MARCH 2004

Notices to Members

Notices

04-14 SEC Approves Amendments to Rule Governing Lending Between Registered Persons and Customers; **Effective date: February 18, 2004** 189

04-15 SEC Approves Amendments to NASD Rules Concerning Member Participation in the National Do-Not-Call Registry; **Effective Date: March 31, 2004** 195

04-16 NASD Adopts Rule 2130 Regarding Expungement of Customer Dispute Information From The Central Registration Depository; **Effective Date: April 12, 2004** 211

04-17 NASD Revises *NASD Sanction Guidelines* 219

04-18 NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest 225

04-19 NASD Releases Minor Rule Violation Plan (MRVP) Guidelines 259

04-20 IPO Distribution Manager to Replace Compliance Desk; Filings Required for All New Issues as Defined in Rule 2790; **Voluntary Effective Date: March 23, 2004; Mandatory Effective Date: April 16, 2004** 275

04-21 NASD Provides Further Guidance on Amendments to NASD Rule 3370—Affirmative Determination Requirements 281

over

04-22 SEC Approves Amendments to Rule 1120 (Continuing Education Requirements) Regarding Regulatory Element Contact Person 285

04-23 NASD Seeks Comment On (1) Amending its Minor Rule Violation Plan (MRVP) to Include Failure Timely to Submit Amendments to the Uniform Termination Notice for Securities Industry Registration (Form U5); and (2) Adopting a Rule to Create an Inactive Disclosure Review Registration Status; **Comment Period Expires April 19, 2004** 289

04-24 SEC Announces Immediate Effectiveness of IM-3150 Governing Exemptions from the Reporting Requirements of NASD Rule 3150; **Effective Date: February 20, 2004** 295

04-25 SEC Approves New NASD Research Analyst Qualification and Examination Requirements (Series 86/87); **Effective Date: March 30, 2004** 301

04-26 NASD Reminds Members of Their Duty to Ensure Proper Application of Discounts in Sales Charges to Sales of Unit Investment Trusts (UITs) 311

Disciplinary and Other NASD Actions

Reported for D1

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Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representatives

Legal & Compliance

Registered Representatives

Senior Management

KEY TOPICS

Borrowing From and Lending to Customers

Rule 2370

INFORMATIONAL

Borrowing From and Lending to Customers

SEC Approves Amendments to Rule Governing Lending Between Registered Persons and Customers; **Effective date: February 18, 2004**

Executive Summary

On August 29, 2003, the Securities and Exchange Commission (SEC) approved the adoption of NASD Rule 2370, prohibiting registered persons from borrowing money from or lending money to a customer unless (1) the member has written procedures allowing such lending arrangements consistent with the rule; (2) the loan falls within one of five prescribed permissible types of lending arrangements set forth in the rule; and (3) the member pre-approves the loan in writing.[1]

The amendments to Rule 2370, as approved by the SEC on February 18, 2004, exempt from the rule's notice and approval requirements lending arrangements involving a registered person and a customer that is: (1) a member of his or her immediate family (as defined in the rule); or (2) a financial institution regularly engaged in the business of providing credit, financing, or loans (or other entity or person that regularly arranges or extends credit in the ordinary course of business), provided the loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose, and creditworthiness. The amendments to Rule 2370 also limit the scope of the rule to lending arrangements between registered persons and their customers, rather than any customer of the firm.

Questions/Further Information

Questions concerning this *Notice* may be directed to Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

04-14

Background

The purpose of Rule 2370 is to prohibit registered persons from borrowing money from or lending money to a customer (collectively referred to as "lending arrangements") unless certain conditions are met. Under Rule 2370, no person associated with a member in any registered capacity may borrow money from or lend money to any customer unless the firm has written procedures allowing such lending arrangements and (1) the customer is a member of the registered person's immediate family (as defined in the rule); (2) the customer is in the business of lending money; (3) the customer and the registered person are both registered persons of the same firm; (4) the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or (5) the lending arrangement is based on a business relationship outside of the broker-customer relationship. As initially adopted by NASD on August 29, 2003, Rule 2370 also required members to pre-approve each lending arrangement in writing.

Since Rule 2370 became effective on November 10, 2003, it became apparent both to members and NASD staff that the pre-approval requirement with respect to lending arrangements between registered persons and financial institutions raised recordkeeping and privacy issues. Members with institutional customers advised NASD of the difficulties registered persons could encounter in determining whether a particular financial institution was a firm customer if that institution was not the representative's customer. Members advised NASD that individual registered persons may not know nor, for privacy reasons, should know, the name of every firm customer. Thus, registered persons employed by members with institutional customers could be in a position of being required to report and get firm approval for, among other things, every credit card application, mortgage, bank loan, and home equity line of credit. This was not the intent of the rule.

Thus, with respect to lending arrangements with financial institutions regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business, Rule 2370 has been amended to provide that a member's written procedures may indicate that registered persons are permitted to enter into such lending arrangements and are not required to notify the member or receive member approval either prior to or subsequent to entering into such lending arrangements, provided that the lending arrangement has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose, and creditworthiness.[2] Such transactions include, but are not limited to, mortgages, personal loans, home equity lines of credit, and credit card accounts, and also include lending arrangements with an affiliate of the customer.

NASD further concluded that the potential for misconduct is most significant when a registered person enters into a lending arrangement with his or her own customer. NASD has, therefore, amended Rule 2370 to indicate that the scope of the rule is limited to lending arrangements between registered persons and their customers, rather than any customer of the firm. It is the firm's responsibility to determine whether a particular individual represents or services a customer.

Additionally, NASD concluded that the potential for misconduct is greatly reduced, or eliminated, when loans occur between family members. As a result, NASD has amended Rule 2370 to allow a member's written procedures to indicate that a registered person is not required to obtain a member's approval, either prior to or subsequent to, entering into a lending arrangement between the registered person and a customer that is a member of his or her immediate family (as defined in the rule).

In sum, NASD has amended Rule 2370 as follows:

- With respect to lending arrangements between family members, as described in paragraph (a)(2)(A), a member's written procedures may indicate that the member permits such lending arrangements and that registered persons need not notify the member or receive member approval either prior to or subsequent to such lending arrangements.
- With respect to lending arrangements between registered persons and financial institutions, as described in paragraph (a)(2)(B), a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval either prior to or subsequent to entering into such lending arrangements, provided that the lending arrangement between a registered person and a financial institution loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose and creditworthiness. The member need not investigate such lending arrangements, but may rely on the registered person's representation that the terms of the loan meet these standards. The fact that a registered person can negotiate a better rate or terms for a loan that is not the product of the broker-customer relationship would not vitiate the idea that the loan occurred on terms generally offered to the public.
- The scope of the rule is limited to lending arrangements between registered persons and their customers, rather than any customer of the firm.

In making these changes, NASD has considered that the purpose of Rule 2370 is to give members the opportunity to evaluate the appropriateness of particular lending arrangements between their registered persons and customers and the potential for unnecessary and ill-advised conflicts of interests between both the registered person and his or her customer and the registered person and the member with which he or she is associated. Rule 2370 does not require that members necessarily have oversight of the terms of the loan, or its execution or administration. However, the absence of such requirements in the rule does not signify the conclusion of NASD that, under certain circumstances, such action by members may be appropriate and necessary in accordance with the member's supervisory obligations. It continues to be the prerogative of member firms to exclude any or all lending arrangements between registered persons and their customers.

Effective Date

These amendments became effective on February 18, 2004.

Endnotes

1 *See* Release No. 34-48242 (Aug. 29, 2003), 68 FR 52806 (Sept. 5, 2003) (File No. SR-NASD-2003-92).

2 The fact that a registered person can negotiate a better rate or terms for a loan that is not the product of the broker-customer relationship would not vitiate the idea that the loan occurred on terms generally offered to the public.

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ATTACHMENT A

Proposed additions are underlined; proposed deletions are in brackets.

* * * * *

2370. Borrowing From or Lending to Customers

(a) No person associated with a member in any registered capacity may borrow money from or lend money to any customer of [the member] <u>such person</u> unless: (1) the member has written procedures allowing the borrowing and lending of money between such registered persons and customers of the member; and (2) the lending or borrowing arrangement meets one of the following conditions: (A) the customer is a member of such person's immediate family; (B) the customer is a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business; (C) the customer and the registered person are both registered persons of the same member firm; (D) the lending arrangement is based on a personal relationship with the customer, such that the loan would not have been solicited, offered, or given had the customer and the associated person not maintained a relationship outside of the broker/customer relationship; or (E) the lending arrangement is based on a business relationship outside of the broker-customer relationship[;and (3) the m].

<u>(b) Procedures</u>

(1) <u>Members</u> [has] <u>must</u> pre-approve[d] in writing the lending or borrowing arrangements <u>described in subparagraphs (a)(2)(C), (D), and (E) above.</u>

<u>(2) With respect to the lending or borrowing arrangements described in subparagraph (a)(2)(A) above, a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval either prior to or subsequent to entering into such lending or borrowing arrangements.</u>

<u>(3) With respect to the lending or borrowing arrangements described in</u>

subparagraph (a)(2)(B) above, a member's written procedures may indicate that registered persons are not required to notify the member or receive member approval either prior to or subsequent to entering into such lending or borrowing arrangements, provided that, the loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose and creditworthiness. For purposes of this subparagraph, the member may rely on the registered person's representation that the terms of the loan meet the above-described standards.

[(b)] (c) No change in text

* * * * *

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Training

KEY TOPICS

Cold Call
Do-Not-Call
Telemarketing
Telephone Solicitation
Established Business Relationship

INFORMATIONAL

Do-Not-Call Registry

SEC Approves Amendments to NASD Rules Concerning Member Participation in the National Do-Not-Call Registry; **Effective Date: March 31, 2004**

Executive Summary

On January 12, 2004, the Securities and Exchange Commission (SEC or Commission) approved amendments to NASD Rule 2212 (Telemarketing) and Rule 3110 (Books and Records). These amendments set forth NASD's requirement that member firms participate in the Federal Trade Commission's (FTC) national do-not-call registry.[1] The amendments will become effective on March 31, 2004.

NASD Rule 2212, Telemarketing, and NASD Rule 3110, Books and Records, as amended, are set forth in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8104.

Background and Discussion

In 2003, the FTC and the Federal Communications Commission (FCC) established requirements for sellers and telemarketers to participate in a national do-not-call registry.[2] Since June 2003, consumers have been able to enter their home telephone numbers into the national do-not-call registry, which is maintained by the FTC. Under rules of the FTC and FCC, sellers and telemarketers generally are prohibited

04-15

from making telephone solicitations to consumers whose numbers are listed in the national do-not-call registry. The FCC's rules are directly applicable to broker/dealers.

In July 2003, the SEC requested that NASD amend its telemarketing rules to include a requirement for its members to participate in the national do-not-call registry.[3] Because broker/dealers are subject to the FCC's jurisdiction, NASD modeled its rules after those of the FCC, with minor modifications tailoring the rules to broker/dealer activities and the securities industry. Members, however, have an independent obligation to comply with both the FCC's and NASD's telemarketing rules. While this *Notice* highlights some of the textual differences between the NASD and FCC rules, NASD cannot advise its members on the manner in which the FCC intends to interpret or apply its telemarketing rules. Accordingly, compliance with NASD's telemarketing rules may not ensure compliance with the FCC's rules, and vice versa.[4]

General Telemarketing Requirements

As a preliminary matter, NASD reminds members that Rule 2212 applies only to telephone solicitations. Rule 2212(g)(2) defines a telephone solicitation as "the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person." As a result, if a member telephones a customer solely concerning a margin call or similar administrative event, such call generally would not constitute a telephone solicitation.

Paragraph (a)(1) of Rule 2212 provides the time-of-day restrictions under which a member or person associated with a member may make a telephone call to the residence of any person for the purpose of soliciting the purchase of securities or related services. Specifically, members may engage in such telephone solicitations only between the hours of 8 a.m. to 9 p.m. (local time at the called party's location) unless (1) the member has an "established business relationship" with the called person based on the person having made a financial transaction or having a security position, a money balance, or account activity with the member or at a clearing firm that provides clearing services to such member within the previous 18 months immediately preceding the date of the telemarketing call;[5] (2) the member has received express written permission from the person that allows the member to call outside the applicable time frame; or (3) the person called is a broker or dealer. These provisions are substantively equivalent to those currently in place, except that NASD is replacing the current "existing customer" exception with an "established business relationship" exception. This change is discussed in detail below.

Paragraph (a)(2) of Rule 2212 requires firms to maintain a firm-specific do-not-call list.[6] NASD established the requirement for firms to maintain their own do-not-call lists in 1995. The new federal legislation imposes the additional requirement for firms to consult the national do-not call registry; it does not eliminate the obligation for firms to maintain their own do-not-call lists. Thus, the provisions in paragraph (a)(2) of Rule 2212 are substantively equivalent to those in current Rule 3110(g)(1). Members should note that under paragraph (d)(3) of Rule 2212, they must honor a request by a person to be placed on a firm-specific do-not-call list within thirty days of such request, or sooner if they are able to do so.

Paragraph (a)(3) of Rule 2212 prohibits a member or person associated with a member from making telephone solicitations to any person who registers his or her phone number on the national do-not-call registry. Members should note that registrations are maintained in the national registry for a period of five years. A consumer may re-register his or her telephone number at any time. Such re-registration re-commences the applicable five-year registration period.

Exceptions from the National Registry Do-Not-Call Requirements

The rules of the FCC and FTC provide certain exceptions under which sellers and telemarketers may make telephone solicitations to persons on the national registry.[7] NASD has adopted these exceptions.

Established Business Relationship

The first exception, contained in paragraph (b)(1) of Rule 2212, is for calls made to persons with whom the member has an "established business relationship." An "established business relationship" may be formed in three ways. First, under paragraph (g)(1)(A)(i), an established business relationship exists between a member and a person if such person has made a financial transaction or has a security position, a money balance, or account activity with the member or at a clearing firm that provides clearing services to such member, within the previous 18 months immediately preceding the date of the telemarketing call. The definition of account activity is borrowed from Rule 2340, which is used to determine when a member or its clearing firm must send a customer account statement.

Second, under paragraph (g)(1)(A)(ii), an established business relationship exists when the member is the "broker/dealer of record" for the account of the person within the previous 18 months immediately preceding the date of the telemarketing call. The term "broker/dealer of record" refers to the broker/dealer identified on a customer's account application for accounts held directly at a mutual fund or variable insurance product issuer. The definition of broker/dealer of record is not contingent on the receipt of compensation.

Third, under paragraph (g)(1)(A)(iii), an established business relationship exists if a person has contacted the member to inquire about a product or service offered by the member within the previous three months immediately preceding the date of the telemarketing call.

As stated above, the definition of "established business relationship" replaces the definition of "existing customer," which was applicable solely to the time-of-day restrictions and disclosure provisions in current Rule 2212. An existing customer was defined as "a customer from whom the broker or dealer, or a clearing broker or dealer on behalf of such broker or dealer, carries an account." Moreover, the existing customer exception applied only to an existing customer who (1) within the proceeding 12 months had effected a securities transaction or made a deposit of funds or securities into an account under the control of a member's associated person; or (2) had deposited funds or securities into an account that was under the control of a member's associated person and his or her account earned interest or dividends within the previous 12 months. NASD believes that requiring members to follow competing definitions of "existing customer" (for the time-of-day restrictions) and "established business relationship" (for the national do-not-call registry restrictions) could cause confusion and lead to inadvertent violations.[8] However, as noted above, for purposes of the time-of-day restrictions, the established business relationship exception must be based on the customer having made a financial transaction or having a security position, money balance, or account activity with the firm or at a clearing firm that provided clearing services to such member within the previous 18 months. A member may not call outside the time-of-day restrictions where an established business relationship is predicated on being the broker/dealer of record for an account of the person within the previous 18 months or having contacted the member to inquire about a product or service within the previous three months.

In general, an established business relationship is formed only through the relationship between a person and a member. The rule contains a narrow exception for persons with an established business relationship with a member's affiliate, provided that the person reasonably expects the member to be included. (*See* Rule 2212(g)(1)(B)). This narrow exception applies solely to affiliates; no established business relationship with a member can exist based on a person's established business relationship with a non-affiliate of the member even if such person would reasonably expect the member to be included.

Importantly, a person's request to be placed on a firm-specific do-not-call list terminates the established business relationship exception. Thus, a member or person associated with a member may not make telephone solicitations to a person with whom it has an established business relationship if such person requests to be placed on the member's do-not-call list. This is consistent with NASD's current firm-specific do-not-call provision, which does not contain an exception for existing customers.

Members should be aware that nothing in amended Rule 2212 prohibits a member from contacting a customer solely concerning the administration of his or her account. As previously stated, such calls, absent more, do not constitute telephone solicitation or telemarketing.

Prior Written Consent

The second exception, contained in paragraph (b)(2) of Rule 2212, is for calls to persons from whom the member has obtained prior express invitation or permission. In accordance with the requirements of the FCC and FTC, permission must be evidenced by a signed, written agreement between the member and person that specifically states that the person agrees to be contacted by the member. The agreement also must include the telephone number to which calls may be placed.

Personal Relationship

The third exception, in paragraph (b)(3) of Rule 2212, is for calls made by an associated person who has a "personal relationship" with the recipient. The definition of personal relationship is set forth in paragraph (g)(3) and means "any family member, friend, or acquaintance of the telemarketer making the call." The FCC has indicated that in determining whether a telemarketer is a friend or acquaintance of the consumer, the FCC will look at, among other things, whether a reasonable consumer would expect a call from such person because they have a close, or, at least, a firsthand relationship. Members and persons associated with a member also should be aware that this exception applies solely to the national do-not-call registry. Thus, if a person with whom an associated person has a personal relationship has requested to be placed on a firm's do-not-call list, the associated person may not make a telephone solicitation to such person.

Safe Harbor Provision for the National Do-Not-Call Registry Requirements

The FCC and FTC rules also contain a "safe harbor" under which a person will not be liable for a violation that is the result of error if the telemarketer's routine business practice meets certain specified standards. The safe harbor is established in paragraph (c) of Rule 2212 and applies only to a violation of paragraph (a)(3) of Rule 2212, the national do-not-call registry provision.

To be eligible for this safe harbor, a member or person associated with a member must demonstrate that the member's routine business practice meets the following four standards. First, the member has established and implemented written procedures to comply with the national do-not-call rules. Second, the member has trained its personnel, and any entity assisting in its compliance, in procedures established pursuant to the national do-not-call rules. Third, the member has maintained and recorded a list of telephone numbers that the member may not contact. Fourth, the member uses a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the FTC no more than three months prior to the date any call is made, and maintains records documenting this process.[9]

Telemarketing Procedures

Paragraph (d) of Rule 2212 tracks the requirements of the FCC rule and existing Rule 2212 in establishing procedures that member firms must institute prior to engaging in telemarketing. These procedures include requirements to: (1) have a written policy for maintaining a do-not-call list; (2) train personnel engaged in telemarketing in the existence and use of the do-not-call list; (3) record and disclose requests from a person to be added to the member's do-not-call list; and (4) have the member provide the called party with the name of the individual caller, the name of the member, a telephone number or address at which the member may be contacted, and that the purpose of the call is to solicit the purchase of securities or related services.

Paragraph (d)(5) of Rule 2212 addresses the effect of a person's firm-specific do-not-call request on the members' affiliates, and mirrors the FCC's position on this point. In general, a person's firm-specific do-not-call request applies only to the member making the call, and does not apply to any affiliated entity unless the person reasonably would expect the affiliated entity to be included given the identification of the caller and the product being advertised.

Paragraph (d)(6) of Rule 2212 requires members to maintain a record of a caller's request not to receive further telemarketing calls and to honor that firm-specific do-not-call request for a period of five years.

Miscellaneous Provisions

Paragraph (e) of Rule 2212 tracks the FCC's position with respect to the application of the rule to wireless telephone numbers. In general, the FCC has stated that wireless subscribers may participate in the national do-not-call registry. Although FCC telemarketing rules only generally apply to residential telephone subscribers, the FCC has stated that it will presume wireless subscribers who ask to be put on the national do-not-call list are residential subscribers. Such a presumption, however, may require a wireless customer who allegedly has been contacted in violation of the national do-not-call provisions to provide further evidence that the number is a residential number.

Paragraph (f) of Rule 2212 provides that if a member uses another entity to perform telemarketing services on its behalf, the member remains responsible for ensuring compliance with all provisions contained in the rule. Members also should be mindful of the limitations on the use of unregistered persons to perform telemarketing services. In *Notice to Members 00-50* (Aug. 2000), NASD identified the limited telemarketing activities that can be performed by unregistered persons. As further discussed in that *Notice*, unregistered persons may only contact prospective customers to: (1) extend invitations to firm-sponsored events; (2) inquire whether the customer wishes to discuss investments with a registered person; and (3) inquire whether the customer wishes to receive investment literature. Members also must be mindful of the related supervision and training requirements for such activities, as discussed in the *Notice*.

Endnotes

1 *See* Securities Exchange Act Release No. 49055 (Jan. 12, 2004), 69 Fed. Reg. 2801 (Jan. 20, 2004) (SEC Notice of Order Approving File No. SR-NASD-2003-131).

2 The do-not-call rules of the FCC and FTC are very similar in terms of substance, in part because Congress asked the FCC to consult with the FTC to maximize consistency between their respective do-not-call rules. See The Do-Not-Call Implementation Act, 108 P.L. 10, 117 Stat. 557 (Mar. 11, 2003).

3 The Telemarketing and Consumer Fraud and Abuse Prevention Act of 1994 requires the SEC to promulgate telemarketing rules substantially similar to those of the FTC or direct self-regulatory organizations to do so, unless the SEC determines that such rules are not in the interest of investor protection. 47 U.S.C. § 6102(d) (2003).

4 For example, as further discussed herein, NASD has determined that an "established business relationship" exists for purposes of NASD's telemarketing rule when, among other things, a member is the broker/dealer of record for a customer. At this time, however, NASD staff is unaware whether the FCC will adopt the same interpretation of this and other provisions.

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5 As further discussed herein, one exception from the prohibition against making a telephone solicitation to persons on the national registry is based on whether the firm has an "established business relationship" with the person being called. For purposes of the prohibition against soliciting a person on the national registry, an "established business relationship" may be formed in one of three ways. For purposes of being permitted to solicit a person outside of the 8 a.m. to 9 p.m. time frame, however, only one of those three ways qualifies as a predicate on which the "established business relationship" may be based, specifically on the customer having made a financial transaction or having a security position, money balance, or account activity with the firm or at a clearing firm that provided clearing services to such member within the previous 18 months. (*See* Rule 2212(a)(1)(A) and Rule 2212(g)(1)(A)(i)).

6 Rule 3110(g)(1) currently requires firms to maintain firm-specific do-not-call lists. In an effort to consolidate and clarify NASD's telemarketing rules, NASD has combined Rule 3110(g)(1) with its telemarketing rule, Rule 2212. The remaining sections of Rule 3110 are substantively unchanged.

7 The FTC rule contains only two exceptions: (1) an established business relationship; and (2) prior express written consent. The FTC rule, unlike the FCC rule, does not include a personal relationship exception.

8 NASD notes that the definition of established business relationship is generally broader than the current definition of existing customer in that it looks back 18 months rather than 12 months and encompasses more activities by the customer.

9 NASD notes that under the rules of the FCC, the safe harbor contains an additional requirement that a seller or telemarketer use a process to ensure that it does not sell, rent, lease, purchase, or use the national do-not-call database, or any part thereof, for any purpose except compliance with the FCC's national do-not-call rules and any such state or federal law to prevent telephone solicitations to telephone numbers registered on the national database. The telemarketer also must purchase access to the relevant do-not-call data from the administrator of the national database and must not participate in any arrangement to share the cost of accessing the national database, including any arrangement with other entities to divide the costs to access the national database among various client sellers.

The FTC will collect fees from sellers and telemarketers to fund the ongoing expenses of the national registry. The annual cost of accessing the FTC's national registry has been set at $25 per area code, with a maximum annual cap of $7,375 (equivalent to 300 area codes). See 68 Fed. Reg. 45134, 45141 (July 31, 2003). In addition, as part of the FTC's Regulatory Flexibility analysis on the burdens to small entities, the FTC determined that it would not charge an access fee for the first five area codes.

Although the safe harbor contained in NASD's telemarketing rule does not contain provisions concerning the sale, rent, lease, purchase, use, or means of accessing the national do-not-call registry as such matters generally fall outside the purview of the investor protection concerns underlying NASD's rule, NASD reminds members that they are subject to the FCC's national do-not-call rules and must comply with these provisions.

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ATTACHMENT A

New language is underlined; deleted language is in brackets.

2200. COMMUNICATIONS WITH THE PUBLIC

* * * * *

2212. Telemarketing

[No member or person associated with a member shall:]

[(a) make outbound telephone calls to the residence of any person for the purpose of soliciting the purchase of securities or related services at any time other than between 8 a.m. and 9 p.m. local time at the called person's location, without the prior consent of the person; or]

[(b) make an outbound telephone call to any person for the purpose of soliciting the purchase of securities or related services without disclosing promptly and in a clear and conspicuous manner to the called person the following information:]

[(1) the identity of the caller and the member firm;]

[(2) the telephone number or address at which the caller may be contacted; and]

[(3) that the purpose of the call is to solicit the purchase of securities or related services.]

[(c) The prohibitions of paragraphs (a) and (b) shall not apply to telephone calls by any person associated with a member, or another associated person acting at the direction of such person for the purpose of maintaining and servicing the accounts of existing customers of the member under the control of or assigned to such associated person:]

[(1) to an existing customer who, within the preceding twelve months, has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or the deposit, was under the control of or assigned to, such associated person;]

[(2) to an existing customer who previously has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or deposit, was under the control of or assigned to, such associated person, provided that such customer's account has earned interest or dividend income during the preceding twelve months, or]

[(3) to a broker or dealer.]

[(d) For the purposes of paragraph (c), the term "existing customer " means a customer for whom the broker or dealer, or a clearing broker or dealer on behalf of such broker or dealer, carries an account. The scope of this Rule is limited to the telemarketing calls described herein; the terms of this Rule shall not otherwise expressly or by implication impose on members any additional requirements with respect to the relationship between a member and a customer or between a person associated with a member and a customer.]

(a) General Telemarketing Requirements

No member or person associated with a member shall initiate any telephone solicitation, as defined in paragraph (g)(2) of this rule, to:

(1) Time of Day Restriction

Any residence of a person before the hour of 8 a.m. or after 9 p.m. (local time at the called party's location), unless

(A) the member has an established business relationship with the person pursuant to paragraph (g)(1)(A)(i),

(B) the member has received that person's prior express invitation or permission, or

(C) the person called is a broker or dealer;

(2) Firm-Specific Do-Not-Call List

Any person that previously has stated that he or she does not wish to receive an outbound telephone call made by or on behalf of the member; or

(3) National Do-Not-Call List

Any person who has registered his or her telephone number on the Federal Trade Commission's national do-not-call registry.

(b) National Do-Not-Call List Exceptions

A member making telephone solicitations will not be liable for violating paragraph (a)(3) if:

(1) Established Business Relationship Exception

The member has an established business relationship with the recipient of the call. A person's request to be placed on the firm-specific do-not-call list terminates the established business relationship exception to that national do-not-call list provision for that member even if the person continues to do business with the member;

(2) Prior Express Written Consent Exception

The member has obtained the person's prior express invitation or permission. Such permission must be evidenced by a signed, written agreement between the person and member which states that the person agrees to be contacted by the member and includes the telephone number to which the calls may be placed; or

(3) Personal Relationship Exception

The associated person making the call has a personal relationship with the recipient of the call.

(c) Safe Harbor Provision

A member or person associated with a member making telephone solicitations will not be liable for violating paragraph (a)(3) if the member or person associated with a member demonstrates that the violation is the result of an error and that as part of the member's routine business practice, it meets the following standards:

(1) Written procedures. The member has established and implemented written procedures to comply with the national do-not-call rules;

(2) Training of personnel. The member has trained its personnel, and any entity assisting in its compliance, in procedures established pursuant to the national do-not-call rules;

(3) Recording. The member has maintained and recorded a list of telephone numbers that it may not contact; and

(4) Accessing the national do-not-call database. The member uses a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the administrator of the registry no more than three months prior to the date any call is made, and maintains records documenting this process.

(d) Procedures

Prior to engaging in telemarketing, a member must institute procedures to comply with paragraph (a). Such procedures must meet the following minimum standards:

(1) Written policy. Members must have a written policy for maintaining a do-not-call list.

(2) Training of personnel engaged in telemarketing. Personnel engaged in any aspect of telemarketing must be informed and trained in the existence and use of the do-not-call list.

(3) Recording, disclosure of do-not-call requests. If a member receives a request from a person not to receive calls from that member, the member must record the request and place the person's name, if provided, and telephone number on the firm's do-not-call list at the time the request is made. Members must honor a person's do-not-call request within a reasonable time from the date such request is made. This period may not exceed thirty days from the date of such request. If such requests are recorded or maintained by a party other than the member on whose behalf the telemarketing call is made, the member on whose behalf the telemarketing call is made will be liable for any failures to honor the do-not-call request.

(4) Identification of sellers and telemarketers. A member or person associated with a member making a call for telemarketing purposes must provide the called party with the name of the individual caller, the name of the member, an address or telephone number at which the member may be contacted, and that the purpose of the call is to solicit the purchase of securities or related service. The telephone number provided may not be a 900 number or any other number for which charges exceed local or long distance transmission charges.

(5) Affiliated persons or entities. In the absence of a specific request by the person to the contrary, a person's do-not-call request shall apply to the member making the call, and will not apply to affiliated entities unless the consumer reasonably would expect them to be included given the identification of the caller and the product being advertised.

(6) Maintenance of do-not-call lists. A member making calls for telemarketing purposes must maintain a record of a caller's request not to receive further telemarketing calls. A firm-specific do-not-call request must be honored for 5 years from the time the request is made.

(e) Wireless Communications

The provisions set forth in this rule are applicable to members telemarketing or making telephone solicitations calls to wireless telephone numbers.

(f) Outsourcing Telemarketing

If a member uses another entity to perform telemarketing services on its behalf, the member remains responsible for ensuring compliance with all provisions contained in this rule.

(g) Definitions

(1) Established business relationship

(A) An established business relationship exists between a member and a person if:

(i) the person has made a financial transaction or has a security position, a money balance, or account activity with the member or at a clearing firm that provides clearing services to such member within the previous 18 months immediately preceding the date of the telemarketing call;

(ii) the member is the broker/dealer of record for an account of the person within the previous 18 months immediately preceding the date of the telemarketing call; or

(iii) the person has contacted the member to inquire about a product or service offered by the member within the previous three months immediately preceding the date of the telemarketing call.

(B) A person's established business relationship with a member does not extend to the member's affiliated entities unless the person would reasonably expect them to be included. Similarly, a person's established business relationship with a member's affiliate does not extend to the member unless the person would reasonably expect the member to be included.

(2) The terms telemarketing and telephone solicitation mean the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person.

(3) The term personal relationship means any family member, friend, or acquaintance of the telemarketer making the call.

(4) the term "account activity" shall include, but not be limited to, purchases, sales, interest credits or debits, charges or credits, dividend payments, transfer activity, securities receipts or deliveries, and/or journal entries relating to securities or funds in the possession or control of the member.

(5) the term "broker/dealer of record" refers to the broker/dealer identified on a customer's account application for accounts held directly at a mutual fund or variable insurance product issuer.

* * * * *

RULE 3100: BOOKS AND RECORDS, AND FINANCIAL CONDITION

Rule 3110: Books and Records

(a) – (f) No Change

(g) [Telemarketing Requirements] Negotiable Instruments Drawn From A Customer's Account

[(1) Each member shall make and maintain a centralized do-not-call list of persons who do not wish to receive telephone solicitations from such member or its associated persons.]

[(2)] No member or person associated with a member shall obtain from a customer or submit for payment a check, draft, or other form of negotiable paper drawn on a customer's checking, savings, share, or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument. [(3)]Each member shall maintain this[e] authorization [required by subparagraph (2)]for a period of three years. This provision shall not, however, require maintenance of copies of negotiable instruments signed by customers.

(h) No Change

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal & Compliance

Registered Representatives

Senior Management

KEY TOPICS

Arbitration

Central Registration Depository (CRD®)

Customer Dispute Information

Dispute Resolution

Expungement

Rule 2130

INFORMATIONAL

Expungement

NASD Adopts Rule 2130 Regarding Expungement of Customer Dispute Information From The Central Registration Depository; **Effective Date: April 12, 2004**

Executive Summary

On December 16, 2003, the Securities and Exchange Commission (SEC) approved new Rule 2130 concerning the expungement of customer dispute information from the Central Registration Depository (CRD® or the CRD system).[1] As further discussed below, Rule 2130 will apply to any request made to a court of competent jurisdiction to expunge customer dispute information from the CRD system that has its basis in an arbitration or civil lawsuit filed on or after April 12, 2004. All requests to expunge customer dispute information from the CRD system arising from arbitrations or civil lawsuits filed before April 12, 2004, including any settlements arising therefrom, will continue to be subject to the terms of the moratorium in effect as of January 19, 1999, as discussed in *Notice to Members 99-09* (February 1999).

The text of Rule 2130 is provided in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Richard E. Pullano, Associate Vice President/Chief Counsel, Registration and Disclosure, at (240) 386-4821; Jean I. Feeney, Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844. Technical and procedural questions may be directed to Ann E. Bushey, Director, Registration and Disclosure, at (240) 386-4724. In addition, questions and answers concerning the application of Rule 2130 soon will be available from NASD's Registration and Disclosure Department at *http://www.nasdr.com/3400_filing_online.asp*.

Background

Rule 2130 establishes procedures for expunging customer dispute information from the CRD system. For purposes of Rule 2130, "customer dispute information" includes customer complaints, arbitration claims, and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings. Customer dispute information generally contains allegations that a member or one or more of its associated persons has violated securities laws, rules, or regulations.

The CRD system is an online registration and licensing system for the U.S. securities industry, state and federal regulators, and self-regulatory organizations (SROs). The CRD system contains broker/dealer information filed on Forms BD and BDW and information on associated persons filed on Forms U4 and U5. The CRD system also contains information filed by regulators via Form U6. The CRD system contains administrative information (*e.g.,* personal, organizational, employment history, registration, and other information) and disclosure information (*e.g.,* criminal matters, regulatory disciplinary actions, civil judicial actions, and information relating to customer disputes) filed on these forms.

NASD operates the CRD system pursuant to policies developed jointly with the North American Securities Administrators Association (NASAA). NASD works with the SEC, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to ensure that information submitted to and maintained on the CRD system is accurate and complete. These procedures, among other things, cover expungement of information from the CRD system in narrowly defined circumstances.

In January 1999, after consultation with NASAA, NASD imposed a moratorium on arbitrator-ordered expungements of customer dispute information from the CRD system. Under the moratorium, NASD would expunge such information from the CRD system only when a directive contained in an arbitration award rendered in a dispute between a public customer and a firm or its associated persons was confirmed by a court of competent jurisdiction. After imposing the moratorium, NASD began considering how to craft an approach to expungement that would allow NASD, in its capacity as an SRO and as operator of the CRD system, effectively to challenge expungement directives that might diminish or impair the integrity of the system and to ensure the maintenance of essential information for regulators and investors.[2] NASD concluded that such an approach necessarily required a balancing of three competing interests: (1) the interests of NASD, the states, and other regulators in retaining broad access to customer dispute information to fulfill their regulatory responsibilities and investor protection obligations; (2) the interests of the brokerage community and others in a fair process that recognizes their stake in protecting their reputations and permits expungement from the CRD system when appropriate; and (3) the interests of investors in having access to accurate and meaningful information about brokers with whom they conduct, or may conduct, business.[3]

In crafting Rule 2130, NASD was guided by these competing interests and the investor protection, data integrity and fairness principles that these interests represent. Underlying Rule 2130 is NASD's commitment to maintaining a CRD system that provides public investors and regulators access to accurate information about firms and brokers and maintains the integrity of the arbitration process. Although public investors, broker/dealers and their associated persons, and regulators may have competing interests, all of these groups share a common interest in a CRD system that contains accurate and meaningful information.

NASD believes that Rule 2130 accomplishes that goal. Rule 2130 will protect regulators' and investors' ability to obtain meaningful data about the members and associated persons with whom they do, or plan to do, business by permitting customer dispute information to be expunged from the CRD system only when arbitrators and a court have affirmatively found that: (1) the claim, allegation, or information is factually impossible or clearly erroneous; (2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or (3) the claim, allegation, or information is false.

Expungement Procedures Under Rule 2130

Rule 2130 establishes procedures for members and associated persons to obtain expungement of customer dispute information. For purposes of Rule 2130, "customer dispute information" includes customer complaints, arbitration claims, and court filings made by customers, and the arbitration awards or court judgments that may result from those claims or filings. Customer dispute information generally contains allegations that a member or one or more of its associated persons has violated securities laws, rules, or regulations.

Rule 2130 continues the requirement started with the January 1999 moratorium that a court of competent jurisdiction must order or confirm all expungement directives before NASD will expunge customer dispute information from the CRD system. Under Rule 2130, members and associated persons seeking to expunge from the CRD system information arising from disputes with customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.[4]

A respondent seeking expungement relief in an arbitration would ask for expungement in his or her prayer for relief. In the event the arbitrators dismiss the claim against the respondent, the arbitrators would then decide whether to grant expungement on the basis of one or more of the standards in Rule 2130; *i.e.*, the expungement relief is based on an **affirmative** arbitral finding that: (1) the claim, allegation, or information is factually impossible or clearly erroneous; (2) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or (3) the claim, allegation, or information is false. The award would state whether expungement is granted, and if so, on what basis.

If the parties settle the arbitration, they may jointly ask the arbitration panel for a stipulated award and request that the panel make affirmative findings and order expungement based on one or more of the standards in Rule 2130. The arbitrators would determine whether to grant expungement relief and, if so, state in the award the basis on which the expungement relief was granted. The arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings.

The next step would be to obtain a court order. Members and associated persons seeking a court order to expunge **must** name NASD as an additional party and serve NASD with all appropriate documents unless NASD waives that requirement. To obtain NASD's waiver, the party seeking expungement would send the necessary documents (*i.e.*, the waiver request and the arbitration award containing the expungement directive and finding indicating the basis on which the expungement was granted) to NASD at the following address:

Rule 2130 - Expungement Notice/Waiver Request
NASD Registration and Disclosure Department - 2nd Floor
9509 Key West Ave.
Rockville, MD 20850

Upon receipt of a request for a waiver, NASD staff will notify the States where the individual is registered or seeking registration of the expungement notice/waiver request. NASD staff will then examine the basis on which the fact finder ordered expungement to determine whether the expungement was based on one or more of the standards in Rule 2130. NASD will waive the obligation to be named as a party if NASD determines that the expungement relief is based on an affirmative finding that the expungement meets one or more of the standards in the rule.[5] Therefore, parties may save time and expense by sending the arbitration award to NASD staff prior to naming NASD as a party, thereby giving NASD the opportunity to waive its right to be named as a party.

If NASD staff determines that the expungement was not based on one or more of the standards in Rule 2130, it will advise the parties that NASD will not waive the requirement to be named as a party in the court confirmation process. The parties would then name NASD as a party, and NASD would oppose the expungement. Parties may serve NASD by serving "CT Corporation" in the jurisdiction in which the lawsuit is being filed.

Persons who have been sued in court may seek expungement relief from the court; however, they will not be able to avail themselves of the rule's waiver provision and will be required to name NASD as a party.[6] NASD will determine whether to oppose the expungement based on the ground(s) on which the person is seeking the expungement.

Endnotes

1 SEC Order Granting Approval of Proposed Rule Change and Amendment No. 1, Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2, Thereto, Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information From the Central Registration Depository System, 68 Fed. Reg. 74667 (Dec. 24, 2003) Exchange Act Release No. 48933 (File No. SR-NASD-2000-168 (Dec. 16, 2003), 68 Fed. Reg. 74667 (Dec. 24, 2003).

2 NASD sought comment on possible approaches to addressing arbitrator-ordered expungements of information from the CRD system in 1999 (*Notice to Members 99-54*) and 2001 (*Notice to Members 01-65*).

3 Although public investors do not have access to the CRD system, the information in that system is available to investors through NASD BrokerCheck and individual state disclosure programs.

4 Consistent with the 1999 moratorium, NASD may continue to expunge, without a court order, arbitration awards rendered in disputes between registered representatives and firms that contain expungement directives in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information.

5 In addition to the three standards discussed above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

- the expungement relief and accompanying findings on which it is based are meritorious; and
- the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

6 Although a judge may make the affirmative finding required under Rule 2130, NASD expects that arbitrators will consider the overwhelming majority of expungement requests.

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ATTACHMENT A

New rule language is underlined.

* * * * *

2130. Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD System)

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with [public] customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.

(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name NASD as an additional party and serve NASD with all appropriate documents unless this requirement is waived pursuant to subparagraph (1) or (2) below.

(1) Upon request, NASD may waive the obligation to name NASD as a party if NASD determines that the expungement relief is based on affirmative judicial or arbitral findings that:

(A) the claim, allegation, or information is factually impossible or clearly erroneous;

(B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or

(C) the claim, allegation, or information is false.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

(A) the expungement relief and accompanying findings on which it is based are meritorious; and

(B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

(c) For purposes of this rule, the terms “sales practice violation,” “investment-related,” and “involved” shall have the meanings set forth in the Uniform Application for Securities Industry Registration of Transfer (“Form U4”) in effect at the time of issuance of the subject expungement order.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representatives

Legal & Compliance

Registered Representatives

Senior Management

KEY TOPICS

Deterrence of Future Misconduct

NASD Sanction Guidelines

INFORMATIONAL

Sanction Guidelines

NASD Revises *NASD Sanction Guidelines*

Executive Summary

This *Notice* advises NASD members of modifications to the *NASD Sanction Guidelines* (Guidelines). NASD is modifying General Principles Nos. 1 and 3 of the Guidelines to emphasize its commitment to imposing sanctions in disciplinary actions that are designed to modify the behavior of respondents and to deter future misconduct in the securities industry. The modifications also clarify that NASD may—in egregious cases—suspend or bar a firm from engaging in one or more areas of business. The changes are effective as of March 15, 2004, and apply to all actions as of that date, including pending disciplinary cases.

General Principle No. 1 and General Principle No. 3, as modified, may be read in their entirety in Attachment A to this *Notice*. The revised General Principles also will be available on the NASD Web Site (*www.nasdr.com*).

Questions/Further Information

Questions concerning this *Notice* may be directed to Carla Carloni, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8019.

04-17

Discussion

NASD initially published the Guidelines in 1993 to promote consistency and uniformity in the imposition of sanctions in disciplinary matters. The Guidelines are divided into three main sections—the General Principles, the Principal Considerations, and the individual guidelines that address specific types of misconduct. The General Principles contain policy considerations that NASD's adjudicatory bodies (Adjudicators) should factor into every sanction determination. The Principal Considerations focus on the severity of a violation by listing potentially aggravating and mitigating factors that may apply to all violations. The individual guidelines contain additional violation-specific aggravating and mitigating factors and recommended sanction ranges for particular violations. Adjudicators rely on the Guidelines to determine appropriately remedial sanctions in disciplinary actions. NASD's Departments of Enforcement and Market Regulation and the defense bar also rely on the Guidelines in negotiating settlements in disciplinary matters.

These amendments revise the discussion in the General Principles section of the Guidelines to emphasize to Adjudicators that sanctions should be significant enough to promote the prevention of future misconduct. The amendments to General Principle No. 1 and General Principle No. 3 highlight NASD's ability to (1) impose fines that are not limited by the harm caused to customers, but rather are significant enough to modify the behavior of the respondent firm; and (2) suspend or bar a firm in egregious cases from engaging in a particular line of business related to the misconduct at issue.

Under NASD's By-Laws, Adjudicators already possess the authority to impose sanctions designed to deter future misconduct either by the imposition of monetary sanctions or the limitation of business activities. The amendments emphasize NASD's ability to achieve deterrence through the imposition of sanctions and clarify that NASD, in crafting appropriately remedial sanctions, intends to focus significant attention on preventing the recurrence of misconduct. Furthermore, the amendments will remind Adjudicators to consider the scope and severity of the misconduct and the financial resources of the respondent when crafting sanctions to avoid imposing sanctions that member firms may view as a cost of doing business and that do not deter future misconduct.

Effective Date

General Principle No. 1 and General Principle No. 3, as modified, supersede General Principle No. 1 and General Principle No. 3 published by NASD in 2001 and referenced in prior *NASD Notices to Members*. The changes are effective as of March 15, 2004, and apply to all actions as of that date, including pending disciplinary cases.

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ATTACHMENT A

Additions are underlined; deletions are in brackets.

General Principles Applicable to all Sanctions Determinations

1. **Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.** The overall purposes of NASD[Regulation]'s disciplinary process and NASD [Regulation]'s responsibility in imposing sanctions are to remediate misconduct by preventing the recurrence of misconduct, improving overall standards in the industry, and [and to] protecting the investing public. Toward this end, Adjudicators should design sanctions that are significant enough to prevent and discourage future misconduct by a respondent, to deter others from engaging in similar misconduct, and to modify and improve [overall]business [standards]practices. [in the securities industry. Adjudicators should balance the concepts of remediation and deterrence by imposing sanctions that both effectively address the violative conduct and are of sufficient moment to discourage and prevent future violations and to improve overall standards.] Depending on the seriousness of the violations, Adjudicators should impose sanctions that are significant enough to ensure effective deterrence. When necessary to achieve this goal, Adjudicators should impose sanctions that exceed the range recommended in the applicable guideline.

When applying these principles and crafting appropriately remedial sanctions, Adjudicators also should consider firm size[1] with a view toward ensuring that the sanctions imposed are not punitive but are sufficiently remedial to achieve deterrence.[2] (Also see General Principle No. 8 regarding ability to pay.)

3. **Adjudicators should tailor sanctions to respond to the misconduct at issue.** [Since s]Sanctions in disciplinary proceedings are intended to be remedial and to prevent the recurrence of misconduct.[,]Adjudicators therefore should impose sanctions tailored to address the misconduct involved in each particular case. Section 15A of the Securities Exchange Act of 1934 and NASD Procedural Rule 8310 provide that NASD [Regulation] may enforce compliance

with its rules by: limitation or modification of a respondent's business activities, functions, and operations; fine; censure; suspension (of an individual from functioning in any or all capacities, or of a firm from engaging in any or all activities or functions, for a defined period or contingent on the performance of a particular act); bar (permanent expulsion of an individual from associating with a firm in any or all capacities); expulsion (of a firm from NASD membership and, consequently, from the securities industry); or any other fitting sanction.

To address the misconduct effectively in any given case, Adjudicators may design sanctions other than those specified in these guidelines. [To remediate misconduct in a particular case, f]For example, to achieve deterrence and remediate misconduct, Adjudicators may impose sanctions that: (a) require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements; (b) suspend or bar a respondent firm from engaging in a particular line of business; (c) require an individual or member firm respondent, prior to conducting future business, to disclose certain information to new and/or existing clients, including disclosure of disciplinary history; (d[c]) require a respondent firm to implement heightened supervision of certain individuals or departments in the firm; (e[d]) require an individual or member firm respondent to obtain an NASD [Regulation]staff letter stating that a proposed communication with the public is consistent with NASD [Regulation]standards prior to disseminating the communication to the public; (f[e]) limit the number of securities in which a respondent firm may make a market; [or](g[f]) limit the activities of a respondent firm[. In addition, in appropriate cases, such as those involving pervasive, firm-wide misconduct and/or repeated violations, Adjudicators may] or (h) require a respondent firm to institute tape recording procedures. **This list is illustrative, not exhaustive, and is included to provide examples of the types of sanctions that Adjudicators may design to address specific misconduct and to achieve deterrence. Adjudicators may craft other sanctions specifically designed to prevent the recurrence of misconduct.**

The recommended ranges in these guidelines are not absolute. The guidelines suggest, but do not mandate, the range and types of sanctions to be applied. Depending on the facts and circumstances of a case, Adjudicators may determine that no remedial purpose is served by imposing a sanction within the range recommended in the applicable guideline, i.e., that a sanction below the recommended range, or no sanction at all, is appropriate. Conversely, Adjudicators may determine that egregious misconduct requires the imposition of sanctions above or otherwise outside of the recommended range. For instance, in an egregious case, Adjudicators may consider barring an individual respondent and/or expelling a respondent member firm, regardless of whether the individual guidelines applicable to the case recommend a bar and/or expulsion or other less severe sanctions. Adjudicators must always exercise judgment and discretion and consider appropriate aggravating and mitigating factors in determining remedial sanctions in each case. In addition, whether the sanctions are within or outside of the recommended range, Adjudicators must identify the basis for the sanctions imposed.

Endnotes

1 Factors to consider in connection with assessing firm size are: the financial resources of the firm; the nature of the firm's business; the number of individuals associated with the firm; the level of trading activity at the firm; other entities that the firm controls, is controlled by, or is under common control with; and the firm's contractual relationships (such as introducing broker/clearing firm relationships). This list is included for illustrative purposes and is not exhaustive. Other factors also may be considered in connection with assessing firm size.

2 Adjudicators may consider firm size in connection with the imposition of sanctions with respect to rule violations involving negligence. With respect to violations involving fraudulent, willful and/or reckless misconduct, Adjudicators should consider whether, given the totality of the circumstances involved, it is appropriate to consider firm size and may determine that, given the egregious nature of the fraudulent activity, firm size will not be considered in connection with sanctions.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representative
Investment Banking
Legal & Compliance
Operations
Research
Senior Management

KEY TOPICS

Advertising
Investment Banking
Research Reports

GUIDANCE

Research Analysts and Research Reports

NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest

Executive Summary

In July 2002, NASD and the New York Stock Exchange (together, the SROs) issued a joint memorandum (the July 2002 Joint Memo) that provides interpretive guidance on NASD Rule 2711 (Research Analysts and Research Reports) and the research analyst provisions of NYSE Rules 351 and 472.[1] Since that time, the SROs have amended their rules governing research analysts and research reports,[2] and members have raised additional questions regarding these rules.

Accordingly, the SROs are issuing a second joint memorandum that provides further interpretive guidance to the research conflict of interest rules. Attachment A is the new joint memorandum. Attachment B is the current version of Rule 2711 for reference. Unless otherwise noted in the new joint memorandum, the guidance included in the July 2002 Joint Memo continues to apply.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-4623; or Philip Shaikun, Associate General Counsel, RPO, at (202) 728-8451.

Endnotes

1 *See Notice to Members 02-39* (July 2002).

2 *See Notice to Members 03-44* (July 2003).

ATTACHMENT A

JOINT MEMORANDUM OF NASD AND THE NEW YORK STOCK EXCHANGE

Discussion and Interpretation of Rules Governing Research Analysts and Research Reports (NASD Rule 2711 and NYSE Rules 351 and 472)

Background

This is a follow up to the joint memorandum issued by NASD and the New York Stock Exchange (the "SROs")[1] in July of 2002 (the "July 2002 Joint Memo") that provided interpretive guidance on NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to NYSE Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements") (collectively, the "SRO Rules").[2]

In July 2003, the Securities and Exchange Commission ("SEC") approved further changes to the SRO Rules that imposed new requirements on members[3] and made other changes necessary to comply with research analyst provisions of the Sarbanes-Oxley Act of 2002 (the "July 2003 Amendments").[4] This joint memorandum serves two purposes. First, the memorandum provides further clarification of previously issued interpretive guidance in light of the July 2003 Amendments. Second, it provides further interpretive guidance on the SRO Rules and responds to common questions that members have asked since the July 2002 Joint Memo was issued.

Continued Applicability of July 2002 Joint Memo

Members have inquired whether the guidance provided in the July 2002 Joint Memo continues to apply given the July 2003 Amendments. Unless otherwise noted below in this memorandum, the guidance in the July 2002 Joint Memo continues to reflect the SROs' interpretations of the SRO Rules. This memorandum is organized by subject matter and any change to the previous guidance in the July 2002 Joint Memo is noted in the applicable section.

Applicability of Registration and Continuing Education Requirements to Fixed Income Research Analysts

Members have inquired whether the new registration and continuing education requirements for research analysts[5] apply to research analysts that only produce research on fixed income securities. As a general matter, the research analyst registration requirements and continuing education requirements apply only to analysts that are the subject to the SRO Rules. That is, these requirements apply only to associated persons that are primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on such a research report. The requirements do not apply to research analysts that only produce research reports on fixed income securities that are not "equity securities" as defined in Section 3(a)(11) of the Securities Exchange Act of 1934.

Definition of "Research Report"

As of September 29, 2003, the term "research report" is defined as "a written or electronic communication that includes an analysis of equity securities or individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision."[6] Previously, the definition also required that the communication include a recommendation. That requirement was deleted in order to conform the SRO Rules to the definition of "research report" in the Sarbanes-Oxley Act.

While the SRO Rules no longer require that a research report contain a recommendation as a determining criteria, the analysis described in the July 2002 Joint Memo generally still applies. Although the issue of whether a communication is a research report still is determined by the individual facts and circumstances surrounding a particular communication, the list of exceptions in the July 2002 Joint Memo that are not generally "research reports" still applies under the new definition. Members should be aware that a disclaimer inserted into a communication with the public that indicates that the communication does not contain information sufficient upon which to base an investment decision has no relevance as to whether the communication falls within the definition of research report and could be misleading in certain circumstances.

Members have inquired whether a client communication that analyzes or recommends individual stocks would be considered a "research report" if it is written by an employee, such as a registered representative, who does not hold the title of "research analyst" and does not work in the member's research department. To clarify this issue, the SROs are adopting the interpretation issued by the SEC with respect to Regulation AC: a client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to at least 15 persons. This conclusion applies even if the author of the communication does not hold the title of "research analyst" and does not work in the member's research department.

The SROs also are adopting the SEC interpretation regarding periodic reports and other communications prepared for investment company shareholders or discretionary investment account clients.[7] Communications that discuss individual securities in the context of a fund's or account's past performance or the basis for previously made discretionary investment decisions (such as a manager's discussion of fund performance in a mutual fund shareholder report) are generally excluded from the definition of "research report."

Likewise, an investment company portfolio manager that prepares these types of communications would not be considered a "research analyst" for purposes of the SRO Rules even if he or she were registered with a member. However, if such a portfolio manager prepares communications that meet the definition of "research report" and do not fall within the exception noted above, those communications will be subject to the SRO Rules and the portfolio manager will be regarded as a research analyst.

Quantitative and Technical Research Reports

The SROs have continued to receive inquiries as to whether quantitative or technical research reports fall within the definition of "research report" under the SRO Rules. The July 2002 Joint Memo excluded from the definition of "research report" communications of "technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price." The SROs do not believe it is consistent with the purposes of the SRO Rules to exclude technical analysis of individual securities. Such an interpretation could allow a research analyst to provide coverage of a security of an issuer with which the member has an investment banking relationship or where the analyst may have a personal financial interest without the disclosures that would identify such potential conflicts. These are some of the very conflicts the

SRO Rules are intended to address. The SEC similarly excluded from the definition of "research report" in Regulation AC only sector, index and industry technical analysis.

The SROs believe the term "quantitative" as applied to research can be subject to various interpretations. Indeed, many research reports typically labeled "quantitative" by members can and do raise conflicts concerns. In this regard, not all mathematical models are inherently objective. Many such models are based on subjective formulas where a person or persons selects or can change the inputs: for example, particular performance ratios or consensus earnings estimates. The SROs are concerned that such models based on subjective formulas could be manipulated to produce a desired result, depending on the ratios or other criteria selected, the universe of securities, and the formula employed.

Consequently, the SROs do not believe it appropriate to categorically exclude any "quantitative" research from the scope of the SRO Rules. Nonetheless, the SROs do recognize that certain "quantitative models" devised by members may sufficiently guard against any potential conflicts of interest to render them outside the definition of a "research report." Thus, reports generated by formulas that are generally free of subjective inputs from an employee of a member may fall outside the definition of research report. However, the SROs believe that such a determination is best considered on a case-by-case basis.

Definition of "Public Appearance"

The SRO Rules define the term "public appearance" as "any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security."[8] Members have inquired whether password-protected conference calls or web casts in which a research analyst provides his or her opinion on individual companies or securities constitute public appearances for purposes of the SRO Rules.

As discussed above, and consistent with SEC Regulation AC, an analysis of individual securities or companies prepared for a specific person or a limited group of fewer than 15 persons is not considered to be a "research report."[9] The SROs believe that a similar standard is appropriate to apply to public appearances. Thus, an appearance before persons representing 15 or more separate investors will be regarded as a public appearance for purposes of the SRO Rules. However, the SROs would not require an analyst to make the disclosures required for public appearances in a password protected web-cast, conference call or similar event with more than 15 existing customers (*e.g.* individuals or entities), provided (1) all of the call participants

previously received the most current research report or other documentation that included the required disclosures and (2) the research analyst making the public appearance corrects and updates any disclosures in the research report that are inaccurate, misleading or are no longer applicable. If representatives of the media attend the public appearance, the analyst must make the required disclosures. Members also are reminded that such appearances are subject to appropriate record keeping requirements, which in this case must include a record of all attendees at the public appearance.

Application of SRO Rules to Third-Party Research

The July 2002 Joint Memo included guidance on the applicability of the SRO Rules to third-party research distributed by a member. That memo states that if a member distributes research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party (other than through a soft dollar arrangement), it must accompany this research with the following "Third-Party Research Disclosures," if applicable:

- the member's and its affiliates' ownership of the subject company's securities;[10]
- that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;[11]
- that the member was making a market in the subject company's securities at the time the research report was published;[12] and
- any other actual, material conflict of interest of the member known at the time of distribution of the research report.[13]

Absent a soft dollar arrangement, when a member distributes another member's research report, the distributing member must include the Third-Party Research Disclosures, while the member that prepared the report must comply with all of the disclosures required by the SRO Rules.

This memorandum addresses three questions that have arisen with respect to third-party research. (1) Are any of the new disclosures required by the recently amended SRO Rules now included in the required Third-Party Research Disclosures? (2) What factors determine whether a

research report is considered to be the product of the member rather than its affiliate or an independent third party? (3) Do different rules apply to the distribution of non-member affiliate research and independent third-party research?

Disclosure of Non-Investment Banking Compensation

The July 2003 Amendments to the SRO Rules require a member to provide additional disclosure in research reports regarding compensation that it or its affiliates receive from the subject company. The SRO Rules now require a member to disclose if it received compensation for products or services other than investment banking. This information must be current as of the end of the month preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month). A member also must disclose if the analyst or an employee with ability to influence the substance of the research report has actual knowledge as of the date of publication that the member received such compensation.

In addition, the July 2003 Amendments also generally require the disclosure in research reports of receipt of non-investment banking compensation received by a member's *affiliates*. However, a member is not required to disclose the receipt of non-investment banking compensation by its affiliates if the member has implemented procedures prescribed by NASD Rule 2711(h)(2)(v)(b) and NYSE Rule 472(k)(1)(iii)a.2. Under these provisions, a member is not required to disclose an affiliate's non-investment banking compensation from a subject company if the member maintains and enforces policies and procedures to wall off research analysts and employees with ability to influence the substance of research reports from receiving information about such compensation.

Finally, a member must disclose if the subject company is or has been during the preceding 12-month period a client of the member. In such cases, the member also must disclose the types of services provided to the subject company, categorized as either investment banking services, non-investment banking securities-related services, or non-securities services.

The SROs will not require a member that distributes third-party research to separately disclose non-investment banking compensation received by the member or an affiliate, unless receipt of that compensation represents an actual, material conflict of interest of the member known at the time of the distribution of the research report. Similarly, a member need not disclose the existence of a client relationship with the subject company, unless such relationship already falls within the current Third-Party Research Disclosures, such as managing or co-managing a public

offering of the subject company within the previous 12 months. In sum, members are required to make the same disclosures under the SRO Rules when distributing third-party research as they were required to make prior to the July 2003 Amendments, recognizing that the receipt of non-investment banking compensation can, under certain circumstances, represent a material conflict of interest.

Member vs. Third-Party Research Report

The determination of whether a research report is considered a product of the member or of a third party depends on: (1) whether the report appears to be the product of a member or (2) whether a "research analyst" (as defined by the SRO Rules) associated with a member is involved in producing the research report. It is irrelevant to the analysis where a report is distributed — domestically or internationally — or to whom it is distributed, or on which market the subject company's securities are traded.

The SROs consider research reports that meet either of these above factors to be reports produced by the member that must meet all of the SRO Rules' requirements. Thus, for example, if a member issues a "globally-branded"[14] research report, all of the SRO Rules would apply to that report. Similarly, if a member adapts, alters or distributes a research report produced by an affiliate or an independent third party in such a way that an investor reasonably could believe it to be the product of the member, rather than that of the affiliate or independent third party, then the report will be considered to be the member's own and subject to all of the SRO Rules. A research report prepared by a "mixed research team" that includes at least one person who meets the definition of "research analyst" and is associated with the member also would be considered a report produced by the member.

Independent and Non-Member Affiliate Research Reports

A research report distributed by a member that is produced either by an independent third party or non-member affiliate must include the Third-Party Research Disclosures. In this regard, the interpretations of the SRO Rules treat independent third-party research and non-member affiliate research the same, with one exception. A member that makes a non-member affiliate's research report available to its customers upon request or through its website or a website maintained by the member must include the Third-Party Research Disclosures. However, these disclosures do not apply to independent third-party research that is similarly made available to customers upon request or through a member-maintained website.

Subject Company Review of Research

The SRO Rules require legal or compliance personnel (the "Gatekeepers") to intermediate certain communications between a member's Research Department and companies that are the subject of a research report. Specifically, the SRO Rules[15] provide:

- That a member **may not submit a research report to the subject company prior to publication**, except for the **review of sections of a draft** of the research report solely to verify facts. Members may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.
- Prior to **submitting any sections of the research report to the subject company**, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.
- If after submission to the subject company, the Research Department intends to change the proposed rating or price target, **the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change.** The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

The SRO Rules prohibit the submission of a research report, in its entirety, to the subject company prior to its publication, even if the research summary, research rating or price target has been redacted from the report. Providing a report with such information redacted could still enable a subject company to discern the tenor of the report and possibly the company's rating or even price target. The rules only permit submission of sections of a report to verify facts in that section. Submission of facts interspersed with opinions, estimates, conclusions and other non-factually based information by the research analyst violates the SRO Rules. Members should consider submitting to the subject company a separate document containing a summary of facts for which the member seeks verification.

The SROs also wish to clarify the role of the Gatekeepers for purposes of these Rules. Gatekeepers may not merely rubberstamp changes in research reports after sections of the report have been submitted to the subject company. Gatekeepers must review the report and changes thereto, and document the basis for approval. In instances where a change in a rating or price target is to be made, the Gatekeepers must review the written justification provided by

the research department, compare it with any comments received from the subject company regarding sections of the draft that had been submitted for factual verification, and conduct such follow-up inquiry as is necessary to establish a reasonable and causal basis for the change.

Restrictions on Publishing Research

Quiet Periods and Blackout Periods

The SRO Rules impose "quiet periods" during which a member may not publish a research report or make a public appearance regarding a subject company for which the member acted as manager or co-manager of a public offering of securities. The SRO Rules impose on managers and co-managers a 40 calendar-day quiet period following an initial public offering ("IPO"), and a 10 calendar-day quiet period (subject to certain exceptions) following a secondary offering.[16] The SRO Rules also impose a 25 calendar-day quiet period on members that have agreed to participate as an underwriter or dealer (other than as a manager or co-manager) of an issuer's IPO.[17]

The SRO Rules also prohibit a member that has acted as manager or co-manager of a securities offering from publishing a research report or making a public appearance concerning a subject company 15 days prior to or after the expiration, waiver or termination of a "lock-up" or similar agreement that restricts the sale of securities after the completion of a securities offering.[18] Finally, the SRO Rules impose a "blackout period" that prohibits a research analyst from purchasing or selling the securities of a company that the analyst follows for a period beginning 30 days before and ending 5 days after the publication of a research report on the subject company or a change in a rating or price target of the company's securities.[19]

Exceptions to the Quiet Periods and Blackout Periods

The SRO Rules allow a member to publish a research report or make a public appearance during the restricted periods concerning the effects of significant news or a significant event that occurs during those periods, provided that the member's legal and compliance department authorizes publication of the report before it is issued or the public appearance before it is made.[20] Members have asked for additional guidance regarding this exception.

The significant news or event exception is intended to allow for coverage in research reports and public appearances of news or events that have a material impact on, or cause a material change to, a company's operations, earnings or financial condition, and that generally would

trigger the filing requirements of SEC Form 8-K. Examples might include the rejection of a patent or drug application; a labor strike; resignation of a chief executive officer or chief financial officer; or a publicly-announced investigation into company activities by a regulator. Members have asked whether a subject company's announcement that it exceeded, met or fell short of expected earnings would constitute significant news permitting an exception to the quiet and blackout periods. As a general matter, the SROs would not regard an announcement about earnings to fall within the exception because an earnings announcement itself generally is not a causal event or news item that materially affects a company's operations, earnings or financial condition. There may be cases, however, where significant news or a significant event has caused the company to exceed or fall short of expected earnings that may permit an exception and allow a member to issue a research report within the quiet or blackout period to the extent that it discusses the news item that affected earnings.

Additionally, members have inquired whether the SRO Rules are intended to limit the content of a research report that is issued during a quiet or blackout period due to a significant event or news item to the effects of the event or news, or whether such a report may discuss any other issues related to the subject company. A research report issued pursuant to this exception must be limited to discussing the effects of the news or event that triggered the exception. However, the report may contain or update a price target, rating or recommendation concerning the subject company's securities.

Members also have inquired whether the private placement of a subject company's equity would be a significant event that would allow an exception from the SRO Rules' quiet period provisions. In general, the SROs would not regard the issuance of such securities as a significant event allowing a member to publish research during a quiet period. The private placement of securities is within the issuer's control, and thus not the sort of unforeseen news or event that the SRO Rules contemplated in allowing an exception to the quiet periods.

Application of Quiet Periods to Unregistered Offerings

Members further have asked whether the rules imposing quiet periods following secondary offerings and before and after waivers of lock-up agreements apply to non-registered securities offerings. In general, the quiet period following a secondary offering and before and after the waiver of a lock-up agreement applies only to offerings of securities that must be registered for offer or sale in the United States. Thus, quiet periods would not apply to private placements of Rule 144A securities and Regulation S offerings.

Lock-up Agreements and Waivers

Finally, members have inquired as to what date a lock-up agreement is considered waived for purposes of applying the 15-day quiet period before and after the waiver of a lock-up agreement. The 15-day quiet period is triggered based on the first date a shareholder that is subject to a lock-up agreement may sell his or her shares pursuant to the waiver. It is *not* triggered based on the date when an underwriter or other party notifies shareholders that a waiver has been granted. It is also not triggered based on the date when an underwriter or other party registers a securities offering under the federal securities laws.

Since SRO rules do not require lock-up agreements, and since parties to such agreements often are outside the jurisdiction of the NASD or NYSE, the SROs typically cannot determine whether a specific act or contractual provision in a lock-up agreement constitutes a waiver for the purposes of the SRO quiet periods. However, the SROs remind members that the purpose of the quiet period is to prevent members from publishing favorable research that is intended to drive up the price of an issuer's stock for the benefit of certain shareholders who will no longer be subject to a lock-up agreement. Accordingly, the SROs will closely examine research that is issued or otherwise distributed around the time that an underwriting client of the member sells, or first becomes eligible to sell, a significant volume of the subject company's shares.

Personal Trading Restrictions

Members have raised a number of issues with regard to the application of the personal trading restrictions under the SRO Rules.[21]

Trading Against Recommendations

The SRO Rules generally prohibit a research analyst account[22] from purchasing or selling any security or option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.[23] Members have inquired as to whether this restriction applies only to recommendations regarding securities of the subject companies covered by the research analyst making the trade, or whether this restriction applies to the recommendations regarding all subject companies covered by the member. This restriction only applies to trades in securities of subject companies covered by the particular research analyst.

Dividend Reinvestment Programs

Members have inquired whether the SROs regard purchases of securities through a dividend reinvestment plan ("DRIP") to be subject to the "blackout periods" on personal trading. The SRO Rules generally prohibit a research analyst account from purchasing or selling any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company or a rating or price target of the company's securities.

DRIPs typically are plans that allow a participant to reinvest dividends paid on securities held by the participant in the same class of securities of the issuer. Most DRIPs have two components. First, they automatically reinvest cash dividends in the purchase of additional shares of the same securities held by the participant. Second, they permit periodic discretionary cash investments in the same securities. The SROs would not regard automatic reinvestments of dividends in securities of a subject company as covered by the personal trading restrictions' blackout periods. The SROs would reach the same conclusion with respect to automatic reinvestments of dividends in investment funds that are subject to the personal trading restrictions.[24] However, any discretionary cash investments in a subject company's securities, or securities of an investment fund that is subject to the personal trading restrictions, that are made through a DRIP would be subject to the blackout periods.

Short Sales

Where a research analyst has a "sell" (or similar) rating on a subject company's securities, establishes a short position with regard to the securities and later covers the short position, the SROs would regard the covering of the short position as trading contrary to his or her recommendation, since as part of that transaction the analyst would have to buy the securities. Moreover, an analyst may not establish a short position on a rated security during an applicable blackout period.

Trades During "Neutral" Ratings

Some members have inquired whether a research analyst may buy or sell a subject company's securities if the analyst has assigned a "neutral" or "market perform" (or similar) rating to such securities. The SROs regard these (or similar) ratings as the same as a "hold" rating. Accordingly, a research analyst may neither buy nor sell a subject company's securities to which he or she has assigned a hold (or similar) rating.

Changes in Earnings Estimates

Several members have inquired whether the personal trading blackout period would be triggered if a research analyst changed his or her earnings estimates for a subject company, assuming that the change did not coincide with the issuance of a new research report and did not result in a change in the rating or price target for the subject company's securities. These circumstances would not trigger the personal trading blackout period.

Trading Restrictions on Supervisors of Research Analysts

The SRO Rules now require a member's legal or compliance personnel to pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee.[25] The SRO Rules also have been amended to make clear that the research analyst personal trading restrictions do not apply to "blind trusts" that are controlled by a person other than the research analyst or a member of the analyst's household where neither the analyst nor a household member knows of the account's investments or transactions.[26] Likewise, the requirements for legal or compliance personnel to pre-approve securities transactions of supervisory personnel do not apply to transactions within "blind trusts" of which supervisory personnel are the beneficiaries.

The SROs have been asked how the requirement that legal or compliance personnel pre-approve the trades of supervisory personnel applies to an account that is managed by a third party (either an outside manager or an in-house account). As a general matter, the SROs would consider a member to have met its obligations to pre-approve a supervisor's transactions in a managed account where the supervisor has no discretion or control if the member has policies and procedures to monitor the managed account's trades. If such policies and procedures are in place, the SROs would not require legal or compliance personnel to pre-approve each transaction made within the managed account.

Disclosure Issues

In reviewing members' research reports, the SROs have found that some reports fail adequately to make the disclosures required by the SRO Rules.[27] This section of the joint memorandum is intended to highlight some of the more common problems that the SROs have found.

Prominence of Disclosures

The first page of a research report must include the disclosures required under the SRO Rules or must refer the reader to the pages on which such disclosures are found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent.[28]

References on the front page of a research report to where disclosures are located must be separated from the report's body text, and in larger font size than the body text. For example, many firms are enclosing the references to disclosure location in a box on the first page of the report that enhances the prominence of the disclosure reference.

A notation on the first page that refers readers to the "end of the report" rather than the specific page is not sufficient. The SRO Rules require a reference to the specific page number or to the last page of the report or to a specific section of the report, such as the appendix. In addition, members may use hyperlinks to direct the reader to the required disclosures only in electronically transmitted reports and compendium reports[29] or as an additional point of reference in written reports.

Regardless of where the required disclosures are placed, they should be labeled using a heading such as "Important Disclosures" or "Required Disclosures" so as to be clearly identifiable. Similarly, the font size of the type must be large enough so that the disclosures are clearly legible and distinguishable from body text, other disclosures or disclaimers

The "Important (or Required) Disclosures" section must include all applicable required textual disclosures (*e.g.*, market making, ownership positions, compensation, etc.), the price chart, the ratings description, ratings distribution (by number of investment banking clients), the valuation methodology, price target and related risk factors description, in a clear and logical order. As an example, related disclosures such as ratings systems and ratings distributions should be in close proximity.

Disclosure of Officer or Director Positions

A member is required to disclose in research reports if the research analyst or member of his or her household is an officer, director, or advisory board member of the recommended issuer.[30] This disclosure, if applicable, must include the position held by the research analyst or household member.

Conditional or Indefinite Language

Members are required to disclose in research reports if they own 1% or more of a subject company's equity securities and if they make a market in a subject company's securities at the time the research report is issued. Members also must disclose if the member or its affiliates: (a) managed or co-managed a public offering of equity securities for the subject company in the past twelve months; (b) received compensation for investment banking services from the subject company in the past twelve months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.[31]

Members may not use conditional or indefinite language in required disclosures, such as "may have a position" or "may make a market" in any of the subject company's securities, or that the reader "should assume" that the firm or its affiliates engaged in investment banking business with a subject company. The required disclosures with respect to past receipt and expectation of investment banking services related compensation must be made separately, if applicable. For example, a member may not disclose that it "received compensation for investment banking services in the past twelve months or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months." Such disclosure lacks the specificity required by the SRO Rules.

Use of Disclaimers

Research reports may not include general or specific disclaimers that contradict or are inconsistent with disclosures required by SRO Rules. For example, it is inconsistent for a research report to disclose that the member makes a market in the specific securities that are the subject of the research report and separately to disclose generally that the member may make a market in some or all of the securities mentioned in the report.

The presence of disclosures and disclaimers not required by the SRO Rules in close proximity to the disclosures required by the SRO Rules may cause confusion and detract from their readability. Therefore, any disclosures or disclaimers not required by the SRO Rules must be clearly separated and appropriately labeled. If the required disclosures are placed near non-required disclaimers and disclosures, each set of disclosures and disclaimers must be clearly labeled, *e.g.*, "Important (or Required) Disclosures," "Other Disclosures," and "Disclaimers." The disclosures required by the SRO Rules also must be separate from disclosures required by foreign jurisdictions.

Use of Stock Symbols

Members may not use stock symbols in the "Important Disclosures" section of the report unless the reader is specifically directed to where in the report the subject companies represented by the symbols are identified by proper names.

Disclosure of Ratings Distributions and Price Charts

The SRO Rules allow members to use any ratings system they deem appropriate in their research reports, so long as they are accompanied by a clear definition of the meaning of each rating used in the system.[32] The SRO Rules require a member to disclose in each research report the percentages of all securities rated by the member to which the member has assigned a "buy", "hold/neutral" or "sell" rating.[33] The SRO Rules also require each report to disclose the percentage of subject companies within each of these three rating categories for whom the member has provided investment banking services within the previous 12 months.[34]

If a member utilizes a ratings system that employs terms different than "buy," "hold/neutral" and "sell," the member must determine, based on its own ratings system, into which of these three categories its ratings fall. The research report must use the terms "buy," "hold" and "sell" in making these ratings distributions disclosures. However, if a member uses a ratings system that employs terms other than "buy," "hold/neutral" and "sell," the member may combine its own ratings terms with those categories required by the SRO Rules to make the ratings distribution disclosures (*e.g.*, "buy/overweight," "hold/equalweight" and "sell/underweight").

The SRO Rules specify that information regarding ratings distributions must be current as of the most recent calendar quarter end (or the second most recent calendar quarter end if the publication date is less than 15 days after the most recent calendar quarter).[35] The SRO Rules do not specify, however, what time period the ratings distribution must cover. Some members have noted that they do not regularly issue ratings and thus were uncertain as to how far back the ratings distribution universe must extend. In general, the ratings distribution should include all current ratings of the member. However, if the member does not issue new ratings on a relatively frequent basis, the SROs will consider a member to have complied with the ratings distribution disclosure requirements if the distribution includes ratings that the member has issued within the past 12 months.

If a research report does not contain any rating – express or implied – of the subject company's stock, the report is not required to include the ratings distribution information required by the SRO Rules. In addition, if the report does not include either a rating or a price target for the subject company's stock, the report is not required to include a price chart.[36]

1 *See NASD Notice to Members 02-39 (*July 2002) and NYSE Information Memo No. 02-26 (June 26, 2002), both of which included a Joint Memorandum.

2 *See* SEC Release No. 34-45908 (May 10, 2000), 67 Fed. Reg. 34968 (May 16, 2002).

3 For purposes of the NYSE Rules, the term "member" as used in this Joint Memorandum refers to both members and member organizations of the NYSE.

4 *See* SEC Release No. 34-48252 (July 29, 2003), 68 Fed. Reg. 45875 (Aug. 4, 2003).

5 NASD Rules 1050 and 1120 and NYSE Rules 344 and 345A.

6 NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).

7 *See* SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

8 NASD Rule 2711(a)(4) and NYSE Rule 472.50.

9 *See* SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

10 NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)c.

11 NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(i)a.

12 NASD Rule 2711(h)(8) and NYSE Rule 472(k)(1)(i)b.

13 NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(iii)d.

14 A "globally-branded" research report refers to the use of a single marketing identity that encompasses the member and its affiliates.

15 NASD Rule 2711(c) and NYSE Rule 472(b)(4).

16 NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) and (2).

17 NASD Rule 2711(f)(2) and NYSE Rule 472(f)(3).

18 NASD Rule 2711(f)(4) and NYSE Rule 472(f)(4).

19 NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).

20 NASD Rules 2711(f)(1)(B)(i), 2711(f)(4) and 2711(g)(2)(B), and NYSE Rules 472(e)(4)(ii) and 472(f)(5).

21 NASD Rule 2711(g) and NYSE Rule 472(e).

22 A "research analyst account" includes any account in which a research analyst or member of the research analyst's household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. NASD Rule 2711(a)(6). *See also* NYSE Rule 472.40.

23 NASD Rule 2711(g)(3) and NYSE Rule 472(e)(3).

24 The SRO Rules exclude from the personal trading restrictions investments in registered diversified investment companies and other investment funds that meet certain criteria. *See* NASD Rule 2711(g)(5) and NYSE Rule 472(e)(4)(v) and (vi).

25 NASD Rule 2711(g)(6) and NYSE Rule 472(e)(5).

26 NASD Rule 2711(a)(6) and NYSE Rule 472.40.

27 *See* NASD Rule 2711(h) and NYSE Rule 472(k)(1).

28 NASD Rule 2711(h)(10) and NYSE Rule 472(k)(1).

29 A "compendium report" is a research report that covers six or more subject companies. *See* NASD Rule 2711(h)(11) and NYSE Rule 472(k)(1).

30 NASD Rule 2711(h)(3) and NYSE Rule 472(k)(1)(iii)c.

31 NASD Rules 2711(h)(1)(B), (h)(2)(A)(ii), and (h)(8); NYSE Rules 472(k)(1)(i)a., b., and c.

32 NASD Rule 2711(h)(4) and NYSE Rules 472(k)(1)(i)f.

33 NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(1)(i)g. and 472.70.

34 NASD Rule 2711(h)(5)(B) and NYSE Rule 472(k)(1)(i)g. and 472.70.

35 NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.

36 *See* NASD Rule 2711(h)(6) and NYSE Rule 472(k)(1)(i)h.

ATTACHMENT B

2711. Research Analysts and Research Reports

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1) "Investment banking department" means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(2) "Investment banking services" include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs or similar investments; or serving as placement agent for the issuer.

(3) "Member of a research analyst's household" means any individual whose principal residence is the same as the research analyst's principal residence.

(4) "Public appearance" means any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity , or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

(5) "Research analyst" means the associated person who is primarily responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of "research analyst."

(6) "Research analyst account" means any account in which a research analyst of member of the research analyst's household has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940.This term does not include a "blind trust" account that is controlled by a person other than the research analyst or member of the research analyst's household where neither the research analyst nor a member of the research analyst's household knows of the account's investments or investment transactions.

(7) "Research department" means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(8) "Research Report" means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

(9) "Subject company" means the company whose equity securities are the subject of a research report or a public appearance.

(b) Restrictions on Relationships with Research Department

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department or any other employee of the member who is not directly responsible for investment research ("non-research personnel"), other than legal or compliance personnel, may review or approve a research report of the member before its publication.

(3) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or identify any potential conflict of interest, provided that:

(A) any written communication between non-research personnel and research department personnel concerning the content of a research report must be made either through authorized legal or compliance personnel of the member or in a transmission copied to such personnel; and

(B) any oral communication between non-research personnel and research department personnel concerning the content of a research report must be documented and made either through authorized legal or compliance personnel acting as intermediary or in a conversation conducted in the presence of such personnel.

(c) Restrictions on Communications with the Subject Company

(1) Except as provided in paragraphs (c)(2) and (c)(3), a member may not submit a research report to the subject company before its publication.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in those sections, provided that:

(A) the sections of the research report submitted to the subject company do not contain the research summary, the research rating or the price target;

(B) a complete draft of the research report is provided to legal or compliance personnel before sections of the report are submitted to the subject company; and

(C) if after submitting the sections of the research report to the subject company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member must retain copies of any draft and the final version of such a research report for three years following its publication.

(3) The member may notify a subject company that the member intends to change its rating of the subject company's securities, provided that the notification occurs on the business day before the member announces the rating change, after the close of trading in the principal market of the subject company's securities.

(4) No research analyst may participate in efforts to solicit investment banking business. Accordingly, no research analyst may, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.

(d) Restrictions on Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) The compensation of a research analyst who is primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing such a research analyst's compensation, if applicable:

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in reviewing and approving such a research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each such research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each such research analyst's compensation and documented the basis upon which this compensation was established.

(e) Prohibition of Promise of Favorable Research

No member may directly or indirectly offer favorable research, a specific rating or a specific price target, or threaten to change research, a rating or a price target, to a company as consideration or inducement for the receipt of business or compensation.

(f) Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage

(1) No member may publish or otherwise distribute a research report and no research analyst may make a public appearance regarding a subject company for which the member acted as manager or co-manager of:

(A) an initial public offering, for 40 calendar days following the date of the offering; or

(B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

(i) paragraphs (f)(1)(A) and (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report , or prevent a research analyst from making a public appearance, concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that legal or compliance personnel authorize publication of that research report before it is issued or authorize the public appearance before it is made; and

(ii) paragraph (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1)), and will not prevent a research analyst from making a public appearance concerning such a company.

(2) No member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report or make a public appearance regarding that issuer for 25 calendar days after the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term "date of the offering" refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or

termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company with "actively traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), or to a public appearance concerning such a subject company.

(5) If a member intends to terminate its research coverage of a subject company, notice of this termination must be made. The member must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is impracticable for the member to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the member or if the member terminates coverage of the industry or sector). If it is impracticable to produce a final recommendation or rating, the final research report must disclose the member's rationale for the decision to terminate coverage.

(g) Restrictions on Personal Trading by Research Analysts

(1) No research analyst account may purchase or receive any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows.

(2) No research analyst account may purchase or sell any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending five calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company's securities; provided that:

(A) a member may permit a research analyst account to sell securities held by the account that are issued by a company that the research analyst follows, within 30 calendar days after the research analyst began following the company for the member;

(B) a member may permit a research analyst account to purchase or sell any security issued by a subject company within 30 calendar days before the publication of a research report or change in the rating or price target of the subject company's securities due to significant news or a significant event concerning the subject company, provided that legal or compliance personnel pre-approve the research report and any change in the rating or price target.

(3) No research analyst account may purchase or sell any security or any option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.

(4) Legal or compliance personnel may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) legal or compliance personnel authorize the transaction before it is entered;

(B) each exception is granted in compliance with policies and procedures adopted by the member that are reasonably designed to ensure that these transactions do not create a conflict of interest between the professional responsibilities of the research analyst and the personal trading activities of a research analyst account; and

(C) the member maintains written records concerning each transaction and the justification for permitting the transaction for three years following the date on which the transaction is approved.

(5) The prohibitions in paragraphs (g)(1) through (g)(3) do not apply to a purchase or sale of the securities of:

(A) any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; or

(B) any other investment fund over which neither the research analyst nor a member of the research analyst's household has any investment discretion or control, provided that:

(i) the research analyst accounts collectively own interests representing no more than 1% of the assets of the fund;

(ii) the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies that the research analyst follows; and

(iii) if the investment fund distributes securities in kind to the research analyst or household member before the issuer's initial public offering, the research analyst or household member must either divest those securities immediately or the research analyst must refrain from participating in the preparation of research reports concerning that issuer.

(6) Legal or compliance personnel of the member shall pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee. This pre-approval requirement shall apply to all persons, such as the director of research, supervisory analyst, or member of a committee, who have direct influence or control with respect to the preparation of the substance of research reports or establishing or changing a rating or price target of a subject company's equity securities.

(h) Disclosure Requirements

(1) Ownership and Material Conflicts of Interest

A member must disclose in research reports and a research analyst must disclose in public appearances:

(A) if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position);

(B) if, as of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934; and

(C) any other actual, material conflict of interest of the research analyst of which the research analyst or member knows or has reason to know at the time of publication of the research report, or at the time of the public appearance.

(2) Receipt of Compensation

(A) A member must disclose in research reports:

(i) if the research analyst received compensation:

a. based upon (among other factors) the member's investment banking revenues; or

b. from the subject company in the past 12 months.

(ii) the member or affiliate:

a. managed or co-managed a public offering of securities for the subject company in the past 12 months;

b. received compensation for investment banking services from the subject company in the past 12 months; or

c. expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(iii) if (1) as of the end of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) or (2) to the extent the research analyst or an employee of the member with the ability to influence the substance of the research knows:

a. the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months; or

b. the subject company currently is, or during the 12-month period preceding the date of distribution of the research report was, a client of the member. In such cases, the member also must disclose the types of services provided to the subject company. For purposes of this Rule 2711(h)(2), the types of services provided to the subject company shall be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(iv) if, to the extent the research analyst or an employee of the member with the ability to influence the substance of the research report knows an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

(v) if, to the extent the research analyst or member has reason to know, an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

a. This requirement will be deemed satisfied if such compensation is disclosed in research reports within 30 days after completion of the last calendar quarter, provided that the member has taken steps reasonably designed to identify any such compensation during that calendar quarter. This requirement shall not apply to any subject company as to which the member initiated coverage since the beginning of the current calendar quarter.

b. The research analyst and the member will be presumed not to have reason to know whether an affiliate received any compensation for products or services other than investment banking services from the subject company in the past 12 months if the member maintains and enforces policies and procedures reasonably designed to prevent the research analysts and employees of the member with the ability to

influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.

(vi) For the purposes of this Rule 2711(h)(2), an employee of the member with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.

(B) A research analyst must disclose in public appearances:

(i) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the past 12 months;

(ii) if the research analyst received any compensation from the subject company in the past 12 months; or

(iii) if, to the extent the research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of distribution of the research report, was, a client of the member. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst.

(C) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(A)(ii)(b) and (c), (h)(2)(A)(iii)(b), or (h)(2)(B)(i) and (iii) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(3) Position as Officer or Director

A member must disclose in research reports and a research analyst must disclose in public appearances if the research analyst or a member of the research analyst's household serves as an officer, director or advisory board member of the subject company.

(4) Meaning of Ratings

A member must define in its research reports the meaning of each rating used by the member in its rating system. The definition of each rating must be consistent with its plain meaning.

(5) Distribution of Ratings

(A) Regardless of the rating system that a member employs, a member must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy," "hold/neutral," or "sell" rating.

(B) In each research report, the member must disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months.

(C) The information that is disclosed under paragraphs (h)(5)(A) and (h)(5)(B) must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

(6) Price Chart

A member must present in any research report concerning an equity security on which the member has assigned any rating for at least one year, a line graph of the security's daily closing prices for the period that the member has assigned any rating or for a three-year period, whichever is shorter. The line graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating and price target assigned or changed on those dates; and

(C) be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

(7) Price Targets

A member must disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by a disclosure concerning the risks that may impede achievement of the price target.

(8) Market Making

A member must disclose in research reports if it was making a market in the subject company's securities at the time that the research report was published.

(9) Disclosure Required by Other Provisions

In addition to the disclosure required by this rule, members and research analysts must provide disclosure in research reports and public appearances that is required by applicable law or regulation, including NASD Rule 2210 and the antifraud provisions of the federal securities laws.

(10) Prominence of Disclosure

The disclosures required by this paragraph (h) must be presented on the front page of research reports or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

(11) Disclosures in Research Reports Covering Six or More Companies

When a member distributes a research report covering six or more subject companies, for purposes of the disclosures required in paragraph (h), such research report may direct the reader in a clear manner as to where they may obtain applicable current disclosures in written or electronic format.

(12) Records of Public Appearances

Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (h) of this Rule. Such records must be maintained for three years from the date of the public appearance.

(i) Supervisory Procedures

Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule (including the attestation requirements of Rule 2711(d)(2)), and a senior officer of such a member must attest annually to NASD by April 1 of each year that it has adopted and implemented those procedures.

(j) Prohibition of Retaliation Against Research Analysts

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such an unfavorable public appearance.

(k) Exceptions for Small Firms

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated $5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal & Compliance

Registered Representatives

Senior Management

KEY TOPICS

Minor Rule Violation Plan (MRVP)

Sanctions

GUIDANCE

NASD Releases Minor Rule Violation Plan (MRVP) Guidelines

Executive Summary

In 1993, NASD established the Minor Rule Violation Plan (MRVP or the Plan) to provide NASD with a process for imposing meaningful sanctions for rule violations that may not warrant the initiation of a full disciplinary proceeding. The MRVP provides an efficient alternative means by which to deter violations of rules while maintaining procedural rights for disciplined persons.

NASD is publishing this *Notice* to provide interested parties with guidance concerning the application of NASD's MRVP to each of the rules under the Plan, as specified in NASD IM-9216. This guidance includes identifying the factors to be considered in determining whether to dispose of an action under the MRVP and discussing the appropriate levels for fines. These factors are intended to provide guidance only and, depending on the facts and circumstances of each matter, it may be appropriate to deviate from the suggested disposition and fines.

The NASD MRVP Guidelines are included in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Carla Carloni, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight (OGC RPO), at (202) 728-8019; or Shirley Weiss, Associate General Counsel, OGC RPO, at (202) 728-8844.

Background and Discussion

In 1984, the SEC adopted amendments to Rule 19d-1(c) under the Securities Exchange Act of 1934 (Exchange Act) to allow self-regulatory organizations to adopt, with SEC approval, plans for the disposition of minor violations of rules.[1] In 1993, pursuant to SEC Rule 19d-1(c), NASD established an MRVP, as set forth in NASD Rule 9216(b).[2] In 2001, the SEC approved significant amendments to NASD's MRVP.[3]

Rule 9216(b) authorizes NASD to impose a fine of $2,500 or less on any member or associated person of a member for a violation of any of the rules specified in IM-9216. NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine. Once NASD has issued an MRVP letter against an individual or member firm, NASD may, at its discretion, issue progressively higher fines for all subsequent minor violations of rules within the next 24-month period or initiate more formal disciplinary proceedings.

The purpose of the MRVP is to provide for the imposition of a meaningful sanction for a minor or technical violation of a rule when the initiation of a full disciplinary proceeding would be more costly and time-consuming than may be warranted. Inclusion of a rule in NASD's MRVP does not mean it is an unimportant rule; rather, inclusion of a rule in the MRVP means that the minor or technical violation of the rule may be appropriate for disposition under the MRVP. NASD retains the discretion to bring full disciplinary proceedings for the violation of any rule listed in the MRVP.

Unlike immediate reporting of full disciplinary adjudications by NASD to the SEC, reporting of minor rule violations to the SEC is done on a quarterly basis. Furthermore, members and associated persons currently do not need to report an MRV letter on Form BD or Forms U4 and U5.[4]

NASD MRVP Guidelines

The MRVP Guidelines (Guidelines) provide NASD staff with a framework from which to decide whether a matter is appropriate for disposition under the Plan and, if so, guidance regarding the level of fine that NASD should impose. The Guidelines allow NASD to examine the facts and circumstances of each violation to make such determinations. Under the Guidelines, NASD staff will not assess MRVP fines through a rigid tier structure (*e.g.*, $1,000 for a first-time violation, $2,000 for a second-time violation, and $2,500 for a third-time violation). Rather, the Guidelines enable NASD staff to take a facts and circumstances approach to each violation and allow NASD staff to tailor the fine to the specific violation at issue.

The Guidelines contain a General Principles Section for use with all violations eligible for MRVP treatment. This section lists factors for NASD staff to use to determine whether to address a matter through informal means (*e.g.*, a Letter of Caution), the MRVP, or full disciplinary proceedings. The General Principles Section states that an important objective of the MRVP is to deter future misconduct by imposing progressively escalating fines for repeat violations and lists factors to be considered for all MRVP eligible dispositions.

The Guidelines also include a Violation-Specific section that provides NASD staff with additional guidance for each violation eligible for disposition under the Plan. The Violation-Specific section includes individualized considerations for NASD staff to take into account when determining whether a matter should be addressed informally, through the MRVP, or through full disciplinary proceedings. For instance, for a violation of Rule 4619(d)—failure to timely file notifications pursuant to SEC Regulation M, the Violation-Specific Guideline states that an MRVP letter and fine are appropriate only when a notification is filed late and that a complete failure to file the required notification should result in full disciplinary proceedings. The Guideline also states that a Letter of Caution may be appropriate for a minor, first-time violation.

The Violation-Specific section also includes specific factors for staff to use in determining the level of fine to impose. For instance, for a violation of SEC Rule 11Ac1-4—failure to properly display limit orders, the Violation-Specific Guideline lists five factors for NASD staff to take into account: (1) whether violations are batched; (2) whether violations are the result of only one individual or the result of faulty systems or procedures; (3) whether the firm has taken remedial measures to correct the violations; (4) prior minor rule violations within the past 24 months; and (5) collateral effects that the failure has on customers.

As with the General Principles section of the Guidelines, all listed factors and considerations are intended to provide guidance only and, depending on the facts and circumstances of each matter, it may be appropriate for NASD staff to deviate from the suggested disposition and fines.

Endnotes

1 *See* Exchange Act Rel. No. 21013 (June 1, 1984), 49 Fed. Reg. 23833 (June 8, 1984).

2 *See* Exchange Act Rel. No. 32076 (Mar. 31, 1993), 58 Fed. Reg. 18291 (Apr. 8, 1993); s*ee also Notice to Members 93-42* (July 1993).

3 *See* Exchange Act Rel. No. 44512 (July 3, 2001), 68 Fed. Reg. 36812 (July 13, 2001).

4 Firms and individuals should consult with their own legal counsel as needed to determine whether any particular matter must be reported on Form BD or Forms U4 and U5.

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ATTACHMENT A

General Guidelines for Violations of Rules Contained in NASD's Minor Rule Violation Plan

Minor Rule Violation Plan

NASD Rule 9216(b) establishes NASD's Minor Rule Violation Plan (MRVP or the Plan). Under the MRVP, NASD may impose a fine of up to $2,500 on any member or associated person of a member for a violation of any of the rules specified in NASD IM-9216 (Violations Appropriate for Disposition under the Plan).

Minor Rule Violation letters provide NASD with an effective and efficient means of addressing violations that warrant more than a Letter of Caution, but do not necessarily rise to the level meriting a full disciplinary proceeding. Consistent with NASD's Sanction Guidelines, MRV letters also represent an additional tool for implementing the concept of progressive discipline. Unlike immediate reporting of full disciplinary adjudications by NASD to the SEC, however, under SEC Rule 19d-1, reporting of minor rule violations to the SEC is done on a quarterly basis. Furthermore, members and associated persons currently do not need to report an MRV letter on Form BD or Forms U4 and U5.[1]

These Guidelines contain both a General Principles section applicable to all violations under the MRVP as well as a Violation-Specific section that provides additional guidance concerning the application of the MRVP to each of the rules under the Plan, as specified in NASD IM-9216. The Violation-Specific section includes factors to be considered in determining whether to dispose of an action under the MRVP and the appropriate levels for fines. These factors are intended to provide guidance only and, depending on the facts and circumstances of each matter, it may be appropriate to deviate from the suggested disposition and fines.

1 Firms and individuals should consult with their own legal counsel as needed to determine whether any particular matter must be reported on Form BD or Forms U4 and U5.

General Principles

In addition to the specific rule-by-rule guidance, there are a number of general principles applicable to the MRVP:

1. **For a first-time violation of a rule, NASD staff may determine that a Letter of Caution, rather than a formal action under the MRVP, is sufficient.** The inclusion of a particular rule violation in the MRVP does not require that the staff dispose of a matter through the MRVP. NASD staff, for instance, may determine in a particular case that a Letter of Caution is more appropriate for a first-time violation. Among the factors to consider in determining whether to issue a Letter of Caution or to dispose of a matter as a Minor Rule Violation are:
   - a whether the particular violation is part of a larger scheme or series of violations;
   - b whether other violations of any kind were revealed in the same or concurrent examinations or investigations by NASD; and
   - c the firm or associated person's prior Minor Rule Violations and/or other disciplinary history.

2. **The MRVP adopts a concept of progressive discipline.** An important objective of the MRVP is to deter future misconduct by imposing progressively escalating fines for repeat violations. In the specific guidance for many of the rule violations under the MRVP, there are recommendations for escalating fines based upon specific listed factors, including the number of prior violations. Among the factors to consider in establishing the level of fine for a Minor Rule Violation are:
   - a whether there have been prior Minor Rule Violations involving the conduct at issue;
   - b whether the firm or associated person has had prior Minor Rule Violations that are unrelated to the violation at issue;
   - c the firm or associated person's other disciplinary history;
   - d the number of violations; and
   - e the seriousness of the violation(s).

   In general, the guidance under the MRVP calls for progressively higher fines for all subsequent minor violations of rules within a 24-month period.

3. **NASD staff retains discretion to bring full disciplinary proceedings for any violation of a rule included in the MRVP.** The decision as to whether a particular violation should be resolved as a Minor Rule Violation or through full disciplinary proceedings depends upon the facts and circumstances of each case. Inclusion of a particular rule within the MRVP does not require the resolution of initial or subsequent violations of that rule as Minor Rule Violations. NASD staff retains the discretion to bring full disciplinary proceedings for any violation listed in the MRVP. Among the factors for staff to consider in determining whether to bypass the MRVP and pursue full disciplinary proceedings are:

   a whether a violation is more than a "technical" violation;

   b whether a violation is deliberate;

   c the complexity of the issues;

   d whether there is a history or pattern of repeat violations;

   e whether the violation has a significant impact on investors or impairs the ability of NASD to regulate the market;

   f the number of violations;[2]

   g the firm or associated person's prior Minor Rule Violations and/or other disciplinary history; and

   h the seriousness of the violation(s).

2 An MRV letter may be appropriate for addressing more than one violation in a single action. In cases where two or more rule violations are disposed of as an MRV, the maximum penalty will be $2,500. In such cases, the determination to pursue full disciplinary proceedings should be made on a case-by-case basis.

Violation-Specific Guidance on the Application of NASD's MRVP

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
Rule 2210(b)(1) – Failure to have advertisements and sales literature approved by a principal prior to use	1) Content-related violations generally require full disciplinary proceedings.	1) Number of advertisements and sales literature not approved; 2) Size and scope of the distribution; 3) Evidence of training of representatives; 4) Adequacy of the firm's internal procedures; and 5) Number of prior failures to obtain a principal's approval, including prior MRVs within the past 24 months.
Rule 2210(b)(2) – Failure to maintain separate files of advertisements and sales literature containing required information	1) Content-related violations generally require full disciplinary proceedings; and 2) An MRV should be strictly limited to the violation of failing to maintain the files at issue.	1) Number and type of documents missing; 2) Length of time since firm has maintained a complete set of files; 3) Number of documents only containing partial information; and 4) Prior MRVs within the past 24 months.
Rule 2210(c) and Rule 2220(c) – Failure to file communications with NASD within the required time limits	1) Content-related violations generally require full disciplinary proceedings; 2) A Letter of Caution may be appropriate instead of issuing an MRV letter based on the relative frequency of a member's late filings. (For example, a firm that has only one or two late filings out of 10,000 total filings may not require an MRV. In comparison, a firm that has one or two late filings out of 10 total filings may require an MRV. A firm that consistently files late may require full disciplinary proceedings.); and 3) An MRV is appropriate only when a document is filed late. A complete failure to file required communications should result in full disciplinary proceedings.	1) Number of late filings compared to the firm's total number of filings; 2) Number of days that a filing is late; 3) Whether the firm has adequate procedures; and 4) Whether the firm has a history of filing compliance/non-compliance, including prior MRVs within the past 24 months.
Rule 3360 – Failure to timely file reports of short positions on Form NS-1	1) A complete failure to file the reports generally requires full disciplinary proceedings; 2) For a first late filing in a 12-month period, a Letter of Caution is appropriate; and 3) For a second late filing in a 12-month period, consider an MRV.	1) Number of days that the filing is late; 2) Prior MRVs within the past 24 months; 3) Collateral effects that the late filing has on customers; and 4) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
Rule 3110 – Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with applicable laws, rules, regulations and statements of policy promulgated thereunder, and with NASD Rules	1) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Number of documents affected and the time frame over which the problem occurred; 2) The materiality of the documents that are missing; 3) Prior MRVs within the past 24 months; and 4) Collateral effects that the failure has on NASD's ability to perform its regulatory function.
Rule 8211, Rule 8212, and Rule 8213 – Failure to submit trading data as requested	1) For any review period, if less than 95% of the blue sheet responses are on time: a. if average delay is between one and nine days, issue a Letter of Caution; b. if average delay is between 10 and 15 days, use an MRV. 2) For any review period, if more than 95% of the blue sheets are on time: a. if average delay is less than 17 days, file without action; b. if average delay is between 17 and 29 days, use an MRV.	1) Percentage of submissions received late; 2) Prior MRVs within the past 24 months; and 3) Collateral effects that the failure has on NASD's ability to perform its regulatory function.
Article IV – Failure to timely submit amendments to Form BD	1) Content-related violations generally require full disciplinary proceedings; 2) An MRV or Letter of Caution should be limited to failure to file a Form BD amendment on the required date; and 3) Letter of Caution may be appropriate for a minor, first-time violation.	1) Number of days that the filing is late; 2) The materiality of the reporting event; 3) Complexity of facts and circumstances giving rise to the amendment; 4) Prior MRVs within the past 24 months; 5) Collateral effects that the late filing has on customers; and 6) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
Article V – Failure to timely submit amendments to Form U4	1) A willful misstatement or omission on Form U4 even if it is not material generally requires full disciplinary proceedings; 2) An MRV or Letter of Caution should be limited to failure to file Form U4 amendments in a timely way or non-negligent errors on Form U-4 due to inadvertence, mistake or incorrect advice from an attorney or member firm after full disclosure by the individual; and 3) Letter of Caution may be appropriate for a minor, first-time violation.	1) Number of days that the filing is late; 2) The materiality of the reporting event; 3) Prior MRVs within the past 24 months; 4) Collateral effects that the late filing has on customers; and 5) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.
Rule 1120 – Failure to comply with continuing education requirements (Firm Element)	1) An MRV will be considered only for violations of the rule if: a. The firm has made a good faith effort to comply with the Rule's requirements; b. The firm has provided training to all or substantially all of its registered representatives; c. The firm has no prior formal or informal action in this area; and d. The firm has promptly corrected any deficiencies after being contacted by the staff. 2) Failure of registered persons to take appropriate and reasonable steps to participate in continuing education programs as required by the member may also result in an MRV against registered person.	1) The length of time the firm failed to comply with the rule; 2) The number of registered persons affected; 3) The nature of the firm's business; and 4) Prior MRVs within the past 24 months.
Rule 3010(b)(2)(vii) – Failure to timely file reports pursuant to the Taping Rule	1) Full disciplinary proceedings generally are required for any failure to establish, maintain and enforce special written supervisory procedures for supervising the telemarketing activities of registered personnel; 2) Full disciplinary proceedings generally are required for the complete failure to file a Taping Rule report and for incomplete filings; 3) MRVs should be limited strictly to failure to file a Taping Rule Report on the required date (Rule 3010(b)(2)(vii)); and 4) A Letter of Caution may be appropriate for a minor, first-time failure to file a Taping Rule report on the required date.	1) Number of days that the filing is late; 2) Prior MRVs within the past 24 months; 3) Collateral effects that the late filing has on customers; and 4) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
Rule 3070 – Failure to timely file reports	1) An MRV is appropriate only when a report is filed late. A complete failure to file required reports should result in full disciplinary proceedings; 2) The nature of information required to be reported may require full disciplinary proceedings; 3) The reason for the failure to timely file reports may require full disciplinary proceedings if the failure is intentional or reckless; and 4) A Letter of Caution may be appropriate for a minor, first-time violation.	1) Number of days that the filing is late; 2) Nature of information required to be reported; 3) Prior MRVs within the past 24 months; 4) Collateral effects that the late filing has on customers; and 5) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.
Rule 4619(d) – Failure to timely file notifications pursuant to SEC Regulation M	1) An MRV is appropriate only when a notification is filed late. A complete failure to file required notification should result in full disciplinary proceedings; and 2) Letter of Caution may be appropriate for a minor, first-time violation.	1) Whether the filing is complete; 2) Length of time that the filing is late; 3) Prior MRVs within the past 24 months; 4) Collateral effects that the late filing has on customers; and 5) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.
Rules 4632, 4642, 4652, 6240, 6420, 6550, 6620, and 6720 – Transaction reporting in equity, convertible debt, and high-yield securities	1) Violations that prevent NASD from performing its regulatory function may not be appropriate for disposition under the MRVP.	1) Total number of reports that are not submitted, submitted late, or not submitted in proper form; 2) The timeframe over which the violations occur; 3) Whether the violation affects data dissemination to the public; 4) Whether violations are batched; 5) Whether the violations are the result of the actions of one individual or the result of faulty systems or procedures; 6) Whether the firm has taken remedial measures to correct the violations; 7) Prior MRVs within the past 24 months; and 8) Collateral effects that the failure has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
Rules 6130 and 6170 – Transaction reporting to ACT	1) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Total number of reports that are not submitted, submitted late, or not submitted in proper form; 2) The timeframe over which the violations occur; 3) Whether violations are batched; 4) Whether the violations are the result of the actions of one individual or the result of faulty systems or procedures; 5) Whether the firm has taken remedial measures to correct the violations; 6) Prior MRVs within the past 24 months; 7) Collateral effects that the failure has on customers; and 8) Collateral effects that the failure has on NASD's ability to perform its regulatory function.
Rules 6954 and 6955 – Failure to submit data in accordance with OATS	1) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Total number of reports that are not submitted or submitted late; 2) The timeframe over which the violations occur; 3) Whether violations are batched; 4) Whether the violations are the result of the actions of one individual or the result of faulty systems or procedures; 5) Whether the firm has taken remedial measures to correct the violations; 6) Prior MRVs within the past 24 months; 7) Collateral effects that the failure has on customers; and 8) Collateral effects that the failure has on NASD's ability to perform its regulatory function.
Rule 11870 – Failure to abide by customer account transfer contracts	1) A Letter of Caution may be appropriate for first-time violations.	1) Number of violations; 2) Adequacy of the firm's internal procedures; 3) Nature of the violation of the transfer contract; 4) Prior MRVs within the past 24 months; and 5) Collateral effects that the failure has on customers.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
SEC Rule 11Ac1-4 – Failure to properly display limit orders	1) A Letter of Caution may be appropriate if the number of violations in a quarter is small and the percentage of orders not properly displayed is small; and 2) If the number of violations or the percentage of orders not handled properly is high, an MRV or a full disciplinary proceeding may be required.	1) Whether violations are batched; 2) Whether violations are the result of only one individual or the result of faulty systems or procedures; 3) Whether the firm has taken remedial measures to correct the violations; 4) Prior MRVs within the past 24 months; and 5) Collateral effects that the failure has on customers.
SEC Rule 11Ac1-1(c)(5) – Failure to properly update published quotes in certain ECNs	1) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Number of violations; 2) Whether violations are batched; 3) Whether violations are the result of only one individual or the result of faulty systems or procedures; 4) Whether the firm has taken remedial measures to correct the violations; 5) Prior MRVs within the past 24 months; and 6) Collateral effects that the failure has on customers.
SEC Rule 17a-5 – Failure to timely file FOCUS reports and annual audits	1) An MRV or Letter of Caution should not be used if the violation is accompanied by other violations, especially Net Capital violations; 2) If a filing is late 10 business days or less, a mandatory $100 fee per day is assessed;[1] 3) If a filing is more than 10 business days late, an MRV may be assessed; and 4) An MRV also may be considered when a firm has exhibited a pattern of late filings, *e.g.*, reports late three times within a year, but the filings were less than 10 business days late.	1) Number of days late; 2) Prior MRVs within the past 24 months; and 3) Collateral effects that the late filing has on NASD's ability to monitor a member firm's financial and operational condition, or otherwise perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
SEC Rule 17a-10 – Failure to timely file Schedule I	1) An MRV or Letter of Caution should not be used if the violation is accompanied by other violations, especially Net Capital violations; 2) If a filing is late 10 business days or less, a mandatory $100 fee per day is assessed; 3) If a filing is more than 10 business days late, an MRV may be assessed; and 4) An MRV also may be considered when a firm has exhibited a pattern of late filings, *e.g.*, reports late three times within a year, but the filings were less than 10 business days late.	1) Number of days late; 2) Prior MRVs within the past 24 months; and 3) Collateral effects that the late filing has on NASD's ability to monitor a member firm's financial and operational condition, or otherwise perform its regulatory function.
MSRB Rule A-14 – Failure to timely pay annual fee	1) A Letter of Caution should be considered if the annual fee is paid less than 30 days late and if the member firm has no prior history of late payment; and 2) An AWC should be considered if the member pays the fee more than 30 days late for three or more consecutive years.	1) A $500 fine should be considered for the first MRV issued to the member firm; and 2) Progressively higher fines should be considered for subsequent MRVs issued over a 24-month period.
MSRB Rule G-12 – Failure to abide by uniform practice rules	1) A Letter of Caution may be appropriate for a first-time occurrence and if the firm's inter-dealer trade compliance statistics, on average, are below the industry average for no longer than a three-month period;[2] 2) If a firm's inter-dealer statistics remain below the industry average following the first Letter of Caution, an MRV would be appropriate if the firm's compliance, on average, is no more than 3% below the industry average for no longer than a three-month period. Otherwise, an AWC should be used; and 3) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Total number of transactions that were reported late, reported inaccurately, or not reported; 2) The timeframe over which the violations occurred; 3) The firm's compliance, as measured by MSRB-generated statistics and as compared with industry averages, taking into consideration the firm's transaction volume and the timeframe over which the violations occurred; 4) Whether the violation affects data dissemination to the public;[3] 5) Whether the violations are the result of the actions of only one individual or the result of faulty systems or procedures; 6) Whether the firm has taken remedial measures to correct the violations, including a proactive compliance process for transaction reporting (*e.g.*, adequate policies and procedures and periodic review of the MSRB Dealer Feedback System); 7) Prior MRVs within the past 24 months; and 8) Collateral effects that the failure has on customers.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
MSRB Rule G-14 – Failure to submit timely and accurate transaction reports	1) A Letter of Caution may be appropriate for a first-time occurrence and only if the firm's customer trade compliance statistics, on average, are below the industry average for no longer than a three-month period;[4] 2) If a firm's transaction reporting statistics remain below the industry average following the first Letter of Caution, an MRV would be appropriate if the firm's compliance, on average, is no more than 3% below the industry average for no longer than a three-month period. Otherwise, an AWC should be used; and 3) Violations that prevent NASD from performing its regulatory function generally require full disciplinary proceedings.	1) Total number of transactions that were reported late, reported inaccurately, or not reported; 2) The time frame over which the violations occurred; 3) The firm's compliance, as measured by MSRB-generated statistics and as compared with industry averages, taking into consideration the firm's transaction volume and the time frame over which the violations occurred; 4) Whether the violation affects data dissemination to the public;[5] 5) Whether the violations are the result of the actions of only one individual or the result of faulty systems or procedures; 6) Whether the firm has taken remedial measures to correct the violations, including a proactive compliance process for transaction reporting (e.g., adequate policies and procedures and periodic review of the MSRB Dealer Feedback System); 7) Prior MRVs within the past 24 months; and 8) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
MSRB Rule G-36 – Failure to timely submit reports (Official Statements; Advance Refunding Documents)	1) An MRV or Letter of Caution is appropriate only when a report is filed late. A complete failure to file required reports or an inadequate filing should result in full disciplinary proceedings; 2) A Letter of Caution should be considered if the firm has fewer than 10 late filings during a 12-month period; and 3) Formal action should be considered if a report is filed more than 30 days late.	1) The number of late filings as a percentage of total filings; 2) The average number of days late; 3) Whether documents were obtained from the issuer in sufficient time to allow the underwriter to comply with the time frames of Rule G-36; 4) Whether the underwriter recorded attempts to obtain such documents; 5) The Rule G-36 compliance history of the firm; 6) Prior MRVs within the past 24 months; and 7) Collateral effects that the late filing has on NASD's ability to perform its regulatory function
MSRB Rule G-37 – Failure to timely submit reports for political contributions	1) An MRV or Letter of Caution is appropriate only when a report is filed late. A complete failure to file required reports or an inadequate filing should result in full disciplinary proceedings; 2) A Letter of Caution should be considered for first violation of rule within a 24-month period if report contains accurate information; and 3) Full disciplinary proceedings should be considered if member firm violates rule more than three times during a 24-month period.	1) A history of late, incomplete, or inaccurate Form G-37 filings, or inaccurate record-keeping as required by Rule G-37 will determine the fine; 2) Whether the firm's filings and associated records are complete; 3) Fines should be increased if a Form was filed 30 or more days late and the firm had political contribution and/or underwriting information to report; 4) Prior MRVs within the past 24 months; and 5) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Rule Specified in the Plan	General Guidelines	Specific Factors to Use in Determining the Amount of the Fine
MSRB Rule G-38 – Failure to timely submit reports detailing consultant activities	1) An MRV or Letter of Caution should be limited to late filing of report. A complete failure to file required reports or an inadequate filing should result in full disciplinary proceedings; 2) A Letter of Caution should be considered for first violation of rule within a 24-month period if report contains accurate information; and 3) Full disciplinary proceedings should be considered if member firm violates rule more than three times during a 24-month period.	1) A firm's past compliance with the filing deadlines; 2) Whether the firm's filings and associated records are complete; 3) Fines should be increased if a Form was filed 30 or more days late and the firm had consultant information to report; 4) Prior MRVs within the past 24 months; and 5) Collateral effects that the late filing has on NASD's ability to perform its regulatory function.

Endnotes

1 NASD established the $100 late fee schedule pursuant to Section 4(l)(1) of Schedule A to the NASD By-laws, not the MRVP. The $100 assessment is an administrative fee, not a disciplinary fine. *See Notice to Members 01-54.*

2 Following are the statistical measures of firm compliance. Current industry averages are provided on every firm report card obtained from the MSRB. The statistics listed below are for November 2003. For further information about MSRB transaction reporting compliance statistics, please see *Notice to Members 03-13* and the NASD-MSRB joint notice attached thereto.

- Inter-dealer statistics: late or stamped trade reporting (7.6%), invalid time of trade reporting (1.7%), uncompared input (7.5%), compared but deleted or withheld input (0.6%);
- Customer trade statistics: late trade reporting (3.5%), canceled trades (1.4%), amended trades (3.0%), invalid time of trade reporting (0.2%); and
- Effecting broker symbol statistics: the current industry compliance average is over 99%.

3 The MSRB's T+1 Daily Report contains municipal securities price information about all transactions reported by dealers the previous trading day. The MSRB provides this report to subscribers, which includes public investment-related Web sites, on T+1. Consequently, if a firm reported a large number of trades late or inaccurately, or deleted a large number of transactions after T+1, not only would this behavior affect regulatory function, but it also would diminish the value of the Daily Report vis-a-vis price transparency to investors.

4 *See supra* note 2.

5 *See supra* note 3.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Corporate Financing
Institutional
Legal & Compliance
Operations
Senior Management
Syndicate
Trading & Market Making
Training

KEY TOPICS

Free-Riding and Withholding
IPO Distribution Manager
IPOs
Retention
Rule 2790
Underwriting Commitment

GUIDANCE

IPO Distribution Manager

IPO Distribution Manager to Replace Compliance Desk; Filings Required for All New Issues as Defined in Rule 2790; **Voluntary Effective Date: March 23, 2004; Mandatory Effective Date: April 16, 2004**

Executive Summary

To coincide with the implementation of NASD Rule 2790 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), NASD has developed a new system for members to submit new issue distribution information (*i.e.*, commitment and retention data of the syndicate members) to NASD. Beginning on March 23, 2004, members will be able to use "IPO Distribution Manager." IPO Distribution Manager, which will replace Compliance Desk, is a Web-based application that will allow members to submit new issue distribution information directly to NASD. Some of the benefits of IPO Distribution Manager are that members no longer will be required to use a third party to submit information to NASD, nor will they be required to purchase or use specialized software, printers, or paper.

Procedures concerning the registration and use of IPO Distribution Manager are provided below. IPO Distribution Manager will be available for use on a voluntary basis on March 23, 2004. Use of IPO Distribution Manager will become mandatory on April 16, 2004. During the transition period (from March 23, 2004, through April 15, 2004), members may use either IPO Distribution Manager or Compliance Desk. Distribution information from Compliance Desk will be converted to IPO Distribution Manager April 16-18, 2004, and, as a result, Compliance Desk will no longer be available to users.

04-20

To help members with the transition to IPO Distribution Manager, and to give them an opportunity to ask questions about its operation, NASD's Corporate Financing Department will hold **Web Ex training workshops on Monday, March 22, and Tuesday, March 23, 2004, from 4:30 p.m. EST to 6:00 p.m. EST**. There are 50 slots per workshop and member firms must register to occupy a slot. Each slot provides a single dial-in number and an online connection to the Web presentation, but a member may have multiple participants at their firm on the call and viewing the presentation. To register, please request a registration form via e-mail at *nasdrcorpfin@nasdr.com*. **Registration requests must be received by Friday, March 19, 2004**. Each contact person will receive further instructions on how to access and register on Web Ex.

Questions/Further Information

Questions regarding *IPO Distribution Manager* may be directed to LaNita A. Tyler, Manager, Corporate Financing Department, at (240) 386-4647; or Sheena Savoy, System Integrity Specialist, Corporate Financing Department, at (240) 386-4645. Questions regarding *Rule 2790* may be directed to Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight (RPO), at (202) 728-8104; or Afshin Atabaki, Attorney, Office of General Counsel, RPO, at (202) 728-8902.

Background and Discussion

Compliance Desk is a proprietary software application that facilitates the transmission of "hot issue" notification and receipt of new issue distribution information between members and NASD. NASD and an outside vendor jointly developed Compliance Desk in May 1996. Currently, NASD uses Compliance Desk to advise members distributing new issues whether an offering is a "hot issue" for purposes of complying with the Free-Riding and Withholding Interpretation (IM-2110-1), and to receive distribution information from managing underwriters. More detailed information about Compliance Desk is provided in *Notice to Members 96-18*.

In light of the changes brought about by new NASD Rule 2790,[1] NASD intends to phase out the operation of Compliance Desk and replace it with IPO Distribution Manager. Some of the functions performed by Compliance Desk no longer are necessary. In particular, because Rule 2790 applies to all "new issues" (rather than only "hot issues," as was the case under the Free-Riding and Withholding Interpretation), NASD no longer has any regulatory need to notify member firms whether an offering is a "hot issue." Accordingly, effective March 23, 2004, NASD will no longer be notifying members whether an offering is a "hot" or "cold" issue. In addition, the use of IPO Distribution Manager will no longer obligate members to use a third party to file data with NASD, nor will they be required to purchase or use specialized software, printers, or paper.

Through IPO Distribution Manager, the lead managing underwriters of offerings involving a “new issue” as defined in Rule 2790 will be required to make two filings with the Corporate Financing Department. In the initial filing, which must be filed on or before the offering date, the managing underwriter must submit the initial list of distribution participants and their commitment and retention amounts. In the final filing, which must be filed no later than three days after the offering date (T+3), the managing underwriter must submit the final list of distribution participants and their commitment and retention amounts. IPO Distribution Manager will permit members to transmit distribution information to NASD through Web COBRA, the Web-based filing system that members are required to use when filing information under the Corporate Financing Rule (Rule 2710). NASD’s examination program will use the data filed through IPO Distribution Manager to assist with examinations for compliance with the federal securities laws and NASD rules, including Rule 2790.

As noted above, IPO Distribution Manager is a Web-based application that facilitates the transmission of new issue distribution information from the managing underwriter to NASD. IPO Distribution Manager will be available via NASD’s Web Site, *www.nasd.com*, beginning on **March 23, 2004**. Prior to using IPO Distribution Manager, each member firm must obtain a member firm identification number. In addition, member firm personnel must register to use IPO Distribution Manager. Member firms may request a firm identification number beginning on **March 19, 2004**. Member firm personnel may commence registering to use IPO Distribution Manager on **March 22, 2004**. Please note that only registered users can access IPO Distribution Manager.

Obtaining a Member Firm Identification Number: The member firm identification number is a unique number that identifies the member firm and its users in IPO Distribution Manager. The member firm identification number is required before member firm personnel can register to use IPO Distribution Manager. A member must follow the steps listed below to receive a member firm identification number:

1. The person requesting the number on behalf of the firm must send an e-mail to *nasdrcorpfin@nasdr.com* to request a member firm identification number. This individual must provide his or her full name, title, member firm legal name, member firm CRD number, address, and telephone number.

2. The requestor may also submit the full name, title, and phone number of any other person who will be authorized to submit distribution information on behalf of the member firm to NASD.

3. Confirmation of the member firm identification number will be sent via e-mail to the requestor within 24 hours of receipt (business days only).

4. The requestor and/or any other authorized person will be able to register to use IPO Distribution Manager after receipt of e-mail confirmation.

User Registration: The requestor and/or any other authorized person must register as a user of the system for the member firm as set forth below:

1. To register, each user must complete the required information displayed on the screen, including member firm identification number, e-mail address, user name, and password.[2]
2. Confirmation of the user's registration will be sent via e-mail to the user within 24 hours of receipt (business days only).
3. Once confirmation has been received by the user, he or she may begin using IPO Distribution Manager.

As noted above, members may, on a voluntary basis, use IPO Distribution Manager beginning on March 23, 2004. Use of IPO Distribution Manager will become mandatory on Friday, **April 16, 2004**, as NASD will no longer accept filings through Compliance Desk. Moreover, during the transition period (between Tuesday, March 23, 2004, and Thursday, April 15, 2004), the Department will be unable to accommodate filing the initial list of distribution participants and data on one system and filing the final list of distribution participants and data on the other. Accordingly, during the transition period members must use either IPO Distribution Manager or Compliance Desk exclusively for initial and final filings with respect to each new issue.

To Use IPO Distribution Manager

1. Access IPO Distribution Manager via NASD's Web Site: *www.nasd.com*.
2. Click on **Regulation**.
3. Click on **Other Regulation Systems**.
4. Click on **IPO Distribution Manager**.
5. Click on **Log On**.
6. Enter **User Name** and **Password** (chosen on registration).
7. Click on **Open Deal** or enter the **NASD File ID** in the blank space and hit **Enter.**

To Submit the Initial Distribution on the Offering Date:

1. Choose the IPO deal from **IPO Distribution Deal List.** <u>**Note:**</u> Only IPOs filed with NASD via COBRADesk that meet the Rule 2790 definition of "new issue" will be displayed. The member name and CRD number will be displayed for the lead managing underwriter and co-managers (if applicable).
2. Enter the commitment and retention amounts for each member displayed.

3. Click **Add** to display the **Members List** and to add additional syndicate and selling group members. **Note:** Do not include foreign broker-dealers—U.S. members only.
4. Choose the participation status **(Bracket)** of each member from the drop-down list.
5. Enter the commitment and retention amounts for each member added.
6. Click **Submit to NASD** (displayed in red) to transmit the distribution information to NASD. (The button will gray-out after information has been submitted.) **Note:** Commitment and retention amounts must be filled in for each member.
7. Confirmation of submission (date/time) will be displayed after **Initial Distribution Submitted.**
8. Confirmation of NASD acceptance or rejection (date/time) will be displayed in the **Submit Log.**
9. When the Corporate Financing Department accepts the information, a date will also be displayed in **DIR Applied** on the **IPO Distribution Deal List.**

To Submit the Final Distribution by T+3:

1. Choose the IPO deal from **IPO Distribution Deal List.**
2. Click the Commitment or Retention field to edit the commitment and/or retention amounts for existing members. **Note:** If no changes are required, click **Submit to NASD.**
3. Click **Add** to display the **Members List** and to add additional syndicate and selling group members.
4. Choose the participation status **(Bracket)** of each member from the drop-down list.
5. Enter the commitment and retention amounts for each member added.
6. Click **Submit to NASD** (displayed in red) to transmit the distribution information to NASD. (The button will gray-out after information has been submitted.) **Note:** Commitment and retention amounts must be filled in for each member.
7. Confirmation of submission (date/time) will be displayed after **Final Distribution Submitted.**
8. Confirmation of NASD acceptance or rejection (date/time) will be displayed in the **Submit Log.**
9. When the Corporate Financing Department accepts the information, a date will also be displayed in **DFR Applied** on the **IPO Distribution Deal List.**

Endnotes

1 Information concerning Rule 2790 is provided in *Notice to Members 03-79*.

2 Users should keep their user names and passwords in a secure place. Users will be prompted to change their passwords every 60 days. NASD does not maintain user passwords. If a user forgets his or her password, he or she must e-mail NASD's Corporate Financing Department at *nasdrcorpfin@nasdr.com* to have the password reset. A temporary password will be assigned, and the user must choose a different password when he or she logs onto the system.

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Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations

KEY TOPICS

NASD Rule 3370
Short Sale Rule
Affirmative Determination

GUIDANCE

Affirmative Determination Requirements

NASD Provides Further Guidance on Amendments to NASD Rule 3370—Affirmative Determination Requirements

Executive Summary

On November 14, 2003, the Securities and Exchange Commission (SEC) approved amendments to Rule 3370 (Prompt Receipt and Delivery of Securities—the "affirmative determination requirements") that expand the scope of the affirmative determination requirements to include orders from non-member broker-dealers.[1] On February 18, 2004, NASD delayed the effective date of these amendments to April 1, 2004, to provide additional time to permit members to make technological changes to their systems to comply with the new requirements.[2] In this *Notice*, NASD staff is providing additional guidance to assist members in their implementation of the new amendments.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Regulatory Policy and Oversight (RPO), at (202) 728-8104; or Patricia M. Albrecht, Assistant General Counsel, RPO, (202) 728-8026.

Background and Discussion

Under the new amendments to Rule 3370, members now are responsible for making an affirmative determination when receiving orders from non-member broker-dealers. Members have sought clarification concerning the scope of these new responsibilities, including whether orders received in response to a quote displayed on an inter-dealer quotation system, exchange, or other quotation medium would trigger the requirements under the Rule.

NASD Rule 3370(b)(2) states that a member may not accept a short sale order from a customer or non-member broker-dealer unless it has made an affirmative determination that it will receive delivery of the security from the customer or non-member broker-dealer or that the member can borrow the security on behalf of the customer or non-member broker-dealer for delivery by settlement date. NASD staff is clarifying that the amendments to the affirmative determination requirements apply to all orders from non-member broker-dealers, whether received manually via the telephone or electronically. The amendments, however, would not apply to those orders executed by the member as an arm's length transaction. It is NASD staff's view that arm's length transactions are defined by the absence of a commercial relationship between the non-member broker-dealer and the member. Thus, the following relationships would not be considered arm's length: (1) arrangements in which a non-member broker-dealer's order flow is sent to a member; (2) pre-existing understandings between a non-member broker-dealer and a member regarding the execution of orders; (3) reciprocal business arrangements between a non-member broker-dealer and a member; (4) *de facto* relationships between a non-member broker-dealer and the member evidenced by the pattern or volume of order flow; or (5) any instance where an order sent by a non-member broker-dealer is to be handled or "worked" by a member. Furthermore, an arm's length transaction is not necessarily determined on an order-by-order basis. Members are cautioned that execution of an order from a non-member broker-dealer against its displayed quote may not be deemed an arm's length transaction if the totality of the circumstances of the relationship between the member and the non-member broker-dealer indicate a commercial relationship.[3] The concept of an arm's length transaction is intended to draw a distinction between those situations in which the member is acting merely as the buyer—as opposed to the facilitator—in respect of a non-member broker-dealer's order flow.

NASD also wishes to clarify that any member operating an electronic communications network (ECN) or alternative trading system (ATS) shall be responsible for ensuring compliance with Rule 3370 with respect to orders, if any, executed by non-member broker-dealers on or through the ECN or ATS.

Lastly, NASD wishes to remind members that, under the affirmative determination requirements, the information necessary for a member to make an affirmative determination must be provided on an order-by-order basis. A member may not rely on a blanket representation from a non-member broker-dealer or customer that all orders it provides are long sales or that it otherwise has met the affirmative determination requirements. In addition, while a member may rely on assurances from a non-member broker-dealer or customer that such party can deliver the securities within three business days to the member (or on the member's behalf where the member has subsequently sold the securities to a third party),[4] a member may only do so when such reliance is reasonable. For example, where a member knows or has reason to believe that a non-member broker-dealer's or customer's prior assurances resulted in a failure to deliver, continued reliance on assurances from such non-member broker-dealer or customer may not be reasonable. Accordingly, in those situations, a member would be required to meet its affirmative determination requirements by locating the stock before accepting a short sale order.[5]

Endnotes

1 File No. SR-NASD-2001-85; SEC Release No. 34-48788 (Nov. 14, 2003); 68 F.R. 65978 (Nov. 24, 2003); *See NASD Notice to Members 04-03* (January 2004).

2 File No. SR-NASD-2004-031, SEC Release No. 34-49285 (Feb. 19, 2004); 69 F.R. 8717 (Feb. 25, 2004); *See NASD Notice to Members 04-08* (February 2004).

3 Accordingly, in circumstances where (i) a non-member broker-dealer may seek to execute against a member's displayed quote, (ii) such transaction would not be viewed as an arm's length transaction, and (iii) the member does not have the capacity to handle such automated or phoned orders in a manner that comports with both their obligations under Rule 3370 and the firm quote obligations of Rule 3320, the member should consider avoiding counterparty trading relationships with non-member broker-dealers in favor of accepting orders on a handled-basis where the member could comply with Rule 3370. It shall not be deemed a violation of Rule 3320 for a member, in response to an order from a non-member broker-dealer seeking to execute against the member's displayed quote, to reject the order based on the fact that such member will only accept such order flow on a handled-basis, provided that, (i) the member makes such restriction known to the non-member broker-dealer promptly upon receipt of the order; (ii) this restriction applies to all orders of the non-member broker-dealer and is not applied on an order-by-order basis; and (iii) such restriction applies generally to the order flow received by the member from all non-member broker-dealers.

4 *See* Rule 3370(b)(4)(B)(i).

5 *See* Rule 3370(b)(4)(B)(ii).

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Notice to Members

MARCH 2004

GUIDANCE

Continuing Education Rules

SEC Approves Amendments to Rule 1120 (Continuing Education Requirements) Regarding Regulatory Element Contact Person

SUGGESTED ROUTING

Continuing Education
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Continuing Education
Rule 1120

Executive Summary

On February 13, 2004, the Securities and Exchange Commission (SEC) approved amendments to Rule 1120 to require that each member designate and identify to NASD the individual(s) who will receive Web Central Registration Depository (Web CRD®) Continuing Education (CE) Regulatory Element e-mails. The amendments also require each member to quarterly review and update the CE contact person(s) information.[1] Rule 1120, as amended, is set forth in Attachment A. The amendments are effective as of April 16, 2004.

Questions/Further Information

Questions regarding this *Notice* may be directed to Grace Yeh, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-6939.

Background and Discussion

NASD Rule 1120 sets forth the CE requirements for registered persons. The CE requirements consist of both a Firm Element and a Regulatory Element. The Firm Element requires each member firm to annually develop and implement a written plan for training its registered persons based on an assessment of its own specific training needs. The Regulatory Element is a computer-based education program administered by NASD to help ensure that registered persons are kept up-to-date on regulatory, compliance, and sales practice matters in the industry. Each registered person is required to complete the Regulatory Element initially within 120 days after the person's second registration anniversary date and,

04-22

thereafter, within 120 days after every third registration anniversary date. A registered person who becomes inactive for failing to complete the required Regulatory Element program (CE inactive) is prohibited from performing, or being compensated for, any activities requiring registration, including supervision. Members are required under Rule 1120 to restrict CE inactive persons from performing the prohibited activities.

To help firms keep track of their registered persons' Regulatory Element status, NASD provides members with e-mail notifications through Web CRD when a person is both 90 days and 30 days away from the end of his or her period to complete the Regulatory Element program before going inactive. CRD also notifies members when a registered person at the firm becomes CE inactive. Receipt of the e-mail notifications has been optional, and some firms have elected not to receive the notifications.

To help firms avoid a Rule 1120(a) violation that would occur if an inactive person were permitted to perform, or receive compensation for, activities that required registration during the period of inactive status, NASD has amended Rule 1120 to require each member to designate a contact person or persons to receive the CRD Regulatory Element e-mail notifications. The amendments require the member to provide to NASD the name and e-mail address of the designated contact person(s) and to promptly notify NASD of any changes to the information. NASD will collect the contact information through the NASD Contact System on NASD's Web Site.[2] The notifications will ensure that firms are positioned to prevent any registered persons from becoming inactive or from conducting business if they become CE inactive.

The amendments also are designed to assist NASD with its efforts to further automate various aspects of its examination program with a goal of removing a substantial portion of CE compliance inspections from on-site firm examinations. NASD believes that a more automated approach will result in a less intrusive regulatory approach for firms and a more efficient use of NASD Department of Member Regulation resources.

To ensure the accuracy of the CE contact information, the amendments require that each member review and, if necessary, update its CE contact person information within 17 business days after the end of each calendar quarter.[3] NASD is examining different methods of reminding members of the obligation to quarterly review and update contact person information, including the possibility of a Web page linked to the act of filing the FOCUS report that would prompt members to update such contact person and/or through periodic e-mail reminders to member firms.[4]

Effective Date

The rule amendments become effective on April 16, 2004. Members will be required to conduct the first quarterly review and update of the contact person information within 17 business days after June 30, 2004.

Endnotes

1 *See* Securities Exchange Act Release No. 49246 (February 13, 2004), 69 FR 8255 (February 23, 2004) (File No. SR-NASD-2003-183) (SEC Approval Order).

2 *See www.nasdr.com/NCS.asp.*

3 This review schedule is consistent with a member's quarterly FOCUS reporting schedule, as well as with the proposed rule change regarding members' business continuity plans (*see* SR-NASD-2002-108, which is pending at the SEC) which would require members to review and update emergency contact information within 17 business days after the end of each calendar quarter. Similarly, the proposed schedule is consistent with a proposed rule change regarding the review and update of a member's Executive Representative designation and contact information (*see* SR-NASD-2003-184).

4 Similarly, NASD would prompt members to review and update, where necessary, their emergency contact and Executive Representative information. *See supra* note 3.

ATTACHMENT A

New language is underlined; deletions are in brackets.

1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with NASD [the Association]. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1) through (6) No change.

(7) Regulatory Element Contact Person

Each member shall designate and identify to NASD (by name and e-mail address) an individual or individuals responsible for receiving e-mail notifications provided via the Central Registration Depository regarding when a registered person is approaching the end of his or her Regulatory Element time frame and when a registered person is deemed inactive due to failure to complete the requirements of the Regulatory Element program, and provide prompt notification to NASD regarding any change in such designation(s). Each member must review and, if necessary, update the information regarding its Regulatory Element contact person(s) within 17 business days after the end of each calendar quarter to ensure the information's accuracy.

(b) No change.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Article V, Section 2 of the NASD By-Laws
Article V, Section 3(a) of the NASD By-Laws
Central Registration Depository (CRD® or Web CRD)
IM-9216
Inactive Disclosure Review Registration Status
Minor Rule Violation Plan (MRVP)
Rule 9216(b)

REQUEST FOR COMMENT

Minor Rule Violation Plan and Inactive Disclosure Review Registration Status

NASD Seeks Comment On (1) Amending its Minor Rule Violation Plan (MRVP) to Include Failure Timely to Submit Amendments to the Uniform Termination Notice for Securities Industry Registration (Form U5); and (2) Adopting a Rule to Create an Inactive Disclosure Review Registration Status; **Comment Period Expires April 19, 2004**

Executive Summary

In July 2002, an NASD task force (the Public Information Review or PIR Task Force) initiated a comprehensive review of disciplinary and other information that NASD makes public, including the information released under NASD Interpretive Material 8310-2 (IM-8310-2). NASD is requesting comment from its members and other interested parties on two of the PIR Task Force's recommendations: (1) expanding the coverage of NASD's MRVP to include the failure to amend the Uniform Termination Notice for Securities Industry Registration (Form U5) in a timely manner; and (2) creating an "Inactive Disclosure Review" (Inactive DR) registration status that would require a registered individual to cease all activities requiring registration and prohibit that individual from functioning in any capacity requiring registration until the member either reports or updates a disclosure item on a Uniform Application for Securities Industry Registration or Transfer (Form U4) or provides the disclosure documentation requested for that individual. These proposals are part of a multi-pronged effort to help ensure that members make required disclosures on all Uniform Forms in a timely manner.[1]

04-23

Action Requested

NASD encourages all interested parties to comment on these two proposals. Comments must be received by April 19, 2004. Members and interested persons can submit their comments using the following methods:

- mailing in the checklist (Attachment A)
- mailing in written comments
- e-mailing written comments to *pubcom@nasd.com*
- submitting comments using the online form at the NASD Web Site (*www.nasdr.com*)

If you decide to submit comments using both the checklist and one of the other methods listed above, please indicate that in your submissions. The checklist and/or hard copy comments should be mailed to:

Barbara Z. Sweeney

Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington, D.C. 20006-1500

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web Site. Generally, comments will be posted on the NASD Web Site one week after the end of the comment period. See *Notice to Members 03-73*.

Before becoming effective, a rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.

Questions/Further Information

As noted above, hard copy comments should be mailed to Barbara Z. Sweeney. Questions concerning this *Notice* may be directed to Victoria M. Pawelski, Assistant Chief Counsel and Assistant Director, Registration and Disclosure, at (240) 386-4803; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

MRVP

In 1984, the SEC adopted amendments to Rule 19d-1(c) under the Securities Exchange Act of 1934 (Exchange Act) to allow self-regulatory organizations to adopt, with SEC approval, plans for the disposition of minor violations of rules.[2] In 1993, pursuant to this Rule, NASD established an MRVP.[3] The purpose of the MRVP is to provide for a meaningful sanction for the violation of a rule when the initiation of a disciplinary proceeding through the formal complaint process would be more costly and time-consuming than would be warranted. The MRVP provides an efficient means by which to deter violations of rules while maintaining procedural rights for disciplined persons. NASD's MRVP currently is described in Rule 9216(b), which authorizes NASD to impose a fine of $2,500 or less on any member or associated person for a minor violation of the rules identified in NASD Interpretive Material 9216 (IM-9216).[4]

Notwithstanding the inclusion of a particular violation in IM-9216, NASD staff retains full discretion to institute disciplinary proceedings based on all of the facts and circumstances. NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine. Further, once NASD has issued an MRVP letter against an individual or member firm, it may, at its discretion, issue progressively higher fines for all subsequent minor violations of rules within the next 24-month period or initiate more formal disciplinary proceedings. Minor rule violations currently are not reportable on an individual's Form U4 or U5 or a member firm's Form BD and, accordingly, do not appear on their respective Central Registration Depository (CRD) records.[5]

Among other things, the current MRVP includes failure timely to submit amendments to the Form U4, as required by Article V, Section 2(c) of the NASD By-Laws, and failure timely to submit amendments to the Form BD, as required by Article IV, Section 1(c) of the NASD By-Laws. NASD proposes to amend its MRVP to include failure timely to submit amendments to the Form U5, as required by Article V, Section 3(a) of the NASD By-Laws. Sanctions imposed pursuant to the proposed amendment to the MRVP would be in addition to late fees that currently may be imposed for late filings, including the recently adopted amendment to Schedule A of the NASD By-Laws, which provides for a $10 per day late fee up to a maximum charge of $300 for submitting late disclosure filings.

Inactive Disclosure Review Registration Status

Currently, when a member fails after repeated requests to report or update a disclosure item on a Form U4 on behalf of a registered person or to provide adequate disclosure documentation in response to NASD staff requests, the registered person continues to have an "Approved" registration status and may continue to function as a registered person, notwithstanding that his or her Form U4 may not be current or complete. To address this situation, the PIR Task Force recommended that NASD implement an "Inactive Disclosure Review" registration status (also referred to as Inactive DR) that would place the registration of a person whose firm has failed to meet a Form U4 reporting requirement, or to provide requested disclosure documentation, in an inactive status and, as a result, such person would be prohibited from engaging in sales or other activities that require registration until the reporting deficiency is cured or information request is met.

Article V, Section 2(c) of the NASD By-Laws requires every application for registration filed with NASD to be kept current at all times by supplementary amendments. Amendments to Forms U4 must be filed not later than 30 days after learning of facts or circumstances giving rise to a reporting obligation. If the amendment being filed involves a statutory disqualification as defined in Exchange Act Sections 3(a)(39) and 15(b)(4), it must be filed not later than 10 days after the disqualification occurs.

Under the proposed rule, failure to make a timely report would initiate the Inactive DR process. The member would receive notice from NASD staff that it has 30 days to comply with a request by NASD staff to report a disclosure event, update a previously reported disclosure event, or provide documentation of a potential or actual disclosure event as requested. Staff would continue its current policy of exercising discretion to grant extensions of time in exceptional cases or accept, in lieu of required documentation, correspondence that provides NASD staff with an adequate explanation as to why compliance with a request is not feasible within that time frame (*e.g.*, difficulty in obtaining court documents despite good faith efforts). If a member fails to comply with a request (or provide an adequate explanation as to why compliance is not feasible) within 30 days, NASD staff would send the member a final notice giving the member an additional 10 days to comply.

If the member fails to comply within the additional 10 days, the registered person would be placed in an inactive status.[6] Members will also receive notice when an individual becomes inactive. Any person whose registration has been deemed inactive under the proposed rule will be required to cease all activities as a registered person and will be prohibited from performing any duties and functioning in any capacity requiring registration until such time as the employing member either updates the person's Form U4 as required or provides the requested documentation to NASD staff. NASD would administratively terminate an individual whose registration has been inactive for two years.

The proposed Inactive Disclosure Review registration status is part of a multi-pronged effort by NASD to help ensure that firms timely update Forms U4 and U5, as required by the NASD By-Laws. The proposed 30-day and additional 10-day notice provisions are designed to give firms adequate notice and time to resolve or cure any deficiencies before the person at issue is deemed inactive. NASD staff also plans to provide members with information about this process on the NASD Web Site. Although the proposed rule will address only the registration status of the registered person, the noncompliant member also will be subject to imposition of late filing fees and potential disciplinary action, as appropriate, based on the facts and circumstances presented.

Endnotes

1 This effort includes the newly established late disclosure fee, which was another recommendation of the PIR Task Force. See Exchange Act Rel. No. 49224 (Feb. 11, 2004), 69 Fed. Reg. 7833 (Feb. 19, 2004) (File No. SR-NASD-2003-192). *See also Notice to Members 04-09* (March 2004).

2 *See* Exchange Act Rel. No. 21013 (June 1, 1984), 49 Fed. Reg. 23833 (June 8, 1984).

3 *See* Exchange Act Rel. No. 44512 (July 3, 2001), 66 Fed. Reg. 36812 (July 13, 2001) (File No. SR-NASD-00-39).

4 NASD recently filed a rule change to expand the MRVP by adding six additional violations. The proposed additions are: (1) violation of the Intermarket Trading System (ITS) trade-through rule; (2) violation of the locked and crossed markets rule; (3) violation of the Trade Reporting and Compliance Engine (TRACE) system transaction reporting requirement; (4) violation of the Alternate Display Facility (ADF) transaction reporting requirement; (5) violation of the standards applicable to communications with the public; and (6) failure to provide or update firm contact information as required by NASD rules. See SR-NASD-2004-25 (Feb. 10, 2004). NASD also recently issued guidance concerning the application of NASD's MRVP to each of the rules specified in the MRVP. *See Notice to Members 04-19* (March 2004).

5 Firms and individuals should consult with their own legal counsel as needed to determine whether any particular matter must be reported on Forms BD, U4, or U5.

6 The Inactive DR status would be similar to the existing Continuing Education (CE) Inactive status (Rule 1120) and the Fingerprint Inactive status (Rule 1140).

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ATTACHMENT A

Request For Comment Checklist

(1) MRVP

Should NASD amend IM-9216 (MRVP) to include failure timely to submit amendments to the Form U5 (as required by Article V, Section 3(a) of the NASD By-Laws), to be consistent with existing provisions regarding the failure timely to submit amendments to Forms U4 and BD?

(1) Inactive Disclosure Review

(a) Should NASD adopt a rule creating an Inactive Disclosure Review registration status for registered persons whose employing member fails timely to report or update a disclosure item on behalf of the registered person and/or fails to provide requested documentation to NASD staff (and fails to provide adequate justification for failing to make such report)?

(b) If so, do the proposed 30-day and supplemental 10-day notice provisions provide adequate time for members to report matters or otherwise resolve deficiencies?

(c) Do you have any additional comments or suggestions?

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal & Compliance

Operations

Senior Management

KEY TOPICS

Clearing Firms

Exemptions to the Reporting Requirements of Rule 3150

IM-3150

National Examination Program (NEP) Surveillance (formerly referred to as INSITE)

Rule 3150

GUIDANCE

Exemptions to Reporting Requirements of Rule 3150

SEC Announces Immediate Effectiveness of IM-3150 Governing Exemptions from the Reporting Requirements of NASD Rule 3150; **Effective Date: February 20, 2004**

Executive Summary

The Securities and Exchange Commission (SEC) has announced the immediate effectiveness of IM-3150, regarding possible exemptions from the reporting requirements of NASD Rule 3150.[1] Under IM-3150, the following classes of self-clearing members will generally be exempt from the filing requirements of Rule 3150: (1) members that derive, on an annualized basis, at least 85 percent of their revenue from transactions in fixed income securities; (2) members that conduct an institutional business that settle transactions on an RVP/DVP basis, provided that such exemption from reporting shall apply only with respect to such institutional business unless NASD determines that any other remaining business otherwise qualifies for an exemption under IM-3150 or is de minimis in nature; or (3) members that do not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts. In addition, a clearing firm may obtain an exemption for one or more of the introducing firms for which it clears if the introducing firm meets one of the above grounds for relief.

IM-3150 continues to require members to request all exemptions from Rule 3150(a), in writing, pursuant to the Rule 9600 Series, including possible exemptions under IM-3150. IM-3150(c) also clarifies that any clearing or self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business or the operation and nature of the business of a firm for which it clears, no longer qualifies for a previously granted exemption must promptly notify NASD and commence compliance with the reporting requirements of Rule 3150.

The text of IM-3150 is set forth in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Victoria Berberi-Doumar, Counsel, Regulation Policy, Department of Member Regulation, at (202) 728-8905; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

Background

Rule 3150(a) requires each clearing firm (both those that are self-clearing and those that clear for other firms) to report to NASD, on a daily basis, and in a format determined by NASD, prescribed data pertaining to the member and any member broker-dealer for which it clears. This data is reported into NASD's electronic surveillance system, which identifies member "exceptions" based on historical and current comparisons of member data. The exceptions trigger follow-up reviews and possible member examinations. As provided in Rule 3150(b), NASD may, in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member or class of members, unconditionally or on specified terms, from any or all of the provisions of Rule 3150 that it deems appropriate.

NASD initially notified its members of the availability of certain exemptions in a letter dated June 20, 2002,[2] in which NASD stated that it would exempt the following classes of self-clearing members from the filing requirements of Rule 3150:

- members that derive the preponderance of their revenue for the last two calendar years from fixed income securities;
- members that conduct an institutional business and that settle transactions on an DVP/RVP basis; or
- members that conduct no traditional retail securities business.

Exemptions under IM-3150

Based on the classes described in the June 20, 2002 letter and NASD's current regulatory needs, IM-3150 establishes three classes of self-clearing members that may be exempt from the reporting requirements of Rule 3150(a).

- **The firm derives, on an annualized basis, at least 85 percent of its revenue from transactions in fixed income securities.**

IM-3150(a)(1) replaces the term "preponderance of [its] revenue" set forth in the June 20, 2002 letter with the phrase "at least 85 percent of its revenue" and eliminates the requirement that a member must have derived at least 85 percent of its revenue from fixed income securities transactions for the last two calendar years. Instead, to qualify for this exemption, a member must be able to ascertain that transactions in fixed income securities account for at least 85 percent of its annual revenue. Annualizing the 85 percent requirement takes into account daily, weekly, and monthly fluctuations in a firm's sources of revenue. These changes are consistent with the exemptions NASD staff has granted under this standard pursuant to the June 20, 2002 letter.

- **The firm conducts an institutional business that settles transactions on an RVP/DVP basis, provided that such exemption from reporting shall apply only with respect to such institutional business unless NASD determines that any other remaining business otherwise qualifies for an exemption under IM-3150 or is de minimis in nature.**

Under IM-3150(a)(2), NASD generally will continue to exempt the institutional business of self-clearing firms that settles on an RVP/DVP basis. NASD will determine whether any other remaining business of such firms otherwise qualifies for an exemption under IM-3150 or is sufficiently de minimis as to not require reporting under Rule 3150.

- **The firm does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (*e.g.*, that engages solely in proprietary trading, or that conducts business only with other broker-dealers or any other non-customer counterparties).**

NASD has modified the language of the exemption pertaining to "members that conduct no traditional retail business" to clarify the types of firms that might qualify for this exemption. Accordingly, under IM-3150(a)(3), NASD generally will exempt a member that does not execute transactions for customers or otherwise hold customer accounts or acts as an introducing broker with respect to customer accounts (*e.g.*, engages solely in proprietary trading, or conducts business only with other broker-dealers or any other non-customer counterparties).

Additional Provisions

- **Exemptions for Introducing Firms**

Under IM-3150(b), upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD also generally will grant an exemption to a clearing firm with respect to one or more of the introducing firms for which it clears if the introducing firm meets one of the above-stated grounds for exemptive relief.

- **Procedures for Firms that No Longer Meet the Requirements for an Exemption**

Under IM-3150, a clearing or self-clearing firm that no longer qualifies for an exemption previously granted by NASD from the reporting requirements of Rule 3150 because of a change in the operation and nature of its business, or the operation and nature of the business of a firm for which it clears, as applicable, must promptly report such change in circumstances to NASD, Department of Member Regulation, and comply with the reporting requirements of Rule 3150. In view of the fact that NASD processes the information collected under Rule 3150 for use in effectuating its National Examination Program (NEP), it is essential that clearing firms and self-clearing firms promptly notify the Department of Member Regulation when they, or any firms for which they clear, no longer qualify for an exemption and immediately comply with the reporting requirements of Rule 3150.

- **Requests for Exemptions that Do Not Fall Within the Three Enumerated Classes**

Members that do not fall within one or more of the three enumerated classes set forth in IM-3150 are not precluded from requesting an exemption from Rule 3150(a), pursuant to Rule 3150(b) and the Rule 9600 Series, if they believe their business activities justify such a request.

- **Requests for Exemptions Must Be Made in Writing**

IM-3150 continues to require members to request all exemptions from Rule 3150(a) in writing pursuant to the Rule 9600 Series, including possible exemptions under IM-3150.

Endnotes

1 *See* Exchange Act Rel. No. 49383 (March 9, 2004), 69 Fed. Reg. 12388 (March 16, 2004) (File No. SR-NASD-2004-014).

2 NASD has posted this letter on its Web Site at *www.nasdr.com/pdf-text/insite_ltr_062002.pdf*.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

* * * * *

3150. Reporting Requirements for Clearing Firms

(a) Each member that is a clearing firm or self-clearing firm shall be required to report to [the Association] NASD in such format as [the Association] NASD may require, prescribed data pertaining to the member and any member broker-dealer for which it clears. A clearing firm or self-clearing firm may enter into an agreement with a third party pursuant to which the third party agrees to fulfill the obligations of a clearing firm or self-clearing firm under this Rule. Notwithstanding the existence of such an agreement, each clearing firm or self-clearing firm remains responsible for complying with the requirements of this Rule.

(b) Pursuant to the Rule 9600 Series, [the Association] NASD may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member, or class of members, unconditionally or on specified terms, from any or all of the provisions of this Rule that it deems appropriate.

IM-3150. Exemptive Relief

(a) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD generally will grant an exemption from the reporting requirements of Rule 3150 to a self-clearing firm that:

> (1) derives, on an annualized basis, at least 85 percent of their revenue from transactions in fixed income securities;
>
> (2) conducts an institutional business that settles transactions on an RVP/DVP basis, provided that such exemption from reporting shall apply only with respect to such institutional business unless NASD determines that any other remaining business otherwise qualifies for an exemption under this IM-3150 or is *de minimis* in nature; or

(3) does not execute transactions for customers or otherwise hold customer accounts or act as an introducing broker with respect to customer accounts (e.g., that engages solely in proprietary trading, or that conducts business only with other broker-dealers or any other non-customer counter-parties).

(b) Upon written request for exemptive relief pursuant to the Rule 9600 Series, NASD also generally will grant an exemption to a clearing firm with respect to one or more of the introducing firms for which it clears if the introducing firm meets one of the above-stated grounds for exemptive relief.

(c) Any clearing or self-clearing firm that, due to a change in the facts pertaining to the operation and nature of its business or the operation and nature of the business of a firm for which it clears, as applicable, no longer qualifies for an exemption previously granted by NASD from the reporting requirements of Rule 3150 must promptly report such change in circumstances to NASD, Department of Member Regulation, and commence compliance with the reporting requirements of Rule 3150.

* * * * *

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Continuing Education
Executive Representatives
Legal & Compliance
Registered Representatives
Registration
Research
Senior Management
Training

KEY TOPICS

Registration
Research Reports

GUIDANCE

Research Analysts and Research Reports

SEC Approves New NASD Research Analyst Qualification and Examination Requirements (Series 86/87); **Effective Date: March 30, 2004**

Executive Summary

The Securities and Exchange Commission (SEC) recently approved amendments to NASD rules to finalize and implement the research analyst registration requirements and examination program. The registration requirements become effective on March 30, 2004.
As of that date, any associated person who functions as a research analyst must pass the new Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption or waiver. The examination consists of an analysis part (Series 86) and regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate must also have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative (Series 17), or the Canada Module of Series 7 (Series 37 or 38). Persons who are functioning as research analysts on the effective date will be granted a one-year grace period within which to meet the registration requirements, provided the member firm with which they are associated applies for the research analyst registration within **60** days of the effective date of the rule. There is no "grandfather" provision for this new qualification requirement.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451; or Carole Hartzog, NASD Testing and Continuing Education Department, at (240) 386-4678.

Background and Discussion

Qualification Requirements

NASD Rule 1050 requires any person associated with a member who functions as a research analyst to be registered as such and pass a qualification examination. In the context of this new qualification requirement, a research analyst is "an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report."

NASD intends for the term "research report" in Rule 1050 to be defined as it is in Rule 2711(a)(8), which applies only to "equity securities" as that term is defined in Section 3(a)(11) of the Exchange Act of 1934. Accordingly, fixed income analysts do not need to be registered as research analysts.

Prerequisite Examination

Prior to sitting for either part of the Research Analyst Qualification Examination, a candidate must be registered pursuant to NASD Rule 1032 as a General Securities Representative and have passed or received a waiver from either the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative (Series 17), or the Canada Module of Series 7 (Series 37 or 38).

Grace Period

All associated persons who currently function as research analysts must pass the required examinations to continue to function in that capacity. The new qualification requirement for Research Analysts does **NOT** have a "grandfather" provision. NASD believes that all persons functioning as research analysts should demonstrate the same requisite analytical competency level and knowledge of applicable laws, rules, and regulations.

However, candidates who are functioning as research analysts on the effective date of March 30, 2004, will be allowed one year to meet the research analyst registration requirements. The one-year grace period is intended to provide these analysts sufficient time to study and pass the examination(s) without causing undue disruption in carrying out their responsibilities to their member firm and its customers.

To avail a research analyst of this grace period, the member firm must submit to NASD a registration application (or amendments thereto) for the research analyst, as described below, before **May 31, 2004**. These research analysts would then have until April 4, 2005, to pass the necessary examination(s). Should a research analyst fail to pass the exam within the one-year grace period, his or her registration as a research analyst will terminate on April 4, 2005. Those individuals who apply for registration as research analysts after May 31, 2004, will be subject to NASD's normal qualification procedure. That is, such candidates must have passed either the Series 7, Series 17, or the Series 37 or Series 38 Exam, as well as the new Series 86/87 Exam, *before* functioning as Research Analysts.

Retaking Failed Exams

The usual policy regarding waiting periods for candidates retaking a failed exam has been modified for candidates subject to the one-year grace period described above. Typically, a candidate must wait 30 days before retaking a failed exam and 180 days after the third and all subsequent failures. Candidates who qualify for the research analyst one-year grace period (*i.e.*, those persons functioning as research analysts on March 30, 2004 whose member firm submits to NASD a registration application (or amendments thereto) for the research analyst before May 31, 2004) must wait 30 days before retaking a failed Series 86 and/or Series 87 Exam, but will not be subject to any 180 day waiting period irrespective of whether the candidate fails an exam three times or more. This special exemption from the usual waiting period rules applies only to those candidates eligible for the grace period for Research Analyst Qualification Examination and only for the duration of the grace period. The usual waiting periods apply in all other circumstances, including those instances where a research analyst must pass either the Series 7, Series 17, Series 37, or Series 38 exam within the one-year grace period.

Exemptions

A research analyst who has passed both **Level I and Level II of the Chartered Financial Analyst (CFA) Examination** that is administered by the Association for Investment Management and Research (AIMR) may request an exemption from Part I (Series 86), the Analysis section of the Research Analyst Qualification Examination. To be eligible for the exemption, an applicant must have passed Levels I and II of the CFA examination and must either (1) have functioned continuously as a research analyst since having passed Level II of the CFA examination or (2) have passed Level II of the CFA examination within two years of application for registration as a research analyst.

In addition to the registration procedures described below, member firms will also be required to request the exemption in writing for eligible candidates. To request the exemption, the member must submit the following candidate information to the NASD Testing and Continuing Education Department via e-mail at *RSCFA@nasd.com*:

Candidate's name (Last, First, Middle Initial)

Candidate's CRD Number

Candidate's Birth Date (MM/DD/YR)

Broker/Dealer Name and CRD#

NASD staff will then contact AIMR to confirm the candidate's eligibility. Upon receipt of a positive response from AIMR, the exemption from the Series 86 will be posted to the candidate's CRD record and notification will be sent to the member firm. Candidates who have not completed the required CFA exams will be required to pass both the Series 86 and 87. For candidates seeking a Series 86 exemption, note that registration approval will not be posted until the candidate also passes the Series 87.

Exam Content

The qualification exam consists of two parts. Part I – Analysis (Series 86) consists of 100 multiple-choice questions that primarily test fundamental analysis and valuation of equity securities. Part II – Regulatory Administration and Best Practices (Series 87) consists of 50 multiple-choice questions that cover relevant federal and industry rules and regulations. Candidates are allowed 240 minutes to complete Part I and 90 minutes to complete Part II. Candidates may take Parts I and II in any order and may schedule the examinations on the same or different days. Since multiple forms of the examination will be administered, the passing score for the Series 86 and 87 will fluctuate moderately from examination to examination. Candidates will be given an informational breakdown of their performance on each of the sections, along with their overall score and grade at the completion of exam session.

A study outline has been prepared to assist member firms in preparing candidates for the Research Analyst Qualification Examination and is available at *www.nasdr.com/analyst_guide.asp*. Members may wish to use the study outline to structure or prepare training material, develop lecture notes and seminar programs, and as a training aide for the candidates. The study outline and test are divided into four topical sections, which are described below along with the number of questions from each section:

Section	Description	Number of Questions
	Part I: Series 86—Analysis	
1	Information and Data Collection	10
2	Analysis, Modeling and Valuation	90
	Part II: Series 87—Regulatory Administration and Best Practices	
3	Preparation of Research Reports	32
4	Dissemination of Information	18
	Total	**150**

The questions used in the examination will be updated to reflect the most current interpretations of the rules and regulations on which they are based. Questions on new rules will be added to the pool of questions for this examination within a reasonable time period of the effective dates of those rules. Questions on rescinded rules will be promptly deleted from the pool of questions. Candidates will only be asked questions pertaining to rules that are effective at the time they take the exam.

The test is administered as a closed-book exam. Severe penalties are imposed on candidates who cheat on NASD-administered examinations. The proctor will provide scratch paper and a *basic electronic calculator* to candidates. These items must be returned to the proctor at the end of the session.

The Research Analyst Qualification Examination will be administered at conveniently located test centers operated by Pearson and Prometric professional testing center networks. Appointments to take the examinations can be scheduled through either network:

- Pearson Professional Centers: contact Pearson VUE's National Registration Center at **1-866-396-6273 (toll free), or 1-952-681-3873 (toll number).**
- Prometric Testing Centers: contact Prometric's National Call Center at **1-800-578-6273 (toll free)** or go to *www.2test.com* for Web-based scheduling.

Registration Procedures

A Uniform Application for Securities Industry Registration or Transfer Form (Form U4) must be submitted to NASD via Web CRD in order to register an individual as a Research Analyst. For persons already registered in one of the prerequisite categories, the member need only submit page one of Form U4 to request the Research Analyst (RS) registration. For new employees, a member must submit a full Form U4 application to request all necessary registrations and any other documents required for registration. The exam fees are $150 for the Series 86 and $100 for the Series 87; the registration fee for new applicants is $85. To obtain the one-year grace period described above, the member firm must request the *RS* registration before **May 31, 2004.** It is possible that a candidate who is within the one-year grace period may transfer to another member firm. If so, the grace period will continue to be available to the candidate, and the candidate will continue to be allowed until April 4, 2005, to pass the examination.

Effective Date

The registration and qualification requirements for research analysts become effective on March 30, 2004.

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Research Analyst Examination Frequently Asked Questions

Definition of Research Analysts under Rule 1050

Q. Who needs to take this exam?

A. Any associated person of a member who is primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on a research report on equity securities. For the purposes of determining who needs to register as a research analyst, the term "research report" has the same meaning as it does in Rule 2711(a)(8): "a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision." Members should refer to *Notices to Members 02-39* and *04-18* for interpretation of the definition of a "research report" under 2711(a)(8).

Q. We have many analysts in our BD/IA firm who both educationally and through industry experience qualify as investment analysts and have passed Series 6, 7, 63, and 65. Would they be "grandfathered" as research analysts?

A. The research analyst registration requirement does not include a "grandfather" provision. All associated persons who meet the definition of a research analyst, new and incumbent, must satisfy the qualification requirements of NASD Rule 1050.

Q. Are "sell-side" equity analysts required to register as research analysts and pass the Series 86/87?

A. Yes. The registration and qualification requirements of Rule 1050 do not distinguish between "sell-side" and "buy-side" analysts. Any person who prepares written or electronic communications that includes an analysis of equity securities and sufficient information upon which to base an investment decision would be required to register as a research analyst.

Q. Would individuals who prepare research for a member firm as consultants be subject to the requirements of NASD Rule 1050?

A. If the consultant is an "associated person" under NASD rules and his or her activities fall under the definition of "research analyst" pursuant to Rule 1050, the consultant would have to register as a research analyst.

Q. **Does this requirement apply to everyone who works in equity research or just those who write a research report that will be seen by the public?**

A. Rule 1050 applies to associated persons who prepare publicly disseminated research reports. Associated persons who prepare reports for use only by a member's sales force, money managers, or other employees of the firm, and who do not have reason to believe that the reports will be redistributed publicly, would not be subject to this rule.

Q. **Is a "technical analyst" who does not rely on fundamental research to prepare his or her research reports on companies required to register as a research analyst and take the qualification examinations?**

A. As explained in the joint memoranda issued by NASD and the NYSE in *Notice to Members 02-39* and *04-18*, a communication that consists of "technical analysis concerning the demand and supply for a sector, index, or industry based on trading volume and price" falls outside the definition of a "research report" under Rule 2711(a)(8). Accordingly, a person who produces only such technical research would not be required to become registered as a research analyst. However, the exclusion does not extend to technical analysis of individual securities. Thus, an associated person who produces technical research on individual companies would be required to become registered as a research analyst pursuant to Rule 1050.

Q. **Is a research analyst who is employed by a foreign broker/dealer affiliate of an NASD member required to register pursuant to Rule 1050 if the member uses that analyst's research reports or distributes in the United States in accordance with SEC Rule 15a-6?**

A. A "research analyst" employed by a non-member affiliate of an NASD member is not required to register as a research analyst pursuant to Rule 1050 unless the research analyst is an "associated person" of the NASD member as that term is defined in the NASD By-Laws.

Exemptions and Waivers

Q. **What evidence will be required from a candidate who has passed the CFA Level I and II examinations?**

A. No evidence will be required. A member must submit electronically to NASD a request for the CFA exemption, and NASD will confirm the candidate's eligibility with AIMR.

Q. Can a research analyst who hasn't passed CFA Level I and II obtain a waiver from Series 86 if he has relevant employment or work experience? What types of employment/experience would qualify for this waiver?

A. While NASD may grant waivers under extraordinary circumstances, in light of the purpose of the new research analyst qualification requirements, NASD does not intend to grant waivers except to those who have either passed the Series 86/87 or the CFA Levels I and II. Even those individuals who have a long history of functioning as a research analyst must meet the qualification requirements within one year of the effective date. A waiver might be considered for individuals who have passed the Series 86 and 87 and have substantial work experience as a research analyst, but who have let their registration lapse. Candidates who receive an exemption from, or waiver of, the Series 86 must still satisfy the Series 7, 17, 37, or 38 prerequisite and pass the Series 87 before becoming qualified as research analysts.

Q. Can a request for an exemption (waiver) of the Series 87 be granted for someone who has Series 7, CFA Levels I, II, & III, and the NYSE Series 16?

A. Waivers of the Series 87 will **NOT** be granted under any circumstances.

Supervision

Q. What registration and qualification requirements must supervisors of registered research analysts possess?

A. All registered NASD research analysts must be supervised by a Series 24 principal. Those members who are also members of the NYSE may continue to satisfy the principal approval requirements under Rule 2210(b)(1) with the signature or initial of a supervisory analyst (Series 16) approved pursuant to NYSE Rule 344. A Series 16 supervisory analyst may also supervise for compliance with the disclosure provisions of Rule 2711; however, a Series 24 principal must supervise all other conduct of a registered research analyst.

Q. Will a Series 24 principal who supervises registered research analysts also be required to pass the Series 86/87?

A. Not at this time. However, NASD is reviewing its supervision rules involving registered research analysts and may require supplemental qualification in the future. In the event that additional qualification requirements are required of supervisors of research analysts, NASD will provide sufficient time for such qualification so as not to disrupt a member's research business.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal and Compliance
Operations
Senior Management

KEY TOPICS

Breakpoints
Unit Investment Trust Sales

GUIDANCE

Unit Investment Trust Sales

NASD Reminds Members of Their Duty to Ensure Proper Application of Discounts in Sales Charges to Sales of Unit Investment Trusts (UITs)

Executive Summary

Unit Investment Trusts (UITs) that charge initial sales charges sometimes offer discounts in the sales charge based on the dollar amount or number of units of the investment. The thresholds at which the discounts are offered in the sale of UITs generally are called price breaks, and are substantially similar to breakpoint discounts in the sale of mutual fund shares. Because breakpoint discounts are widespread in the sale of front-load Class A mutual funds, NASD recently has taken a number of steps to ensure that members understand, inform customers about, and correctly apply breakpoint discounts in the sale of mutual fund shares. The purpose of this *Notice* is to remind members that the same duties extend to the sale of UITs that offer price breaks, and that they should develop and implement the same type of procedures for ensuring the proper application of such discounts in connection with the sale of UITs as they have in connection with the sale of mutual funds.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Marc Menchel, Executive Vice President and General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

04-26

Discussion

Mutual funds that charge front-end sales charges often offer discounts in the sales charge based on the dollar amount of an investment. For example, a mutual fund may charge a sales charge of 5.75 percent for purchases of less than $50,000; reduce the charge to 4.50 percent for aggregate purchases over that amount; reduce it again for aggregate purchases over $100,0000; and further reduce it or eliminate it entirely for still higher purchases. In the sale of mutual funds, the dollar thresholds at which the discounts are offered are generally called breakpoints. Breakpoints are set by the mutual fund company in the fund's prospectus, and vary from fund to fund. Investors may be eligible for breakpoint discounts based on a single transaction that meets a dollar threshold. In addition, depending on the terms of the prospectus, investors may be entitled to a discount for aggregate purchases by using a letter of intent (LOI) or based on rights of accumulation (ROA). It is the responsibility of firms and their employees selling mutual fund shares to review and understand the terms of the prospectus, and to ensure that customers are aware of and receive applicable breakpoint discounts.

NASD recently has taken several steps to ensure that firms are fulfilling that responsibility. In December 2002, NASD issued *Special Notice to Members 02-85*, which reminded members that they must: (a) understand the breakpoint discounts offered by mutual funds; (b) determine what information should be recorded on their books and records to allow them to provide all available discounts; (c) inform each customer of relevant discount opportunities; and (d) correctly process the transaction so that the customer receives any applicable discount. Subsequently, at the request of the SEC, NASD convened and led a Joint NASD/Industry Breakpoint Task Force (Joint Task Force) to develop recommended practices that would facilitate the complete and accurate delivery of breakpoint discounts. The Joint Task Force released its report in July 2003, *Report of the Joint NASD/Industry Task Force on Breakpoints*, available on NASD's Web Site at *www.nasdr.com/breakpoints_report.asp.* Among other things, the Joint Task Force recommended that firms develop procedures for: training employees about breakpoint discounts; informing customers about what breakpoints apply to products in which they are planning to invest; and correctly processing applicable breakpoint discounts. NASD has developed a range of training materials and forms for firms to use in implementing these recommendations, which can be found on NASD's Web Site at *www.nasdr.com/breakpoints_members.asp.*

UITs are investment companies that offer redeemable shares, or units, of a generally fixed portfolio of securities in a one-time public offering, and terminate on a specified date. Like mutual funds, some UITs that charge initial sales charges offer discounts in the sales charge based on the dollar amount or number of units of the investment, although in the context of UITs such discounts generally are called price breaks rather than breakpoints. For example, a UIT may charge an initial sales charge of 1.00 percent

for purchases of less than 50,000 units; reduce the charge to .75 percent for purchases of between 50,000 and 100,000 units; reduce it again to. 25 percent for purchases of between 100,000 and 250,000 units; and eliminate it entirely for purchases of more than 250,000 units. As in the case of mutual fund shares, investors may be eligible for discounts based on a single transaction. There may also be limited rights of accumulation, depending on the terms and conditions set forth in the prospectus.

The purpose of this *Notice* is to remind members that they have the same duty to understand, inform customers about, and correctly apply price breaks in the sale of UITs that they have with regard to breakpoint discounts in the sale of Class A mutual fund shares, and that they should develop and implement the same type of procedures for ensuring the proper application of such discounts in connection with the sale of UITs that they have in connection with the sale of mutual funds. Although many of the recommendations of the Joint Task Force, as well as the training materials and forms developed by NASD in response to those recommendations, are specific to mutual funds, NASD suggests that firms look to both sources for guidance in devising appropriate procedures with respect to the sale of UITs.

Conclusion

NASD considers it essential that sales of UITs be affected on the most advantageous terms available to the customer. It is the responsibility of firms to take appropriate steps to ensure that they and their employees understand, inform customers about, and apply correctly any applicable price breaks available to customers in connection with UITs. Furthermore, the principles underlying this *Notice* and *Special Notice to Members 02-85* are the same: a member has a duty to train employees, inform customers, and correctly process every transaction in a manner that promotes and ensures delivery of all promised commercial terms of an investment or product, including any applicable discounts to pricing, commissions, fees, or spreads. Failure to take such steps may constitute a violation of NASD rules.

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Disciplinary and Other NASD Actions

REPORTED FOR MARCH

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of February 2004.

Firms Fined, Individuals Sanctioned

Berry-Shino Securities, Inc. (CRD #38098, Scottsdale, Arizona) and Ralph Matthew Shino (CRD #1380293, Registered Principal, Scottsdale, Arizona) were fined $52,500, jointly and severally, and Shino was suspended from association with any NASD member in any principal capacity for 10 business days. The sanctions were based on findings that the firm, acting through Shino, charged public customers excessive and unfair commissions on listed option transactions. The findings also stated that the commissions were greater than the amount of commission warranted by market conditions, the cost of executing the transactions, the value of services rendered to the customer by the firm, and other pertinent factors. In addition, NASD found that the firm, acting through Shino, accepted and executed, or caused the execution of, orders to purchase listed options in customer accounts without having obtained required information and documentation from the customers as required by NASD Conduct Rule 2860(B)(16)(A).

Shino's suspension began March 1, 2004, and concluded at the close of business March 12, 2004. **(NASD Case #C3A030001)**

Investment Management Corporation (CRD #37196, Bountiful, Utah) and Kevin Dee Kunz (CRD #1274540, Registered Principal, Fruit Heights, Utah) were fined $28,753, jointly and severally. Kunz was suspended from association with any NASD member in any principal capacity for six months, barred from association with any NASD member firm as a financial and operations principal, and ordered to requalify in any principal capacity in which he seeks to register. The National Adjudicatory Council (NAC) imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that Kunz, acting on behalf of the firm, conducted a securities business while failing to maintain the required minimum net capital. The findings also stated that the firm and Kunz maintained inaccurate books and records, filed inaccurate FOCUS reports, submitted an incomplete and materially inaccurate notice of a possible net capital deficiency to NASD, and failed to file required information concerning an arbitration award and its subsequent settlement. In addition, the findings stated that Kunz and the firm allowed an unregistered person to function in a capacity that required registration. NASD also found that the firm failed to maintain adequate written supervisory procedures with respect to the reporting of arbitration awards and settlements.

Kunz' suspension began February 16, 2004, and will conclude at the close of business August 16, 2004. **(NASD Case #C3A010045)**

SunAmerica Securities, Inc. (CRD #20068, Phoenix, Arizona) and Michael Robert Roeser (CRD #1304673, Registered Principal, Libertyville, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined $75,000, and ordered to pay a cash settlement in the amount of $105,769.86 to public customers. The firm was also ordered to establish procedures regarding recommendations of Class B share purchases and to require its representatives and principals to complete an online training module that addresses the economic considerations applicable to the recommendation of Class B shares, the availability of sales charge breakpoints, and the use of Mutual Fund Analyzers/ Calculators that compare the expenses of the different fund classes. Roeser was fined $5,000; ordered to pay $39,000 to public customers, which represents disgorgement of his additional commissions earned by selling Class B shares; suspended from association with any NASD member in any capacity for 30 days; and ordered to requalify as a investment company and variable contracts representative.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Roeser, recommended and sold approximately $9.6 million of Class B mutual fund shares to public customers and, because the purchase of Class B shares were recommended, the customers did not obtain the benefit of sales charge breakpoints to which they would have been entitled if the accounts had purchased Class A shares in fewer funds and fund families. The findings also stated that the recommendations to purchase Class B shares were unsuitable because the internal expenses of the Class B shares over the period that the customers expected to hold the shares exceeded the amount of the sales charges that would have been paid on the purchase of Class A shares, thus costing the customers more to purchase and hold Class B shares than Class A shares. In addition, NASD determined that the firm failed to establish, maintain, and enforce adequate written proceedings and a supervisory system reasonably designed to detect and prevent unsuitably large purchases of Class B mutual fund shares.

Roeser's suspension began March 1, 2004, and will conclude at the close of business March 30, 2004. **(NASD Case #C3A040005)**

Firm and Individual Fined

Hornblower Fischer & Co. (CRD #10885, New York, New York) and Richard Francis Morgan (CRD #340044, Registered Principal, Verona, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which they were fined $15,000, jointly and severally. Without admitting or denying the allegations, the firm and Morgan consented to the described sanction and to the entry of findings that the firm, acting through Morgan, permitted persons whose registrations were inactive due to their failure to complete the Regulatory Element of NASD's Continuing Education Requirement within the prescribed period to function in capacities requiring registration. The findings also stated that the firm, acting through Morgan, had established written supervisory procedures addressing the Regulatory Element of NASD's Continuing Education Requirement, but these procedures were not reasonably designed to achieve full compliance with the requirements of NASD Membership and Registration Rule 1120. **(NASD Case #C3A040003)**

Firms Fined

ABN Amro Incorporated (CRD #15776, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined $15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through the Automated Confirmation Transaction Service℠ (ACT℠) last sale reports of transactions in NASDAQ National Market® (NNM®) securities and failed to designate through ACT such last sale reports as late. The findings also stated that the firm incorrectly designated as ".SLD" through ACT last sale reports of transactions in NNM securities reported to ACT within 90 seconds of execution. **(NASD Case #CMS040005)**

The Buckingham Research Group Incorporated (CRD #13233, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined $29,000, $10,000 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it permitted a research analyst to act as a general securities representative of the firm by allowing him to generate research reports that identified him by name while failing to be registered in such capacity. The findings also stated that the firm reported proprietary short sale transactions through ACT without a short sale modifier and one long sale transaction was reported as short. NASD also found that the firm failed to report to ACT the correct symbol indicating that the firm executed transactions in eligible securities in an agency capacity. In addition, NASD found that the firm allowed individuals to act in the capacity of

registered representatives while their registrations were deemed inactive due to their failure to satisfy the Regulatory Element of NASD's Continuing Education Requirement. Moreover, NASD found that the firm failed to preserve e-mail communications sent to institutional investors for three years, the first two years in an easily accessible place. **(NASD Case #C05040005)**

Cantor Fitzgerald & Co. (CRD #134, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined $29,000, and required to revise its written supervisory procedures concerning the requirements of quotation activity in OTC Equity securities. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to contemporaneously or partially execute customer limit orders in NASDAQ securities after it traded each subject security for its own market-making account at a price that would have satisfied each customer's limit order. The findings also stated that the firm executed short sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security.

NASD found that the firm executed short sale orders in certain securities and failed to make an affirmative determination prior to executing such transactions. In addition, NASD found that the firm failed, within 90 seconds after execution, to transmit through ACT last sale reports of transactions in an NNM security and eligible securities and failed to designate through ACT such last sale reports as late; failed to report the correct price of transactions in NNM securities in last sale reports of transactions; failed to report through ACT last sale reports of transactions in NNM securities; failed to designate through ACT last sale reports as reflecting a price different from the current market when the execution was based on a prior reference point in time; failed to report to ACT the correct symbol indicating whether the transaction was a buy, sell, sell short, sell short exempt, or cross for transactions in eligible securities; failed to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities in a principal or agency capacity; failed to provide written notification disclosing to its customers its correct capacity in transactions; and failed to display immediately customer limit orders in NASDAQ securities in its public quotation when each such order was at a price that would have improved the firm's bid or offer in each such security, or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each such security and the size of the order represented more than a de minimis change in relation to the size associated with the firm's bid or offer in each such security.

In addition, NASD found that the firm failed to show the order entry time, the correct time of execution, correct capacity, correct price of execution, correct date of order receipt, that an order was long, and quotations from three dealers on the memorandum of brokerage orders. Moreover, NASD found that the firm failed to preserve for a period of not less than three years, the first two in an accessible place, the memorandum of brokerage orders. Furthermore, NASD found that the firm made available a report on the covered orders in national market system securities that it received for execution from any person. This report included incorrect information as to how orders should be categorized. The findings also stated that the firm incorrectly designated as ".SLD" through ACT last sale reports of transactions in eligible securities reported to ACT within 90 seconds of execution. NASD also found that the firm published quotations for an OTC Equity Security in a quotation medium and did not have in its records the documentation required by SEC Rule 15c2-11(a); did not have a reasonable basis under the circumstances for believing that the Paragraph (a) information was accurate in all material respects; or did not have a reasonable basis under the circumstances for believing that the sources of the Paragraph (a) information were reliable. The findings further stated that the quotations did not represent a customer's indication of unsolicited interest, and the firm, for each quotation, failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation medium. NASD also determined that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding quotation activity in OTC Equity securities. **(NASD Case #CMS040008)**

Greenhill & Co., LLC (CRD #40290, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined $20,000, $5,000 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it permitted individuals to act in capacities that required registration while their registration status with NASD was inactive due to their failure to complete the Regulatory Element of NASD's Continuing Education Requirement. **(NASD Case #C10040001)**

Paramount Capital, Inc. (CRD #29795, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined $10,000, $5,000 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described allegations and to the entry of findings that, acting under the direction and control of an individual, it was a participating broker in a contingency offering of securities, and investor funds raised in the offering were not transmitted to a separate bank escrow account meeting the requirements of Rule 15c-2-4. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with SEC Rule 15c2-4. **(NASD Case #C9B040003)**

Synovus Securities, Inc. (CRD #14023, Columbus, Georgia) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm failed to establish, maintain, and enforce adequate written supervisory procedures reasonably designed to prevent the conversion or misuse of public customer funds. **(NASD Case #C07040013)**

Individuals Barred or Suspended

Ronald David Armitage (CRD #7228, Registered Principal, Staten Island, 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, Armitage consented to the described sanction and to the entry of findings that he failed to respond to an NASD request to appear for an on-the-record interview. **(NASD Case #CMS040002)**

Michael John Blanchard (CRD #1246309, Registered Principal, Belmont, New Hampshire) 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, Blanchard consented to the described sanctions and to the entry of findings that he made an unsuitable recommendation to a public customer to invest funds in a variable annuity without reasonable grounds for believing that the variable annuity was suitable for the customer.

Blanchard's suspension began March 15, 2004, and will conclude at the close of business March 26, 2004. **(NASD Case #C11040005)**

Christopher Alan Booze (CRD #3263962, Registered Representative, Lexington, Kentucky) was barred from association with any NASD member in any capacity. The sanction was based on findings that Booze completed a firm instruction form to request that a $3,200 check, made payable to a third party, be issued from the account of a public customer and given to Booze without the customer's knowledge, authorization, or consent, thereby improperly using customer funds. The findings also stated that Booze created and sent to the customer a fictitious account statement that overstated the value of the customer's holdings in his firm account to conceal his withdrawal from the customer's account. NASD also found that Booze failed to respond to NASD requests for information. **(NASD Case #C05030048)**

Jeffrey Harlan Boss (CRD #2685155, Registered Representative, North Caldwell, New Jersey) was barred from association with any NASD member in any capacity. The sanction was based on findings that Boss failed to respond to NASD requests for information. The findings also stated that Boss engaged in outside business activity, for compensation, and failed to provide prompt written notice to his member firms. **(NASD Case C9B030042)**

Gerald Page Brockman (CRD #1362573, Registered Representative, Charlotte, North Carolina) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Brockman consented to the described sanction and to the entry of findings that he converted the funds of public customers to his own use without authorization. **(NASD Case #C07040002)**

Gregg Thomas Catalano (CRD #2551346, Registered Representative, Syosset, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $22,500, including partial disgorgement of $15,000, and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Catalano reassociates with any NASD member in any capacity following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Catalano consented to the described sanctions and to the entry of findings that he recommended and sold securities products to public customers while unregistered with NASD.

Catalano's suspension began March 1, 2004, and will conclude at the close of business May 31, 2004. **(NASD Case #C10040004)**

Mario Lucas Chavez (CRD #4082977, Registered Representative, Albuquerque, New Mexico) was barred from association with any NASD member in any capacity. The sanction was based on findings that Chavez received $22,103.24 from a public customer intended by the customer for investment purposes, and directed the office staff to purchase a fixed annuity for $11,000 and to remit the balance to his firm's clearing firm. The findings also stated that Chavez took possession of the check payable to the clearing firm and deposited it into a securities account in his name with his member firm, thereby misappropriating customer funds. NASD also found that Chavez prepared an account statement that purported to represent the customer's investment and delivered it to the customer in order to conceal his misappropriation of the customer's funds. Furthermore, the findings stated that Chavez failed to respond to NASD requests for information. **(NASD Case #C3A030025)**

Douglas Conant Day (CRD #1131612, Registered Principal, San Jose, California) was fined $125,000, barred from association with any NASD member in any capacity, and ordered to pay $79,500 in restitution, plus interest, to public customers.

The sanctions were based on findings that Day made egregious, unsuitable recommendations to public customers. The findings also stated that Day failed to respond to NASD requests for information. **(NASD Case #C01020024)**

Robert Michael Dooley (CRD #2735594, Registered Representative, Highlands Ranch, Colorado) was fined $49,400, suspended from association with any NASD member in any capacity for two years, and ordered to pay $4,258 in restitution to a public customer. The sanctions were based on findings that Dooley made unsuitable recommendations to a public customer to purchase mutual funds without having a reasonable basis for believing that the recommendations made were suitable for the customer, based on the customer's circumstances and needs.

Dooley's suspension began February 17, 2004, and will conclude at the close of business February 16, 2006. **(NASD Case #C3A030036)**

Doyle Scott Elliott (CRD #1727061, Registered Principal, Anna Maria, Florida) was barred from association with any NASD member in any capacity. The sanction was based on findings that Elliott received $35,000 from a public customer to purchase a low-priced stock in collaboration with Elliott, and was told that the stock would be sold at a profit within 30 days, and that they would split the profit. The findings also stated that Elliott failed to use the customer's funds and sent him fictitious trade confirmations purporting to confirm sell transactions from the customer's account at Elliott's member firm although he did not have an account at the firm and none of the transactions occurred. NASD also found that Elliott failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C07030057)**

Salvatore John Fabrizio (CRD #2505827, Registered Representative, Long Island City, New York) was fined $25,000, suspended from association with any NASD member in any capacity for two years, and ordered to pay $4,914.50, plus interest, in restitution to public customers. The sanctions were based on findings that Fabrizio purchased securities for the accounts of public customers without the customers' knowledge, authorization, or consent. The findings also stated that Fabrizio failed to respond timely to NASD requests to provide information and to give testimony.

Fabrizio's suspension began March 1, 2004, and will conclude at the close of business March 1, 2006. **(NASD Case #C10030073)**

David Bosley Fenwick (CRD #1957952, Registered Supervisor, Bowling Green, Kentucky) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $15,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Fenwick reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Fenwick consented to the described sanctions and to the entry of findings that he exercised discretion in transactions in the accounts of public customers without prior written authorization from the customer and prior written acceptance of the account as discretionary by his member firm. The findings also stated that Fenwick executed an unauthorized equity purchase in the account of public customers without the customers' knowledge or consent.

Fenwick's suspension began March 1, 2004, and will conclude at the close of business March 30, 2004. **(NASD Case #C05040003)**

Maxine Elaine Fowler (CRD #2416814, Registered Representative, Greer, South Carolina) was barred from association with any NASD member in any capacity. The sanction was based on findings that Fowler failed to respond to NASD requests for information. The findings also stated that Fowler made misrepresentations to public customers in the sale of long-term callable certificates of deposit (CDs) by telling the customers that the CDs had significantly shorter maturities than they actually had. **(NASD Case #C05030043)**

David Logan Froede (CRD #2032725, Registered Representative, San Jose, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Froede sent a misleading account statement to a public customer purporting to represent all of the activities in the customer's account but failed to reflect a share redemption and check withdrawals totaling $250,000 that Froede converted to his own use and benefit. The findings also stated that Froede forged the customer's name to checks without the customer's authorization, knowledge, or consent. NASD also found that Froede failed to respond to NASD requests for information and documentation. **(NASD Case #C8A030075)**

Gary Joseph Giordano (CRD #2722480, Registered Principal, Brooklyn, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Giordano consented to the described sanction and to the entry of findings that he used fraudulent and deceptive misrepresentations and omissions of material fact in making unsuitable recommendations of securities to public customers. The findings also stated that Giordano egregiously failed to supervise the sales activities and conduct of registered representatives and unregistered persons. **(NASD Case #CMS030182)**

Ryan Goolcharan (CRD #2884804, Registered Representative, South Brunswick, New Jersey) submitted an Offer of Settlement in which he was fined $5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Goolcharan reassociates with any NASD member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Goolcharan consented to the described sanctions and to the entry of findings that he recommended the purchase of a stock to public customers without a reasonable basis for believing the stock was suitable for any investor. The findings also stated that Goolcharan made material misrepresentations and omitted material facts when he recommended the stock to public customers. In addition, NASD found that Goolcharan solicited public customers to buy a stock and failed to submit the required form to his member firm for approval of the solicitations and marked the solicited trades as "unsolicited" in his firm's automated order-entry system. The findings stated that Goolcharan caused his firm's records to be inaccurate and caused the firm to violate Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-3 promulgated thereunder.

Goolcharan's suspension began March 1, 2004, and will conclude at the close of business August 31, 2004. **(NASD Case #CAF030064)**

Cary Edwin Grant (CRD #1314269, Registered Principal, Chicago, Illinois) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for three months and suspended from association with any NASD member in any principal or supervisory capacity for six months thereafter. In light of the financial status of Grant, no monetary sanction has been imposed. Without admitting or denying the allegations, Grant consented to the described sanctions and to the entry of findings that he performed duties as a general securities principal and was the president of his member firm while his registration status with NASD was inactive due to his failure to timely complete the Regulatory Element of NASD's Continuing Education Rule. The findings also stated that Grant failed to file timely a written application for change in ownership of his member firm in contravention of his member firm's membership agreement with NASD. NASD also found that a member firm, acting through Grant, opened a branch office and failed to properly notify NASD of its intent in contravention of the firm's membership agreement. The findings further stated that Grant failed to establish and maintain a supervisory system over the activities of a branch office of his member firm reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules in that Grant permitted his NASD Electronic Signature and password to be used by an individual at the firm who was not a registered principal and permitted new accounts to be opened and orders executed without the approval of a firm principal. In addition, NASD found that Grant failed to respond promptly to NASD requests for information and documentation.

Grant's suspension in all capacities began February 19, 2004, and will conclude at the close of business May 18, 2004. Grant's suspension as a general securities principal will begin May 19, 2004, and will conclude at the close of business November 18, 2004. **(NASD Case #C8A030013)**

Robert Haar Griffin (CRD #2149540, Registered Representative, Montrose, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $33,500, $8,500 of which represents financial benefits received, and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Griffin reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Griffin consented to the described sanctions and to the entry of findings that he executed unauthorized transactions in the account of public customers. NASD also found that Griffin made recommendations to public customers and did not have a reasonable basis for believing that the recommendations made were suitable for the customers.

Griffin's suspension began February 17, 2004, and will conclude at the close of business August 16, 2005. **(NASD Case #C3A040002)**

Stratos Hatzikontos (CRD #2599724, Registered Representative, Fresh Meadows, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Hatzikontos received $40,000 from public customers for investment in a fictitious security and misappropriated the funds for his own use. The findings also stated that Hatzikontos prepared false and fictitious account statements that purported to represent the performance of the customers' funds in his fictitious corporation. NASD also found that Hatzikontos failed to respond to NASD requests for information. **(NASD Case #C10030065)**

Jerry Moore Hill (CRD #3357, Registered Principal, San Antonio, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $2,500 and suspended from association with any NASD member in any principal or supervisory capacity for 10 business days. Without admitting or denying the allegations, Hill consented to the described sanctions and to the entry of findings that she accepted $45,179 of customer funds into the firm's bank account that triggered a reserve computation requirement. The findings also stated that the member firm then failed to calculate a reserve computation or to make any required deposits to a reserve account to cover customer credits during the time the firm held customer funds.

Hill's suspension will begin March 22, 2004, and will conclude at the close of business April 2, 2004. **(NASD Case #C06040002)**

Jerri Shavon Hunter (CRD #4405016, Registered Representative, Silver Spring, Maryland) was barred from association with any NASD member in any capacity. The sanction was based on findings that Hunter received $2,578 from a public customer as an advance to assist the customer in selling a real estate time-share she owned. The findings also stated that Hunter endorsed and negotiated the check but failed to assist the customer in selling her time-share, thereby converting the funds to her own use and benefit. NASD also found that Hunter failed to respond to NASD requests for information. **(NASD Case #C07030070)**

Barry Duane Jordan (CRD #1074870, Registered Principal, Moreno Valley, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Jordan consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior notice to, and receiving approval from, his member firm.

Jordan's suspension began March 1, 2004, and will conclude at the close of business April 29, 2004. **(NASD Case #C02040003)**

David Theodore Kaagan (CRD #2727926, Registered Representative, Beverly Hills, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kaagan failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C02030026)**

James Allen Kenas (CRD #2095140, Registered Principal, Coeur d'Alene, Idaho) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for six months. In light of the financial status of Kenas, no monetary sanction has been imposed. Without admitting or denying the allegations, Kenas consented to the described sanction and to the entry of findings that he made recommendations to public customers that they purchase $80,000 in mutual fund shares using the proceeds from a mortgage on their home. The findings also stated that Kenas' recommendations were made without reasonable grounds for believing that such recommendations were suitable for the customers upon the basis of the facts disclosed by the customers as to their other security holdings, financial situation, and needs.

Kenas' suspension began March 1, 2004, and will conclude at the close of business August 31, 2004. (**NASD Case #C3B040001)**

William Michael Kenyon (CRD #1937708, Registered Representative, Canandaigua, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Kenyon consented to the described sanction and to the entry of findings that, without the knowledge or consent of public customers, he signed the names of the customers on conversion documents converting term life insurance policies to permanent insurance products that did not require additional medical underwriting in order to create a temporary income stream. The findings also stated that Kenyon failed to respond to NASD requests for information. **(NASD Case #C8B030030)**

Diana Lou Knutson (CRD #1047287, Registered Representative, Minneapolis, Minnesota) 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, Knutson consented to the described sanction and to the entry of findings that she converted $84,620.55 of a public customer's securities funds to her own personal use and benefit without the customer's authorization, knowledge, or consent. The findings also stated that Knutson failed to respond to NASD requests for information. **(NASD Case #C04040001)**

Jay Alvin Leishman (CRD #1581645, Registered Representative, San Diego, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Leishman consented to the described sanction and to the entry of findings that he obtained a $12,647 check from a public customer intended to be invested for the customer's sole and exclusive benefit. The findings also stated that Leishman, without the customer's knowledge or consent, deposited the check into his personal bank account and subsequently used the funds for his own benefit. **(NASD Case #C02040007)**

Heather Ann Mann (CRD #4617603, Associated Person, Unadilla, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Mann willfully failed to disclose a material fact on her Uniform Application for Securities Industry Registration or Transfer (Form U4). The findings also stated that Mann failed to respond to NASD requests for documents and information. **(NASD Case #C9A030033)**

David Anthony Mauro (CRD #4649662, Associated Person, Orlando, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Mauro reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Mauro consented to the described sanctions and to the entry of findings that he willfully misrepresented material facts on his Form U4.

Mauro's suspension began February 2, 2004, and will conclude August 1, 2004. **(NASD Case #C07040001)**

Sampson McKie, III (CRD #4209727, Associated Person, Staten Island, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that McKie redirected $1,072.94, which was to be credited to the account of a public customer, into his personal account at his member firm without the customer's authorization, knowledge, or consent and used the funds for his own personal use. **(NASD Case #C9B030055)**

Jairzinho Merzius (CRD #4020892, Associated Person, Brooklyn, 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 two years. The fine must be paid before Merzius reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Merzius consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4.

Merzius' suspension began February 2, 2004, and will conclude at the close of business February 1, 2006. **(NASD Case #C10040003)**

Jordan A. Ness (CRD #2706916, Registered Representative, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $22,500 and suspended from association with any NASD member in any capacity for 120 days. The fine must be paid before Ness reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ness consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm. The findings also stated that Ness established securities accounts at other member firms, and after he became registered with member firms, he failed to promptly notify his member firm in writing that he had established the accounts, and failed to promptly notify the other firms of his association with his member firm. NASD also found that Ness, while associated with a member firm, engaged in outside business activities for compensation without providing prompt written notice to his member firm.

Ness' suspension began March 15, 2004, and will conclude at the close of business July 14, 2004. **(NASD Case #C3B040002)**

Luther Ernest Oliver (CRD #737073, Registered Principal, Chesterfield, Missouri) 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, Oliver consented to the described sanction and to the entry of findings that he was associated with a member firm without the approval of the Securities and Exchange Commission (SEC) and/or NASD while subject to a statutory disqualification. **(NASD Case #C04040005)**

Derek Michael Pagan (CRD #2630393, Registered Representative, Fort Myers, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Pagan consented to the described sanction and to the entry of findings that he effected purchases of Class A mutual fund shares in the account of a public customer but failed to apply the reduced sales charges applicable in breakpoint sales and imposed excessive sales charges on the transactions by failing to account for rights of accumulation to which the customer was entitled. The findings also stated that Pagan effected unauthorized purchases of Class B mutual fund shares in the customer's account and failed to disclose to his member firm that the customer had not authorized the transactions or that the customer had passed away before the transactions were effected. NASD also found that Pagan permitted the customer's son to forge the customer's signature on a mutual fund switch letter after the customer's death. **(NASD Case #C07040004)**

Peter Michael Panagiotou (CRD #2233079, Registered Principal, Westborough, Massachusetts) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for two years. In light of the financial status of Panagiotou, no monetary sanction has been imposed. Without admitting or denying the allegations, Panagiotou consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without prompt written notice to his member firm. The findings also stated that Panagiotou failed to amend his Form U4 to reflect his outside business activities.

Panagiotou's suspension began March 1, 2004, and will conclude at the close of business February 28, 2006. **(NASD Case #C11030039)**

Michael Jay Plummer (CRD #2813048, Registered Principal, Anderson, Indiana) submitted an Offer of Settlement in which he was fined $1000 and suspended from association with any NASD member in any capacity for 10 business days. In light of the financial status of Plummer, the fine imposed is $1,000. Without admitting or denying the allegations, Plummer consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, and failed and neglected to give prompt written notice of his activities to his member firm.

Plummer's suspension began March 1, 2004, and concluded at the close of business March 12, 2004. **(NASD Case #C8A030067)**

Leaudria Maria Polk (CRD #2136432, Registered Representative, New Orleans, Louisiana) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined $15,000, including disgorgement of $2,798.92 in financial benefits received, and suspended from association with any NASD member in any capacity for four months. Without admitting or denying the allegations, Polk consented to the described sanctions and to the entry of findings that she recommended and effected a series of transactions for public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customer on the basis of the customers' financial situations and needs. The findings also stated that Polk sent communications to public customers in connection with the sale of equities and mutual funds that failed to present the risks of the security in a balanced manner, contained unwarranted and misleading statements, omitted material facts, and included exaggerated statements and claims. In addition, NASD found that the communications contained annual rates of return and projections of returns that appeared to predict investment results.

Polk's suspension will begin April 1, 2004, and will conclude July 31, 2004. **(NASD Case #C05040006)**

Ronald J. Ponella (CRD #2616823, Registered Representative, Port Jefferson Station, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Ponella consented to the described sanction and to the entry of findings that he converted $2,000 of a public customer's funds for his own use and benefit. The findings also stated that Ponella failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #CLI030030)**

Charles Alfred Pulcano (CRD #2139987, Registered Representative, Manorville, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $10,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Pulcano consented to the described sanctions and to the entry of findings that he abetted violations of Title 18, Section 1954, of the U.S. Code in connection with another registered representative's involvement in the unlawful and knowing, direct and indirect, giving and offering and/or promise to give and offer fees, kickbacks, commissions, gifts, money, and/or things of value in violation of said statute arising from dealings with a member of the board of trustees of the pension funds of two labor unions.

Pulcano's suspension began February 17, 2004, and will conclude at the close of business August 16, 2004. **(NASD Case #C10040002)**

George Cawood Quinn (CRD #1000586, Registered Principal, Conway, South Carolina) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Quinn reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Quinn consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing notice to, and receiving approval from, his member firm.

Quinn's suspension began February 17, 2004, and will conclude at the close of business March 16, 2004. **(NASD Case #C9B040002)**

Mark Anthony Rizzi (CRD #4216139, Associated Person, Lorain, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Rizzi consented to the described sanction and to the entry of findings that he withdrew $25,662 from the money market account of an association claiming that the money would be invested in bond funds, but, in actuality, he converted the money for his personal use or for some other purpose other than the benefit of the association without the permission or authority of the association. The findings also stated that Rizzi created falsified financial statements and records to deceive the association into believing the money had been invested in the bond market. NASD also found that Rizzi failed to respond to NASD requests for information. **(NASD Case #C8B040003)**

Adam R. Rodriguez (CRD #4299928, Registered Representative, San Antonio, Texas) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Rodriguez consented to the described sanction and to the entry of findings that he misused public customer funds without the authorization, knowledge, or consent of the customer. NASD also found that Rodriguez was instructed by a

public customer to invest $85,000 in a fixed annuity; he invested $75,000 and used the remaining $10,000 to purchase a check made payable to an account he controlled without the customer's authorization, knowledge, or consent. The findings also stated that Rodriguez was instructed to withdraw $190,796 from a public customer's account to invest in a fixed annuity but withdrew an additional $5,000 to purchase a check made payable to an account he controlled without the customer's authorization, knowledge, or consent. In addition, NASD found that Rodriguez forged the customer's signature on an annuity service request form, without the authorization, knowledge, or consent of the customer. **(NASD Case #C06030037)**

Nathan Richard Root (CRD #4407342, Registered Representative, Cincinnati, Ohio) 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 before Root reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Root consented to the described sanctions and to the entry of findings that he sold $13,022.34 worth of shares in a retirement money fund from the brokerage accounts of public customers and purchased $13,292.34 worth of shares in mutual funds for the customers without the knowledge or consent of the customers and in the absence of written or oral authorization to exercise discretion in the accounts.

Root's suspension will begin March 15, 2004, and will conclude at the close of business March 14, 2006. **(NASD Case #C8B040004)**

Brett James Sandman (CRD #4018124, Registered Representative, Boca Raton, Florida) was barred from association with any NASD member in any capacity and ordered to pay $9,008, plus interest, in restitution. The sanctions were based on findings that Sandman failed to respond to NASD requests to appear for an on-the-record interview. The findings also stated that Sandman made misrepresentations and omissions of material fact in connection with the sale of securities to public customers. **(NASD Case #CAF030044)**

Michael Francis Sefchek (CRD #3200085, Registered Representative, Kingston, Rhode Island) 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 20 business days. The fine must be paid before Sefchek reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sefchek consented to the described sanctions and to the entry of findings that he executed transactions in the account of a public customer without the customer's knowledge, authorization, or consent.

Sefchek's suspension began February 17, 2004, and will conclude at the close of business March 15, 2004. **(NASD Case #C9B040001)**

Timothy Patrick Shively (CRD #1664561, Registered Representative, San Antonio, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $200,000, including disgorgement of $147,193.26 in commissions, and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Shively consented to the described sanctions and to the entry of findings that he recommended that public customers purchase and accumulate large positions in mutual fund Class B shares without a reasonable basis to believe that the recommendations were suitable because the customers could have purchased Class A shares with a reduced sales charge by applying breakpoints, using letters of intent, and/or using rights of accumulation. The findings also stated that Shively recommended that public customers purchase mutual fund Class B shares without a reasonable basis to believe that the recommendations were suitable because the customers who were liquidating other mutual funds and incurring liquidation charges could have purchased Class A shares at net asset value, would have incurred lower annual costs, and would not have been subject to contingent deferred sales charges (CDSCs). NASD also found that Shively recommended that public customers purchase mutual fund Class B shares without a reasonable basis to believe the recommendations were suitable because the customers could have purchased other share classes with lower charges and/or fees, and, by utilizing the breakpoints available through the other share classes, the customers could have reduced or eliminated CDSCs.

Shively's suspension will begin April 16, 2004, and will conclude at the close of business July 15, 2004. **(NASD Case #C04040002)**

Timothy Daniel Skelly (CRD #2012322, Registered Principal, Wareham, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Skelly consented to the described sanctions and to the entry of findings that he purchased various municipal bonds for public customers and prepared "fact sheets" that provided specific details about the bonds being purchased, including their creditworthiness, as requested by the customers. The findings also stated that, in connection with the various "fact sheets" prepared by Skelly, certain municipal bonds purchased by the customers were inaccurately represented as "county guaranteed" or "moral obligation bonds" when in fact the bonds contained neither guarantees nor pledges.

Skelly's suspension will begin March 15, 2004, and will conclude at the close of business March 26, 2004. **(NASD Case #C11040004)**

Dave Randall Smith (CRD #4151393, Registered Representative, Merritt Island, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Smith consented to the described sanction and to the entry of findings that he made improper use of public customers' funds given to him for investment purposes. **(NASD Case #C07040010)**

Steven Floyd Smithson (CRD #1960852, Registered Principal, Toledo, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $2,500 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Smithson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Smithson consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information in a timely manner.

Smithson's suspension begins March 15, 2004, and will conclude at the close of business April 13, 2004. **(NASD Case #C8A040003)**

James Robert Snyder (CRD #1266667, Registered Representative, Canal Fulton, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Snyder consented to the described sanction and to the entry of findings that he settled a customer complaint that had been filed against him and entered into written agreements with the plaintiffs that included improper confidentiality provisions in each settlement agreement that effectively prohibited the customers from disclosing the underlying facts of their complaints and the settlement terms to anyone, including NASD. NASD also found that Snyder failed to respond to NASD requests for information. **(NASD Case #C8B040002)**

Gerald Francis Stonehouse (CRD #437455, Registered Representative, Hingham, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Stonehouse consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm.

Stonehouse's suspension began February 2, 2004, and will conclude at the close of business August 2, 2004. **(NASD Case #C11040003)**

Jason M. Sudweeks (CRD #4527175, Registered Representative, Peoria, Arizona) 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, Sudweeks consented to the described sanction and to the entry of findings that he pasted the signatures of public customers to documents pertaining to their securities accounts using copies of signatures from other firm documents that the customers had signed and submitted the documents to his member firm. **(NASD Case #C3A040004)**

Jeffrey Dwight Summerford (CRD #2291904, Registered Supervisor, Decatur, Alabama) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $14,951.25, including disgorgement of $4,951.25 in financial benefits received, and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Summerford reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Summerford consented to the described sanctions and to the entry of findings that he exercised discretionary transactions in the account of a public customer without prior written acceptance of the account as discretionary by his member firm.

Summerford's suspension began March 1, 2004, and will conclude at the close of business August 31, 2004. **(NASD Case #C05040004)**

Edward Hartman Tarbell (CRD #816644, Registered Representative, Las Vegas, Nevada) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Tarbell reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Tarbell consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in the account of a public customer on a discretionary basis without obtaining prior written authorization from the customer and acceptance in writing by his member firm of the account as discretionary.

Tarbell's suspension begins March 15, 2004, and will conclude at the close of business March 14, 2006. **(NASD Case C3B040003)**

David Brian Thomas, Sr. (CRD #1418983, Registered Representative, Houston, Texas) 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 weeks. The fine must be paid before Thomas reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Thomas consented to the described sanctions and to the entry of findings that he participated in a private securities transaction without notice to, or approval from, his member firm.

Thomas' suspension began February 17, 2004, and will conclude at the close of business March 29, 2004. **(NASD Case #C05040002)**

Robert Charles Tollefson (CRD #447751, Registered Principal, Rolling Meadows, Illinois) submitted a Letter of Acceptance, Waiver, and Consent 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 before Tollefson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Tollefson consented to the described sanctions and to the entry of findings that he allowed, aided, and assisted individuals to assume the duties and perform the functions of a registered representative although the individuals were not properly registered.

Tollefson's suspension began March 1, 2004, and will conclude at the close of business February 28, 2005. **(NASD Case #C8A040002)**

Darrel Thomas Uselton (CRD #2051430, Registered Principal, Edmond, Oklahoma) and Mark Alan Uselton (CRD #2229571, Registered Principal, Edmond, Oklahoma) submitted a Letter of Acceptance, Waiver, and Consent in which Darrel Uselton was fined $15,000, suspended from association with any NASD member in any general securities principal capacity for one year, and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Uselton reassociates with any NASD member following the suspensions or before requesting relief from any statutory disqualification. Mark Uselton was fined $5,000 and suspended from association with any NASD member in a financial and operations principal capacity for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they caused a member firm to engage in a securities business when the firm's net capital was below the required minimum and caused the firm to fail to provide timely notification required by SEC Rule 17a-11 that the firm's net capital was below the required minimum. The findings also stated that Darrel and Mark Uselton caused a member firm to file inaccurate FOCUS Part IIA reports. NASD also found that Darrel and Mark Uselton failed and neglected to ensure the preparation and maintenance of accurate books and records for their member firm, resulting in their inability to provide NASD with information regarding the financial condition of the firm. In addition, NASD found that Darrel Uselton acted in the capacity of a general securities principal while not being registered in such capacity.

Darrel Uselton's suspensions begin March 15, 2004; the suspension in a general securities principal capacity will conclude at the close of business March 14, 2005. The suspension in all capacities will conclude at the close of business September 14, 2004. Mark Uselton's suspension will begin March 15, 2004, and will conclude at the close of business September 14, 2004. **(NASD Case #C05040009)**

Duane Scott Vallie (CRD #3035902, Registered Representative, Cape Coral, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $50,000, including disgorgement of $45,291 in commissions received, and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Vallie reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Vallie consented to the described sanctions and to the entry of findings that he engaged in private securities transactions and outside business activities, for compensation, without prior written notice to, or written approval from, his member firms.

Vallie's suspension began March 1, 2004, and will conclude at the close of business August 31, 2005. **(NASD Case #C07040005)**

Reynolds Michael Verdiner (CRD #2858516, Registered Principal, Brooklyn, New York) was fined $20,000 and suspended from association with any NASD member in any capacity for four months. The NAC imposed the sanctions following appeal of an OHO decision. The sanctions were based on findings that Verdiner opened accounts for public customers without authorization and effected unauthorized transactions in the accounts.

Verdiner's suspension began February 2, 2004, and will conclude at the close of business June 2, 2004. **(NASD Case #CAF020004)**

John Philip Warner (CRD #2094770, Registered Representative, Covington, Louisiana) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined $10,000 and suspended from association with any NASD member in any capacity for 90 days. The fine must be paid before Warner reassociates with any NASD member following the suspension or before requesting relief from any statutory

disqualification. Without admitting or denying the allegations, Warner consented to the described sanctions and to the entry of findings that he borrowed $31,219.17 from a public customer and recommended and executed the liquidation of mutual funds in the account of the customer for the purpose of funding the loan to himself. The findings also stated that Warner persuaded the customer to loan him the funds by offering a nine percent return, thereby replacing the customer's original investment with an unsecured loan without reasonable grounds for believing that the recommendation and resultant transactions were suitable for the customer on the basis of the customer's financial situation, investment objectives, or needs.

Warner's suspension began February 2, 2004, and will conclude May 1, 2004. **(NASD Case #C05040001)**

Scott Alan Webster (CRD #2250242, Registered Principal, Riverview, Florida) was fined $5,000 and suspended from association with any NASD member in any capacity for 10 business days. The sanctions were based on findings that Webster opened securities accounts at other member firms while he was associated with a member firm, failed to provide written notice to his member firm, and failed to advise the other member firms that he was a representative prior to opening the accounts or placing initial orders in the accounts.

Webster's suspension began February 2, 2004, and concluded at the close of business February 13, 2004. **(NASD Case #C07030050)**

Michael Fred Zanders (CRD #475794, Registered Principal, Leawood, Kansas) 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 principal or supervisory capacity for 30 days. Without admitting or denying the allegations, Zanders consented to the described sanctions and to the entry of findings that he failed to adequately and properly supervise a registered representative in that he failed to detect and take adequate steps to prevent unsuitable recommendations to public customers.

Zanders' suspension began March 1, 2004, and will conclude at the close of business March 30, 2004. **(NASD Case #C04040003)**

Decisions Issued

The following decisions have been issued by the District Business Conduct Committee (DBCC) or the OHO and have been appealed to or called for review by the NAC as of February 6, 2004. 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*.

D.L. Cromwell Investments, Inc. (CRD #37730, Boca Raton, Florida), David Stewart Davidson (CRD #1212799, Registered Principal, Boca Raton, Florida), Lloyd Sylvester Martin Beirne (CRD #1982417, Registered Principal, Boca Raton, Florida), and Eric Scott Thomes (CRD #2233456, Registered Principal, Boca Raton, Florida). The firm was expelled from NASD membership and Davidson and Beirne were barred from association with any NASD member in any capacity. The firm, Davidson, and Beirne were fined $3.8 million, jointly and severally. Thomes was fined $10,000, suspended from association with any NASD member in any capacity for one year, and ordered to requalify by examination before again becoming associated with any NASD member in any capacity requiring registration.

The sanctions were based on findings that the firm engaged in manipulative practices when it managed a private placement of securities by placing a substantial portion of the offering with customer accounts that the firm, Davidson, or Beirne effectively controlled—rather than with the investing public—and the firm later retrieved the securities, building a very substantial long position in the stock that it falsely described as unsolicited arms-length purchases from unaffiliated customers. The findings stated that the firm sold the stock, and stock that it did not yet own, to retail customers at prices substantially higher than the distribution price had been and filled its short positions by retrieving units from another controlled account in transactions falsely reported as bona fide arms-length transactions, thereby obtaining large profits. NASD also found that Thomes, as the firm's head trader, effected most, if not all, of the manipulative transactions by entering quotations and executing orders through which the manipulation was accomplished. In addition, NASD found that the respondents violated SEC Regulation M by bidding for and purchasing securities in the secondary market while distributions of those securities were still in progress. Moreover, the findings stated that Davidson and Beirne failed to respond to NASD requests for documents and to appear and give testimony. Furthermore, NASD found that the firm failed to establish and maintain adequate written supervisory procedures and systems reasonably designed to achieve compliance with Regulation M or SEC Rule 10b-5.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #CAF020007)**

Fox & Company Investment, Inc. (CRD #18517, Phoenix, Arizona) and James Wilfred Moldermaker (CRD #858894, Registered Principal, Scottsdale, Arizona) were fined $35,000, jointly and severally. Moldermaker was barred from association with any NASD member as a financial and operations principal and suspended from association with any NASD member in any supervisory and principal capacity for 10 business days. The sanctions were based on findings that the firm, acting

through Modermaker, conducted a securities business while failing to satisfy the firm's net capital requirements. The findings also stated that the firm, acting through Moldermaker, maintained material inaccuracies in the firm's books and records, submitted materially inaccurate FOCUS reports, failed to file an amended Form U5 when a terminated individual was named in a consumer-initiated arbitration matter, and failed to report an arbitration award to NASD in violation of NASD Rule 3070.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C3A030017)**

Mark Francis Mizenko (CRD #1812411, Registered Principal, Rootstown, Ohio) was fined $5,000, suspended from association with any NASD member in any capacity for 18 months, and ordered to requalify in all capacities. The sanctions were based on findings that Mizenko, in an attempt to attract new customers, affixed the signature of his member firm's executive vice president, without the officer's knowledge or consent, on a corporate resolution that purported to guarantee to prospective customers automobile purchases and leases from an automobile dealership.

The decision was called for review by the NAC, and the sanctions are not in effect pending consideration of the review. **(NASD Case #C8B030012)**

PAZ Securities, Inc. (CRD #17554, Boca Raton, Florida) and Joseph Mizrachi (CRD #337288, Registered Principal, Boca Raton, Florida). The firm was expelled from NASD membership and Mizrachi was barred from association with any NASD member in any capacity. The sanctions were based on findings that the firm and Mizrachi failed to respond to NASD requests for information.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C07030055)**

Complaints Filed

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

Donald Joseph Boyles (CRD #3040178, Registered Representative, Austin, Texas) was named as a respondent in an NASD complaint alleging that he signed the name of a public customer on a insurance application and submitted it to his member firm for processing without the customer's authorization, knowledge, or consent, causing funds to be removed from the customer's escrow account maintained at a mortgage company to pay for the insurance, without the customer's authorization, knowledge, or consent. The complaint also alleges that Boyles failed to respond to an NASD request to appear for on-the-record testimony. **(NASD Case #C06040001)**

Charles Albert DaCruz (CRD #2444684, Registered Representative, Williston Park, New York) was named as a respondent in an NASD complaint alleging that, while using the means and instrumentalities of interstate commerce to offer securities for sale, DaCruz omitted to state material facts necessary in order to make the statements made in connection with such offers, in light of the circumstances in which they were made, not misleading. The complaint also alleges that, while using the means and instrumentalities of interstate commerce to offer securities for sale, DaCruz made material misrepresentations in the form of price predictions to induce transactions, and transactions did occur. **(NASD Case #C3A040001)**

Jamie Arnold Engelking (CRD #3120784, Registered Representative, Arvada, Colorado) was named as a respondent in an NASD complaint alleging that he made unsuitable recommendations to public customers in that he had no grounds for believing that public customers had the financial ability to purchase a recommended variable annuity without mortgaging their home to do so. The complaint also alleges that Engelking had no reasonable grounds for believing that the public customers would be able to meet their mortgage commitment should the variable annuity not perform at the very optimistic levels needed to avoid depletion of principal. **(NASD Case #C3A040006)**

Kojo Nantambu Kandi (CRD #3055831, Registered Representative, Columbus, Ohio) was named as a respondent in an NASD complaint alleging that he recommended and effected securities transactions for the individual retirement account of a public customer that constituted excessive trading activity. The complaint also alleges that Kandi's recommendations and transactions were made without having a reasonable basis for believing that they were suitable for the customer based upon the customer's age, net worth, financial situation, and investment objectives. **(NASD Case #C8B040001)**

Kenneth David Krassinger, Jr. (CRD #1982792, Registered Representative, Byrnes Mill, Missouri) was named as a respondent in an NASD complaint alleging that he misused a public customer's funds totaling $50,000, intended for investment purposes, without the knowledge or consent of the customer. **(NASD Case #C04040004)**

Robert Waldo Leavenworth (CRD #2766524, Registered Representative, Atlanta, Georgia) was named as a respondent in an NASD complaint alleging that he opened accounts for public customers at his member firm and recommended and purchased securities for the accounts that were unsuitable for the customers based on their age, employment status, income needs, net worth, and investment experience. **(NASD Case #C07040012)**

Christopher Scott Maury (CRD #2778197, Registered Representative, Manalapan, Florida) was named as a respondent in an NASD complaint alleging that he received $13,500 from a public customer for investment purposes and converted the funds to his own use without authorization from the customer. The complaint also alleges that Maury failed to respond to NASD requests for information and documents. **(NASD Case #C07040011)**

Jeffrey Patrick Murphy (CRD #2316701, Registered Representative, Oregon, Wisconsin) was named as respondent in an NASD complaint alleging that he completed a life insurance company's withdrawal/surrender forms with a public customer's personal information that requested withdrawal of $350,000 from the customer's annuity account without the knowledge or consent of the customer and deposited the funds into his personal bank account, thereby using the proceeds for his own benefit or for some purpose other than the benefit of the customer. The complaint further alleges that Murphy failed to respond to NASD requests for documents and information. **(NASD Case #C8A040001)**

Christopher Michael Reno (CRD #2128187, Registered Principal, Staten Island, New York) was named as a respondent in an NASD complaint alleging that he effected transactions in the accounts of public customers without their prior authorization or consent. The complaint also alleges that Reno failed to respond to NASD requests for information. **(NASD Case #C9B040004)**

Roger Paul Stewart (CRD #1190849, Registered Representative, Morgantown, West Virginia) was named as a respondent in an NASD complaint alleging that he received $400 from a customer to pay for premiums on her automobile insurance policy and failed to remit the funds to an insurance company, thereby converting the funds for his own personal use. The complaint also alleges that Stewart failed to respond to NASD requests for information. **(NASD Case #C9A040002)**

Suspension Lifted

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

Blue Marble Financial, LLC
Irving, Texas
(January 13, 2004)

Individuals Barred Pursuant to NASD Rule 9544 for Failure to Provide Information Requested Under NASD Rule 8210

(The date the bar became effective is listed after the entry.)

Brisbin, May Yan
Denton, Texas
(January 22, 2004)

Cobb, Edward Peter
Glen Rock, New Jersey
(January 21, 2004)

Cohen, Alan Marc
Irvine, California
(January 23, 2004)

Eltzroth, Geoffrey
Marion, Indiana
(January 26, 2004)

Emslie, Patrick
Tucson, Arizona
(January 5, 2004)

Fischer, Francois
Valley Stream, New York
(January 5, 2004)

Gura, Lee
Vista, California
(January 22, 2004)

Gura has appealed this decision to the SEC. (NASD Case # 8210-02030008)

Jin, Yanshi Rock
Vienna, Virginia
(January 20, 2004)

Nelson, Thomas E.
Scottsdale, Arizona
(January 21, 2004)

Plata, Edwin
Lodi, New Jersey
(January 27, 2004)

Smith, Jr., James L.
Jackson, Tennessee
(January 5, 2004)

Tran, Jack H.
Boca Raton, Florida
(January 26, 2004)

Young, Christopher K.
Shreveport, Louisiana
(January 20, 2004)

Individuals Suspended Pursuant to NASD Rule 9541(b) for Failure to Provide Information Requested Under NASD Rule 8210

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

Foreman, James A.
Lafayette, Louisiana
(January 8, 2004)

Gilbert, Martin
Jersey City, New Jersey
(January 15, 2004)

Yeninas, Michael S.
Brooklyn, New York
(January 5, 2004)

Zander, Melissa J.
Sterling Heights, Michigan
(January 14, 2004)

Individuals Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply with an Arbitration Awardor a Settlement Agreement

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

Ford, George P.
Rye, New York
(February 2, 2004 – February 19, 2004)

Hart, Marlene
Sanford, Florida
(February 3, 2004)

NASD Fines State Street Research Investment Services $1 Million for Market Timing Supervision Violations; Firm Ordered to Pay More than $500,000 in Restitution

NASD fined State Street Research Investment Services, Inc. (SSR) $1 million for failing to prevent market timing of State Street Research mutual funds due to its inadequate supervisory systems. SSR also agreed to pay more than $500,000 in restitution to the individual State Street Research mutual funds to compensate the for losses attributed to the market-timing activity. SSR, located in Boston, MA, distributes State Street Research mutual funds to NASD-regulated broker-dealers for sale to their customers.

NASD found that, from 2001 through August 2003, SSR's inadequate supervisory system improperly permitted the customers of at least one other securities firm, Prudential Equity Group, Inc., formerly known as Prudential Securities, Inc., to exchange (alternatively buy and sell) shares of State Street Research funds beyond the annual limits set forth in the prospectuses. The annual limits, typically six exchanges per year, were designed to limit market timing in the funds. Market timing is the frequent trading of mutual fund shares in order to take advantage of pricing inefficiencies or market movements.

"Market timing, in violation of prospectus limits, can dilute the value of fund shares, raise transaction costs, and thus harm other fund shareholders," said Mary L. Schapiro, Vice Chairman of NASD. "When a firm is on notice, as SSR was, that its funds are being timed, the firm must respond quickly and effectively."

In its investigation, NASD found that, by November 2001, SSR's operations personnel had reason to believe that the Boston office of Prudential Securities was engaged in market-timing activities on behalf of its clients and that, among others, certain Prudential Securities customers had been able to exchange shares of State Street Research funds beyond the annual limits described in the applicable prospectus.

SSR was aware that a number of Prudential Securities' registered representatives engaged in deceptive conduct so that their customers could exchange funds in excess of prospectus limits. For example, if SSR sent "block letters" prohibiting customers from making future fund exchanges in an account because the customer had exceeded a fund's annual exchange limit, Prudential Securities' registered representatives would use a different account number for that customer in order to evade the block. This ensured the "blocked" customer would be able to continue to buy and sell shares of that fund.

NASD found that SSR's supervisory procedures and systems were not adequate to prevent and detect customers circumventing the block restrictions. The firm's written supervisory procedures and systems failed to provide for adequate follow-up to the "block letters" it sent to brokerage firms. Some customers of these firms were able, through the establishment of new customer accounts, to continue trading in SSR funds even after one of their accounts had been blocked. Moreover, SSR's systems and procedures were not able to ensure that accounts were blocked in a timely manner. In several instances, SSR sent "block letters" after the customer had already exceeded the fund exchange limits. The firm did not have an effective system for tracking and enforcing compliance with the "block letters."

In addition to fining the firm, NASD also required SSR to certify that it has disclosed all instances of fund trading that were inconsistent with the prospectus exchange limits and that it has implemented appropriate systems and controls with respect to market timing.

During its investigation, NASD also found that SSR failed to preserve and maintain internal e-mail communications relating to the firm's business as required by the federal securities laws and NASD rules. For example, the firm failed to retain all e-mails that were sent but later deleted by its employees.

In addition to paying a $1 million fine, SSR was ordered to pay more than $500,000 to the State Street Research funds to compensate them for losses resulting from the prohibited market timing during the three-year period ending December 31, 2003.

The restitution payment will be apportioned among the affected State Street Research Funds.

In settling this matter, SSR neither admitted nor denied the charges.

Fifteen Firms to Pay Over $21.5 Million in Penalties to Settle SEC and NASD Breakpoints Charges; Affected Mutual Fund Customers to Receive Refunds

The Securities and Exchange Commission (SEC) and NASD announced enforcement and disciplinary actions against a total of 15 firms for failure to deliver mutual fund breakpoint discounts during 2001 and 2002. Breakpoint discounts are volume discounts applicable to front-end sales charges on Class A mutual fund shares (front-end loads). SEC and NASD each brought cases against a group of seven firms, and NASD separately brought actions against the other eight firms. The 15 firms have agreed to compensate customers for the overcharges, pay fines in an amount equal to their projected overcharges that total over $21.5 million, and undertake other corrective measures.

The SEC and NASD had previously determined that many investors were not receiving correct breakpoint discounts on their mutual fund purchases. (See Joint SEC/NASD/NYSE Report of Examinations of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds (link below)). NASD directed securities firms to conduct an assessment of their mutual fund transactions, using a statistically significant sample of the 2001 and 2002 transactions. The assessments showed that most firms did not uniformly deliver appropriate breakpoint discounts to customers. Overall, discounts were not delivered in about one of five eligible transactions (eligible transactions were certain automated purchases of Class A Shares). The average amount of overcharge per transaction was $243, ranging up to $10,000. Based on the self-assessment, NASD estimated that at least $86 million was owed to investors for 2001 and 2002 alone. NASD directed all firms to provide refunds to customers who were overcharged, directed 446 firms to notify customers that they may be due refunds, and directed 174 firms to conduct a complete review of individual transactions for possible missed opportunities. The firms named in today's enforcement actions fell into two categories: those with higher-than-average failure rates and high dollar amounts of total overcharges; and those whose failure rates were significantly higher than average.

To resolve these actions, each of the 15 firms agreed to review all front-end load mutual fund trades in excess of $2,500 conducted between January 1, 2001, and November 3, 2003; to provide written notification of the firm's problem delivering breakpoint discounts to each customer who purchased front-end load mutual funds from January 1, 1999, through November 3, 2003, and advise these customers that they may be entitled to a refund; to provide refunds where appropriate; and to pay a fine equal to the amount of the firm's projected overcharges.

The names of the firms charged, fines to be paid (equal to projected overcharges to customers), and projected rates of missed breakpoints, are as follows:

Firms settling with the SEC and NASD in separate actions:

Firm	Fine	Rate
Wachovia Securities, LLC	$ 4,844,465	28.77%
UBS Financial Services Inc.	$ 4,621,768	30.03%
American Express Financial Advisors Inc.	$ 3,706,693	29.70%
Raymond James Financial Services, Inc.	$ 2,595,129	31.78%
Legg Mason Wood Walker, Inc.	$ 2,315,467	34.61%
Linsco/Private Ledger Corp.	$ 2,232,805	35.64%
H.D. Vest Investment Securities, Inc.	$ 725,216	33.39%

Firms settling with NASD only:

Firm	Fine	Rate
Bear, Stearns & Co. Inc.	$ 280,469	52.00%
Lehman Brothers Inc.	$ 123,882	59.96%
Cresap, Inc.	$ 99,458	88.48%
SWS Financial Services	$ 66,468	89.69%
Kirkpatrick, Pettis, Smith, Polian Inc.	$ 39,935	53.56%
Southwest Securities, Inc.	$ 36,971	89.02%
David Lerner Associates, Inc.	$ 32,711	64.88%
Brecek & Young Advisors, Inc.	$ 31,224	53.74%

The SEC orders find that the firms, by failing to disclose to certain customers that they were not receiving the benefit of applicable breakpoint discounts, violated Section 17(a)(2) of the Securities Act of 1933. NASD made findings that the firms violated NASD's just and equitable principles of trade rule by failing to give customers the benefit of applicable breakpoint discounts and by failing to disclose to those customers that they were not receiving the benefit of applicable discounts. In addition, the Commission charged six of the seven firms (all but Raymond James Financial Services) with failing to disclose on customer confirmations the remuneration the firms received in connection with the front-end loads, in violation of Rule 10b-10 under the Securities Exchange Act of 1934. H.D. Vest also resolved charges by the Commission related to unsuitable sales of Class B mutual fund shares, as described in more detail below. The fine imposed on Cresap, Inc., was reduced to $50,000 based on the firm's demonstrated financial condition.

Stephen M. Cutler, Director of the SEC's Division of Enforcement, remarked: "These Commission actions target seven firms whose breakpoint overcharges totaled $21 million over a two-year period. But our actions and the NASD's are a message to every broker-dealer: you must exercise due care to provide appropriate breakpoint discounts to mutual fund investors, or enforcement action will be taken against you, and substantial penalties will be imposed."

"Securities firms must deliver on promises made to customers; breakpoints are no exception. We estimate that for 2001 and 2002 alone, $86 million is owed to investors from the failure to award breakpoint discounts, demonstrating just how critical it is that firms identify, remediate and take steps to prevent problems in this critical segment of the markets," said Mary Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "The fines and other remedial measures make clear that these types of failures, whatever the cause, will not be tolerated, and that the interests of customers are paramount."

As described in the NASD and SEC settlements, when an investor buys mutual fund shares with a front-end load, the sales charge, or load, portion of the offering price is not invested in the fund, but instead is paid to the fund's principal underwriter or distributor. When the purchase is made through a broker-dealer, the fund's principal underwriter or distributor pays a part of the front-end load amount to the broker-dealer that sold the fund shares to the investor. Mutual funds that sell shares charging front-end loads usually offer discounts at certain pre-determined levels of investment, which are called breakpoints. Front-end loads and breakpoints can vary among funds within a fund complex or across fund complexes. For example, a mutual fund might charge an investor 5.75 percent of the sales price for purchases of less than $50,000, but reduce the sales charge to 4.75 percent for investments between $50,000 and $99,999. An investor can usually procure discounts on sales charges at investment levels of $50,000, $100,000, $250,000, and $500,000. At the $1 million investment level, generally there is no sales charge. Investors may aggregate purchases in one or more accounts to reach a breakpoint threshold.

The NASD and SEC orders further state that broker-dealers that sell mutual fund shares to retail customers must disclose applicable breakpoint discount information to their customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints. A failure to do so can result not only in the customer being deprived of a benefit to which he or she is entitled, but also in the broker-dealer and registered representative receiving increased commissions at the customer's expense.

In addition to finding breakpoint violations, the SEC's settled order against H.D. Vest Investment Securities, Inc., finds that the firm, in recommending that certain customers purchase large amounts ($100,000 or greater) of Class B mutual fund shares, failed to adequately disclose that an equivalent investment in Class A shares could yield a higher return as a result of applicable breakpoint discounts and reduced ongoing expenses. Among other things, the order directs Vest to pay a $691,812 fine based on its excess Class B share commissions, and to offer the affected customers the opportunity to convert their Class B shares to A shares. Further, Vest agreed to retain an independent consultant to conduct a review of, and make recommendations regarding, the firm's Class B share policies and procedures.

The original examination findings underlying these breakpoints actions were outlined in the Joint SEC/NASD/NYSE Report of Examinations of Broker-Dealers Regarding Discounts on Front-End Sales Charges on Mutual Funds (available at: *www.nasdr.com/pdf-text/bp_joint_exam.pdf* and *www.sec.gov/news/studies/breakpointrep.htm*). Earlier this year, NASD led an industry task force that explored and recommended ways that the mutual fund and broker-dealer industries could prevent breakpoint problems and errors in sales load calculations in the future. The Task Force issued a report that recommends a number of operational enhancements, disclosure requirements, and regulatory changes, which is available at: *www.nasdr.com/breakpoints_report.asp*. Industry working groups are in the process of implementing the Task Force's recommendations.

NASD Fines Prudential $2 Million; Orders $9.5 Million to Customers for Annuity Sales in Violation of NY Insurance Regs

NASD has fined Prudential Equity Group, Inc., (formerly known as Prudential Securities, Inc.) and Prudential Investment Management Services LLC, $2 million and ordered the firms to pay customers $9.5 million for sales of annuities, including variable annuities, that violated a New York State Insurance Department regulation and NASD rules.

From November 1998 through mid-2002, certain Prudential employees repeatedly circumvented Regulation No. 60 of the New York State Insurance Department, which governs replacement sales of annuity contracts. The regulation requires documentation of two separate interactions with a customer, documentation of specific information about the old annuity contract, and disclosure of comparison information before a replacement sale can be completed. The regulation is intended to protect investors by requiring disclosure of information in order to reduce opportunities for misrepresentation and to allow investors to make comparisons between their current annuity and the proposed replacement annuity.

In an organized effort to circumvent the regulation, Prudential employees compressed the procedures to one contact during which customers were instructed to sign, but leave undated, all required forms. Subsequently, employees would insert dates in the documents in order to create an appearance that the two-step procedure had been followed and that there had been an appropriate interval between the steps during which information had been obtained from the issuer of the annuity proposed for replacement. In some instances when customers had dated documents despite instructions not to do so, Prudential employees would alter documents so that it appeared that Regulation No. 60 and the two-step procedure had been followed.

"The procedures required by New York State regulations exist to protect investors from unsuitable recommendations and hasty decisions and to arm investors with the information necessary to understand the complexities of variable annuity contracts as well as the cost and other implications of replacement," said Mary Schapiro, NASD Vice Chairman. "Because of the complexities of variable annuities, short-cutting the rules and regulations governing sales cannot and will not be tolerated."

During the three and one-half year period at issue, Prudential completed 906 annuity replacement sales subject to Regulation No. 60, and a substantial number of these involved violations of the regulation.

Additionally, during the same time period, certain Prudential employees prepared and used incorrect annuity performance illustrations in sales of annuity contracts.

Prudential discovered the violations in mid-2002 when a review of a replacement sale uncovered altered documents. Prudential promptly reported the matter to NASD and other regulators, and, in consultation with NASD, initiated a remediation program for all affected customers that will result in payments of more than $9.5 million.

In concluding this settlement, Prudential Equity Group, Inc., and Prudential Investment Management Services LLC neither admitted nor denied the charges.

2004 NASD

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