurance policy from the value of another life insurance policy or annuity, such as through the use of loans or cash values, unless the transaction is otherwise suitable for the customer. The NASD believes that the burden of demonstrating that such financed transactions are in the customer's best interests would generally be more difficult than for a routine sale of variable life insurance. In the *Pruco* case, many customers' existing cash values were depleted to pay the premiums of new policies. The new policies lapsed when the required premium for the new variable life insurance policy exceeded the dividend stream or cash value of the original policy.

When financing is recommended, registered representatives should disclose to the policy owner the potential consequences to both the existing and new policy. Members should provide a form to the registered representative that

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documents the customer's informed consent to the financing. The form should include the customer's acknowledgment, the registered representative's signature, and a registered principal's signature.

Members should monitor these arrangements so that they can prevent improper and excessive financed and replacement sales. For internalized activity, members could create a system that matches new policies with disbursements from existing policies for a set time period and track that activity. Members should consider whether to vary review and report periods in order to prevent registered representatives from timing financed or replaced transactions to escape detection.

### **F. Advertising And Sales Literature**

Under NASD Rule 2210, members must file with NASD Regulation's Advertising/Investment Companies Regulation Department all variable life insurance advertisements and sales literature within 10 days of first use or publication. Members are also required to file the format for hypothetical illustrations used in the promotion of variable life insurance policies, since these formats qualify as sales literature. Members must have supervisory procedures in place to ensure

compliance with the rule's filing requirements. Members also must ensure that all advertisements and sales literature regarding variable life insurance are approved in writing by a registered principal and prior to use with the public.

Any communication discussing the tax-deferral benefits of variable life insurance should not obscure or diminish the importance of the life insurance features of the product. Any variable life insurance communication that overemphasizes the investment aspects of the policy or potential performance of the subaccounts may be misleading.

### **G. Members' Supervisory Systems And Procedures**

*Notice to Members 99-45* (June 1999) provides guidance on member supervisory procedures. The *Notice* emphasizes that NASD Rule 3010 require members, regardless of their size or complexity, to adopt and implement a supervisory system that is tailored specifically to a member's business. Supervisory systems must address the activities of all of the member's registered representatives and associated persons and may include components such as automated exception reports and surveillance programs that monitor unusual activity. Members must adopt

written supervisory procedures that document the supervisory system and that are reasonably designed to achieve compliance with all applicable securities laws and regulations and NASD rules.

Members may wish to design their own supervisory system to monitor variable life insurance sales activities based upon the member's organization and structure. For some members with geographically dispersed offices and personnel, a decentralized supervisory system may be sufficient. For other members, a centralized compliance supervisory system may be more appropriate.

Members should design systems that provide an easy and expeditious way for customers to communicate complaints, and that ensure that customer complaints are acted upon, analyzed, and researched.

### **Endnote**

<sup>1</sup>Letter of Acceptance, Waiver and Consent No. CAF990010 (July 8, 1999).

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## INFORMATIONAL

### SEC Rule 15c3-3 Reason Codes

NASD Announces  
Changes To SEC Rule  
15c3-3 Extension  
Request Reason Codes;  
**Effective Date: July 10,  
2000**

## SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Operations
- Senior Management

## KEY TOPICS

- Reason Codes
- SEC Rule 15c3-3

## Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) is enhancing its Extension Request Reason Codes regarding Securities and Exchange Commission (SEC) Rule 15c3-3 (the Rule). The changes to the reason codes will allow firms to request extensions of time pursuant to paragraphs (d)(2), (d)(3), and (h) of the Rule. The changes will take effect on July 10, 2000.

The chart in Attachment A outlines the current reason codes to be used for extension requests made pursuant to paragraph (m) of the Rule, *i.e.*, reason codes 040 to 052, as well as the new reason codes 070 to 078, and 080 to be used for extension requests pursuant to paragraphs (d)(2), (d)(3), and (h).

## Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Susan DeMando, Director, Member Regulation, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) at (202) 728-8411.

## Background

Paragraph (m) of the Rule requires that if a security sold long by a customer has not been delivered within 10 business days after the settlement date, the broker/dealer must either buy the customer in or apply for and receive an extension from its designated examining authority.

Paragraph (d)(2) requires that when a broker/dealer has a possession and control requirement relative to a security, and the firm has failed to receive that security for more than 30 calendar days, that the broker/dealer must buy-in the security or obtain an extension. Paragraph (d)(3) requires a buy-in or extension for securities that are receivable due to a stock dividend receivable, stock split, or similar action for more than 45 calendar days. Finally, paragraph (h) requires that short security differences not resolved within 45 days of discovery be bought in or the broker/dealer must obtain an extension of time.

## Key Features

Following are key features of the new reason codes:

- Under the Rule, reason codes have been added to be applied with Rule Type d2, d3, and h. The reason codes 070, 071, 072, 073, 074, 075, 076, 077, 078, and 080 are to be used for Type d2, d3, and h extension requests. The reason codes will be effective starting July 10, 2000.
- For Rule Type d2, d3, and h, the entry of both the Issue Symbol and CUSIP number will be mandatory.

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### Attachment A

SEC Rule 15c3-3 Extension Request Reason Codes								
Reason Code	Reason Text	Extension Type	Days Permitted	Limit of 9 per Customer	Limit per Reason Code	Final Reason Code	NASD Only	Business Or Calendar Days
040	Security In Transit	m	14	N	2	Y	N	C
041	Death Of Seller	m	14	Y	2	Y	N	C
042	Can't Buy In, Sec Short Supply	m	14	N	5	Y	N	C
043	Dividend Sold Before Payable Date	m	14	Y	2	Y	N	C
044	Still In Foreign Deposit	m	14	Y	2	Y	N	C
045	Sec Exchange Or Merger	m	14	Y	2	Y	N	C
046	Strike Or Xmas	m	14	N	0	N	Y	C
047	Coming From Another Broker	m	14	N	2	Y	N	C
048	Customer Ill Or Hospitalized	m	14	Y	2	Y	N	C
049	Lost Certificate	m	30	N	5	N	N	C
050	Other	m	14	N	0	N	Y	C
051	Acts Of God	m	14	N	0	N	Y	C
052	Foreign Settlements	m	10	N	2	Y	N	C
070	Security In Transfer	d2, d3, h	14	N/A	2	Y	N	C
071	Security In Mail	d2, d3, h	7	N/A	1	Y	N	C
072	Buy-in Issued	d2, d3, h	14	N/A	2	Y	N	C

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### SEC Rule 15c3-3 Extension Request Reason Codes

Reason Code	Reason Text	Extension Type	Days Permitted	Limit of 9 per Customer	Limit per Reason Code	Final Reason Code	NASD Only	Business Or Calendar Days
073	Unable To Buy-in	d2, d3, h	14	N/A	2	Y	N	C
074	Security At Foreign Depository	d2, d3, h	14	N/A	2	Y	N	C
075	Merger, Exchange, Or Reorganization	d2, d3, h	14	N/A	2	Y	N	C
076	Mutual Fund	d2, d3, h	14	N/A	2	Y	N	C
077	SRO Halted Trading Or Buy-in Privilege	d2, d3, h	14	N/A	5	Y	N	C
078	Lost Certificate	d2, d3, h	30	N/A	5	Y	N	C
080	Other	d2, d3, h	14	N/A	0	N	Y	C

### INFORMATIONAL

## Series 55— Equity Trader Examination

### NASD Announces Interpretation Of NASD Rule 1032(f) Regarding Series 55/Equity Trader Registration Requirement

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Legal & Compliance
- Registration
- Senior Management
- Trading & Market Making
- Training

### KEY TOPICS

- Equity Trader
- Proprietary Trading
- Series 55 Examination

### Executive Summary

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) has received a number of inquiries regarding the registration category for representatives who trade equity securities in The Nasdaq Stock Market<sup>®</sup> (Nasdaq<sup>®</sup>) and/or over-the-counter (Series 55). The purpose of this *Notice to Members* is to revise NASD Regulation's position regarding the scope of the Series 55 registration requirement. Previously, NASD Regulation took the position that any associated person who makes trading decisions that place a firm's capital at risk needs to be registered under Series 55. In this *Notice to Members*, NASD Regulation is announcing that such decision-makers only need the Series 55 registration if they also are involved in the execution or processing of trades.

### Questions/Further Information

Questions regarding this *Notice* may be directed to Carole Hartzog, Assistant Director, Member Regulation, Testing and Continuing Education, NASD Regulation, at (301) 590-6696; or Eric Moss, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8982.

### Background

Effective April 1, 1998, NASD Regulation amended its rules to require representatives who trade equity securities in Nasdaq or over-the-counter markets to register as equity traders. NASD Rule 1032(f) established the Series 55 registration category and qualification examination for equity traders.

Specifically, NASD Rule 1032(f) states that a representative must

register as a "Limited Representative—Equity Trader" if the representative is engaged in proprietary trading or in the execution of transactions on an agency basis in equity, preferred, or convertible debt securities. The Rule also applies to persons who directly supervise those who are engaged in such activities. In order to register as a Limited Representative—Equity Trader, representatives must be registered as General Securities Representatives (Series 7) or as Limited Representatives—Corporate Securities (Series 62) and must pass the Series 55 Examination. Rule 1032(f) contains an exemption for representatives whose principal trading activities involve executing orders on behalf of affiliated investment companies registered with the SEC under the Investment Company Act of 1940.

NASD Regulation has received a number of inquiries from member firms and registered representatives regarding the registration requirements for equity traders. In the Fall 1999 issue of *Regulatory & Compliance Alert*, NASD Regulation addressed many of these issues.<sup>1</sup> Since the date of this publication, NASD Regulation has received additional inquiries as to the scope of the equity trader registration requirement, particularly whether certain decision-makers who direct investments of firms' proprietary capital need to register under Series 55. These requests have caused NASD Regulation to reconsider its prior position. As noted above, previously, NASD Regulation took the position that any associated person who makes trading decisions that place a firm's capital at risk needs to be registered under Series 55. In this *Notice to Members*, NASD Regulation is revising this position.

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### Interpretive Guidance

In this *Notice to Members*, NASD Regulation is announcing that a person will not be deemed to be engaged in proprietary trading for purposes of the equity trader registration requirement based solely on the fact that he or she is making decisions to invest the firm's capital in specific Nasdaq or over-the-counter securities. This conclusion, however, assumes that this person will not participate in the execution or processing of trades, and that someone qualified under Series 55 will perform these tasks. The following questions and answers illustrate this position.

- Q. 1.** A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer occasionally selects a particular investment, including quantity and price (if limit order). The trades are submitted to a clearing firm for execution; the president plays no role in the execution or processing of the trade. Would the president be subject to the Series 55 registration requirement?
- A.** No. The president is not involved in the execution or processing of trades. If anyone at the firm is involved in the execution or processing of the trades, that person would need to be registered under Series 55.
- Q. 2.** A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer occasionally selects a particular investment, including quantity and price (if limit order). The trades are submitted to a clearing firm for
- execution; however, the president is involved in negotiating the terms of the transaction with the contra-side of the transaction. Would the president be subject to the Series 55 registration requirement?
- A.** Yes. The president is engaged in proprietary trading, and needs to be registered under Series 55. The president is establishing the terms of the trade with the contra-side of the transaction.
- Q. 3.** A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer is the immediate supervisor of a trader who negotiates the terms of the transactions in Nasdaq and/or over-the-counter equity securities. The trades are submitted to a clearing firm for execution; the president plays no role in the execution or processing of the trades. Would the president be subject to the Series 55 registration requirement?
- A.** Yes. The president would need to register under Series 55. Rule 1032(f) applies to persons who directly supervise equity traders.
- Q. 4.** A broker/dealer is registered with the SEC as an investment adviser. Investment management professionals at the firm produce portfolio management advice that is used by the firm's investment advisory clients, and by the firm in its own proprietary trading. Whenever an investment management professional determines that a security should be purchased or sold for the firm's proprietary account, he or she communicates with a trader employed by the firm. The investment management professional does not communicate any information to the traders other than to occasionally identify particular investments, including quantity and price (if limit order). The traders are required to be Series 55 registered. Would the investment management professionals be subject to the equity trader registration requirement?
- A.** No. The investment management professionals are not involved in the execution or processing of trades.
- Q. 5.** A person processes proprietary trades for a firm by calling or electronically communicating with a contra-side to the transaction. Is this person engaged in proprietary trading, and therefore required to register as a Series 55 representative?
- A.** Yes. NASD Rule 1032(f) covers proprietary traders who effect any transaction in equity, preferred, or convertible debt securities in the Nasdaq or over-the-counter markets.
- Q. 6.** Under a payment-for-order-flow relationship, Firm A routes all its proprietary and agency orders to Firm B for execution. Is Firm A involved in the execution or processing of trades?
- A.** No. Firm A is not involved in the execution or processing of trades, and its personnel will not be required to be registered under Series 55. The result would be the same if Firm A routes orders to multiple firms

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for execution. Further, the payment-for-order-flow arrangement is not a fact that is taken into consideration in this situation.

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### **Endnote**

<sup>1</sup>To the extent that this *Notice to Members* conflicts with prior positions taken by NASD Regulation staff, including guidance outlined in the NASD's *Regulatory & Compliance Alert* (Fall 1999), the guidance provided in this *Notice to Members* is controlling.

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## NASD Notice to Members 00-47

### INFORMATIONAL

## FIPS Changes

Fixed Income Pricing  
System Additions,  
Changes, And Deletions  
As Of June 23, 2000

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Corporate Finance
- Legal & Compliance
- Municipal/Government Securities
- Operations
- Senior Management
- Trading & Market Making

### KEY TOPIC

- FIPS

As of June 23, 2000, the following bonds were added to the Fixed Income Pricing System<sup>SM</sup> (FIPS<sup>®</sup>).

Symbol	Name	Coupon	Maturity
AVIT.GA	AAVID Thermal Tech Inc.	12.750	02/01/07
AXTO.GC	Abraxas Petro Corp.	11.500	11/01/04
BMRL.GA	Better Minerals & Aggregates Co.	13.000	09/15/09
CHCG.GD	Charter Commun Hldgs Cap Corp.	10.000	04/01/09
CSTA.GC	Capstar Broadcasting Ptr	12.000	07/01/09
FCOM.GB	Focal Communications Corp.	11.875	01/15/10
GBIX.GB	Globix Corp.	12.500	02/01/10
GGC.GB	Georgia Gulf Corp.	10.375	11/01/07
IACP.GA	IASIS Healthcare Corp.	13.000	10/15/09
IMDW.GA	Insight Midwest/Insight Capital	9.750	10/01/09
MGMG.GA	MGM Grand Inc.	9.750	06/01/07
MLOP.GA	Merrill Corp.	12.000	05/01/09
SOL.GA	Sola International Inc.	6.875	03/15/08
TUES.GC	Tuesday Morning Corp.	11.000	12/15/07
TWRS.GE	Crown Castle Int'l Corp.	10.375	08/01/11
VSTR.GA	Voicestream Wire Holdings	11.875	11/15/09
VSTR.GB	Voicestream Wire Holdings	10.375	11/15/09
WAXS.GA	World Access Inc.	13.250	01/15/08
WLWH.GA	Woolworth Corp.	7.000	06/02/00

As of June 23, 2000, the following bonds were deleted from FIPS.

Symbol	Name	Coupon	Maturity
AEWS.GA	Andrews Group Inc.	10.000	12/30/99
AGY.GA	Argosy Gaming Co.	13.250	06/01/04
ARTL.GA	American Cont'l Corp.	10.750	08/01/90
AS.GE	Armco Inc.	11.375	10/15/99
AUML.GA	AutoSpa Automalls Inc.	15.000	12/01/99
BALO.GA	Baltimore Bancorp	10.875	12/15/99
BGOI.GA	Buttes Gas & Oil Co.	10.250	08/15/97
BVPS.GA	BVPS II Funding Corp.	7.38	12/01/99
CBNT.GA	Cencom Cable Entertainment Inc.	15.000	02/25/00
CMCS.GE	Comcast Corp.	9.125	10/15/06
CMNH.GB	Clark R & M Hldgs Inc.	0.000	02/15/00
COL.GI	Columbia/HCA Healthcare Corp.	6.410	06/15/00
COMN.GA	Comdata Network Inc.	12.500	12/15/99
CON.GA	Cont'l Homes Hldgs Corp.	12.000	08/01/99
CRC.GA	Carolco Pictures Inc.	13.000	12/01/96
CYAP.GA	Conn Yankee Atomic Power Co.	12.000	06/01/00

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Symbol	Name	Coupon	Maturity
DPGE.GA	Dial Page Inc.	12.250	02/15/00
DTC.GC	Domtar Inc.	11.750	03/15/99
EGLE.GA	Eagle Food Ctrs Inc.	8.625	04/15/00
FCHC.GA	First Cap Hldg Corp.	13.000	05/15/99
FENA.GB	Fairchild Industry Inc.	12.250	02/01/99
FLVC.GA	Flexi-Van Leasing Inc.	9.750	07/15/96
FPO.GA	FPA Corp.	14.500	09/01/00
GLM.GA	Global Marine Inc.	12.750	12/15/99
GNT.GA	Green Tea Finl Corp.	10.250	06/01/02
GRLC.GA	Great Lakes Carbon Corp.	10.000	01/01/06
GSU.GA	Gulf USA Corp.	10.875	10/15/97
GTRP.GA	Gilbert Robinson Inc.	15.000	05/01/99
GVRH.GA	Gold River Hotel & Casino Corp.	13.375	08/31/99
HAYN.GB	Haynes Intl. Inc.	13.500	08/05/99
HCCI.GB	HCC Industries Inc.	7.250	04/15/00
HCN.GA	Health Care Reit Inc.	7.570	04/15/00
HDS.GA	Hills Stores Co.	10.250	09/03/03
ICOG.GA	ICO Global Communications Holdings Ltd.	8.00	08/01/05
ICPA.GA	Imperial Corp America	12.400	01/01/97
ICUY.GA	Integrated Circuit Sys Inc.	11.500	05/15/09
IVPR.GA	Intervest Corp.	0.000	04/01/00
JAIL.GB	Johnstown America Inds Inc.	11.750	08/15/05
KBH.GA	Kaufman & Broad Home Corp.	10.375	09/01/99
KMFD.GC	K-Mart Funding Corp.	7.560	01/01/99
KPLA.GB	Key Plastics Inc.	14.000	11/15/99
LAMR.GA	Lamar Advertising Corp.	11.000	05/15/03
LAMR.GB	Lamar Advertising Corp.	9.625	12/01/06
LAMR.GC	Lamar Advertising Corp.	8.625	09/15/07
LNOU.GA	LanesBorough Corp.	10.000	04/15/00
MACA.GA	Macandrew & Forbes Group Inc.	12.250	07/01/96
MED.GA	Mediq/PRN Life Support Svs Inc.	12.125	07/01/99
MESA.GB	Mesa Capital Corp.	13.500	05/01/99
MMG.GC	Metromedia Int'l Group Inc.	10.000	10/14/99
MPBP.GA	MBP Corp.	14.500	10/15/99
MULR.GA	Mueller Co.	12.125	07/15/96
MXM.GA	Maxxam Inc.	12.500	12/15/99
NMK.GA	Niagara Mohawk Power Corp.	6.500	07/01/99
OROC.GA	Orion Pictures Corp.	10.000	10/31/01
ORX.GE	Oryx Energy Corp.	10.000	06/15/99
ORX.GF	Oryx Energy Corp.	9.500	11/01/99
OTDR.GA	Outdoor Communication Inc.	9.250	08/15/07
PAUH.GA	Paul Harris Stores Inc.	11.375	01/31/00
PCST.GA	Polycast Technology Corp.	10.375	08/01/95
PIDM.GD	Piedmont Aviation Inc. Ser A	9.800	01/15/00
PIDM.GE	Piedmont Aviation Inc. Ser B	9.800	01/15/00
PIDM.GF	Piedmont Aviation Inc. Ser C	9.800	01/15/00
PIDM.H0	Piedmont Aviation Inc. Ser D	10.100	03/28/00
PIDM.HP	Piedmont Aviation Inc. Ser E	10.100	03/28/00



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Symbol	Name	Coupon	Maturity
PIDM.HQ	Piedmont Aviation Inc. Ser F	10.100	03/28/00
PIDM.HR	Piedmont Aviation Inc. Ser G	10.100	03/28/00
PIDM.JL	Piedmont Aviation Inc. Ser H	9.700	05/08/00
PIDM.JM	Piedmont Aviation Inc. Ser I	9.700	05/08/00
PIDM.KL	Piedmont Aviation Inc. Ser J	9.850	05/13/00
PIDM.KM	Piedmont Aviation Inc. Ser K	9.850	05/13/00
PIHG.GA	PI Holdings Inc.	18.500	03/01/04
PR.GA	Price Comm Corp.	5.000	10/09/99
PUSM.GA	Purity Supreme Inc. Ser B	11.750	08/01/99
QNTX.GA	Halmi Robert Corp.	12.000	05/15/97
RAPA.GA	Rapid American Corp. Del	0.000	03/01/00
RCEO.GA	Robertson-Ceco Corp.	12.000	11/20/99
RLLY.GA	Rally's Hamburger's Inc.	8.625	06/15/00
SLT.GA	Salant Corp.	10.500	12/31/98
SNGY.GA	Synergy Group Inc.	11.625	03/15/97
STLV.GE	SCI Television Inc.	8.500	06/30/98
STO.GF	Stone Container Corp.	11.000	08/15/99
TEDP.GD	Toledo Edison Co.	7.250	08/01/99
TIPK.GC	Tiphook Finance Corp.	8.000	03/15/00
TXF.GB	Texfi Industries Inc.	8.750	08/01/99
UIS.GI	Unisys Corp.	12.000	04/14/03
USAR.GJ	US Airway Inc. Ser A	10.300	01/15/00
USAR.GK	US Airway Inc. Ser B	10.300	01/15/00
USAR.GL	US Airway Inc. Ser C	10.300	01/15/00
USAR.GM	US Airway Inc. Ser D	10.300	01/15/00
USAR.GN	US Airway Inc. Ser E	10.300	01/15/00
USAR.GO	US Airway Inc. Ser F	10.300	01/15/00
USAR.JC	US Airway Inc. Ser A	9.800	01/15/00
USAR.JD	US Airway Inc. Ser B	9.800	01/15/00
USAR.JE	US Airway Inc. Ser C	9.800	01/15/00
USAR.JF	US Airway Inc. Ser D	9.800	01/15/00
USAR.LC	US Airways Inc. Ser 88-E	10.550	01/01/00
USAR.LD	US Airways Inc. Ser 88-F	10.550	01/01/00
USAR.LE	US Airways Inc. Ser 88-F	10.550	01/01/00
USAR.LF	US Airways Inc. Ser 88-H	10.550	01/01/00
USAR.LG	US Airways Inc. Ser 88-I	10.550	01/01/00
USAR.LH	US Airways Inc. Ser 88-J	10.550	01/01/00
USAR.LI	US Airways Inc. Ser 88-K	10.550	01/01/00
USAR.LJ	US Airways Inc. Ser 88-L	10.550	01/01/00
USTR.GA	U S Trails Inc.	12.000	07/15/98
VLIN.GA	Valassis Inserts Inc.	8.875	03/15/99
VNDH.GA	Vendell Healthcare Inc. Ser B	12.000	05/15/00
WBB.GA	Webb (Del) Corp.	8.000	03/15/00
WHCR.GA	Westinghouse Credit Corp.	8.875	06/14/14
WHEN.GA	Wherehouse Entertainment Inc.	13.000	08/01/02
WLWH.GA	Woolworth Corp.	7.000	06/01/00
WMAS.GC	Western Mass Electric Co.	6.875	01/01/00

## **NASD Notice to Members 00-47**

As of June 23, 2000, changes were made to the symbols of the following FIPS bonds.

<b>New Symbol</b>	<b>Old Symbol</b>	<b>Name</b>	<b>Coupon</b>	<b>Maturity</b>
COF.GB	COP.GB	Capital One Financial Corp.	7.250	12/01/03
COF.GC	COP.GC	Capital One Financial Corp.	7.250	05/01/06
FCOM.GA	FCLU.GA	Focal Communications Corp.	12.125	02/15/08
USAR.LS	USRA.LS	US Air Inc.	10.600	01/01/02
VHT.GD	VHD.GD	Venture Holdings Inc.	12.000	06/01/09

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to FIPS trade-reporting rules should be directed to Patricia Casimates, Market Regulation, NASD Regulation<sup>SM</sup>, at (301) 590-6447.

Any questions regarding the FIPS master file should be directed to Cheryl Glowacki, Nasdaq<sup>®</sup> Market Operations, at (203) 385-6310.

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### INFORMATIONAL

## Decimalization

NASD Adopts Rule Requiring Member Participation In Decimalization Testing; NASD Reminds Selected Members Of Survey Deadline: **July 28, 2000**

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Operations
- Options
- Registered Representatives
- Senior Management
- Technology
- Trading & Market Making

### KEY TOPICS

- Decimalization

### Executive Summary

In response to the Securities and Exchange Commission (SEC) Order requiring a decimalization "phase-in" plan, the National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) has adopted a new rule (NASD Rule 3420) that will mandate member participation in decimalization testing. The rule became effective immediately upon filing with the SEC on June 27, 2000. Attachment A contains the text of the new rule.

The NASD also wants to remind selected members to return the Decimalization Survey by July 28, 2000.

### Questions/Further Information

Questions regarding this *Notice to Members* may be directed to the NASD Decimalization Program Management Office (DPMO) toll free at: (888) 227-1330 or via e-mail at [decimals@nasd.com](mailto:decimals@nasd.com); or to Kosha Kantharia Dalal, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>), at (202) 728-6903.

Members can view the NASD Decimalization Web Site ([www.nasd.com](http://www.nasd.com)) for general information and the Securities Industry Association Web Site ([www.sia.com](http://www.sia.com)) for testing information (view the *Decimalization Testing & Implementation Guide*).

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## **NASD Notice to Members 00-48**

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### **SEC Order**

On June 8, 2000, the SEC released an Order ("Order Directing the Exchanges and NASD to Submit a Phase-In Plan to Implement Decimal Pricing In Equity Securities and Options") directing the exchanges and the NASD to submit a plan by July 24, 2000, regarding the phase in of decimal pricing for exchange-listed stocks and certain options that should begin on or before September 5, 2000, and the phase in of decimal pricing for Nasdaq<sup>®</sup> securities that should begin on March 12, 2001. The Order requires that all securities be priced in decimals by no later than April 9, 2001.

To view this SEC Order, go to the following SEC Web Page:  
<http://www.sec.gov/rules/other/34-42914.htm>.

### **Mandating Member Participation In Decimal Pricing Testing**

In preparation for conversion to decimal pricing, the NASD has adopted a new rule that requires some members to participate in decimalization testing.

Specifically, the rule requires market makers and clearing firms to:

- conduct or participate in the testing of their computer systems to ensure decimal pricing conversion compatibility in such a manner and frequency as the NASD staff may prescribe;
- provide the NASD with reports relating to the mandatory testing;
- maintain adequate documentation of the tests and the testing

results for inspection by the NASD staff.

The purpose of the new rule is to ensure an effective implementation of the June 8, 2000 SEC Order. NASD believes that mandatory testing should be limited to market makers and clearing firms because the failure of the computer systems of these firms for decimal pricing has the potential to cause systemic disruption of the markets as a whole.

### **Decimalization Survey**

Selected members were mailed the Decimalization Survey during the week of June 26, 2000. NASD requests that members complete and return the survey to the DPMO by July 28, 2000.

### Attachment A

#### Text Of New Rule

##### **Rule 3420. Mandatory Decimal Pricing Testing.**

(a) Clearing firms and market makers of the Association must conduct or participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of such systems in such manner and frequency as the Association may prescribe.

(b) Every clearing firm and market maker required by the Association to conduct or participate in testing of computer systems shall provide to the Association such reports relating to the testing as the Association may prescribe.

(c) Clearing firms and market makers shall maintain adequate documentation of tests required pursuant to this Rule and the results of such testing for examination by the Association.

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### INFORMATIONAL

## SEC Interpretive Guidance

### SEC Issues Staff Interpretation On The "Free Trading" Status Of Blank Check Company Securities Under Certain Scenarios

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Senior Management
- Trading & Market Making

### KEY TOPICS

- Blank Check Companies
- Freely Tradeable Securities

### Executive Summary

A unit of the NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) Market Regulation Department recently asked the Securities and Exchange Commission (SEC) for interpretive guidance regarding initial distribution or the redistribution in the aftermarket of the shares issued by "blank check" companies<sup>1</sup> and whether these distributions were in compliance with SEC Rules.

NASD Regulation's request for guidance and the SEC's response are included with this *Notice*.

### Questions/Further Information

Questions regarding this *Notice* may be directed to Ken Worm, Assistant Director, Market Regulation Department, NASD Regulation, at (301) 978-2097.

### Background

The Market Regulation Department's OTC Compliance Unit (Unit) reviews Form 211 filings submitted by potential Market Makers to determine whether they are in compliance with Rule 15c2-11(a) of the Securities Exchange Act of 1934 (Exchange Act) and NASD Rule 6740 before Market Makers are permitted to initiate or resume quotation of a non-Nasdaq<sup>®</sup> security in any quotation medium. During the course of these reviews, the Unit's staff has raised concerns regarding certain factual scenarios where either the initial distribution or the redistribution in the aftermarket of the shares issued by blank check companies may violate Section 5 of the Securities Act of 1933 (Securities Act) based on the nature of the initial distribution of the securities of certain issuers. As a result of these concerns, the Market Regulation Department

requested guidance from the Division of Corporation Finance (Division) of the SEC on whether certain factual scenarios may present potential violations of Section 5 of the Securities Act. In response to the NASD Regulation staff request, the Division issued a staff interpretation dated January 21, 2000, on the "free trading" status<sup>2</sup> of securities initially issued by blank check companies in a number of factual scenarios.

As an initial matter, it is important to emphasize that the restrictions on trading of securities of blank check companies, as described in the Division's response letter, are not limited to the scenarios described within this *Notice*. Based on the Division's response letter as well as subsequent conversations with Division staff, in most, if not all, cases, the resale of securities of blank check companies is restricted and such securities can only be resold through registration under the Securities Act. In addition, Rule 144 would not be available to promoters or affiliates of blank check companies or to their transferees either before or after a business combination with an operating company or other person.

Moreover, NASD Regulation staff will require a Market Maker, when seeking NASD Regulation clearance pursuant to NASD Rule 6740 to initiate or resume quotation of a security of a blank check company, to provide an independent opinion from its own counsel detailing why the sale of such securities would not violate the registration requirements of the Securities Act. In addition, the NASD Regulation staff will continue to scrutinize closely such filings and will vigorously pursue disciplinary action and/or refer the staff's findings to the SEC for further action.

## NASD Notice to Members 00-49

### Specific Factual Scenarios Presented To The SEC

In its November 1, 1999 letter to the Division, NASD Regulation staff requested guidance on whether the following factual scenarios presented potential violations of Section 5 of the Securities Act.

**Scenario 1:** The issuer transfers a nominal amount of its shares (less than 10 percent of the total float) as a gift to between 20 and 50 individuals under Section 4(2) of the Securities Act. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who controls the issuer frequently has gifted shares of other companies to the same individuals on other occasions.

**Scenario 2:** The issuer transfers a significant amount of its shares to one individual under Section 4(2) of the Securities Act. That individual subsequently gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.

**Scenario 3:** The issuer transfers a significant amount of its shares to one individual

under Section 4(2) of the Securities Act. That individual holds the shares for two years and then subsequently gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares a few months, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.

**Scenario 4:** A small number of shareholders (less than 10) hold all of the free-trading shares of an issuer. A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly.

**Scenario 5:** A small number of shareholders (less than 10) control nearly all (more than 90 percent) of the free-trading shares in the issuer. The remaining nominal amount of free-trading shares (less than 10 percent) are widely dispersed among a larger number of shareholders (50 or more individuals). A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly and considers the number of total shareholders to be determinative.

**Scenario 6:** An issuer controlled by one individual issues shares to another company controlled by the same individual pursuant to Rule 701 of the Securities Act. The issuer files a Form 10 with the SEC that became effective by default. The second company then sells all its shares in the issuer through a brokerage firm. A second broker/dealer submits a Form 211 indicating that the shares sold through the first broker/dealer are all free-trading securities.

**Scenario 7:** A reporting shell company merges with a private company and the former controlling shareholder of the reporting shell company sells his shares to numerous individuals more than three months after he ceases to be an affiliate of the post-merger company. A Market Maker submits a Form 211 citing the post-merger shares sold by the former control person as the only free-trading shares.

### Division Response

In its response letter, the Division indicated that each of the scenarios initially suggests the availability of Rule 144 or Section 4(1) of the Securities Act following the lapse of some period of time after the issuance of shares in the blank check company, regardless of whether a merger has occurred. The Division noted that in several of the scenarios, promoters of the issuers also appear to be in the business of creating blank check companies, then gifting or selling the securities of the companies without registration, either directly or through intermediaries.

Section 4(1) exempts transactions not involving issuers, underwriters,

## NASD Notice to Members 00-49

or dealers. The availability of this exemption depends upon the facts and circumstances of each particular situation. The Division indicated that transactions in blank check company securities by their promoters or affiliates, especially where they control or controlled the "float" of the "freely tradable" securities, are not the kind of ordinary trading transactions between individual investors of securities already issued that Section 4(1) was designed to exempt.<sup>3</sup> Moreover, the Division noted that purchasers who are mere conduits for a wider distribution of securities may be deemed "underwriters." When such purchasers sell their securities, they assume the risk of possible violation of the registration requirements of the Securities Act and consequent civil liabilities. Persons engaged in the business of buying and selling securities who function in this capacity are subject to careful scrutiny.<sup>4</sup>

The Division noted in its response that both before and after the business combination or transaction with an operating entity or other person, the promoters or affiliates of blank check companies, as well as their transferees, would be considered "underwriters" of the securities issued. As a result, the securities involved can only be resold through registration under the Securities Act.<sup>5</sup> Similarly, Rule 144 would not be available for resale transactions in this situation, regardless of technical compliance with that rule, because these resale transactions appear to be designed to distribute or redistribute securities to the public without compliance with the registration requirements of the Securities Act.<sup>6</sup>

**Accordingly, the Division concluded that each of the scenarios illustrates what it**

**believes to be a scheme to evade the registration requirements of the Securities Act.** Consequently, the resale of the shares in scenarios 1 through 7 would require registration. In addition, with regard to scenario 6, the Division noted that Rule 701 is not available for issuances to companies or entities, but only to individuals. In view of the business of a blank check company which generally has few or no employees, it seems unlikely that reliance upon this exemption would be appropriate; therefore, Rule 701 generally would not be available to blank check companies when issuing shares to their consultant or advisors.

Moreover, the Division was advised by staff of the SEC's Division of Market Regulation that Rules 101 and 102 of Regulation M<sup>7</sup> impose restrictions on issuers, selling shareholders, and distribution participants when they effect transactions in securities that are part of a distribution. Generally, a distribution exists when a sufficient magnitude of shares is being sold and special selling efforts are employed to sell these shares. If a distribution exists, the persons involved in the distribution are prohibited from bidding for or purchasing the securities in distribution. The rule covers the persons selling securities, their affiliates, and others participating in the distribution. Persons selling in the manner described in the scenarios above should carefully analyze the facts surrounding the sales to determine whether the security being sold is in a distribution for purposes of Regulation M. This analysis specifically should consider the actions taken by any persons assisting with the transactions. In particular, selling through a Market Maker into an illiquid market raises heightened concerns regarding compliance with Regulation M.<sup>8</sup>

### Compliance Guidance

Based on the Division's response letter as well as subsequent conversations with Division staff, in most, if not all, cases, the resale of securities of blank check companies is restricted and such securities can only be resold through registration under the Securities Act. In addition, Rule 144 would not be available to promoters or affiliates of blank check companies or to their transferees either before or after a business combination with an operating company or other person.

Moreover, NASD Regulation staff will require a Market Maker, when seeking NASD Regulation clearance pursuant to NASD Rule 6740 to initiate or resume quotation of a security of a blank check company, to provide an independent opinion from its counsel detailing why the sale of such securities would not violate the registration requirements of the Securities Act. Member firms are reminded that, in complying with these requirements, a Market Maker cannot reasonably rely on a legal opinion provided by the issuer or the issuer's counsel, or by counsel acting for any individual or entity involved in the transaction.<sup>9</sup> To ensure reliability of the opinion, the Market Maker must obtain an independent opinion from its own counsel.<sup>10</sup> The NASD Regulation staff will continue to closely scrutinize such filings and will vigorously pursue disciplinary action and/or refer the staff's findings to the SEC for further action.



## NASD Notice to Members 00-49

### Endnotes

<sup>1</sup>A blank check company is a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person.

<sup>2</sup>The concept of "freely tradable" securities is used to describe securities that are exempt from the registration requirements pursuant to Section 4(1) of the Securities Act because no issuer, underwriter, or dealer is engaged in the transaction.

<sup>3</sup>See *SEC v. Cavanagh*, 1 F. Supp. 2d 337 (S.D.N.Y. 1998).

<sup>4</sup>See SEC Release No. 33-4552 (Nov. 6, 1962).

<sup>5</sup>This view is analogous to one the SEC has expressed with respect to business combinations under Rule 145 where affiliates of parties to the transaction are viewed to be "underwriters." Further, the nature of these types of resale transactions

are closely analogous to shares from an unsold allotment held by professional underwriters. Generally, these securities are only resaleable through registration. Shares purchased by non-affiliates in a registered transaction such as one offered in compliance with Rule 419, however, would not be subject to this restriction.

<sup>6</sup>SEC Release No. 33-5223 (Jan. 11, 1972).

In view of the objectives and policies underlying the Act, the rule shall not be available to any individual or entity with respect to any transaction which, although in technical compliance with the provisions of the rule, is part of a plan by such individual or entity to distribute or redistribute securities to the public. In such case, registration is required.

<sup>7</sup>17 CFR 242.101 - 102.

<sup>8</sup>See SEC Release No. 34-38067 (Dec. 20, 1996).

<sup>9</sup>See James L. Owlsey, 54 S.E.C. Docket 739, SEC Release No. 34-32941 (June 18,

1993) (citing *SEC v. Datronics Engineers, Inc.*, 490 F. 2d 250, 253-254) (4th Cir. 1973).

<sup>10</sup>*SEC v. Harwyn Indus. Corp.*, 326 F. Supp. 943, 954-55 (S.D.N.Y. 1971). The Market Maker's duty to seek independent counsel stems from its obligation to make a "searching inquiry" and to conduct a meaningful investigation of the surrounding circumstances in order to ensure that it is not engaged in the distribution of an unregistered security on behalf of an issuer, any person in a control relationship with an issuer, or an underwriter. See *Stead v. SEC*, 444 F. 2d 713 (10th Cir. 1971) cert. denied, 404 U.S. 1059 (1972); see also SEC Release No. 33-4445, Distribution by Broker-Dealers of Unregistered Securities (Feb. 2, 1971).

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November 1, 1999

Richard K. Wulff  
Assistant Director  
Office of Small Business  
Division of Corporation Finance  
450 5<sup>th</sup> Street, N.W.  
Washington, D. C. 20549

Re: Tradeability of Securities Distributed by Means Other than Public Offerings

Dear Mr. Wulff:

The purpose of this letter is to request the guidance of the Division of Corporation Finance ("Division") as to whether certain specific factual scenarios present potential violations of Section 5 of the Securities Act of 1933 ("Securities Act"). The Market Regulation Department's OTC Compliance Unit ("Unit") reviews Form 211 filings submitted by potential market makers to determine whether they are in compliance with SEC 15c2-11 and NASD Rule 6740 before they are cleared to initiate or resume quotation of a non-Nasdaq security in any quotation medium. During the course of these reviews, the staff has been presented with certain factual scenarios that, based on the nature of the initial security distribution of blank check shell company issuers, either the initial distribution or the redistribution of the shares in the aftermarket may constitute violations of Section 5 of the Securities Act. Set forth below are various scenarios that the Unit has encountered, or feels that it may encounter, while reviewing Form 211 filings. The staff requests that the Division provide its opinion on the following scenarios with respect to potential violations of the securities rules:

1. As a gift the issuer transferred a nominal amount of its shares (less than 10% of the total float) to between 20 and 50 individuals under Section 4(2) of the Securities Act. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who controls the issuer frequently has gifted shares of other companies to the same individuals on other occasions.
2. The issuer transferred a significant amount of its shares to one individual under Section 4(2) of the Securities Act. Then that individual in turn gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.

3. The issuer transferred a significant amount of its shares to one individual under Section 4(2) of the Securities Act. That individual holds the shares for two years and then in turn gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares a few months, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.
4. A small number of shareholders (less than ten) hold all of the free-trading shares. A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly.
5. A small number of shareholders (less than ten) control nearly all (more than 90%) of the free trading shares in the issuer. The remaining nominal amount of free-trading shares (less than 10%) are widely dispersed among a larger number of shareholders (50 or more individuals). A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly and considers the number of total shareholders to be determinative.
6. An issuer controlled by one individual issued shares to another company controlled by the same individual pursuant to SEC Rule 701. The issuer filed a Form 10 with the SEC that became effective by default. The second company then sells all its shares in the issuer through a brokerage firm. A second broker/dealer submits a Form 211 indicating that the shares sold through the first broker/dealer are all free-trading securities.
7. A reporting shell company merged with a private company and the former controlling shareholder of the reporting shell company sold his shares to numerous individuals more than three months after he ceased to be an affiliate of the post-merger company. A market maker submits a Form 211 citing the post-merger shares sold by the former control person as the only free-trading shares.

Thank you for your attention to this matter. We look forward to receiving the Division's guidance on whether any of these scenarios are of regulatory concern to the Division. If you have any questions, please do not hesitate to contact me at (301) 978-2097.

Sincerely,



Ken Worm  
Assistant Director  
OTC Compliance Unit



DIVISION OF  
CORPORATION FINANCE

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

January 21, 2000

Mr. Ken Worm  
Assistant Director  
OTC Compliance Unit  
NASD Regulation, Inc.  
9513 Key West Avenue  
Rockville, MD 20850

Re: NASD Regulation, Inc.  
Incoming letter dated November 1, 1999

Dear Mr. Worm:

You have raised a question regarding the "free trading" status<sup>1</sup> of securities initially issued by so-called blank check companies in a number of factual scenarios.

A blank check company is a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person. In 1990, the U. S. Congress found that offerings by these kinds of issuers were common vehicles for fraud and manipulation in the market for penny stocks which undermines investor confidence and inhibits legitimate capital formation by small issuers and other companies.<sup>2</sup> The Commission has adopted several rules, as Congress directed, to deter fraud in connection with registered offerings by blank check companies.<sup>3</sup> The Commission has also excluded blank check companies from eligibility for several exemptions from Securities Act registration requirements.<sup>4</sup>

Each of your scenarios suggests the availability of Rule 144 or Section 4(1) of the Securities Act following the lapse of some period of time following the issuance of shares in the

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<sup>1</sup> Because the Securities Act of 1933 establishes the requirement to register securities for sale, subject to a series of exemptions, the concept of freely tradable securities is not a technically accurate one. In common parlance, the term is used to describe securities subject to the exemption provided by section 4(1) when it is available because no issuer, underwriter or dealer is engaged in the transaction.

<sup>2</sup> Securities Enforcement Remedies and Penny Stock Reform Act of 1990, S. 647, Pub. L. 101-429. See H. R. Rep. No. 101-617; 101 Cong., 2d Sess. at 23.

<sup>3</sup> Rule 419 under the Securities Act of 1933 and Rule 15g-8 under the Securities Exchange Act of 1934.

<sup>4</sup> See, e.g., Rule 504 under Regulation D and Regulation A.

blank check company regardless of whether a merger has occurred. In a number of cases, promoters of these issuers appear to be in the business of creating blank check companies, then gifting or selling the securities of the companies without registration, either directly or through intermediaries.

Section 4(1) exempts transactions not involving issuers, underwriters or dealers. The availability of the exemption depends upon the facts and circumstances of each particular situation, which the staff generally is not in a position to determine. Nonetheless, transactions in blank check company securities by their promoters or affiliates, especially where they control or controlled the "float" of the "freely tradable" securities, are not the kind of ordinary trading transactions between individual investors of securities already issued that Section 4(1) was designed to exempt.<sup>5</sup>

Furthermore, as the Commission has indicated, purchasers who are mere conduits for a wider distribution of the securities are "underwriters." When they do sell, these purchasers assume the risk of possible violation of the registration requirements of the Securities Act and consequent civil liabilities. Persons engaged in the business of buying and selling securities who function in this capacity are subject to careful scrutiny.<sup>6</sup>

It is our view that, both before and after the business combination or transaction with an operating entity or other person, the promoters or affiliates of blank check companies, as well as their transferees, are "underwriters" of the securities issued. Accordingly, we are also of the view that the securities involved can only be resold through registration under the Securities Act.<sup>7</sup> Similarly, Rule 144 would not be available for resale transactions in this situation, regardless of technical compliance with that rule, because these resale transactions appear to be designed to distribute or redistribute securities to the public without compliance with the registration requirements of the Securities Act.<sup>8</sup>

<sup>5</sup> SEC v. Cavanagh, 1 F. Supp. 2d 337 (S.D.N.Y. 1998).

<sup>6</sup> Release No. 33-4552 (Nov. 6, 1962).

<sup>7</sup> This view is analogous to the one the Commission has expressed with respect to business combinations under Rule 145 where affiliates of parties to the transaction are viewed to be "underwriters." Further, the nature of these types of resale transactions are closely analogous to shares from an unsold allotment held by professional underwriters. Generally, these securities are only resaleable through registration. Shares purchased by non-affiliates in a registered transaction such as one offered in compliance with Rule 419, however, would not be subject to this restriction.

<sup>8</sup> Release No. 33-5223 (Jan. 11, 1972).

In view of the objectives and policies underlying the Act, the rule shall not be available to any individual or entity with respect to any transaction which, although in technical compliance with the provisions of the rule, is part of a plan by such individual or entity to distribute or redistribute securities to the public. In such case, registration is required.

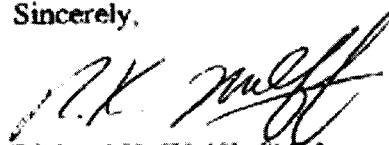
Each of your scenarios illustrates what we believe to be a scheme to evade the registration requirements of the Securities Act. Consequently, it is our view that the resale of the shares in scenarios 1 through 7 would require registration.

In addition, with regard to scenario 6, we are of the view that Rule 701 is not available for issuances to companies or entities, but only to individuals. In view of the business of a blank check company which generally has few or no employees, it seems unlikely that reliance upon this exemption would be appropriate. It is our view that Rule 701 would generally not be available to blank check companies for issuing shares to their consultants or advisors.

Moreover, we have been advised by staff of the Division of Market Regulation that Rules 101 and 102 of Regulation M<sup>9</sup> impose restrictions on issuers, selling shareholders and distribution participants when they effect transactions in securities that are part of a distribution. Generally, a distribution exists when a sufficient magnitude of shares is being sold and special selling efforts are employed to sell these shares. If a distribution exists, the persons involved in the distribution are prohibited from bidding for or purchasing the securities in distribution. The rule covers persons selling securities, their affiliates, and others participating in the distribution. Persons selling in the manner described in your letter should carefully analyze the facts surrounding the sales to determine whether the security being sold is in distribution for purposes of Regulation M. This analysis should specifically consider the actions taken by any persons assisting with the transactions. In particular, selling through a market maker into an illiquid market raises heightened concerns regarding compliance with Regulation M.<sup>10</sup>

Because these positions are based upon representations made in your letter, any different facts or conditions might require a different conclusion.

Sincerely,



Richard K. Wulff, Chief  
Office of Small Business

<sup>9</sup> 17 CFR 242.101 - 102.

<sup>10</sup> See Release No. 34-38067 (Dec. 20, 1996).

# Disciplinary Actions

## Disciplinary Actions Reported For July

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) has taken disciplinary actions against the following firms and individuals for violations of National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) 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 June 23, 2000.

### Firms Expelled, Individuals Sanctioned

**Liberty National Securities, Inc. (CRD #17955, Dundee, Michigan) and Robert James Guyer (CRD #1292105, Registered Principal, Dundee, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was expelled from membership with the NASD and Guyer was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Guyer, permitted a statutorily disqualified person to be associated with the firm. **(NASD Case #C8A000032)**

**USA Investments Incorporated (CRD #41280, Morristown, New Jersey), Richard Paul Rodgers (CRD #501208, Registered Principal, Morris Plains, New Jersey), and John Henry Suhre (CRD #1670360, Registered Principal, Fairless Hills, Pennsylvania).** The firm was expelled from membership with the NASD, suspended from membership in the NASD for two years, and fined \$160,000. Rodgers was suspended from association with any NASD member in any capacity for two years, barred from association with any NASD mem-

ber in any capacity, and fined \$185,000. Suhre was barred from association with any NASD member in any capacity and fined \$30,000. The fines must be paid before any application for reentry into the securities industry will be considered. The sanctions were based on findings that the firm and Rodgers filed Secured Demand Note Collateral Agreements (agreements) with the NASD that contained material misrepresentations to obtain approval to permit the firm to classify the agreements as equity capital, instead of debt, in order to avoid being subject to the debt-equity requirements. In addition, the firm, acting through Rodgers, gave false testimony during an on-the-record interview; falsified the firm's corporate books and records; and provided the NASD with false, forged corporate resolutions purporting to reflect the issuance of one share of preferred stock to the lenders listed in the agreements. Moreover, the firm, acting through Rodgers, failed to maintain required net capital and filed a false and misleading FOCUS Part IIA report. Rodgers also failed to respond truthfully during his on-the-record interview and failed to respond completely to an NASD request for information. Also, the firm, acting through Rodgers, permitted individuals to maintain their securities registrations with the firm even though they were not active in the firm's securities business, and the firm, acting through Rodgers and Suhre, improperly held Suhre out as the firm's registered financial and operations principal (FINOP), even though he did not perform the functions of a FINOP.

The firm and Rodgers' suspensions began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C9B990029)**

## **Firms Fined, Individuals Sanctioned**

**Joseph Stevens & Company, Inc. (CRD #35459, New York, New York)** and **Joseph Sorbara (CRD #1001403, Registered Principal, Muttontown, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm and Sorbara were fined \$75,000, jointly and severally. The firm was also censured and ordered to disgorge \$796,907 to the NASD. Sorbara was also suspended from association with any NASD member in any capacity, including clerical or ministerial functions, for 75 days. Without admitting or denying the allegations, the firm and Sorbara consented to the described sanctions and to the entry of findings that the firm, acting through Sorbara, purchased warrants from the firm that was the lead underwriter for the initial public offering (IPO), sold nearly all the warrants to public customers within 45 minutes, and did virtually no trading in any other securities. The findings also stated that the firm's sales force received higher than normal compensation for the warrant sales that were of substantial magnitude and accompanied by special selling efforts and methods so as to constitute a distribution. The findings further stated that the firm, acting through Sorbara, made a market in this security in violation of Securities and Exchange Commission (SEC) and NASD rules and created a public offering without filing the required documents and information with the NASD for review. In addition, the respondents failed to obtain an opinion from the NASD that it had no objections to the underwriting and other terms and arrangements. Moreover, as a result of this transaction constituting a public offering receiving an unreasonable amount of underwriting

compensation, the firm and Sorbara failed to disclose all items of underwriting compensation in a prospectus or similar document and, as a result, the firm received \$871,907 in excessive underwriting compensation.

Sorbara's suspension began on June 19, 2000, and will conclude at the close of business on September 1, 2000. **(NASD Case #CAF000006)**

**Stonebridge Securities, Inc. (CRD #38602, Lynbrook, New York)** and **Joseph Giulio Chiulli (CRD #1149276, Registered Principal, Lynbrook, New York)** submitted an Offer of Settlement in which the firm and Chiulli were censured and fined \$75,000, jointly and severally. Chiulli was also barred from association with any NASD member in any principal capacity and barred from association with any NASD member in any capacity with the right to reapply for association in a non-principal capacity after three years from the date of acceptance of the Offer. Payment of the fine shall be a prerequisite before Chiulli seeks to reassociate with a member firm or requests relief from any statutory disqualification. Without admitting or denying the allegations, the firm and Chiulli consented to the described sanctions and to the entry of findings that they violated the firm's restriction agreement by effecting proprietary and equity trades, transferring customer accounts from other firms to Stonebridge, and opening an account for a new customer. The findings also stated that the firm and Chiulli failed to respond truthfully to the NASD regarding proprietary trading, new customer account forms, bank accounts not previously disclosed, the source of entries in the firm's cash blotter, and sources of revenue. The firm and Chiulli also

created false entries in the firm's cash blotter to hide revenues generated by equity trading activities and filed an inaccurate FOCUS Part II report. In addition, they operated a securities business while failing to maintain the required minimum net capital and failed to notify NASD of the firm's net capital violations. Furthermore, the firm and Chiulli failed to respond to NASD requests for information and documentation. **(NASD Case #C10960211)**

## **Firm And Individual Fined**

**Arka Securities, Inc. (CRD #19920, San Diego, California)** and **Denise Yvette Filotas (CRD #2519444, Registered Principal, San Diego, California)** submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$20,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanction and to the entry of findings that the firm, acting through Filotas, engaged in the securities business while failing to have and maintain sufficient net capital. **(NASD Case #C02000029)**

## **Firms Fined**

**CIBC Oppenheimer (CRD #630, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to have in place a supervisory system adequate to oversee and monitor the activities of individuals acquiring and selling certificates of participation and failed to have supervisory procedures for the sale of unrated municipal securities. The findings also stated that the firm



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 federal securities laws and NASD rules. **(NASD Case #CAF000020)**

**Kemper Distributors, Inc. (CRD #37306, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent (AWC) in which the firm was censured, fined \$100,000 to be paid within 10 days of notice of acceptance by the National Adjudicatory Council (NAC) of this AWC, and required to pre-file with the NASD all advertisements depicting performance information through the use of graphs, bar charts, or pie charts for approval 15 days prior to their initial use for six months from the date of acceptance by the NAC of this AWC. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published advertisements that failed to depict accurately performance of several mutual funds underwritten and distributed by the firm. The findings also stated that the firm failed to obtain approval from a registered principal prior to the use of certain of the advertisements. In addition, the firm failed to file, or filed in an untimely manner, a number of the advertisements with the NASD. Moreover, the firm failed to establish and maintain procedures reasonably designed to achieve compliance with the NASD's principal approval and filing requirements. **(NASD Case #CAF000012)**

**Pan-American Financial Advisors (CRD #15578, New Orleans, Louisiana)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and

fined \$7,500, jointly and severally with an individual. The firm was fined an additional \$5,000 and required to conduct an internal audit to ensure that all mutual fund liquidation transaction commissions incorrectly charged to the customer were properly refunded within 90 days of acceptance of the AWC by the NAC and to report the audit results, in writing, to the NASD. Without admitting or denying the allegations, the firm consented to the described allegations and to the entry of findings that the firm, acting through an individual, engaged in a securities business while failing to maintain the required minimum net capital and failed to give immediate telegraphic notice that its net capital was below the required minimum. The findings also stated that the firm, acting through the individual, failed to record aggregate receivables due from its clearing firm, inaccurately reported the firm's net capital on FOCUS Part I and Part II reports, and charged commissions to customer accounts in connection with mutual fund liquidation transactions without disclosing that the transactions would have been free if they had been conducted directly with the mutual fund. In addition, the firm allowed an individual to act in the capacity of a general securities principal while not properly registered with the NASD due to the firm's failure to file a Form U-4. **(NASD Case #C05000025)**

#### **Individuals Barred Or Suspended**

**Mark Steven Balbirer (CRD #2297951, Registered Representative, Sunrise, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Balbirer effected an unauthorized transaction in a customer account. **(NASD Case #C07000001)**

**Greg Spencer Barton (CRD #2336541, Registered Principal, Redmond, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$4,000 and suspended from association with any NASD member as a general securities representative for 10 days. Without admitting or denying the allegations, Barton consented to the described sanctions and to the entry of findings that he failed to provide prompt written notice to his member firm, although he was given opportunities to do so, that he had provided investment advisory services to public customers and received compensation totaling \$24,777.

Barton's suspension began July 3, 2000, and concluded at the close of business on July 12, 2000. **(NASD Case #C3B000008)**

**Jeffrey Dale Bates (CRD #2386066, Registered Representative, Stephens City, Virginia)** 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, Bates consented to the described sanction and to the entry of findings that he received a \$6,500 check from a public customer to be deposited into new accounts for the benefit of the customer's son, failed to deposit the funds, and, instead, deposited the check into the account of another customer to offset previous losses incurred in the account, without the first customer's knowledge or consent. **(NASD Case #C05000027)**

**James Oakley Baxter, Jr. (CRD #1176297, Registered Representative, Norfolk, Virginia)** was barred from association with any NASD member in any capacity.

The NAC imposed the sanction following appeal of an Office of Hearing Officers (OHO) decision. The sanction was based on findings that Baxter invested customer funds in limited liability companies without customer authorization. Baxter also failed to respond to an NASD request for information. **(NASD Case #C07990016)**

**Kurt Francis Chatham (CRD #33296, Registered Representative, Hobe Sound, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegation, Chatham consented to the described sanction and to the entry of findings that he made improper use of approximately \$20,000 in funds of a public customer, fabricated an account statement, and provided a copy of that statement to the customer. According to the findings, the fabricated statement indicated that the customer's funds were in an account titled in her name, which was untrue, and also listed Chatham as the account executive, when he was not registered or associated with the member firm carrying the account.

Chatham's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C07000031)**

**Victor Andrew Chu (CRD #2170077, Registered Principal, Costa Mesa, California)** submitted an Offer of Settlement in which he was fined \$12,500, suspended from association with any NASD member as a general securities principal for two years, and ordered to requalify by examination as a general securities principal. Without admitting or denying the allegations, Chu con-

sent to the described sanctions and to the entry of findings that he permitted his firm's principal owner and sole director to actively engage in the management of the firm's securities business without being registered with the NASD in a principal capacity. The findings also stated that Chu recommended to public customers the purchases of limited partnership interests without having reasonable grounds for believing that they were suitable for the customers, and failed to establish or follow procedures reasonably designed to carry out the supervision of sales representatives to ensure compliance with applicable securities rules and regulations. Moreover, Chu failed to respond adequately in a supervisory capacity when confronted with, or exposed to, various red flags which indicated that the recommendations by sales representatives were unsuitable.

Chu's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C02970012)**

**Patrice Cohen (CRD #1643865, Registered Representative, Tampa, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cohen consented to the described sanction and to the entry of findings that she completed change forms for client accounts that modified the amounts invested by each client through automatic payroll deductions into tax-deferred annuity accounts, without the authorization or knowledge of her clients. The findings also stated that Cohen forged her clients' names to the change forms and received thousands of dollars in unearned commissions from her member firm. **(NASD Case #C07000036)**

**Brian Lamont Dale (CRD #2521526, Registered Representative, South Holland, Illinois)** was barred from association with any NASD member in any capacity, and ordered to repay his member firm \$2,798.56 in insurance commissions. The sanctions were based on findings that Dale used another agent's name and code number to submit insurance applications in order to wrongfully receive commissions totaling \$2,798.56 from the firm. Dale also failed to respond to NASD requests for information. **(NASD Case #C8A990043)**

**Yan Dikshteyn (CRD #2528880, Registered Representative, Chicago, Illinois)** and **Igor M. Fleyshmakher (CRD #2102367, Registered Principal, Chicago, Illinois)** submitted an Offer of Settlement in which they were barred from association with any NASD member in any capacity. In light of the financial status of the respondents, no monetary sanction has been imposed. Without admitting or denying the allegations, Dikshteyn and Fleyshmakher consented to the described sanction and to the entry of findings that they engaged in fraudulent sales practices that resulted in substantial harm to public customers and engaged in extensive and egregious unauthorized trading. The findings also stated that Dikshteyn made baseless price predictions and other misrepresentations to induce customers to purchase securities or to ratify unauthorized trades. **(NASD Case #CAF990044)**

**John Patrick DiPre (CRD #1223670, Registered Representative, Solon, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$32,453.77, which included disgorgement of \$17,453.77, and suspended from

association with any NASD member in any capacity for two years. The fine must be paid prior to reassociation with a member firm following the suspension or prior to any request for relief from any statutory disqualification. Without admitting or denying the allegations, DiPre consented to the described sanctions and to the entry of findings that he sold promissory notes to public customers away from his member firm and received \$17,453.77 in commissions. DiPre failed to provide his firm with written notice describing the transactions and his role and also failed to receive written approval from his firm to participate in the transactions. The findings also stated that DiPre did not respond completely to NASD requests for information and documents.

DiPre's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C8B000007)**

**Michael Robblee Ferguson (CRD #2220143, Registered Representative, East Amherst, 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, Ferguson consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. **(NASD Case #C8B000006)**

**Thomas Patrick Gorman (CRD #3144585, Registered Representative, Springfield, Massachusetts)** 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, Gorman consented to

the described sanction and to the entry of findings that he received \$30,626.81 in cash and checks from a public customer to invest in mutual fund accounts, failed to deposit the funds as directed, forged the customer's name to the checks, and took the cash in order to convert and misappropriate the funds for his own use and benefit. The findings also stated that Gorman failed to respond to NASD requests to provide information. **(NASD Case #C11000003)**

**Robert Mark Gray (CRD #1504190, Registered Representative, Oceanside, 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, Gray consented to the described sanction and to the entry of findings that he caused the execution of transactions in a public customer's account without the customer's knowledge or consent. **(NASD Case #C10000080)**

**Roland Imre Greenspan (CRD #1453740, Registered Principal, Loxahatchee, Florida)** and **Joseph David Belcastro (CRD #1415745, Registered Principal, Amityville, New York)** submitted Offers of Settlement in which Greenspan was fined \$10,000 and suspended from association with any NASD member in any principal or supervisory capacity for two years. Belcastro was fined \$6,000 and suspended from association with any NASD member in the capacity of a FINOP for 15 business days. The fines must be paid before any application for reentry into the securities industry will be considered. Without admitting or denying the allegations, the respondents consented to the described

sanctions and to the entry of findings that Greenspan failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance by his member firm with applicable laws, rules, and regulations relating to marketmaking and unauthorized transactions in customer accounts. The NASD also found that Greenspan failed to report customer complaints received by his member firm and failed to take reasonable measures to address, investigate, and resolve numerous customer complaints of unauthorized trades filed against an individual or to prevent such misconduct by the individual. The findings also stated that Belcastro permitted his member firm to conduct a securities business while failing to meet its minimum net capital requirement, failed to file notices of net capital deficiencies within the required time period, and filed an incomplete notice for a net capital deficiency.

Greenspan's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. Belcastro's suspension began June 19, 2000, and concluded at the close of business on July 11, 2000. **(NASD Cases #C07000008 and #C07000025)**

**Mark Andrew Greven (CRD #1453418, Registered Representative, Roswell, Georgia)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fines must be paid before any application for reentry into the securities industry will be considered. Without admitting or denying the allegations, Greven consented to the described sanctions and to the

entry of findings that he intercepted a customer complaint that was faxed to his branch manager and failed to disclose it to his branch manager.

Greven's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2001. **(NASD Case #C07000035)**

**Stephen William Guercio (CRD #1523331, Registered Representative, Staten Island, New York)** submitted an Offer of Settlement in which he was fined \$15,000, suspended from association with any NASD member in any capacity for 30 days, and required to pay \$15,000 in restitution to public customers. Without admitting or denying the allegations, Guercio consented to the described sanctions and to the entry of findings that he executed unauthorized transactions in the accounts of public customers and failed to execute customer sale orders.

Guercio's suspension began on July 3, 2000, and will conclude at the close of business on August 1, 2000. **(NASD Case #C10000026)**

**Patrick Brian Hammons (CRD #1030468, Registered Principal, Mesa, Arizona)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 45 days. Without admitting or denying the allegations, Hammons consented to the described sanctions and to the entry of findings that he failed to file an amended Form U-4 disclosing that he was named as a respondent in a civil action alleging that he had converted funds belonging to an estate and seeking to enjoin him in connection with investment related activity. The findings also stated

that Hammons failed to timely provide information and documentation requested by the NASD.

Hammons' suspension began June 19, 2000, and will conclude at the close of business on August 3, 2000. **(NASD Case #C01990020)**

**Gregory James Hill (CRD #1799748, Registered Principal, Aurora, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$7,500, suspended from association with any NASD member in a supervisory capacity for 45 days, and required to requalify by exam as a principal (Series 24) prior to resuming duties as a supervisor. Without admitting or denying the allegations, Hill consented to the described sanctions and to the entry of findings that he received a \$12,500 loan from a public customer to fund his wholesale trading account for which the customer was to receive 70 percent of the profits generated in the account. The findings also stated that Hill gave the customer a document purportedly reflecting a \$826 profit generated in Hill's wholesale trading account but was unable to provide documentation supporting the assertion of a profit.

Hill's suspension began on July 3, 2000, and will conclude at the close of business on August 16, 2000. **(NASD Case #C3A000021)**

**Marcus Kevin Hughes (CRD #1602626, Registered Principal, Chicago, Illinois)** was barred from association with any NASD member in any capacity and ordered to pay \$834,103.64 in restitution to public customers. The sanctions were based on findings that Hughes made misrepresentations of material facts to investors and potential investors in connection

with the purchase or sale of securities and effected private securities transactions. In addition, Hughes permitted an unregistered person to sell securities. **(NASD Case #C8A990032)**

**Adam Harold Kaplan (CRD #2436956, Registered Representative, Brooklyn, New York)** submitted an Offer of Settlement in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, Kaplan consented to the described sanctions and to the entry of findings that he executed transactions in the account of a public customer without the prior knowledge, authorization, or consent of the customer or an individual acting on behalf of the customer's estate. The findings also stated that Kaplan entered into a settlement agreement with the customer's estate that prohibited cooperation with NASD inquiries in violation of SEC and NASD rules.

Kaplan's suspension began June 19, 2000, and will conclude on September 16, 2000. **(NASD Case #C10000026)**

**Mazen Jim Kherdeen (CRD #2989920, Registered Representative, Denver, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid prior to any application for reassociation with a member firm following the suspension. Without admitting or denying the allegations, Kherdeen consented to the described sanctions and to the entry of findings that he submitted a Form U-4 and failed to provide a "yes" answer to Question

22B although charges previously been filed against him warranted a “yes” answer.

Kherdeen’s suspension began July 3, 2000, and will conclude at the close of business on August 14, 2000. **(NASD Case #C3A000017)**

**William Arthur Kittredge, Jr. (CRD #2852820, Registered Representative, Georgetown, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. In light of the financial status of the respondent, no monetary sanction has been imposed. Without admitting or denying the allegations, Kittredge consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior notice to, or approval from, his member firm. **(NASD Case #C11000010)**

**Christos Kiziriglou (CRD #2472959, Registered Principal, San Diego, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD as a general securities principal for one year. The fine must be paid before any application for reentry into the securities industry will be considered. Without admitting or denying the allegations, Kiziriglou consented to the described sanctions and to the entry of findings that he permitted a person subject to an NASD supervisory bar order to become and remain associated with his member firm in a principal and supervisory capacity in violation of the bar order.

Kiziriglou’s suspension began June 19, 2000, and will conclude at the close of business on June 18, 2001. **(NASD Case #C02000028)**

**Evan Harrison Lasher (CRD #2186676, Registered Representative, Syosset, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity with the right to reapply for association after five years from acceptance of the AWC. In light of the financial status of the respondent, no monetary sanction has been imposed. Without admitting or denying the allegations, Lasher consented to the described sanction and to the entry of findings that he manipulated the prices of securities in the aftermarket trading of the securities, pre-arranged aftermarket demand, sold repurchased IPO shares to pre-arranged aftermarket purchasers at manipulated prices, and repurchased securities for his firm’s account prior to the completion of the distribution. The findings also stated that Lasher failed to report the repurchases in a timely manner. **(NASD Case #CAF000017)**

**Stephen Roger Lennox, Jr. (CRD #2613210, Registered Representative, Smyrna, Georgia)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Lennox effected unauthorized transactions in a customer’s account and made unsuitable recommendations to the customer. **(NASD Case #C07990063)**

**Marc Alan Luxenberg (CRD #2091350, Registered Principal, North Bellmore, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any principal capacity for two years and suspended from association with any NASD member in any capacity

for 30 days. Without admitting or denying the allegations, Luxenberg consented to the described sanctions and to the entry of findings that while he was the compliance director at a member firm, he failed to take sufficient steps to ensure customer sell orders were executed on a timely basis and failed to recommend sufficient disciplinary action against individuals alleged to have committed sales practice violations. Luxenberg failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules.

The suspensions began on June 19, 2000. The suspension in any principal capacity will conclude at the close of business on June 18, 2002. The suspension in any capacity will conclude at the close of business on July 19, 2000. **(NASD Case #CAF000018)**

**John Joseph Margiotta (CRD #1742811, Registered Principal, Larchmont, New York)** submitted an Offer of Settlement in which he was fined \$30,000, barred from association with any NASD member in any principal capacity, and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Margiotta consented to the described sanctions and to the entry of findings that he improperly encouraged his firm’s sales force to solicit aftermarket orders prior to the completion of an IPO. The findings also stated that Margiotta enforced a “no-net sale” policy that discouraged brokers from allowing customers to sell a house stock when they so desired, absent a corresponding order to purchase a different house stock. Margiotta also failed to investigate or remedy

the firm's fraudulent sales practices in connection with the sale of low-priced, highly speculative securities.

Margiotta's suspension began June 26, 2000, and will conclude on December 25, 2000. **(NASD Case #C10970143)**

**Kenneth Scott Milne (CRD #2828038, Registered Representative, Ypsilanti, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid prior to reassociation with a member firm following the two-year suspension or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding. Without admitting or denying the allegations, Milne consented to the described sanctions and to the entry of findings that he affixed the signatures of at least 92 individuals, all of whom were public customers, on documents associated with a variable annuity products, without the customers' knowledge or consent.

Milne's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C8A000028)**

**Richard Emmit Monroe (CRD #1005672, Registered Representative, Petaluma, California)** submitted an Offer of Settlement in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid either prior to reassociation with a member firm following the one-year suspension or prior to any

application for request for relief from any statutory disqualification from this or any other event or proceeding, whichever is earlier. Without admitting or denying the allegations, Monroe consented to the described sanctions and to the entry of findings that he recommended unsuitable purchases and sales of mutual funds to public customers and effected these transactions in the customers' accounts. The transactions were unsuitable for the customers in light of the transaction costs involved; the availability of intra-fund exchange privileges; and the customers' other security holdings, financial situations, and needs.

Monroe's suspension began July 3, 2000, and will conclude at the close of business on July 2, 2001. **(NASD Case #C01970014)**

**Anthony Stephen Mundy (CRD #2077841, Registered Representative, Brooklyn, New York)** submitted an Offer of Settlement in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 20 days, and ordered to pay \$10,000 in restitution to a public customer. Satisfactory proof of payment of the restitution must be submitted to the NASD no later than 120 days after acceptance of this Offer. Without admitting or denying the allegations, Mundy consented to the described sanctions and to the entry of findings that he executed transactions in the accounts of public customers without their authorization, knowledge, or consent. The findings also stated that Mundy failed to execute customer sell orders.

Mundy's suspension began July 3, 2000 and will conclude on July 22, 2000. **(NASD Case #C10000026)**

**Sylvia Bonin Perez (CRD #1558521, Registered Representative, Lafayette, Louisiana)** submitted an Offer of Settlement in which she was fined \$10,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Perez consented to the described sanctions and to the entry of findings that she accepted \$185,000 in currency from public customers for the purchase of securities, retained possession of the currencies for up to two months prior to purchasing the securities or returning a portion of the amount to the customers. The findings also stated that Perez failed and neglected to report the receipts of currency to her member firm as required by the SEC.

Perez's suspension began June 19, 2000, and concluded at the close of business on June 30, 2000. **(NASD Case #C05990057)**

**William Lewis Petitta (CRD #2726426, Registered Representative, Draper, Utah)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$10,000, and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Petitta consented to the described sanctions and to the entry of findings that he forged the signature of a public customer to an account transfer form for the purpose of expediting the transfer of the customer's account from one firm to another without the customer's authority.

Petitta's suspension began July 3, 2000, and will conclude at the close of business on July 31, 2000. **(NASD Case #C3A000020)**

**Stephen Douglass Pratt (CRD #803598, Registered Representative, West Des Moines, Iowa)** 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 31 days. The fine must be paid prior to reassociation with a member firm following the suspension. Without admitting or denying the allegations, Pratt consented to the described sanctions and to the entry of findings that he sent sales literature via e-mails to members of the public concerning the prospects for the market price of shares of stock, and he failed to submit the sales literature to a registered principal of his member firm prior to sending the e-mails to the public. Furthermore, the NASD found that one of the e-mails contained statements and claims that were exaggerated, unwarranted, and misleading. Pratt also failed to respond to NASD requests for information.

Pratt's suspension began on July 3, 2000, and will conclude at the close of business on August 2, 2000. **(NASD Case #C8A000033)**

**Jeffrey Wyatt Puckett (CRD #2270409, Registered Principal, Las Vegas, Nevada)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,000 and suspended from associating with any member of the NASD as a FINOP for 30 business days. The fine must be paid either prior to reassociation with any NASD member in any capacity or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier. Without admitting or denying the allegations, Puckett consented to the described sanctions and to the

entry of findings that he engaged in the securities business while failing to have and maintain sufficient net capital. The findings also stated that Puckett failed to accurately make, keep current, and preserve certain books and records which delayed the NASD's ability to examine his member firm's compliance with the net capital rules.

Puckett's suspension began June 19, 2000, and will conclude at the close of business on July 31, 2000. **(NASD Case #C02000026)**

**Vikram Randhawa (CRD #2498370, Registered Representative, Albertson, New York)** was fined \$50,000, suspended from association with any NASD member in any capacity for one year, barred from association with any NASD member in any capacity, and ordered to requalify by examination before reassociating with any member firm. The fine must be paid before any application for reentry into the securities industry will be considered. The sanctions were based on findings that Randhawa sold shares of stock to public customers in states that he was not registered. Furthermore, Randhawa arranged for a coworker who was registered in the states to take credit for the sales by misrepresenting that he was the registered representative for these securities transactions on his member firm's records. Randhawa also failed to respond to NASD requests for information.

Randhawa's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2001. **(NASD Case #C9B990028)**

**Richard Valentino Rizzo (CRD #2497077, Registered Representative, Oceanside, 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 10 business days. Without admitting or denying the allegations, Rizzo consented to the described sanctions and to the entry of findings that he effected various purchases of stock in the accounts of public customers without the knowledge or consent of the customers.

Rizzo's suspension began July 3, 2000, and will conclude at the close of business on July 17, 2000. **(NASD Case #C02000030)**

**Andrew Ruscio, Jr. (CRD #2595323, Registered Representative, Brooklyn, New York)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and required to pay \$18,012.50, plus interest, in restitution to public customers. Proof of restitution will be a prerequisite prior to reassociation with a member firm or prior to any request for relief from any statutory disqualification. Without admitting or denying the allegations, Ruscio consented to the described sanctions and to the entry of findings that he engaged in unauthorized transactions in the accounts of public customers and failed to execute a customer's sale order. **(NASD Case #C10000026)**

**Steven Owen Sahagian (CRD #1392244, Registered Representative, Oradell, 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 five days. Without admitting or denying the allegations, Sahagian consented to the described sanctions and to the entry of findings that, at the direction of his

sales manager, Sahagian signed his name on a life insurance policy application that falsely represented that he had witnessed a customer sign such application.

Sahagian's suspension began July 3, 2000, and concluded at the close of business on July 7, 2000. **(NASD Case #C9B000016)**

**Brian William Spencer (CRD #2262929, Registered Principal, Lexington, Kentucky)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any principal capacity for six months and required to requalify as a general securities principal by taking and passing the Series 24 exam. If Spencer fails to requalify within the six-month period, he will be suspended in that capacity until he does complete and pass the exam. In light of the financial status of the respondent, no monetary sanction has been imposed. Without admitting or denying the allegations, Spencer consented to the described sanctions and to the entry of findings that he failed and neglected to exercise reasonable and proper supervision of his firm's associated person and its registered representative.

Spencer's suspension began June 19, 2000, and will conclude at the close of business on December 18, 2000. **(NASD Case #C05000006)**

**Richard Stephan Taylor (CRD #1894258, Registered Representative, Spokane, Washington)** 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, Taylor consented to the described sanction and to the entry of findings that he participated in

investments made by a public customer and failed to provide prior written notice to his member firm describing in detail the proposed transactions, his proposed role, and stating whether he would receive selling compensation in connection with the transactions. **(NASD Case #C3B000009)**

**Robert L. Tisinai (CRD #2823214, Registered Representative, Harwood Heights, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before any application for reentry into the securities industry will be considered. Without admitting or denying the allegations, Tisinai consented to the described sanctions and to the entry of findings that he affixed the signatures of public customers on takeover forms without the customers' knowledge or consent.

Tisinai's suspension began June 19, 2000, and will conclude at the close of business on December 18, 2000. **(NASD Case #C8A990082)**

**Michael Allen Usher (CRD #734581, Registered Principal, Greeley, Colorado)** was fined \$25,000, barred from association with any NASD member as a general securities principal, and ordered to disgorge \$3,914.70, plus interest, to the NASD. The NAC imposed the sanctions following appeal of an OHO decision. The sanctions were based on findings that Usher conducted a securities business while his and his member firm's registrations were suspended for failure to pay an arbitration award. **(NASD Case #C3A980069)**

**Edward Paul Walunas (CRD #706319, Registered**

**Representative, Wilsonville, Oregon)** 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, Walunas consented to the described sanction and to the entry of findings that he participated in investments totaling \$469,705 made by individuals in limited partnership units and failed to provide prior written notice to his member firm describing in detail the proposed transactions, his proposed role, and stating whether he would receive selling compensation. The findings also stated that Walunas continued to participate in the offering and sale of the limited partnership units after orally asking his firm whether such activity was permissible and his firm responded that any such request would be denied. **(NASD Case #C3B000006)**

**Joel Mark Warren (CRD #2676655, Registered Principal, Hyattsville, Maryland)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Warren caused the withdrawal of \$286,000 from an account maintained by a public customer and transferred the funds to other bank accounts without the customer's authorization. The findings also stated that Warren failed to respond to NASD requests for information. **(NASD Case #C9A000004)**

**Robert Gordon Wathen, Sr. (CRD #1007396, Registered Representative, Ft. Mitchell, Kentucky)** 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, Wathen consented to the described sanction and to the entry of findings that he received a \$2,451.61 check from a public customer for deposit in her Individual Retirement Account (IRA) account, failed and neglected to deposit the funds, and, instead, made improper use of the funds by retaining the proceeds of the check for 14 months without the customer's knowledge or consent. **(NASD Case #C05000024)**

**Bryce Johnson Winkel (CRD #2108104, Registered Principal, Beaverton, Oregon)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 10 days, and required to requalify as an investment company products/variable contracts principal (Series 26) within 90 days of acceptance of the AWC. If Winkel fails to requalify, he will be precluded from acting in any capacity requiring a Series 26 license until he passes the exam. Without admitting or denying the allegations, Winkel consented to the described sanctions and to the entry of findings that he made a \$5,000 investment in a private placement of securities and failed to provide prior written notice to his member firm describing the proposed transaction, his proposed role, and stating whether he would receive selling compensation in connection with the transaction. The findings also stated that Winkel failed to timely or adequately supervise an individual to ensure that the individual ceased to be connected with the unsupervised sales of unapproved products away from his/her member firm and to ensure the individual's termination from the firm.

Winkel's suspension began July 3, 2000, and concluded at the close of business on July 12, 2000. **(NASD Case #C3B000007)**

**Howard Charles Zelin (CRD #1616516, Registered Principal, Boynton Beach, Florida)** submitted an Offer of Settlement in which he was censured, fined \$20,000, and suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, Zelin consented to the described sanctions and to the entry of findings that during the course of his member firm's pre-membership interview, he failed to disclose a \$100,000 subordinated loan to the firm, an additional \$50,000 contributed by third parties, and substantial reductions in the firm's capital due to withdrawals by himself and others. The findings also stated that Zelin operated a securities business with a net capital deficiency and permitted an individual to be employed by the firm without the written permission of the NASD as required by a restriction agreement.

Zelin's suspension began June 19, 2000, and will conclude at the close of business on June 18, 2002. **(NASD Case #C10950102)**

**Peter Girard Zimmerman (CRD #2679422, Registered Representative, Leicester, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Zimmerman consented to the described sanction and to the entry of findings that he forged customer signatures on IRA applications and transfer request forms effecting the transfer of

customer funds from a variable annuity contract to an IRA without customer consent. **(NASD Case #C11000009)**

### Individual Fined

**Neil Lewis Kiperman (CRD #1971451, Registered Principal, New York, New York)** submitted an Offer of Settlement in which he was censured and fined \$41,950, which includes disgorgement in the amount of \$36,950. The fine and disgorgement must be paid prior to Kiperman's reassociation with a member firm or prior to any request for relief from any statutory disqualification. Without admitting or denying the allegations, Kiperman consented to the described sanctions and to the entry of findings that, in violation of the NASD's venture capital restrictions, he sold shares of an IPO that he owned within 90 days following the effective date of the offering. **(NASD Case #C10950051)**

### Decision Issued

The following decision has been issued by the District Business Conduct Committee (DBCC) or the OHO and has been appealed to or called for review by the NAC as of June 9, 2000. The findings and sanctions imposed in the decision may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notices to Members*.

**Vincent Grieco (CRD #1568462, Registered Principal, W. Islip, New York)** was fined \$500,000, barred from association with any NASD member in any capacity, and ordered to pay \$589,466.88, plus interest, in restitution to public

customers. The sanctions were based on findings that Grieco directed a boiler room operation at the branch which he co-owned and enforced fraudulent sales practices, unauthorized transactions, and a refusal policy to effect customer sell orders.

Grieco has appealed this action to the NAC and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #CAF990008)**

### Complaints Filed

The following complaints were issued by the NASD. Issuance of a disciplinary complaint represents the initiation of a formal proceeding by the 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.

**Richard Philip Chingos (CRD #2504767, Registered Representative, Long Island City, New York)** was named as a respondent in an NASD complaint alleging that he executed transactions in the accounts of public customers without their prior knowledge, authorization, or consent and failed to respond truthfully or accurately during an NASD on-the-record interview. **(NASD Case #C10000095)**

**Michael Dabney (CRD #500768, Registered Representative, Plainsboro, New Jersey)** was named as a respondent in an NASD complaint alleging that he received from a public customer checks totaling \$10,000 for the

purchase of stock, and, instead of using the funds to purchase stock for the customer as he had represented, he converted these funds to his own use and benefit without the customer's knowledge or consent. The complaint also alleges that in an effort to conceal his conversion and to mislead the customer about the status of his investment, Dabney presented a subscription agreement to the customer that was not genuine but had been created and altered by Dabney to deceive the customer. Furthermore, the complaint alleges that Dabney made misrepresentations and omissions regarding the stock and failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C9B000015)**

**Martin Yungshu Fang (CRD #2934646, Registered Representative, Monterey Park, California)** was named as a respondent in an NASD complaint alleging that he executed unauthorized purchases and sale transactions in the accounts of public customers. The complaint also alleges that Fang failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C02000021)**

**Harold B. J. Gallison, Jr. (CRD #1040211, Registered Principal, Las Vegas, Nevada)** was named as a respondent in an NASD complaint alleging that he became and remained associated with a member firm in a principal and supervisory capacity after a supervisory bar order was issued. **(NASD Case #C02000027)**

**Barrett Trent Hill (CRD #2712469, Registered Representative, Charlotte, North Carolina)** was named as a respondent in an

NASD complaint alleging that he received a \$625 check from a public customer to open a retirement account, endorsed and cashed the check, and converted the funds to his own use. **(NASD Case #C07000034)**

**Shek Wai Hui (CRD #2024873, Registered Representative, New York, New York)** was named as a respondent in an NASD complaint alleging that he misappropriated or improperly used public customer funds totaling \$38,977.01 by collecting cash, premium payments, and refund checks and using the funds without the customers' knowledge, permission, or authority. The complaint also alleges that Hui failed to respond to NASD requests for documents or information. **(NASD Case #C10000078)**

**Morris Malone Johnson, Jr. (CRD #2541001, Registered Representative, Huntsville, Alabama)** was named as a respondent in an NASD complaint alleging that he executed unauthorized purchases and sales of securities in the accounts of public customers and failed to respond to NASD requests for information. **(NASD Case #C05000026)**

**Janet Lorraine Keitt (CRD #2764397, Registered Representative, Amityville, New York)** was named as a respondent in an NASD complaint alleging that she used forged withdrawal slips to misappropriate approximately \$47,300 from the passbook savings accounts of bank customers without their knowledge, authorization, or consent. The complaint also alleges that she failed to respond to NASD requests for information and documentation. **(NASD Case #C10000081)**

**Eric Peter Lesak (CRD #2390075, Registered Representative, Wantagh, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in the account of a corporate customer and failed to respond to an NASD request to appear for an on-the-record interview. **(NASD Case #C10000087)**

**Anthony Andrew Marx, Jr. (CRD #2180220, Registered Representative, Long Island City, New York)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized transactions in the account of public customers. The complaint also alleges that Marx drew checks on the customers' account, endorsed the checks, and deposited the funds into his personal bank account, thereby converting \$13,623.71 to his own use and benefit. The complaint further alleges that Marx failed to respond to NASD requests for information. **(NASD Case #C10000100)**

**Sean Peter McManus (CRD #2169076, Registered Representative, Boynton Beach, Florida)** was named as a respondent in an NASD complaint alleging that he purchased, or caused to be purchased, shares of stock in the accounts of public customers without the customers' knowledge or consent. **(NASD Case #C02000025)**

**Peter David Ragofsky (CRD #2066034, Registered Representative, Brooklyn, New**

**York)** was named as a respondent in an NASD complaint alleging that he executed transactions for the accounts of public customers without their knowledge or consent and in the absence of written or oral authorization to exercise discretion in the accounts. **(NASD Case #C10000086)**

**David Reynoso (CRD #2406265, Registered Representative, Westbury, New York)** was named as a respondent in an NASD complaint alleging that he purchased securities in the account of a public customer without the customer's prior knowledge, authorization, or consent. The complaint also alleges that Reynoso failed to execute the customer's order to buy securities. **(NASD Case #C10000099)**

**Rick Ray Ruppert (CRD #2122885, Registered Principal, Las Vegas, Nevada)** was named as a respondent in an NASD complaint alleging that he received \$3,000 in cash from public customers for investment purposes and did not apply the funds as directed by the customers. The complaint further alleges that instead, without the knowledge or consent of the customers, Ruppert failed to promptly apply the customers' funds to any investment until a later date at which time he purchased two bank cashiers checks in the amount of \$1,500 each to fund separate Roth IRA accounts for the customers. In addition, the complaint alleges that Ruppert failed to respond to NASD requests for information. **(NASD Case #C02000023)**

**David Robert Scholle (CRD #2461242, Registered Representative, Pittsburgh, Pennsylvania)** was named as a respondent in an NASD complaint alleging that he received approximately \$3,500 from public customers to pay insurance policy premiums, failed to pay or direct the payment of the premiums, and, instead, converted the funds to his own use and benefit without the customers' knowledge or consent. The complaint also alleges that Scholle failed to respond to NASD requests for information and documentation. **(NASD Case #C9A000021)**

#### **Firms Canceled**

The following firms were canceled from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of NASD Rule 8210 and Article VII, Section 2 of the NASD By-Laws. The date the cancellation commenced is listed after the entry.

**Continuum Capital, Inc.**, New York, New York (May 23, 2000)

**Kensington, Bentley & Barnes, Inc.**, Dallas, Texas (May 23, 2000)

**Retirement Foundations, Inc.**, Great Neck, New York (June 13, 2000)

**R.P. Borgan, Inc.**, Biebergemund, Germany (June 13, 2000)

## **Firms Suspended**

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

**Anchor Investment Securities, Ltd.**, Geneva, Illinois (June 8, 2000)

**Caribbean Securities LLC**, New York, New York (May 22, 2000 - June 2, 2000)

**Daly Investment Co.**, Lombard, Illinois (June 8, 2000)

**Millennium Capital LLC**, Woodstock, Illinois (June 8, 2000)

**San Clemente Securities, Inc.**, San Clemente, California (June 8, 2000)

## **Firm Suspended Pursuant To NASD Rule Series 9510 For Failure To Pay An Arbitration Award**

**The Golden Lender Financial Group, n/k/a J.P. Gibbons & Co., Inc.**, Manasquan, New Jersey (May 19, 2000)

## **Non-summary Suspension Imposed**

The following individual has been suspended from association with any member of the NASD by a Subcommittee of the NAC pursuant to NASD Rule 8220 for failure to respond to NASD Rule 8210 notices. The suspension will end when the individual complies with the Rule 8210 investigatory requests. The date the suspension began is listed after the entry.

**Fernandez, Juan Carlos**, Lakeworth, Florida (June 23, 2000)

## **Suspensions Lifted**

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

**First American Equities, Inc.**, Ft. Lauderdale, Florida (May 24, 2000)

**Fuerst Securities Corporation**, Grand Junction, Colorado (May 24, 2000)

**Salisbury Capital Corporation**, New York, New York (June 12, 2000)

## **Individuals Whose Registrations Were Revoked For Failure To Pay Fines, Costs, And/Or Provide Proof Of Restitution In Connection With Violations**

**Biggs, Dudley A.**, Yonkers, New York (June 7, 2000)

**Hart, Terrance D.**, Oak Park, Illinois (June 7, 2000)

**Maggipinto, Gregory P.**, San Jose, California (June 7, 2000)

**Rusch, Thomas A.**, Greenville, South Carolina (June 7, 2000)

## **NASD Regulation Fines J. P. Morgan \$200,000 For Limit Order Violations**

NASD Regulation announced that it has censured and fined J. P. Morgan Securities, Inc., \$200,000 for violations of the SEC Limit Order Display Rule (Display Rule) continuing over a 21-month period, and for failing to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with the Display Rule. NASD Regulation also found other violations relating to the handling of customer transactions including best execution and limit order protection violations.

For a period of 21 months, J. P. Morgan Securities failed to detect and then correct problems with its display of customer limit orders, despite being told of the problems found by NASD Regulation and assuring NASD Regulation that it would correct its systems and procedures to enable the firm to comply with the Display Rule. During this time, three separate examinations uncovered multiple violations of the Display Rule.

Moreover, shortly after the firm installed an upgraded system designed to enable it to comply with the Display Rule, the head trader of the OTC trading desk had the automatic execution and display systems disabled because of problems caused by the systems. The systems remained disabled without discovery by the firm's compliance department until February 1999, when NASD Regulation staff informed the firm it was commencing an examination.

J. P. Morgan's supervision of limit order display was an institutional failure. While the firm recognized the need for an improved supervisory system with respect to display of customer limit orders in October 1997, the 1998 and 1999 Market Regulation examinations revealed that the firm failed to establish, maintain, and enforce the written supervisory procedures. After the firm upgraded its order handling system in 1998, the employee responsible for reviewing the firm's handling of customer limit orders performed initial spot checks of the new system, then stopped performing the review for limit order display. Consequently, the firm's supervisory system did not detect that the display and execution features had been disabled.

Moreover, J. P. Morgan's written supervisory procedures did not require that the reviews for limit order display be documented. Therefore, the firm's management was not able to ensure that the reviews were being performed. Indeed, the firm only discovered that the automatic display and execution systems had been disabled and that the reviews for limit order display were not being performed when it started preparation for its February 1999 NASD Regulation examination.

In settling the matter, J. P. Morgan neither admitted nor denied NASD Regulation's findings.

### **NASD Regulation Files Complaint Against LH Ross For Taping Rule Violation**

NASD Regulation announced that it has issued a complaint charging LH Ross & Company, Inc., and its President, Franklyn Michelin, with violating the Taping Rule instituted by the NASD. The Taping Rule requires a brokerage firm to tape all

of its brokers' phone calls with existing and potential customers for a two-year period if a certain percentage of the firm's brokers were previously employed by a firm that was expelled from the securities industry for sales practice misconduct within the last three years.

On August 5, 1999, NASD Regulation notified LH Ross that it had become subject to the Taping Rule, as a result of hiring several brokers that had been employed by Biltmore Securities, Inc., previously expelled by the NASD in February 1999. LH Ross was instructed to commence taping the calls of all its brokers and establish supervisory procedures within 30 days for oversight of all telemarketing activities conducted by its brokers.

LH Ross applied for an exemption from the Taping Rule, but that application was denied by NASD Regulation. The firm appealed the decision, but the appeal was denied.

LH Ross was notified on March 17, 2000, that, once again, it had 30 days to comply with the Taping Rule. On April 18th, Michelin notified NASD Regulation that LH Ross did not intend to implement a tape-recording system as required by the Rule. To date, LH Ross has failed to comply with the provisions of the Taping Rule.

The issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD Regulation 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 this complaint is unadjudicated, the respondents should be contacted before drawing any conclusion regarding the allegations in the complaint.

### **NASD Regulation Fines First Union Securities, Inc. \$350,000 And Fines And Suspends Former Executives For Books And Records And Supervisory Violations Arising From Payments To Armacon Securities, Inc.**

NASD Regulation announced a settlement in which it fined First Union Securities, Inc., \$350,000 for books and records violations and supervisory violations arising from inaccurately recorded municipal securities payments made to Armacon Securities, Inc. Three former senior executives of the firm were also suspended and fined a total of \$125,000. The conduct described in the settlement took place at Wheat First Securities, Inc., prior to its 1998 acquisition by First Union.

NASD Regulation found that Wheat's books and records failed to reflect accurately approximately \$1.5 million of payments made to Armacon for more than 30 municipal securities transactions from late 1991 through April 1993. During that time period, Nicholas A. Rudi, then owner of the now-defunct Armacon, directed many New Jersey municipal securities transactions to Wheat. After Wheat paid a finders fee to Armacon for three New Jersey State municipal transactions, Rudi told Wheat that he did not want to receive checks in the future for state transactions because they could be embarrassing in light of his previous business relationship with the chief-of-staff to the Governor of New Jersey. As a result, Armacon did not bill Wheat, and Wheat did not record its liability to Armacon, for numerous New Jersey state transactions Armacon directed to Wheat. Instead, Wheat paid Armacon extra amounts for several local municipal transactions to

make up for the finder's fees not billed. As a result, Wheat's books and records failed to reflect payments to Armacon on numerous municipal securities transactions, and overstated the amount that was owed and paid to Armacon for others.

Wheat also authorized a third-party broker to make payments to Armacon to reduce Wheat's outstanding balance to Armacon. Those payments reduced amounts owed by Wheat to Armacon for other transactions without recording the amounts paid to Armacon on the firm's books and records. Wheat also paid and reflected in its books and records "management fees" to Armacon for five Pennsylvania transactions where Armacon provided no underwriting

or distribution services. These fees were paid in lieu of finder's fees payments to Armacon for help in referring to Wheat specific New Jersey municipal securities offerings.

Pursuant to the settlement, First Union, as successor to Wheat, was charged with violating the supervisory provisions of the MSRB and the recordkeeping provisions of the federal securities law and the MSRB, and was fined \$350,000. James Losty, the former head of Wheat First's Public Finance Group, was charged with causing violations of the recordkeeping provisions of the MSRB and was fined \$50,000 and suspended for 30 days. NASD Regulation previously entered into a related settlement with Thomas Zoidis,

former head of Wheat First's Municipal Department, in which Zoidis was charged with violating the supervisory provisions of the MSRB and was fined \$50,000 and suspended from acting in a supervisory capacity for 30 days. Mark Gambill, the former President of Wheat First was charged with violating the supervisory provisions of the MSRB and was fined \$25,000 and suspended from acting in a supervisory capacity for 15 days.

In settling this matter, First Union, Losty, Zoidis, and Gambill neither admitted nor denied NASD Regulation's findings.

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# For Your Information

## Staff Relocations

Over the next several months, some NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) and National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) staff will be moving from Washington, D.C. to a new location in Rockville, Maryland. The move will be conducted in a staggered fashion beginning early July, with completion expected in the fall of this year. This relocation plan affects over 1,300 employees and contractors in the Washington and Rockville areas.

Please note that most phone and fax numbers for these departments/staff will change; however, we plan to retain a voice mail message at the old number providing callers with the new phone number for a period of 60 days.

Departments that will be moving include Advertising Regulation, Corporate Financing, Continuing Education, Testing and Qualifications, CRD/Public Disclosure, Market Regulation, Business Program Services, and some Member Regulation staff.

Please refer to the NASD Regulation Web Site ([www.nasdr.com](http://www.nasdr.com)) for more details as they become available. NASD Regulation will also be sending information via e-mail broadcasts to NASD Executive Representatives during the course of the moves, as needed and appropriate. And, if you are unable to locate someone given the options above, please call the Gateway Call Center at (301) 590-6500.

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