

NASD Notice to Members 01-70

INFORMATIONAL

Member Surcharges And Process Fees In Arbitrations

SEC Approves Increases To Member Surcharges And Process Fees In NASD Arbitration Proceedings, And Other Amendments To Fee-Related Provisions Of The NASD Code Of Arbitration Procedure

SUGGESTED ROUTING

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

- Executive Representatives
- Legal & Compliance
- Senior Management

KEY TOPICS

- Arbitration Fees
- Code of Arbitration Procedure

Executive Summary

The Securities and Exchange Commission (SEC or Commission) has approved increases to the member surcharges and process fees paid by member firms in National Association of Securities Dealers, Inc. (NASD®) arbitration proceedings. For claims filed on or after November 19, 2001, member surcharges and hearing process fees will increase by an aggregate of 10 percent. In addition, the incremental prehearing process fee payments currently paid by member firms will be combined into a single payment of \$750, an overall increase of \$150, which will be payable at the time arbitrator lists are sent to the parties pursuant to Rule 10308(c)(5) of the NASD Code of Arbitration Procedure (Code).¹ These increases will be used to fund NASD Dispute Resolution's share of the cost of developing and implementing a new computer system, which will greatly enhance the administration of cases in the forum, and to cover inflationary cost increases.

In addition, the SEC has approved several other amendments to provisions of the Code relating to the assessment and payment of fees in NASD arbitration proceedings that will also go into effect on November 19, 2001.²

Specifically:

- Rule 10306 of the Code has been amended to provide that any forum fees unpaid at the time of settlement will be divided equally among the parties when settling parties fail to allocate the fees in their settlement agreements;
- Rule 10319 of the Code has been amended to provide that payment of the adjournment fee is required only if an

adjournment is granted, rather than when a request for adjournment is made, and to raise the current cap on adjournment fees from \$1,000 to \$1,500; and

- Rule 10328 of the Code has been amended to clarify that when a claim is amended to increase the amount in dispute, NASD Dispute Resolution will recalculate filing fees, hearing session deposits, process fees, and surcharges based on the new, increased claim.

The text of the amendments described in this *Notice* is included as Attachment A.

Questions/Further Information

Questions regarding this *Notice* may be directed to Laura Leedy Gansler, Counsel, NASD Dispute Resolution, Inc., at (202) 728-8275.

Discussion

Increases In Member Surcharge And Prehearing And Hearing Process Fees

Member Surcharge Increase

Rule 10333 of the Code requires that each member that is a party to an arbitration proceeding, or that employed an associated person who is a party to an arbitration proceeding at the time of the events that gave rise to the dispute, pay a non-refundable member surcharge. The amount of the surcharge varies depending on the amount in dispute. For all claims filed on or after November 19, 2001, member surcharges, which were last raised in 1997, will increase by an aggregate of 10 percent. Actual increases in each case will vary depending on the

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amount in dispute. The highest per-case increase will be \$350.

Prehearing Process Fees

Rule 10333 also provides that, in cases in which the amount in controversy exceeds \$25,000, each member that is a party, or that employed an associated person named as a party at the time of the events that gave rise to the arbitration proceeding, must pay a prehearing process fee. Until now, the prehearing process fee was divided into three segments, which accrued as follows: \$50 at the time of the service of claim; \$150 when the first answer to the claim was received or due, and discovery and motions proceedings begin; and \$400 when the parties were first notified of the names of any of the arbitrators selected to hear the matter, or given the names of arbitrators to select.

For all claims filed on or after November 19, 2001, these three prehearing process fee payments will be combined into a single payment of \$750, due at the time the parties receive the arbitrator lists.

Hearing Process Fee Increase

Rule 10333 also requires that each member that is a party to an arbitration proceeding, or that employed an associated person who is a party to an arbitration proceeding at the time of the events that gave rise to the dispute, pay a hearing process fee, which accrues when the parties are notified of the date and location of the first hearing session. The amount of the hearing process fee varies depending on the amount of damages requested. For all claims filed on or after November 19, 2001, hearing process fees will go up an aggregate of 10 percent.

Actual increases in each case will range from zero to 14 percent, depending on the amount in dispute. The highest per-case increase will be \$500.

Other Changes To Rule 10333

Rule 10333 also has been reorganized to make it simpler to use, and to conform the rest of the rule to the consolidation of the prehearing process fee payments. The rule has been broken into two sections: Member Surcharges, and Prehearing and Hearing Process Fees. In addition, language in Rule 10333(d) relating to the disposition of accrued but unpaid member fees has been deleted. This language is no longer necessary in light of the amendment to Rule 10306 of the Code described in this *Notice*, which clarifies that, in the event of a settlement, parties remain responsible for all fees incurred under the Code.

Other Amendments To The Fee Provisions

Settlement Default For The Allocation Of Forum Fees

Rule 10306 of the Code provides that parties to arbitrations may settle their dispute at any time. The terms of any settlement agreement need not be disclosed to NASD Dispute Resolution. However, settling parties remain responsible for payment of outstanding fees incurred under the Code. NASD Dispute Resolution encourages parties to agree on how any outstanding fees shall be divided among the parties as part of the settlement agreement. Unfortunately, this often does not happen. When the parties fail to allocate fees in settlements, the staff must present this issue to the arbitrator(s) for resolution. This is a time-consuming process that is an unnecessary burden to the

arbitrator(s), and can result in surprises to the parties. To eliminate any ambiguity in this area, Rule 10306 has been amended to provide that if settling parties fail to agree on the allocation of outstanding fees, the fees will be divided equally among all parties by default. This rule change will apply to all settlements entered into on or after November 19, 2001.

Adjournment Fees

Rule 10319 of the Code previously required parties requesting adjournment of an arbitration hearing to deposit a fee at the time the adjournment is requested. If the adjournment was not granted, the deposit was returned; if it was granted, the arbitrators could return the deposit in their discretion. Rule 10319 has been amended to minimize the burden this rule placed on parties, arbitrators, and staff by providing that payment of the adjournment fee is required only if an adjournment is granted, rather than when a request for adjournment is made. This will eliminate the need for parties to deposit funds that may be returned to them, as well as the need for the staff to track the deposits and issue refunds if necessary. It will also help to expedite the resolution of adjournment requests. The rule also has been amended to increase the current \$1,000 cap on adjournment fees to \$1,500. This rule change will apply to all adjournment requests made on or after November 19, 2001.

Recalculating Fees When Amount In Dispute Is Amended

Rule 10328 of the Code, governing amendments to pleadings, has been amended to clarify that when a claim is amended to increase the amount in dispute, NASD Dispute Resolution will recalculate filing

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fees, hearing session deposits, process fees, and surcharges based on the new, increased claim. This will eliminate confusion regarding the effect on such fees when the amount of dispute is increased. This rule change will apply to all amended pleadings filed on or after November 19, 2001.

Effective Date

The amendments to Rule 10333 will apply to all claims filed on or after November 19, 2001. The amendments to Rule 10306 will apply to all settlements entered into on or after November 19, 2001. The amendments to Rule 10319 will apply to all adjournment requests made on or after November 19, 2001. The amendments to Rule 10328 will apply to all amended pleadings filed on or after November 19, 2001.

Endnotes

- 1 Exchange Act Release No. 44897 (October 2, 2001) (File No. SR-NASD-2001-62), 66 *Federal Register* 51711 (October 10, 2001).
- 2 Exchange Act Release No. 44573 (July 18, 2001) (File No. SR-NASD-2001-21), 66 *Federal Register* 38773 (July 25, 2001).

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ATTACHMENT A

New language is underlined; deletions are in brackets.

10000. Code of Arbitration Procedure

* * *

10306. Settlements

[All settlements upon any matter shall be at the election of the parties.]

(a) Parties to an arbitration may agree to settle their dispute at any time.

(b) The terms of a settlement agreement do not need to be disclosed to NASD Dispute Resolution. However, the parties will remain responsible for payment of fees incurred under the Code. If the parties fail to agree on the allocation of outstanding fees, the fees shall be divided equally among all parties.

* * *

10319. Adjournments

(a) The arbitrator(s) may, in their discretion, adjourn any hearing(s) either upon their own initiative or upon the request of any party to the arbitration.

(b) [Unless waived by the Director of Arbitration upon a showing of financial need,] if an adjournment requested by a party is granted after arbitrators have been appointed, the [a] party requesting the adjournment [after arbitrators have been appointed shall deposit with the request for an adjournment,] must pay a fee equal to the initial deposit of hearing session fees for the first adjournment and twice the initial deposit of hearing session fees, not to exceed \$1,500 [\$1,000] for a second or subsequent adjournment requested by that party. [If the adjournment is granted, the arbitrator(s) may direct the return of the adjournment fee.] The arbitrators may waive these fees in their discretion. If more than one party requests the adjournment, the fees shall be allocated among the requesting parties by the arbitrators.

(c) Upon receiving a third request consented to by all parties for an adjournment, the arbitrator(s) may dismiss the arbitration without prejudice to the Claimant filing a new arbitration.

* * *

10328. Amendments

(a) After the filing of any pleadings, if a party desires to file a new or different pleading, such change must be made in writing and filed with the Director of Arbitration with sufficient additional copies for each arbitrator. The party filing a new or different pleading shall serve on all other parties, a copy of the new or different pleading in accordance with the provisions set forth in Rule 10314(b). The other parties may, within ten (10) business days from the receipt of service, file a response with all other parties and the Director of Arbitration in accordance with Rule 10314(b).

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(b) If a new or amended pleading increases the amount in dispute, all filing fees, hearing session deposits, surcharges, and process fees required under Rules 10332 and 10333 will be recalculated based on the amended amount in dispute.

(c) After a panel has been appointed, no new or different pleading may be filed except for a responsive pleading as provided for in (a) above or with the panel's consent.

* * *

10333. Member Surcharge and Process Fees

(a) Member Surcharge

(1) Each member that is named as a party to an arbitration proceeding, whether in a Claim, Counterclaim, Cross-Claim or Third-Party Claim, shall be assessed a non-refundable surcharge pursuant to the schedule below when the Director of Arbitration perfects service of the claim naming the member on any party to the proceeding.

(2) For each associated person who is named, the surcharge shall be assessed against the member or members that employed the associated person at the time of the events which gave rise to the dispute, claim or controversy. No member shall be assessed more than a single surcharge in any arbitration proceeding.

(3) The surcharge shall not be chargeable to any other party under Rules 10332(c) and 10205(c) of the Code.

Member Surcharge Schedule

Amount in Dispute	Surcharge
\$.01 - \$2,500	\$150
\$2,500.01 - \$5,000	\$200
\$5,000.01 - \$10,000	[\$300] <u>\$325</u>
\$10,000.01 - \$25,000	[\$400] <u>\$425</u>
\$25,000.01 - \$30,000	\$600
\$30,000.01 - \$50,000	[\$800] <u>\$875</u>
\$50,000.01 - \$100,000	[\$1,000] <u>\$1,100</u>
\$100,000.01 - \$500,000	[\$1,500] <u>\$1,700</u>
\$500,000.01 - \$1,000,000	[\$2,000] <u>\$2,250</u>
\$1,000,000.01 - \$5,000,000	[\$2,500] <u>\$2,800</u>
\$5,000,000.01 - \$10,000,000	[\$3,000] <u>\$3,350</u>
Over 10,000,000	[\$3,600] <u>\$3,750</u>

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([b]4) Unchanged.

([c]5) If the dispute, claim, or controversy does not involve, disclose, or specify a money claim, the non-refundable surcharge shall be [\$1,200] \$1,500 or such greater or lesser amount as the Director of Arbitration or the panel of arbitrators may require, but shall not exceed the maximum amount specified in the schedule.

([d]b) Prehearing and Hearing Process Fees

(1) Each member that is a party to an arbitration proceeding in which more than \$25,000 is in dispute will pay:

(A) [a non-refundable process fee as set forth in the schedule below for each stage of the proceeding] a non-refundable prehearing process fee of \$750, due at the time the parties are sent arbitrator lists in accordance with Rule 10308(b)(5); and

(B) a non-refundable hearing process fee, due when the parties are notified of the date and location of the first hearing session, as set forth in the schedule below.

(2) [The prehearing and hearing process fees shall not be chargeable to any other party under Rules 10332(c) and 10205(c) of the Code.] If an associated person of a member is a party, the member that employed the associated person at the time of the events which gave rise to the dispute, claim or controversy will be charged the process fees[.], even if the member is not a party. No member shall be assessed more than one prehearing and one hearing process fee in any arbitration proceeding.

(3) The prehearing and hearing process fees shall not be chargeable to any other party under Rules 10332(c) and 10205(c) of the Code.

[The prehearing process fee will accrue according to the schedule set forth below, but will not become due until (1) the parties are notified of the prehearing conference, or (2) if no prehearing conference is scheduled, the parties are notified of the date and location of the first hearing session. The hearing fee will accrue and be due and payable when the parties are notified of the date and location of the first hearing session. All accrued but unpaid fees will be due and payable at the conclusion of the member's or associated person's involvement in the proceeding. No member will pay more than one prehearing and hearing process fee for any case. The process fees will stop accruing when either the member enters into a settlement of the dispute or the member is dismissed from the proceeding or, if the member is paying a process fee as a result of an associated person being named as a party, when the associated person enters into a settlement or is dismissed from the proceeding, whichever is later.]

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[Prehearing Process Fee Schedule

(proceedings where more than \$25,000 is in dispute)

Service of Claim (accrues when the claim has been submitted and is ready to be served on the respondents)	\$50
Case Preparation (accrues when the first answer to the claim is received or due and discovery or motions proceedings commence)	\$150
Prehearing Activities (accrues when the parties are first notified of the names of any arbitrators selected to hear the matter or are given the names of arbitrators to select)	\$400
	Total \$600]

Hearing Process Fee Schedule

[(accrues and becomes due and payable when the parties are notified of the date and location of the first hearing session)]

Damages Requested	Hearing Process Fee
\$1 - \$25,000	\$ 0
\$25,000.01 - \$50,000	\$1,000
\$50,000.01 - \$100,000	[\$1,500] <u>\$1,700</u>
\$100,000.01 - \$500,000	[\$2,500] <u>\$2,750</u>
\$500,000.01 - \$1,000,000	[\$3,500] <u>\$4,000</u>
\$1,000,000.01 - \$5,000,000	[\$4,500] <u>\$5,000</u>
More than \$5,000,000	[\$5,000] <u>\$5,500</u>
Unspecified	[\$2,000] <u>\$2,200</u>

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INFORMATIONAL

Continuing Education

Content Outline For New Series 6 Program Regulatory Element (S106) For Investment Representatives

SUGGESTED ROUTING

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

- Continuing Education
- Legal & Compliance
- Registration Department
- Senior Management

KEY TOPICS

- Regulatory Element
- General Program (S101)
- Series 6 Program (S106)

Executive Summary

NASD Rule 1120 (Continuing Education Requirements) permits the NASD, as appropriate, to designate specific Continuing Education Regulatory Element programs for various registration categories. The first initiative under Rule 1120 was the General Program (S101) in 1995, followed by the Supervisor's Program (S201) in 1998. We are now preparing to introduce the Series 6 Program (S106), which has been developed specifically for Series 6 registered persons.

The S106 will differ in three respects from the existing General Program (S101).

- 1) The Series 6 Program will feature audio in addition to text on screen.
- 2) Module 7 of the Series 6 Program is called Application Of Product Knowledge To Sales Practice. It replaces New and Secondary Offerings, Module 7 of the General Program.
- 3) The scenarios in all seven modules of the S106 will only deal with mutual funds or variable contracts.

Upon implementation of the new program, Series 6 registered persons will take the S106 Program. Supervisors/Principals of Series 6 registered persons will continue to take the Supervisor's Program (S201). Other registration categories will continue to take the General Program (S101).

Attached is the combined Content Outline for both the S101 and S106 programs. Please note that there is some overlap in subject matter between the two programs. However, those areas specific to the individual programs are indicated.

A future *Notice to Members* will be published with the specific date of the implementation of the Series 6 Program as soon as that date is determined. In the interim period, Series 6 registered persons will continue to take the General Program.

To obtain copies of the *Content Outline For The Regulatory Element*, phone either of the parties listed below, or download it from www.securitiescep.com, the Web Site of the Securities Industry/Regulatory Council on Continuing Education.

Questions/Further Information

Questions about this *Notice* should be directed to John Linnehan, Director, Continuing Education, NASD Regulation, at (240) 386-4684; or Heather Bevans, Continuing Education Communications Coordinator, NASD Regulation, at (240) 386-4685.

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Securities Industry/Regulatory Council on Continuing Education

Content Outline For The Regulatory Element

Introduction

Six self-regulatory organizations (SROs) - The American Stock Exchange, Inc.; the Chicago Board Options Exchange, Inc.; the Municipal Securities Rulemaking Board; the National Association of Securities Dealers, Inc.; the New York Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. - have enacted rules establishing a continuing education program for the securities industry. The rules call for a formal, two-part program, comprising a Firm Element and a Regulatory Element.

The Firm Element requires broker/dealers to keep employees up to date on job- and product-related subjects by means of a formal, ongoing training program. Each broker/dealer is required to establish a training process meeting certain minimum criteria and standards. In planning, developing, and implementing the Firm Element, each broker/dealer must take into consideration its size, structure, scope of business, and regulatory concerns.

The Regulatory Element requires all registered persons to participate in a prescribed computer-based training session within 120 days of their second registration anniversary date and every three years thereafter. The Regulatory Element is designed to cover significant subject matter which is broadly applicable to all registered persons. Programs have been specifically developed for registered Supervisors/Principals and Series 6 (Investment Company Products/Variable Contracts Representative), in addition to the General Program for persons in other registration categories (Series 7 General Securities Representative and other registration categories not covered in the Supervisor and Series 6 programs). The content is developed by industry committees representing a diverse range of broker/dealers, in conjunction with the Securities Industry/Regulatory Council on Continuing Education, industry regulatory agencies, and SROs.

The Securities Industry Continuing Education Program is intended to keep registered securities industry personnel current regarding rules and other issues important to performing their jobs appropriately.

The Regulatory Element

The Regulatory Element focuses on compliance, regulatory, ethical, and sales-practice standards. Its content is derived from rules and regulations, as well as standards and practices widely accepted within the industry. Although the specific requirements of certain rules may differ slightly among the various SROs, the program is based on standards and principles applicable to all. In certain instances, particular SRO requirements may be more restrictive than those represented in the program. Additionally, many broker/dealers limit the types of activities in which their registered employees may engage and/or the investment products they may represent, or they may require specific approvals for certain functions. Registered persons and their supervisors are responsible for ensuring that their activities are within the scope permitted by their employing broker/dealers and conducted in accordance with the rule requirements of all the SROs and jurisdictions regulating them.

The content for the General (101) and Series 6 (106) programs is organized into seven modules. While the content is specific to the respective registration categories covered by each program, the subject titles for modules 1 through 6 in both the General (101) and Series 6 (106) programs are the same. The content of Module 7 will vary according to the program. Each of these topics is covered thoroughly in the corresponding module, and some may be covered in more than one module. The content of these modules is outlined starting on page 3. Unless otherwise specified, the topics are covered at basic levels of knowledge and understanding.

Content Outline For The Regulatory Element

Please note that there is no specific content outline for the Supervisor/Principal program (201). This program is designed to draw on the experience of the supervisor/principal involving such topics as supervision, suitability, insider trading, money laundering, and interviewing and hiring.

There are no study materials available from the Council or the SROs as the Regulatory Element programs are based on industry experience. Please consult your training or compliance department if you need additional information on any of the topics listed in this outline.

General Program (101)	
Module 1	Registration & Reporting Issues
Module 2	Communications with the Public
Module 3	Suitability
Module 4	Handling Customer Accounts
Module 5	Business Conduct
Module 6	Customer Accounts, Trade & Settlement Practices
Module 7	New & Secondary Offerings

Series 6 Program (106)	
Module 1	Registration & Reporting Issues
Module 2	Communications with the Public
Module 3	Suitability
Module 4	Handling Customer Accounts
Module 5	Business Conduct
Module 6	Customer Accounts, Trade & Settlement Practices
Module 7	Application of Product Knowledge to Sales Practices

How The Training Is Presented In Each Program

In each module of the General Program and the Series 6 Program, participants are led through scenarios depicting situations faced by registered persons in the course of their business. The format of the scenarios in the General Program (101) is computer interactive text based, while the Series 6 Program (106) will also feature audio segments. After reading the scenario, the participant must demonstrate his or her understanding of the issues by choosing the most appropriate response(s) to questions concerning the facts in the scenario. The program will assess the individual's understanding of the topic. If the individual does not answer a sufficient number of questions correctly, the program delivers tutorials about the topics in the module and the participant must try again with another scenario on the same general topic. The participant must successfully complete one scenario in the module before he or she can advance to the next module.

The Supervisor/Principal Program (201) is specifically designed to enhance a supervisor's problem-detection and resolution skills. The program comprises lifelike situations in the form of cases covering such topics as suitability, supervision, insider trading, money laundering, and interviewing and hiring.

A participant in the Regulatory Element must complete the entire program to satisfy the Regulatory Element requirement. Each program is designed to provide ample time to complete all scenarios within the timeframe allotted. Failure to complete the Regulatory Element within 120 days after the prescribed anniversary dates will result in a person's registration becoming inactive. This means that he or she may not engage in, or be compensated for, activities requiring a securities registration until he or she satisfies the requirements.

This is the content outline for both the General (101) and the Series 6 (106) programs. Topics that are specific to the 101 General Program appear in text boxes.

Module 1: Registration And Reporting Issues

1.1 Registration/Licensing Requirements

Requirements of the self-regulatory organizations (SROs)
State authority and jurisdiction, general requirements for registered representative (RR) and broker/dealer registration/licensing in states
Conditions, restrictions, and requirements for amending Form U-4
Restrictions on activities of RRs
General registration/licensing requirements for and limitations on activities of Investment Advisers
Restrictions on activities of nonregistered persons
Consequences of violating registration/licensing requirements
Continuing Education requirements

1.2 Securities And Exchange Commission (SEC) And SRO Authority And Investigations

Jurisdiction of SEC, SROs, and state regulators
Obligations for response to regulatory inquiries
Definition and consequences of statutory disqualification [Section 3(a)(39) of the Securities Exchange Act of 1934]
Settlement of employer-employee disputes

1.3 Blue-Sky Laws, Registration Of Securities

Requirements for securities to be registered or exempt in states in which they are being sold
Distinction between exempt/nonexempt securities
General exemptions from registration

1.4 Differences In Insurance Appointments And Securities Licensing

Variable Annuity/Variable Universal Life

Module 2: Communications With The Public

2.1 Communications With The Public

Definitions, general standards, and required approvals for public communications:

Telephone solicitations, correspondence, advertisements, market letters, research reports, sales literature, educational material, electronic communications, communications in and with the press, seminars, lectures, shareholder services, broker/dealer use only, summary statements

Restrictions on telephone solicitations/cold calling

2.2 Customer Complaints And Inquiries

Requirements for reporting, investigation, and documentation

Handling of disputes with customers; arbitration procedures and awards

CRD toll-free number and type of information publicly disclosed in disciplinary records

Module 3: Suitability

3.1 Specific Elements In Evaluating Current Status Of Customer

Financial profile - Balance sheet, income statement, other financial considerations

Life profile - Non-financial investment considerations

Risk tolerance and investment experience

Investment objectives and considerations

Solicited versus unsolicited accounts and transactions

Tax considerations

3.2 Concepts And Implications Related To Risk

Diversification and risk reduction - Concepts and specific responsibilities of the RR

Definitions and examples of types of risk - Liquidity risk, interest rate risk, call risk, credit risk, legislative risk, purchasing power risk (inflation risk), reinvestment risk, principal risk, currency risk, political risk, sector risk

Risk characteristics of categories of investments (*e.g.*, equity, debt, asset-backed, mutual funds, insurance products)

Business cycle - Definition and effects

Effects of international events, interest rate fluctuations

3.3 Monitoring Customer Needs, Objectives, And Portfolio

Obligation and procedures for routine monitoring and updating of customer's financial and life profile, investment objectives, and portfolio.

Module 4: Handling Customer Accounts

4.1 Prohibited/Fraudulent Practices

Definitions and examples of prohibited and improper activities such as insider trading, entering false orders, misappropriation of funds, stealing/conversion, forgery, unauthorized trading, guarantees to customers, selling away, piggy-backing/shadowing, selling dividends, commingling funds, selling to breakpoints, churning, switching, and twisting.

In addition to the above stated practices, the following also pertains to the 101 Program only: market manipulations, unfair and excessive pricing, front running, free-riding, parking, trading at the close/marketing the close.

4.2 Third-Party Orders And Authority To Transact

Required instructions, requirements for third-party checks, requirements for written authorization for orders

4.3 Account Transfers And Customer Records

General requirements and procedures for transferring account (*e.g.*, dealer-to-dealer, representative-to-representative)

Confidentiality issues and responsibilities related to customer accounts and records; firm ownership of records

4.4 Gifts And Gratuities

Restrictions on giving and receiving; requirements for approvals

Noncash compensation, sales contests

Prohibition on compensating nonmembers

4.5 Sharing Profits And Losses

Restrictions on and allowable circumstances

4.6 “Prudent Man” Rule

Basic principle

4.7 “Chinese Wall” Requirements (*Pertains to the 101 Program only*)

Module 5: Business Conduct

5.1 Private Securities Transactions

Restrictions, required authorizations, legal risks

5.2 Outside Business Activities

Permitted and prohibited activities - Dual licensing, part-time employment, conflicts of interest
Required notifications/approvals (regulatory and broker/dealer)

5.3 Compensation

Rules, regulations, and standards governing sharing commissions or part of compensation

5.4 Payment Of Referral Fees (To Nonaffiliated Persons)

Restrictions; approval and disclosure requirements

5.5 Restrictions On Loans To/From Customers

5.6 Conflicts Of Interest And Potentially Illegal Situations

RR awareness, things to watch for, recognition, prohibitions

5.7 Cash Transaction Reporting Requirements (e.g., money laundering)

Module 6: Customer Accounts, Trade And Settlement Practices

6.1 Customer Accounts, Documents, Approvals, And Restrictions

Procedures for opening customer accounts, including required approvals, and recordkeeping

Definitions and requirements related to:

Accounts for Clients of Investment Advisers - Additional trading authorization required, written evidence of power of attorney

Discretionary Accounts - Requirements for written authorization and broker/dealer approval; prohibition by many broker/dealers

Legally Restricted Accounts - Restrictions/prohibitions on accounts for minors, persons incompetent, entities, death of customer, fiduciary accounts

Custodial Accounts (UGMA/UTMA) - General requirements and characteristics

Qualified Accounts [such as 401(k), IRA, IRA Rollover, 403(b), & 457] - Tax advantages, restrictions

Joint Accounts - Characteristics and purpose of accounts such as joint tenants with right of survivorship, joint tenants in common.

Broker/Dealer Employee Accounts - Approval of and disclosures, procedures for opening

Obligations of and limits on fiduciaries, limits on the use of powers of attorney

Authorization to transact

6.2 *Regulation T, SRO Margin And Short Sales Rules (Pertains to the 101 Program only)*

Basic distinctions between cash and margin accounts.

Appropriate use of margin accounts and associated risks - Initial and maintenance concepts

Obligations for informing customers of risks and benefits.

Margin accounts for fiduciaries.

6.3 Securities Investor Protection Corporation (SIPC)

Purpose of SIPC, coverage limits and amounts, disclosures to customers

6.4 Payment And Delivery For Securities Transactions

General requirements, consequences of nonpayment/nondelivery

6.5 Payment For Investment Company/Variable Contract Products

Regulation T requirements for payment

Free-look provisions

Forward pricing of shares

6.6 Correction Of Errors

Procedures, approvals, and prohibitions

Module 7: New And Secondary Offerings (Pertains to the 101 Program only)

7.1 SEC Registration and Prospectus Requirements (Securities Act of 1933)

General Requirements - Definition of offer; prospectus delivery requirements; limits on advertising and other written materials; prohibition of sales before effective date; use of preliminary prospectus (red herring); restrictions before, during, and after a distribution; exemptions from registrations; restrictions on hot issues

New Issues and Securities Trading - Registration requirements, restricted accounts, prospectus requirements, exemptions from registration

7.1 Penny Stock Rules

General knowledge of written suitability and disclosure requirements

Module 7: Application Of Product Knowledge To Sales Practices

Note: *Module 7 content for the 106 Program will consist of subject matter described below. The same subject areas may also be covered in Modules 1 through 6 of the 101 Program.*

7.1 Investment Companies

Characteristics of Unit Investment Trusts (UIT); Closed-end investment companies; open-ended investment companies; diversified and non-diversified companies

7.1.1 Mutual Funds

Structure and Operation of funds - costs of operation; functions/responsibilities of board of directors, investment advisers, underwriters (distributor), custodians, and transfer agents; rights of shareholders; conveniences and services provided to shareholders

7.1.2 Types Of Distributions

Net investment income, capital gains, returns of capital, distribution alternatives

7.1.3 Types Of Mutual Funds

Characteristics and investment policies by objective and underlying investment (e.g., aggressive growth funds, income funds, money market funds, municipal bond funds)

7.1.4 Important Factors In Comparing Funds

Basis of comparison; performance statistics and other factors (e.g., sales and distribution charges, minimum purchase requirements)

7.1.5 Prices Of Mutual Fund Shares

Determination and consequences of Net Asset Value (NAV)

Sales Charges - computation of; types (e.g., front end load, level load, contingent deferred and no load); qualification for reduction (e.g., breakpoints, letter of intent), expenses and 12b-1 fees

Definition of Dollar Cost Averaging (DCA)

7.1.6 Redemption Of Mutual Fund Shares

Redemption prices and systematic withdrawals

7.1.7 Prospectus And Statement Of Additional Information (SAI)

Delivery requirements

7.1.8 Federal Income Tax Regulations For Mutual Funds

Tax consequences of activities by the Investment Company or investor.

Cost basis, holding period, wash sales, inheritance of securities

7.1.9 Contractual Plan/Periodic Payment Plan

Characteristics; prospectus requirements; operation of contractual plan

7.2 Variable Contracts

Separate Accounts

7.2.1 Variable Annuity Contracts

Characteristics and types of variable and fixed annuities, related sales charges and expenses, valuation of a variable annuity contract, and tax treatment of individual non-tax qualified variable annuity contracts

7.2.2 Variable Life Insurance (Fixed And Flexible Premium Types)

Characteristics of universal and variable life insurance (*e.g.*, death benefits, cash value, risk premium payments, conversion privileges)

Fees and related expenses (*e.g.*, mortality costs, cost of insurance, investment management fee)

Valuation of a variable life insurance policy

Tax treatment of variable life insurance to the policyholder

7.3 Retirement Plans

Characteristics including purpose, funding, eligibility, employee coverage, contribution limits, taxation, rollover/transfer rules, distribution rules, taxation:

Individual Retirement Accounts (IRAs), Simplified Employee Pension (SEP) Plans, Keogh/HR 10 Plans, Corporate Pension Plans - Defined contribution plan and Defined benefit plan, Profit sharing plans, 401(k) plans, 403(b) Tax-Deferred Annuity Plans/Custodial Accounts

INFORMATIONAL

Continuing Education

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

SUGGESTED ROUTING

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

- Continuing Education
- Legal & Compliance
- Registration
- Senior Management

KEY TOPICS

- Continuing Education
- Firm Element

Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued a *Firm Element Advisory*, a guide for firms to use when developing their continuing education Firm Element training plans. The attached *Firm Element Advisory* lists topics that the Council considers to be particularly relevant to the industry at this time. The list is based on a review of recent regulatory events, as well as advisories issued by self-regulatory organizations (SROs) since the last *Firm Element Advisory* of October 2000. Firms should review the training topics listed in the *Firm Element Advisory* in conjunction with their annual Firm Element Needs Analysis in which firms identify training issues to be addressed by their written Firm Element training plan(s).

Also, please note that the Council has two additional resources available on its Web Site to assist firms with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application in which a firm identifies specific investment products or services and selects training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources like those listed in the *Firm Element Advisory*, and provides a report listing relevant resources sorted by investment product or service. A firm can use a word processing program to edit the report that can help create a written Firm Element plan. The second resource comprises scenarios from the Regulatory Element computer-based training, which may be suitable for Firm Element training. For more information, to use the *Firm Element Organizer*, or to order Regulatory Element scenarios, log on to www.securitiescep.com.

Questions/Further Information

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

Background

The Council includes 14 members representing a cross-section of securities firms and six SROs.¹ Both the Securities and Exchange Commission and the North American Securities Administrators Association have appointed liaisons to the Council.

The Council facilitates industry/regulatory coordination of the administration and future development of the Continuing Education Program. Council responsibilities also include recommending and helping to develop specific content and questions for the Regulatory Element programs and minimum core curricula for the Firm Element.

Endnotes

- ¹ The American Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc. are members of the Council.

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The Securities Industry Continuing Education Program

The Securities Industry Continuing Education Program

Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (Council) publishes the *Firm Element Advisory* to identify pertinent regulatory and sales practice issues for possible inclusion in Firm Element training plans. This year's topics have been taken from a review of industry regulatory and self-regulatory organization (SRO) publications issued since the last *Firm Element Advisory* of October 2000.

The Council recommends that firms use the *Firm Element Advisory* when they undertake their annual Firm Element Needs Analysis. Begin by reviewing the training topics listed in the *Firm Element Advisory* that are most relevant to the firm's business as it exists today, including training for supervisors. Then, consider training topics prompted by new products or services the firm plans to offer, such as security futures, where Firm Element training is mandated before a registered person can conduct business in this area. Other training topics may address issues raised by new rules, customer complaints, or regulatory examination findings. Once the firm has identified and prioritized training topics, it should review the training resources listed in the *Firm Element Advisory*. Remember that any training topics included in the firm's written training plan should be relevant to the firm's unique situation and implementation of the plan should be appropriate to the firm's size and structure.

The Council now has two additional resources available on its Web Site to assist firms with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application in which a firm identifies specific investment products or services and selects training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources like those listed in the *Firm Element Advisory*, and provides a report listing relevant resources sorted by investment product or service. A firm can use a word processing program to edit the report that can help create a written Firm Element plan. The second resource comprises scenarios from the Regulatory Element computer-based training, which may be suitable for Firm Element training. For more information, to use the *Firm Element Organizer*, or to order Regulatory Element scenarios, log on to www.securitiescep.com, or phone Roni Miekle, Continuing Education Manager, the New York Stock Exchange (212-656-2156), or John Linnehan, Director, Continuing Education, NASD Regulation, Inc. (240-386-4684).

<p>Certificates of Deposit (CDs)</p>	<p>The New York Stock Exchange (NYSE) reminded its member organizations that the risks associated with Long-Term CDs must be disclosed to prospective purchasers. In addition, the NYSE advised its members that after September 2001, par pricing may not be utilized on statements for Long-Term CDs and if market value is not provided, Long-Term CD positions must be reflected on customer statements as unpriced.</p> <p>See NYSE Information Memo Nos. 01-05 and 01-19, <i>“Long-Term Certificates of Deposit Sales Practice,”</i> March 7, 2001 and July 20, 2001, respectively.</p>
<p>Communications with the Public</p> <p>Electronic Communications— Stock Spams and Scams</p>	<p>NASD Regulation has published <i>Stock Spams and Scams</i>, an <i>Investor Alert</i> on junk e-mail communications about investing in stock. See http://www.nasdr.com/alert_05-01.htm.</p>
<p>Communications with the Public</p> <p>Electronic Communications— Suitability and Online Communications</p>	<p>In light of the dramatic increase in the use of the Internet for communication between broker/dealers and their customers, NASD Regulation issued a Policy Statement to provide guidance concerning a firm’s obligations under the NASD general suitability rule, Rule 2310, in this electronic environment.</p> <p>The Policy Statement briefly discusses some of the issues created by the intersection of online activity and the suitability rule, and it provides examples of electronic communications that NASD Regulation considers to be either within or outside the definition of “recommendation” for purposes of the suitability rule. In addition, the Policy Statement sets forth guidelines to assist members in evaluating whether a particular communication could be viewed as a “recommendation,” thereby triggering application of the suitability rule.</p> <p>See <i>NASD Notice to Members 01-23, Suitability Rule And Online Communications</i>, April 2001.</p>

**Customer Accounts,
Trade and Settlement
Practices**

Customer Account
Transfer Contracts

Recent modifications to the Automated Customer Account Transfer Service (ACATS) provide the capability to facilitate the transfer of accounts containing third-party and “in-house” proprietary products, including mutual funds. The NYSE approved amendments to an Interpretation of NYSE Rule 412 (Customer Account Transfer Contracts). The amendments are intended to expedite the transfer of accounts containing such products, as well as clarifying the responsibilities of a carrying organization when transferring accounts that have been internally reassigned, with new account numbers, to another registered representative. The amendments become effective January 28, 2002.

See NYSE Information Memo No. 01-23, *Amendments to the Interpretation of Rule 412 (“Customer Account Transfer Contracts”)*, August 16, 2001.

**Customer Accounts,
Trade and Settlement
Practices**

Direct Registration
System (DRS)

The Securities and Exchange Commission (SEC) views DRS as a very important component of the move to T+1 and of the continuing effort to immobilize the movement of physical certificates. DRS allows a shareholder to have securities registered electronically in the shareholder’s name directly on the books of the issuer or its transfer agent without the need for a physical certificate to evidence ownership. The use of DRS also enables a shareholder to electronically move a shareholder’s securities from a directly registered position on the books of an issuer or its transfer agent to a street-name position in the shareholder’s broker/dealer’s account at the Depository Trust Company, and vice-versa. As more issuers choose to make their securities eligible for DRS and more investors seek to take advantage of it, it is imperative that affected registered persons be aware of DRS.

For more information on DRS, see SEC Release No. 34-44696, “Order Relating to the Movement of All DRS Issues into Profile,” dated August 14, 2001, and also the Web Sites for the SEC Division of Market Regulation (<http://www.sec.gov/divisions/marketreg.shtml>), the Depository Trust Company (<http://www.dtc.org>), and the Securities Industry Association (<http://www.sia.com>).

**Customer Accounts,
Trade and Settlement
Practices**

NASD Three Quote
Rule

On September 21, 2000, the SEC approved amendments to NASD Rules 2320(g) (Best Execution and Interpositioning) and 3110(b) (Books and Records – Marking of Order Tickets).

The amendments to Rule 2320(g) require members to obtain quotations from three dealers (or all dealers if three or fewer) only when there are fewer than two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTCBB or the electronic pink sheets).

Under the amendments to Rule 3110(b)(2), members are no longer required to indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market whenever two or more priced quotations are displayed in an inter-dealer quotation system and NASD Regulation has access to the quotation data.

See NASD Notice to Members 00-78, SEC Approves Proposed Changes To The NASD Three Quote Rule And Related Recordkeeping Requirements, November 2000.

**Customer Accounts,
Trade and Settlement
Practices**

NYSE Rule 80A Collars
and NYSE Rule 80B
Circuit Breaker Levels

NYSE Rule 80A (Index Arbitrage Trading Restrictions) addresses the change in the Dow Jones Industrial Average that triggers the rule's tick restrictions.

NYSE Rule 80B (Trading Halts Due To Extraordinary Market Volatility) addresses halt provisions and circuit breaker levels.

The NYSE changes the trading collars and circuit breaker levels on a quarterly basis.

See NYSE Information Memo Nos. 00-32, 01-08, and 01-15, "New Rule 80A Collars and Rule 80B Circuit Breaker Levels", December 29, 2000, April 2, 2001, and July 2, 2001.

<p>Customer Accounts, Trade and Settlement Practices</p> <p>Options</p> <p>Order Entry</p> <p>Prohibition Against Electronically Generated Orders</p>	<p>The SEC on September 12, 2000, approved Chicago Board Options Exchange (CBOE) Rule 6.8A, <i>Electronically Generated and Communicated Orders</i>. Rule 6.8A restricts the entry of certain options orders that are created and communicated electronically without having been reviewed by the firm.</p> <p>See <i>CBOE Regulatory Circular RG00-139</i>.</p>
<p>Customer Accounts, Trade and Settlement Practices</p> <p>Options</p> <p>Prohibition Against Entering RAES Orders within 15 Seconds in the Same Option Class</p>	<p>The SEC on March 26, 2001, approved changes to CBOE Rule 6.8, RAES Operations. Changes to Rule 6.8 include the requirements imposed by paragraph (e) which require member organizations that are able to route orders to the Exchange's Order Routing System to:</p> <ul style="list-style-type: none"> ● provide written notice to all users regarding the proper use of RAES, and ● not enter or cause the entry of multiple orders in the same option class within any 15-second period for an account or the accounts of the same beneficial owner. <p>See <i>CBOE Regulatory Circular RG01-41</i>.</p>
<p>Customer Accounts, Trade and Settlement Practices</p> <p>Regulation S-P</p>	<p>Regulation S-P (effective July 1, 2001) requires financial institutions to provide notice to consumers about the institution's privacy policy and practice, restricts the ability of financial institutions to share non-public personal information about consumers with non-affiliated third parties, and allows consumers to prevent such information sharing by "opting out." It also requires the safeguarding of customer information by firms.</p> <p>See <i>NASD Regulatory & Compliance Alert</i>, Summer 2001 (http://www.nasdr.com/rca_summer01.htm), and NYSE Information Memo No. 01-10, "Regulation S-P," June 19, 2001.</p>

<p>Individual Retirement Accounts</p> <p>“Stretch” IRAs</p>	<p>In response to Internal Revenue Service rule changes that created a variation on traditional IRAs, NASD Regulation published an <i>Investor Alert</i> on “Stretch” IRAs. Sales presentations for stretch IRAs usually include value tables that give hypothetical examples showing how much the IRA account will be worth over time, sometimes for periods up to 90 years. Investors should realize that the huge values contained in the sales presentations depend on assumptions that can change and greatly reduce the projected value of the IRA.</p> <p>See “<i>Stretch IRAs - Too Much of a Stretch for You?</i>,” http://www.nasdr.com/alert_07-01.htm.</p>
<p>Margin</p>	<p>NASD Regulation has published a number of communications for members, investors, and others about margin-related topics. Please see http://www.nasdr.com/5700.htm for more information.</p>
<p>Margin</p> <p>Day-Trading Margin Requirements</p>	<p>The SEC approved amendments establishing new minimum equity requirements to address the risks associated with day trading in customer accounts. Among other things, the amendments require that equity and maintenance margin be deposited and maintained in customer accounts that engage in a pattern of day trading. In addition, the amendments define the term “pattern day-trader” and establish minimum equity requirements of \$25,000 for pattern day-traders.</p> <p>See <i>NASD Notice to Members 01-26, SEC Approves Proposed Rule Change Relating To Day-Trading Margin Requirements</i>, April 2001, and <i>NYSE Information Memo 01-09, Amendments to Rule 431 (“Margin Requirements”)</i>, April 2, 2001.</p>

<p>Margin</p> <p>Margin Disclosure Statement to Non-Institutional Customers</p>	<p>On April 26, 2001, the SEC approved NASD Rule 2341, which requires all NASD members to deliver to retail customers a specified disclosure statement that discusses the operation of margin accounts and the risks associated with trading on margin.</p> <p><i>See NASD Notice to Members 01-31, SEC Approves NASD Rule Proposal Requiring Delivery Of Margin Disclosure Statement To Non-Institutional Customers, May 2001, and NASD Notice to Members 01-37, NASD Regulation Extends Deadline For Delivery Of Margin Disclosure Statement To Existing Non-Institutional Customers To January 31, 2002, June 2001.</i></p>
<p>Municipal Securities</p> <p>Municipal Fund Securities, Including 529 Plans</p>	<p>A municipal fund security (e.g., 529 Plans and local government investment pools) is defined in Municipal Securities Rulemaking Board (MSRB) Rule D-12 as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company thereunder.</p> <p>The MSRB has amended Rule G-3, on professional qualifications, to provide a temporary alternative method for qualification of municipal securities principals in connection with municipal fund securities. Until July 31, 2002, a dealer may designate an investment company/variable contracts limited principal or a general securities principal to act as a municipal fund securities limited principal. A designated municipal fund securities limited principal will have all of the powers and responsibilities of a municipal securities principal under MSRB rules with respect to transactions in municipal fund securities and, under certain circumstances, may be counted toward the dealer's numerical requirement with regard to municipal securities principals.</p> <p>See "Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market," January 18, 2001, <i>MSRB Rule Book</i> (July 1, 2001) at 14; "Municipal Fund Securities- Qualification of Municipal Securities Principals and Application of MSRB Rules to Fees, Disclosure and Other Market Practices," MSRB Reports, Vol. 21, No. 2 (July 2001) (http://www.msrb.org/msrb1/reports/0701v212/MFS.htm).</p>

Municipal Securities

Delivery of Official Statements to Customers and Other Dealers

During the underwriting period, a dealer is prohibited from selling new issue municipal securities (other than commercial paper) to a customer unless the dealer delivers to the customer by settlement of the transaction a copy of the final official statement if one is prepared by or on behalf of the issuer. If a municipal securities issuer will prepare only a preliminary official statement and not a final official statement, a dealer must deliver the preliminary version along with a written notice to customers that no final official statement will be prepared.

See MSRB Rule G-32: Disclosures in Connection with New Issues, *MSRB Rule Book*.

Municipal Securities

Delivery of Official Statements and Advance Refunding Documents to the MSRB

Managing underwriters are required to deliver to the MSRB, among other things, copies of final official statements for most primary offerings of municipal securities, if such documents are prepared by or on behalf of the municipal securities issuer. For refunding issues, dealers must send to the MSRB two copies of the refunding escrow agreement, or its equivalent, if prepared by or on behalf of the municipal securities issuer. Dealers must send these documents to the MSRB using the appropriate form.

Effective January 1, 2002, underwriters may begin making submissions in electronic form. See MSRB Rule G-36: Delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to Board or its Designee, *MSRB Rule Book*; *Form G-36 Manual* published by the MSRB; "SEC Approval of Electronic Submission System under Rule G 36" (<http://www.msrb.org/msrb1/whatsnew/Esubmissionapproval.htm>).

<p>Municipal Securities</p> <p>Political Contributions and Prohibitions on Municipal Securities Business</p>	<p>Dealers are prohibited from engaging in municipal securities business with a municipal securities issuer within two years after any contribution to an official of such issuer made by the dealer, any municipal finance professional associated with such dealer, or any political action committee controlled by the dealer or any municipal finance professional. The only exception to this absolute prohibition on municipal securities business is for certain contributions made to issuer officials by municipal finance professionals, but only if the municipal finance professional is entitled to vote for such official and provided any contributions by such municipal finance professional do not exceed, in total, \$250 to each official, per election. Dealers must report certain information about political contributions, political party payments, municipal securities business, and consultants to the MSRB on Form G-37/G-38 or, if appropriate, dealers may file a Form G-37x with the MSRB.</p> <p>See MSRB Rule G-37: Political Contributions and Prohibitions on Municipal Securities Business, <i>MSRB Rule Book</i>.</p>
<p>Municipal Securities</p> <p>Consultants</p>	<p>MSRB Rule G-38 defines a consultant as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the dealer or any other person. Dealers must disclose to issuers certain information about their consultants and report certain information about their consultants to the MSRB on Form G-37/G-38, including certain of their consultants' political contributions to issuer officials and payments to state and local political parties.</p> <p>See MSRB Rule G-38: Consultants, <i>MSRB Rule Book</i>; "Bank Affiliates as Municipal Finance Professionals or Consultants," <i>MSRB Rule Book</i> (July 1, 2001) at 239.</p>

<p>Municipal Securities</p> <p>Flat Transaction Fees</p>	<p>The MSRB has issued a notice concerning dealers that will charge a flat transaction fee of \$15.00 for trades executed through an automated trading system. Since this fee is relatively small and unrelated to the par value of the transaction, the MSRB believes that the transaction fee should be considered a miscellaneous transaction fee. Therefore, the fee would not have to be incorporated into the stated yield, but would need to be separately disclosed on the confirmation.</p> <p>See "Notice Concerning Flat Transaction Fees," June 13, 2001, <i>MSRB Rule Book</i> (July 1, 2001) at 114.</p>
<p>Mutual Funds</p> <p>Understanding Mutual Fund Classes</p>	<p>NASD Regulation has published an <i>Investor Alert</i> on the subject of mutual fund classes. See http://www.nasdr.com/alert_12-02.htm.</p>
<p>Performance Fees</p>	<p>On February 15, 2001, the SEC approved amendments to NASD Rule 2330(f)(2) to permit NASD members and associated persons that act as investment advisers to share in the customer account profits and gains, subject to the provisions of Rule 205-3 under the Investment Advisers Act of 1940.</p> <p>See <i>NASD Notice to Members 01-24, SEC Approves Proposed Changes To Rule 2330(f)(2) Relating To Performance Fees</i>, April 2001.</p>
<p>Promissory Notes</p>	<p>A brochure, produced jointly by the North American Securities Administrators Association (NASAA), NASD, SEC, and SIA outlines the risks and rewards of investing in promissory notes. Investors learn what to consider in evaluating whether promissory notes are sound investments. Concrete examples illustrate the kinds of scams that have cost some investors their life savings. See http://www.sia.com/publications/html/promissory_notes_brochure.html, and also <i>Promissory Notes Can Be Less Than Promised</i>, an <i>Investor Alert</i> published by NASD Regulation at http://www.nasdr.com/alert_12-01.htm.</p>

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

The Commodity Futures Modernization Act of 2000 amended the Securities Act of 1933, the Securities and Exchange Act of 1934, and the Commodity Exchange Act of 1936 to permit the trading of “security futures (also known as Single Stock Futures)”: futures on individual stocks and narrow-based indexes. This statutory change removes the ban on U.S. futures trading on an array of equity securities and securities indexes that has been in place since 1982. The introduction of security futures is expected to begin December 21, 2001.

Because security futures will have different characteristics and requirements than existing securities, industry SROs are requiring that each registered person complete a Firm Element continuing education program on security futures before he or she can conduct a public business in security futures.

Please monitor the following SRO Web Sites for information about security futures and training requirements.

- American Stock Exchange: <http://www.amextrader.com>
- Chicago Board Options Exchange:
<http://www.cboe.com/Institutional/SingleStockFutures.asp>
- NASD Regulation: <http://www.nasdr.com>
- New York Stock Exchange: <http://www.nyse.com>
- Philadelphia Stock Exchange: <http://www.phlx.com>

Supervision

Compensation of
Members and Dual
Employment as Relates
to Floor Activities

The NYSE identified, clarified, and emphasized three areas for its members and member organizations: (1) employment, compensation, and dual employment of members, (2) the appropriate type of agreement for a member executing transactions with public customers, and (3) direct access business.

See NYSE Information Memo No. 01-18, “*I. Compensation of Members and Dual Employment, II. Executing Broker Arrangements, III. Direct Access,*” July 11, 2001.

Also see PHLX Memorandum 93-14 and related Equity Floor Procedures Advice.

<p>Variable Contracts</p> <p>Exchanges of Variable Annuities</p>	<p>NASD Regulation has published an <i>Investor Alert</i> on exchanging variable annuities. See http://www.nasdr.com/alert_02-01.htm</p> <p>See also:</p> <ul style="list-style-type: none"> ● <i>NASD Notice to Members 99-35, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Annuities</i>, May 1999. ● Variable Annuities: What You Should Know at www.sec.gov/consumer/varanntty.htm ● <i>NASD Regulatory & Compliance Alert, Advertising Of Bonus Variable Annuities</i>, Summer 2000. (http://www.nasdr.com/rca_summer00.htm).
<p>Variable Contracts</p> <p>Sales of Variable Life Insurance</p>	<p>Variable life insurance and variable annuity contracts (Variable Contracts) are securities, and accordingly, their distribution is subject to industry rules. Of particular importance are:</p> <ul style="list-style-type: none"> ● NASD Rule 3010 (Supervision), which requires each member to establish and maintain systems to supervise the activities of each registered representative and associated person in order to achieve compliance with the securities laws, regulations, and rules; and ● NASD Rule 2310 (Suitability), which requires that a member, when recommending the purchase, sale, or exchange of any security to a customer, have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts disclosed by the customer. <p>See <i>NASD Notice to Members 00-44, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Life Insurance</i>, July 2000. [This <i>Notice</i> focuses on retail sales of variable life insurance, including both scheduled premium and flexible premium products, and provides a set of guidelines to assist members in developing sales-related supervisory procedures.]</p>

TO OBTAIN MORE INFORMATION

Organization Address	Phone Number	Online Address
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	http://www.amex.com http://www.amextrader.com
Chicago Board Options Exchange	Investor Services Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 800-OPTIONS	http://www.cboe.com
Municipal Securities Rulemaking Board	MSRB Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	http://www.msrb.org
National Association of Securities Dealers	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 240-386-4200	http://www.nasdr.com
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street, 18th Floor New York, NY 10005 212-656-5273 212-656-2089	http://www.nyse.com
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX 215-496-5158	http://www.phlx.com info@phlx.com
Securities Industry/Regulatory Council on Continuing Education		http://www.securitiescep.com

NASD Notice to Members 01-73

INFORMATIONAL

Continuing Education

Amendment To The Policy For Granting Foreign Deferrals Of The Regulatory Element – New VUE Center In Singapore

SUGGESTED ROUTING

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

- Continuing Education
- Registration

KEY TOPICS

- Continuing Education
- Regulatory Element

Executive Summary

With the opening in October of a VUE-authorized testing and training center (VUE center) in Singapore, NASD Regulation, Inc. will no longer grant foreign deferrals to registered persons residing approximately 350 miles or less from the site. This area includes Kuala Lumpur, Malaysia.

Questions/Further Information

Questions concerning this *Notice* may be directed to John Linnehan, Director, Continuing Education, NASD Regulation, Inc., at (240) 386-4684; or Heather Bevans, Continuing Education Communications Coordinator, NASD Regulation, Inc., at (240) 386-4685.

Background

A foreign deferral from the Continuing Education Regulatory Element prevents a registered person from becoming CE Inactive for failing to satisfy his or her Regulatory Element requirement, and is valid until the person's next anniversary requirement. *NASD Notice to Members 01-50* (August 2001) amended NASD Regulation's policy on granting foreign deferrals in light of the VUE centers opened outside the United States and Canada.

Now that there is a VUE center operating in Singapore, NASD Regulation will no longer grant foreign deferrals of Regulatory Element requirements for registered persons residing within approximately 350 miles of the VUE center.¹

Importantly, principals and supervisors who reside within 350 miles of Singapore will be given 120-day extensions to their anniversary requirement windows

until the S201 Principal Session becomes available internationally. Firms must alert NASD Regulation's Field Support Services to request extensions for their principals residing within 350 miles of Singapore. To reach Field Support Services, call (800) 999-6647 and select Option 1.

Below is a listing of the locations where foreign deferrals will no longer be granted for S101 Registered Representative Sessions or S106 Series 6 Investment Representative Sessions.

Locations Not Eligible For A Foreign Deferral Of The Regulatory Element

Asia:

- Hong Kong
- Japan
- Singapore and Kuala Lumpur, Malaysia
- South Korea

Australia:

- Sydney (and all locations within 350 miles of Sydney)

Europe:

- Belgium
- France (all locations within 350 miles of Paris)
- Germany
- Holland
- Ireland
- Luxembourg
- Switzerland
- United Kingdom

NASD Notice to Members 01-73

North America:

- Canada
- United States

Any questions about distances to a VUE center or whether a particular location entitles a registered person to a foreign deferral of the Regulatory Element should be referred to Heather Bevans at (240) 386-4685. To view an updated list of VUE centers and phone numbers, please see the Exam Location Web Page located on the NASD Regulation Web Site at <http://www.nasdr.com/exam/userlistlocations.asp>.

Endnote

- 1 The center is located at:
NTUC Computer Training Centre
10 Anson Road
06-18 International Plaza
Singapore 079903

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INFORMATIONAL

Continuing Education

Securities Industry/Regulatory Council On Continuing Education Announces Continuing Education Web Site

SUGGESTED ROUTING

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

- Continuing Education
- Legal & Compliance
- Registration
- Senior Management

KEY TOPICS

- Continuing Education
- Firm Element
- Regulatory Element

Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council), on which the National Association of Securities Dealers, Inc. (NASD®) participates, has developed a Web Site containing information, publications, and reference materials relative to the Securities Industry Continuing Education Program. The Web Site's address is www.securitiescep.com and was launched on October 26, 2001.

In addition to its value as an archive of continuing education information, the Council Web Site contains the following features.

- An easy-to-use software application, the Firm Element Organizer, can aid member firms in the development of their Firm Element training plans. The Firm Element Organizer prompts the user to identify specific investment products or services and select training topics from a defined list. The Firm Element Organizer then searches an extensive database and provides a report listing relevant resources sorted by investment product or service. A user can then edit the report with a word processing program to help create a written Firm Element plan.
- Retired scenarios from the Regulatory Element may be ordered for a nominal fee from a catalogue on the Web Site. Available on CDs, these scenarios can be used for development of training for the Firm Element or for other compliance needs. Registered persons taking the Regulatory

Element for the first time may also find them helpful. At this time only scenarios from the Regulatory Element General Program (S101) are available, but scenarios from the Supervisor's Program (S201) will be available in the near future.

- A user can register for e-mail alerts of new rules, regulations, and other subjects of interest related to securities industry continuing education.
- A "Contact Us" feature allows the user to submit questions regarding the Regulatory and Firm Elements.

Questions/Further Information

Questions about this *Notice* may be directed to John Linnehan, Director, Continuing Education, NASD Regulation, Inc., at (240) 386-4684; or Heather Bevans, Continuing Education Communications Coordinator, NASD Regulation, Inc., at (240) 386-4685.

Background

The Council includes 14 members representing a cross-section of securities firms and six SROs.¹ The Council facilitates industry/regulatory coordination of the administration and future development of the Continuing Education Program. The Council recommends and helps develop specific content and questions for the Regulatory Element programs and minimum core curricula for the Firm Element.

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Endnote

- 1 The American Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc., are members of the Council.

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NASD Notice to Members 01-75

ACTION REQUIRED

Broker/Dealer, Investment Adviser, And Agent Renewals

Broker/Dealer,
Investment Adviser,
And Agent Renewals
For 2002; Payment
Deadline: **December 7,
2001**

SUGGESTED ROUTING

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

- Executive Representatives
- Legal & Compliance
- Operations
- Registered Representative
- Registration
- Senior Management

KEY TOPICS

- Maintenance Fees
- Registration
- Renewals
- Web CRD
- Web IARD

Executive Summary

The National Association of Securities Dealers, Inc. (NASD®) Broker/Dealer, Firm, and Agent and the Investment Adviser Firm Renewal Program for the year 2002 began November 5, 2001. This annual program simplifies the registration renewal process through the payment of one amount on the member firm's Preliminary Renewal Statement. This is the first year the NASD will collect Investment Adviser Renewal fees for Investment Adviser (IA) firms for state regulators.

Renewal Statement fees will include: NASD personnel assessments, NASD system processing fees, NASD branch offices, as well as New York Stock Exchange (NYSE), American Stock Exchange (Amex), Chicago Board Options Exchange (CBOE), International Securities Exchange (ISE), Pacific Exchange (PCX), and Philadelphia Stock Exchange (PHLX) maintenance fees. The statement will also include state agent, state broker/dealer, and if applicable, state IA firm Renewal fees.

Members should read this *Notice to Members*, any instructions posted to the NASD Regulation Web Site (www.nasdr.com), the Investment Adviser Web Site (if applicable) (www.iard.com), and any other mailed information to ensure continued eligibility to conduct business in the states effective January 1, 2002. Any Renewal processing changes subsequent to the publishing of this *Notice to Members* will be provided to you in a *Special Notice to Members*.

Questions/Further Information

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

Preliminary Renewal Statements

As of November 5, 2001, Preliminary Renewal Statements are available for viewing and printing on Web CRD for all member firms. The statements will include fees for NASD personnel assessments, NASD system processing fees, NASD branch office fees, NYSE, Amex, CBOE, ISE, PCX, and PHLX maintenance fees, state agent Renewal fees, and state broker/dealer, and if applicable, IA firm Renewal fees. The NASD must receive full payment of the November Preliminary Renewal Statement amount **no later than December 7, 2001**.

Fees

The NASD *Personnel Assessment* fee for 2002 will be based on the number of registered personnel with an approved NASD license (that includes Approved Pending Prints, Inactive-Prints, Temporary Registration, and Inactive-Continuing Education registration statuses) on or before December 31, 2001. The personnel assessment is currently \$10 per person.

The NASD *System Processing* fee of \$30 will be assessed for each person who renews registration with **any regulator** through the NASD Renewal Program.

The NASD *Branch Office* assessment fee is \$75 per branch based on the number of active NASD branches as of December 31, 2001.

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

Currently, the state of California does not participate in the Broker/Dealer Renewal Program. Firms registered in that state must contact the state directly to ensure compliance with Renewal requirements. In addition, some participating states may require steps beyond the payment of Renewal fees to complete the Broker/Dealer or Investment Adviser Renewal process. Members should contact each jurisdiction directly for further information on state Renewal requirements.

For detailed information regarding Investment Adviser Renewals, you may visit the Investment Adviser Web Site (www.iard.com). A matrix that includes a list of Investment Adviser Renewal Fees for states that participate in the 2002 IARD Investment Adviser Renewal Program is posted at www.iard.com/pdf/reg_directory.pdf.

Please Note: The NASD does not currently process the registration of Investment Adviser Representatives (IARs) and also will not process IAR Renewal Fees for 2002. All IAR Renewals for 2002 must be paid directly to, and will be processed by, the states.

Renewal Payment

Payment of the Preliminary Renewal Statement should be either in the form of a check made payable to NASD Regulation, Inc., or by bank wire transfer. The check should be drawn on the member firm's account, with the firm's CRD Number included on the check, along with the word "Renewals" written on the front of the check. Submit all Renewal payments, along with the first page of the online Renewal Statement, directly to:

U.S. Mail

NASD Regulation, Inc.
CRD-IARD
P.O. Box 7777-W8705
Philadelphia, PA 19175-8705

(Note: This P.O. Box will not accept courier or overnight deliveries.)

or

Express/Overnight Delivery

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

Members should use the full address, including the "W8705" designation in either address to ensure prompt processing.

Please Note: The addresses for Renewal payments are **different** from the addresses for funding your firm's CRD Daily Account.

To ensure prompt processing of your Renewal Payment by check:

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

Wire Payment Instructions

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

Transfer funds to:	Riggs National Bank in Washington, D.C.
ABA Number:	054-000030
Beneficiary:	NASD Regulation, Inc.
NASD Regulation Account Number:	086-761-52
Reference Number:	Firm CRD Number and the word, "Renewals"

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

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

Members are advised that failure to return full payment to the NASD by the December 7, 2001 deadline could cause a member to become ineligible to do business in the jurisdictions effective January 1, 2002.

Renewal Reports

Beginning November 5, 2001, the Renewal Reports are available to request, print, and/or download via Web CRD. There will be four reports available for reconciliation with the Preliminary Renewal Statement:

- The **Firm Renewal Roster** (Agent) will list all agents registered with your firm, sorted alphabetically by regulator.
- The **Firm Renewal Roster Download** (Agent) will list all agents registered with your firm, sorted alphabetically by regulator in downloadable format.
- The **Branches Renewal Roster** lists each branch registered with the NASD and lists branch offices for which the firm is being assessed a fee. Firms should use this roster to reconcile their records for Renewal purposes.

- The **Non-NASD Registered Individuals Roster** will contain all individuals who are not registered with the NASD but are registered with one or more jurisdictions. This roster will only be available if a firm has agents whose status falls within this category. Use this roster to determine if any NASD registrations need to be requested or jurisdictions terminated.

Filing Form U-5

If Forms U-5 (either full or partial) were filed electronically via Web CRD for agents terminating one or more jurisdiction affiliations by 11:00 p.m., Eastern Time (ET), November 2, 2001, those agent Renewal fees were not included on the Preliminary Renewal Statement.

The deadline for electronic filing of Forms U-5 for firms that want to terminate an agent affiliation before year-end 2001 is 11:00 p.m., ET, on December 21, 2001. Firms may process both partial and full Forms U-5 with a post-dated termination date of December 31, 2001. (This is the only date that can be used for a post-dated Form U-5.) For more detailed information on post-dated Forms U-5, see the section titled "Post-Dated Form Filings."

Filing Forms BDW

The CRD Phase II Program allows firms requesting broker/dealer termination (either full or partial) to electronically file their Forms BDW via Web CRD. Firms that filed either a full or partial Form BDW by 11:00 p.m., ET, November 2, 2001 avoided the assessment of Renewal Fees on the Preliminary Renewal Statement, provided that the regulator is a CRD Phase II participant. Currently, there are

four regulators that participate in Web CRD Renewals for agent fees but **do not** participate in CRD Phase II:

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

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

The deadline for electronic filing of Forms BDW for firms that want to terminate an affiliation before year-end 2001 is 11:00 p.m., ET, on December 21, 2001. This same date applies to the filing of Forms BDW with regulators that are not Phase II participants. For information regarding the post-dating of Forms BDW with the termination date of December 31, 2001, see the section titled, "Post-Dated Form Filings."

Filing Forms ADV To Cancel Notice Filings Or Forms ADV-W To Terminate Registrations

Firms that filed either a Form ADV Amendment, unmarking a state (generating the Status Detail of "Removal Requested at End of Year"), or a full or partial Form ADV-W by 11:00 p.m., ET, November 2, 2001 avoided the assessment of Renewal Fees on the Preliminary Renewal Statement.

The deadline for electronic filing of Form ADV Amendments or Forms ADV-W for firms that want to cancel a Notice Filing or terminate a state registration before year-end 2001 is 11:00 p.m., ET, on December 21, 2001.

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For information regarding post-dating Forms ADV-W with the termination date of December 31, 2001 for state registrations, see the section below.

Post-Dated Form Filings

Web CRD and IARD started accepting post-dated electronic filing of Forms U-5, BDW, Schedule E, and ADV-W on November 1, 2001. This program allows firms to file a termination form on, or after, November 1 with a termination date of December 31, 2001. These firms **will not** be assessed Renewal Fees on the Final Renewal Statement in January.

Between November 1 and December 21, 2001, firms may process Forms U-5, BDW, Schedule E, and ADV-W (both partial and full terminations) with a post-dated termination date of **December 31, 2001**. (This is the only date that can be used for a post-dated form filing.) If a Form U-5, BDW, Schedule E, or ADV-W indicates a termination date of December 31, 2001, an agent, broker/dealer, and/or IA firm may continue doing business in the jurisdiction until the end of the calendar year without being assessed Renewal Fees. Please ensure that Forms U-5, BDW, Schedule E, and ADV-W are filed by the Renewal deadline date of 11:00 p.m., ET, on December 21, 2001.

Members should exercise care when submitting post-dated Forms U-5, BDW, Schedule E, and ADV-W. The NASD will systematically process these forms as they are received but cannot withdraw a post-dated termination once submitted and processed. A member would have to electronically file a new Form

U-4, BD Amendment, or ADV when Web CRD and/or IARD resumes filing processing on January 2, 2002.

Removing Open Registrations

Beginning November 5, 2001, member firms will be able to request via Web CRD the *Non-NASD Registered Individual Roster*. This roster identifies agents whose NASD registration is either terminated or purged due to the existence of a deficient condition (*i.e.*, exams or fingerprints) but maintain an approved registration with a state. Member firms should use this roster to terminate obsolete state registrations through the submission of Forms U-5 or reinstate the NASD licenses through the filing of a Form U-4 Amendment. This roster should aid in the reconciliation of personnel registrations prior to year's end. The *Non-NASD Registered Individuals Roster* will also advise a firm if there are no agents within this category.

Final Renewal Statements

Beginning January 2, 2002 the NASD will make available Final Renewal Statements via Web CRD. These statements will reflect the final status of agent and firm registrations and/or Notice Filings as of December 31, 2001. Any adjustments in fees owed as a result of registration terminations, approvals, Notice Filings, or transitions subsequent to the Preliminary Renewal Statement will be made in this final reconciled statement on Web CRD. If a firm has more agents, branch offices, or jurisdictions registered and/or Notice Filed on Web CRD and IARD at year-end (than it did

when the Preliminary Renewal Statement was generated), additional fees will be assessed. If a firm has fewer agents, branch offices, or jurisdictions registered and/or Notice Filed at year-end (than it did when the Preliminary Renewal Statement was generated), a credit/refund will be issued.

NASD member firms should access the Web CRD Reports function for the *Firm Renewal Roster*, which will list all renewed personnel with the NASD, NYSE, Amex, CBOE, PCX, ISE, PHLX, and each jurisdiction. Agents whose registrations are "approved" in any of these jurisdictions during November and December will be included in this roster, while registrations that are "pending approval" or are "deficient" at year-end will not be included in the Renewal Process. A download version of this report is also available. Member firms will also be able to request the *NASD Renewal Branch Office Roster* that lists all NASD branches for which they have been assessed.

Two additional reports will also be available with the Final Renewal Statement—a Billing Code Summary Report and a Billing Code Detail Report. These reports will aid firms in their internal research and allocation of fees.

Firms will have until March 15, 2002 to report any discrepancies on the Renewal Reports. All jurisdictions should be contacted directly in writing. Specific information and instructions concerning the Final Renewal Statements and Renewal Reports will appear in the January 2002 issue of *Notices to Members*. Firms may also refer to the November *CRD/PD Bulletin*, which is devoted entirely to Renewals

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and was mailed to all firms in October. It is also available for viewing on the CRD Page of the NASD Regulation Web Site (www.nasdr.com).

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NASD Notice to Members 01-76

FIPS Changes

Fixed Income Pricing SystemSM Additions, Changes, And Deletions As Of September 24, 2001

SUGGESTED ROUTING

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

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

KEY TOPICS

- FIPS

As of September 24, 2001, the following bonds were added to the Fixed Income Pricing System (FIPSSM).

Symbol	Name	Coupon	Maturity
ATK.GA	Alliant Techsystems Inc	8.500	05/15/11
BRK.GA	Berkshire Hathaway	1.000	12/02/01
BEV.GE	Beverly Enterprises Inc	9.625	04/15/09
CHCG.GJ	Charter Comm Hldgs Cap Corp	9.625	11/15/19
CHCG.GK	Charter Comm Hldgs Cap Corp	10.000	05/15/11
CHCG.GL	Charter Comm Hldgs Cap Corp	11.750	05/15/11
COD.GA	Chiles Offshore LLC/Fin	10.000	05/01/08
DAL.GI	Delta Air Lines Inc	7.900	12/15/09
DAL.GJ	Delta Air Lines Inc	8.300	12/15/29
DAL.GH	Delta Air Lines Inc	7.700	12/15/05
DIG.GA	DII Group Inc	8.500	09/15/07
DUOC.GB	Dura Operating Corp	9.000	05/01/09
ESA.GB	Extended Stay America	9.875	06/15/11
FMK.GA	Fibermark Inc	10.750	04/15/11
FST.GD	Forest Oil Corp	8.000	06/15/08
ICCI.GA	Insight Communications Inc	12.250	02/15/11
IWOH.GA	IWO Holdings Inc	14.000	01/15/11
JOYG.GA	Joy Global Inc	10.750	04/30/06
KMP.GA	Kinder Morgan Energy Partners LP	0.000	03/22/02
RTA.GA	Rochester Tel	9.000	08/15/21
RCL.GB	Royal Caribbean Cruises	8.125	07/28/04
RCL.GC	Royal Caribbean Cruises	8.250	04/01/05
RCL.GD	Royal Caribbean Cruises	7.125	09/18/02
RCL.GE	Royal Caribbean Cruises	7.250	08/15/06
RCL.GF	Royal Caribbean Cruises	7.000	10/15/07
RCL.GG	Royal Caribbean Cruises	7.500	10/15/27
RCL.GH	Royal Caribbean Cruises	6.750	03/15/08
RCL.GI	Royal Caribbean Cruises	7.250	03/15/18
RCL.GJ	Royal Caribbean Cruises	8.750	02/02/11
SFP.GB	Salton Inc	12.250	04/15/08
UAL.GU	United Air Lines Inc	10.110	02/19/06
UAL.GV	United Air Lines Inc	10.850	07/05/14
UAL.GW	United Air Lines Inc	9.760	05/13/06
UAL.GX	United Air Lines Inc	9.760	05/20/06
UAL.GY	United Air Lines Inc	9.760	05/27/06
UAL.HA	United Air Lines Inc	10.360	11/27/12
UAL.GZ	Untied Air Lines Inc	10.360	11/20/12
YBTV.GE	Young Broadcasting Inc	10.000	03/01/11

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As of September 24, 2001, the following bonds were deleted from the Fixed Income Pricing System.

Symbol	Name	Coupon	Maturity
ADOU.GA	Adams Outdoor Advertising	10.750	03/15/06
BRK.GA	Berkshire Hathaway	1.000	12/02/01
CRSE.GB	Case Credit Corp	6.125	10/15/01
CDGY.GA	Cody Energy Inc	10.500	04/01/06
HVY.GA	Harvey Casinos Resorts	10.625	06/01/06
ICN.GA	ICN Pharmaceuticals	9.250	08/15/05
IGL.GE	IMC Global Inc	6.625	10/15/01
IN.GB	Integon Corp Del	9.500	10/15/01
ITTO.GB	ITT Corp	6.750	11/15/05
ITTO.GC	ITT Corp	7.375	11/15/15
ITTO.GD	ITT Corp	7.750	11/15/25
LEA.GB	Lear Corporation	9.500	07/15/06
LWN.GA	Loewen Group Intl Inc	7.750	10/15/01
MSI.GA	Movie Star Inc NY	12.875	10/01/01
NEGX.GB	National Energy Group	10.750	11/01/06
NEGX.GC	National Energy Group	10.750	11/01/06
CHX.GA	Pilgrim's Pride Corp	10.875	08/01/03
RCL.GB	Royal Caribbean Cruises	8.125	07/28/04
RCL.GC	Royal Caribbean Cruises	8.250	04/01/05
RCL.GD	Royal Caribbean Cruises	7.125	09/18/02
RCL.GE	Royal Caribbean Cruises	7.250	08/15/06
RCL.GF	Royal Caribbean Cruises	7.000	10/15/07
RCL.GG	Royal Caribbean Cruises	7.500	10/15/27
RCL.GH	Royal Caribbean Cruises	6.750	03/15/08
RCL.GI	Royal Caribbean Cruises	7.250	03/15/18
RYL.GC	Ryland Group Inc	10.500	07/01/06
UIS.GG	Unisys Corp	11.750	10/15/04
WLMC.GA	William Carter Co	10.375	12/01/06

As of September 24, 2001 changes were made to the symbols of the following FIPS bonds:

New Symbol	Old Symbol	New Name/Old Name	Coupon	Maturity
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There were no symbol changes for this time period.

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to FIPS trade-reporting rules should be directed to Patricia Casimates, NASDR Market Regulation, at (240) 386-4994.

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

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INFORMATIONAL

Trade Date— Settlement Date

Trade Date—Settlement
Date Schedule For
Veterans' Day,
Thanksgiving,
Christmas, And
New Year's Day

SUGGESTED ROUTING

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

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

KEY TOPIC

- Holiday Trade Date—Settlement Date Schedule

Veterans' Day And Thanksgiving Day: Trade Date— Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance of the financial community of Veterans' Day, Monday, November 12, 2001, and Thanksgiving Day, Thursday, November 22, 2001. On Monday, November 12 The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans' Day. All securities markets will be closed on Thursday, November 22, 2001, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Reg. T Date*
Nov. 6	Nov. 9	Nov. 13
7	13	14
8	14	15
9	15	16
12	15	19
13	16	20
16	21	26
19	23	27
20	26	28
21	27	29
22	Markets Closed	—
23	28	30

Note: November 12, 2001, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Transactions made on November 12 will be combined with transactions made on the previous business day, November 9, for settlement on November 15. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 12.

**Christmas Day And New Year's Day: Trade Date—
Settlement Date Schedule**

The Nasdaq Stock Market and the securities exchanges will be closed on Tuesday, December 25, 2001, in observance of Christmas Day, and Tuesday, January 1, 2002, in observance of New Year's Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Dec. 19	Dec. 24	Dec. 27
20	26	28
21	27	31
24	28	Jan. 2, 2002
25	Markets Closed	—
26	31	3
27	Jan. 2, 2002	4
28	3	7
31	4	8
Jan. 1, 2002	Markets Closed	—
2	7	9

Brokers, dealers, and municipal securities dealers should use the foregoing settlement dates for purposes of clearing and settling transactions pursuant to the National Association of Securities Dealers, Inc. (NASD®) Uniform Practice Code, the Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice, and the General and Floor Rules of the Rules of the Board of Governors of The American Stock Exchange®.

Questions regarding the application of those settlement dates to a particular situation may be directed to the NASD Uniform Practice Department at (203) 375-9609.

* Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within five business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column titled "Reg. T Date."

Disciplinary Actions

Disciplinary Actions Reported For November

NASD Regulation, Inc. (NASD RegulationSM) has taken disciplinary actions against the following firms and individuals for violations of National Association of Securities Dealers, Inc. (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 October 2001.

Firms Expelled, Individuals Sanctioned

Michael Patterson, Inc. (CRD #44361, Columbus, Ohio) and Michael William Patterson (CRD #2101227, Registered Principal, Powell, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was expelled from NASD membership and Patterson was barred from association with any NASD member in any capacity. In light of the financial status of the respondents, no monetary sanctions have been imposed. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Patterson, failed to deal fairly; charged unreasonable prices; and violated the antifraud provisions of MSRB and Securities and Exchange Commission (SEC) rules by failing to obtain the best available market price for municipal bonds, charging excessive prices, and interpositioning a member firm's inventory account between the customer and the best available market price. The findings also stated that the firm, acting through Patterson, failed to disclose to public customers that

its prices were not reasonably related to the market price of the securities and that it adhered to an exclusive trading agreement that interpositioned the inventory account between the customer and the best available price. In addition, the NASD found that the firm, acting through Patterson, charged its customers excessive markups totaling \$13,600, and fraudulent markups totaling \$5,950. Furthermore, the findings stated that the firm and Patterson knowingly, or with reckless disregard, failed to ensure that the prices paid by customers were fair and reflected the available market price and sold bonds to retail customers at prices significantly higher than the market price of the bonds. **(NASD Case #CAF010002)**

VonFeldt & Associates, Inc. (CRD #37591, Oklahoma City, Oklahoma) and Dewayne Richard VonFeldt (CRD #455630, Registered Principal, Oklahoma City, Oklahoma) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was expelled from NASD membership and VonFeldt was fined \$10,000, suspended from association with any NASD member in any capacity for one month, and barred from association with any NASD member in any principal capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through VonFeldt, engaged in a securities business when its net capital was below the required minimum. The findings also stated that VonFeldt attempted to conceal net capital deficiencies from the NASD.

VonFeldt's suspension began November 5, 2001, and will conclude at the close of business December 4, 2001. **(NASD Case #C05010044)**

Firm Suspended, Individual Sanctioned

West America Securities Corp. (CRD #35035, Westlake Village, California) and Robert Brian Kay (CRD #1133657, Registered Principal, Westlake Village, California) submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$51,371, jointly and severally. In addition, the firm was suspended from engaging in any penny stock business for one year, except the firm may effect transactions for its proprietary account and effect transactions for customers that are non-recommended. Kay was suspended from association with any NASD member as a general securities principal for 30 days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Kay, failed to comply with all of the provisions of the SEC's Penny Stock Rules with respect to securities transactions as a result of the firm's failure to establish and maintain a system to supervise the activities of various registered persons that was reasonably designed to achieve compliance with the Penny Stock Rules.

The firm's suspension began November 5, 2001, and will conclude at the close of business November 4, 2002. Kay's suspension began November 5, 2001, and will conclude at the close of business December 4, 2001. **(NASD Case #C02010051)**

Firm Fined, Individual Sanctioned

Centex Securities, Inc. (CRD #18493, La Jolla, California) and Bruce Alan Biddick (CRD #1124697, Registered Principal, Rancho Santa Fe, California) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally, and Biddick was suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Biddick, failed to file an amended Form U-4 disclosing material information on behalf of an individual registered through the firm.

Biddick's suspension began October 15, 2001, and concluded at the close of business October 19, 2001. **(NASD Case #C02010046)**

Firm And Individual Fined

Merrill Weber & Co., LLC (CRD #31799, Northfield, Illinois) and Merrill Evan Weber (CRD #2305631, Registered Principal, Chicago, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$25,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they permitted an individual, who was not registered with the firm in any capacity, to engage in the investment banking or securities business of the member firm. **(NASD Case #C8A010062)**

Firms Fined

American Third Market Co., LLC (CRD #34361, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures with respect to the Order Audit Trail System (OATSSM) rules. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to transmit to OATS any order data for its orders for equity securities traded on The Nasdaq Stock Market[®]. The findings also stated that the firm did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning the OATS rules. Specifically, the NASD found that the firm's supervisory system did not include written supervisory procedures providing for the identification of the person(s) responsible at the firm to ensure compliance with the applicable rules, a statement of the step(s) that such person(s) should take to ensure compliance, a statement as to how often such person(s) should take such step(s), and a statement as to how enforcement of such written supervisory procedures should be documented at the firm. **(NASD Case #CMS010157)**

CIBC World Markets Corporation (CRD #630, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market makers

whose quotations would be locked or crossed, entered bid or asked quotations in The Nasdaq Stock Market that caused a locked or crossed market condition to occur in each instance. **(NASD Case #CMS010158)**

Corporate Securities Group, Inc., n/k/a First Union Securities Financial Network, Inc. (CRD #11025, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to establish an adequate supervisory system of follow-up and review to ensure review of active accounts and failed to devote sufficient resources to its supervisory system to detect and prevent unsuitable activity in customer accounts. **(NASD Case #C11010029)**

Davis Distributors, LLC (CRD #7975, Tucson, Arizona) submitted a Letter of Acceptance, Waiver, and Consent in which it was censured and fined \$25,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file a Form U-4 for an individual who was engaged in securities activities that required registration but was not properly registered. The findings also stated that the firm allowed an individual whose registration was inactive due to non-compliance with the Regulatory Element of continuing education to remain associated with the firm as a mutual fund wholesaler and to engage in activities that required registration. In addition, the NASD found that the firm's written supervisory procedures were not

reasonably designed to ensure that associated persons were properly registered before engaging in securities activities and to ensure compliance with the NASD's Regulatory Element of Continuing Education. **(NASD Case # C3A010033)**

Gerard Klauer Mattison & Co., Inc. (CRD #16686, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, as a market maker in securities, was a party to a locked or crossed market condition prior to the market opening and received a trade-or-move message in each instance through SelectNet®, and within 30 seconds of receiving such messages, failed to fill the incoming trade-or-move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. **(NASD Case #CMS010153)**

Heartland Securities, Inc. (CRD #43201, Edison, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$18,000, which includes \$10,000 of the financial benefit the firm obtained by permitting representatives to conduct a securities business while unregistered. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to ensure that individuals were properly registered as equity traders in accordance with the NASD's Series 55 rule requirements. The findings also stated that the firm permitted several

registered persons to conduct a securities business while they were inactive for failing to satisfy the Regulatory Element of the NASD's Continuing Education Requirements. In addition, the NASD found that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations. **(NASD Case #C9B010082)**

Investment Services Capital Corp. (CRD #31271, Haverstraw, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures with respect to the OATS Rules. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it submitted to OATS reports with respect to equity securities traded on The Nasdaq Stock Market that were not in the electronic form prescribed by the NASD. According to the findings, the subject reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web Site and the firm did not correct or replace the reports and, thus, failed to correctly report such information to OATS.

The findings also stated that the firm failed to transmit to OATS any order data for its orders for equity securities traded on The Nasdaq Stock Market, and that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning the OATS Rules. Specifically, the firm's supervisory system did not include written supervisory

procedures providing for the identification of the person(s) responsible at the firm to ensure compliance with the applicable rules, a statement of the step(s) that such person(s) should take to ensure compliance, a statement as to how often such person(s) should take such step(s), and a statement as to how enforcement of such written supervisory procedures should be documented at the firm. **(NASD Case #CMS010140)**

National Financial Services LLC (CRD #13041, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed, the firm entered bid or ask quotations in The Nasdaq Stock Market that caused a locked or crossed market condition to occur in each instance and, as a market maker in securities, caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation that locked/crossed another market maker's quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quote(s) it locked or crossed a trade-or-move message that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares. The NASD also found that the firm, as a market maker in securities, was a party to a locked or crossed market condition prior to the market opening and received a trade-or-move message in each instance

through SelectNet and, within 30 seconds of receiving such messages, failed to fill the incoming trade-or-move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. **(NASD Case #CMS010144)**

Parker/Hunter Incorporated (CRD #7324, Pittsburgh, Pennsylvania) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$100,000, and required to revise its written supervisory procedures reasonably designed to prevent future violations of applicable securities laws and regulations regarding the handling of material, non-public information. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that its supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning the handling of material, non-public information. Specifically, the firm's supervisory system directed analysts to consult and seek advice outside the research department from an individual, potentially disclosing material, non-public information to the individual, and placing the individual in a position to trade on the basis of that information for himself and others. In addition, the firm's supervisory system did not include written supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations concerning the handling of material, non-public information. Specifically, with regard to trading on the basis of material, non-public information, the firm's written

supervisory procedures did not provide for the identification of the person(s) responsible at the firm to ensure compliance with applicable rules, a statement of the step(s) that such person(s) should take to ensure compliance, a statement as to how often such person(s) should take such step(s), and a statement as to how enforcement of such written supervisory procedures should be documented at the firm. **(NASD Case #CMS010134)**

Pershing Trading Company, L.P. (CRD #36671, Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures to achieve compliance with respect to applicable securities laws and regulations concerning firm quote compliance. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a registered market maker in securities, it failed to execute orders presented at the firm's published bid or published offer in an amount up to its published quotation size, and thereby failed to honor its published quotation. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning firm quotations. According to the findings, the firm's supervisory system did not include written supervisory procedures providing for the identification of the person(s) responsible at the firm to ensure compliance with the applicable rules, a statement of the step(s) that such person(s) should take to ensure compliance, a statement as to how often such person(s) should take such

step(s), and a statement as to how enforcement of such written supervisory procedures should be documented at the firm. **(NASD Case #CMS010139)**

Robertson Stephens Investment Banking (CRD #41271, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening. The NASD determined that the firm received a trade-or-move message in each instance through SelectNet and, within 30 seconds of receiving such messages, failed to fill the incoming trade-or-move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. **(NASD Case #CMS010155)**

Tucker Anthony, Incorporated (CRD #837, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$78,500; required to revise its written supervisory procedures regarding the Automated Confirmation Transaction ServiceSM (ACTSM) rule compliance, best execution, limit order protection, SEC Order Execution Rules, trade reporting, Small Order Execution System (SOES), record keeping, locked and crossed markets, anti-competitive practices, front-running and short sales; and required to pay \$201.99, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of

findings that it failed 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 its 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 its bid or offer in each such security.

The findings also stated that the firm 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, failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customers was as favorable as possible under prevailing market conditions. Furthermore, the NASD found that the firm executed short-sale transactions and failed to report each of these transactions to ACT with a short-sale modifier, entered priced broadcast orders into SelectNet that were each priced better than the firm's public quote without reflecting each such order in the firm's public quote as required by SEC Rule 11Ac1-1, and reported to Fixed Income Pricing SystemSM (FIPSSM) transactions in FIPS securities and high-yield securities incorrectly. The NASD also determined that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules. Specifically, the firm's written supervisory procedures

were found to be deficient in that they did not provide for the identification of the person(s) responsible at the firm for ensuring compliance with such laws, regulations, and rules, a statement of the step(s) that such person(s) should take to ensure compliance, a statement as to how often such person(s) should take such step(s), and a statement as to how enforcement of such written supervisory procedures should be evidenced at the firm. **(NASD Case #CMS010145)**

Windsor Capital Advisors, LLC (CRD #47317, Garden City, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, as a market maker in securities, caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation that locked/crossed another market maker's quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quote(s) it locked or crossed, a trade-or-move message that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares. The findings also stated that the firm, as a market maker in securities, was a party to a locked or crossed market condition prior to the market opening and received a trade-or-move message in each instance through SelectNet and, within 30 seconds of receiving such messages, failed to fill the incoming trade-or-move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. **(NASD Case #CMS010154)**

Individuals Barred Or Suspended

Salam Aburas (CRD #2969004, Registered Representative, Berwyn, Illinois) 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 Aburas effected an unauthorized transaction in the account of a public customer.

Aburas' suspension began October 15, 2001, and concluded at the close of business October 26, 2001. **(NASD Case #C8A010014)**

Christopher Aguado (CRD #3089463, Registered Representative, Secaucus, New Jersey) submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for two months, and required to requalify by exam before again becoming registered in any capacity. The fine must be paid before Aguado reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Aguado consented to the described sanctions and to the entry of findings that he recommended to, and effected for the securities account of a public customer, the sale and purchase of shares of common stock without having reasonable grounds for believing that such recommendation was suitable for the customer's financial situation and needs in that the recommendation involved investing the entire value of the account in a single speculative stock.

Aguado's suspension began October 15, 2001, and will

conclude at the close of business on December 14, 2001. **(NASD Case #C9B010045)**

Gary Irving Berman (CRD #2413745, Registered Principal, Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Berman consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on a Form U-4. The findings also stated that Berman submitted a false and/or misleading written statement to the NASD when he falsely stated that he had inadvertently accessed his former member firm's proprietary account and effected a trade. The NASD determined that the statement was false and/or misleading in light of Berman's on-the-record testimony wherein he testified that without authorization he intentionally used his former supervisor's system log-on identification rather than his own to access accounts. **(NASD Case #C9B010075)**

Christopher Michael Block (CRD #2073057, Registered Principal, Houston, Texas) and Jeffrey Schwartz Burke (CRD #2007369, Registered Principal, Houston, Texas). Block was fined \$50,000 and barred from association with any NASD member in any capacity. Burke was fined \$15,000, suspended from association with any NASD member in any principal or supervisory capacity for 30 days, and required to requalify by exam as a general securities principal. The National Adjudicatory Council (NAC) imposed the sanctions following appeal and review of an Office of Hearing Officers (OHO) decision. The sanctions were based on

findings that Block failed to keep accurate books and records, operated his member firm while it failed to maintain minimum required net capital, filed inaccurate FOCUS Part IIA reports, and failed to provide notification that the firm's net capital was below the required minimum. The findings also stated that Block induced the purchase of stock by including false and misleading information in a stock purchase agreement. The NASD also found that Burke operated his member firm while the firm failed to maintain minimum required net capital and failed to supervise properly the firm's financial and operations principal.

Burke's suspension began October 1, 2001, and concluded at the close of business October 30, 2001. **(NASD Case #C05990026)**

Shafeqah Bakir Calder (CRD #4286879, Registered Representative, Newark, New Jersey) 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, Calder consented to the described sanction and to the entry of findings that she willfully failed to disclose material facts on her Form U-4. The NASD also found that Calder failed to respond to NASD requests for information. **(NASD Case #C9B010080)**

Michael Caso (CRD #2222058, 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, Caso consented to the described sanction and to the entry of findings that he executed unauthorized trades in the accounts

of public customers, and failed to disclose to the customers that his recommendations to purchase securities were for highly speculative securities or that there were risks associated with the purchase of his recommended securities. The NASD found that Caso made purchase and sale transactions in the accounts of public customers without having properly obtained discretionary authority over the accounts. The findings also stated that Caso failed to execute an order in the account of a public customer and made material misrepresentations and omissions in the accounts of public customers concerning price predictions and information that would have been material to a reasonable investment decision by a reasonable investor. In addition, the NASD found that Caso completed and signed a new account form for a public customer in which he knowingly, willfully, or recklessly stated a false income for the customer. Furthermore, the NASD found that Caso failed to respond to NASD requests for information and to appear for an on-the-record interview. **(NASD Case #CAF990019)**

James Burling Chase (CRD #368743, Registered Representative, Milwaukee, Wisconsin) was fined \$25,000, suspended from association with any NASD member in any capacity for one year, and ordered to requalify as a general securities representative before re-entering the industry. The NAC imposed the sanctions following the appeal of an OHO decision. The sanctions were based on findings that Chase recommended and effected transactions in a public customer's account without a reasonable basis for believing that such recommendations were suitable for the customer due to the nature

of the securities, the concentration of the securities in the account, and the customer's investment objectives, financial situation, and needs.

Chase has appealed this action to the SEC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C8A990081)**

Stephen Roy Connors, Sr. (CRD #726642, Registered Representative, Castaic, California) was barred from association with any NASD member in any capacity and ordered to pay \$20,000, plus interest, in restitution to a public customer. The sanctions were based on findings that Connors guaranteed a customer against loss. **(NASD Case #C02000062)**

Ernest Leroy Dahlen, III (CRD #720666, Registered Principal, Columbus, Ohio) 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 Dahlen, no monetary sanctions have been imposed. Without admitting or denying the allegations, Dahlen consented to the described sanction and to the entry of findings that a member firm, acting through Dahlen, failed to get the best price and best execution on dealer-to-dealer trades in high-yield municipal bond transactions. The findings also stated that the member firm, acting through Dahlen, knew, or was reckless in not knowing, that the prices charged for the bonds and the interpositioning of the firm's inventory account as required by a trading agreement would result in excessive prices being charged to retail customers. In addition,

the NASD found that Dahlen intentionally, or with reckless disregard, misled a registered representative by failing to disclose the actual cost basis of the bonds.

Dahlen's suspension began November 5, 2001, and will conclude at the close of business May 4, 2002. **(NASD Case #CAF010023)**

James Newton Darwin, II (CRD #1779045, Registered Representative, Spicewood, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Darwin consented to the described sanction and to the entry of findings that he created, forged, and submitted fraudulent applications for tax sheltered annuities to an insurance company that contained the names of fictitious persons and addresses. The findings also stated that Darwin received \$24,000 in advance commissions and used the funds for his own benefit. Darwin also willfully failed to disclose a material fact on his Form U-4. **(NASD Case #C06010026)**

Glenmore F. Diaz (CRD #11015945, Associated Person, Northridge, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Diaz received a \$10,283.15 check from a public customer to purchase bonds on the customer's behalf, cashed the check, and converted the funds for his personal benefit. **(NASD Case #C02010026)**

Joseph Doria (CRD #2356685, Registered Representative, Franklin Square, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Doria received \$60,000 from a public customer to invest in the stock market and, instead, converted the funds to his own use and benefit without the customer's prior knowledge, authorization, or consent. **(NASD Case #C10010060)**

Michael John Fleyzor (CRD #1928099, Registered Representative, Clark, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,200, which includes disgorgement of \$200 in commissions in partial restitution to the customer, and suspended from association with any NASD member in any capacity for 30 days. The fine and disgorgement must be paid before Fleyzor reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Fleyzor consented to the described sanctions and to the entry of findings that he engaged in a private securities transaction, in that he sold a promissory note without prior written notice to, or approval from, his member firm.

Fleyzor's suspension began November 5, 2001, and will conclude at the close of business December 4, 2001. **(NASD Case #C9B010078)**

Antonia Geronimo (CRD #2757476 Registered Representative, Overland Park, Kansas) 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, Geronimo consented to the described sanction and to the entry of findings that she caused a \$3,000 check to be issued from the customer's Individual Retirement Account (IRA), payable to a third party, sent to an address not that of the customer, and applied the funds to an account in her name held at the third party. The NASD found that by doing so, Geronimo converted and used the funds for her own benefit or for some purpose other than the benefit of the customer. Geronimo also failed to respond to NASD requests for information. **(NASD Case #C04010034)**

Howard Jay Goldman (CRD #1088882, Registered Representative, Marlboro, New Jersey) was barred from association with any NASD member in any capacity. The sanction was based on findings that Goldman made false statements to his member firm about certain short sell orders. Goldman also failed to respond to NASD requests for information. **(NASD Case #C9B010004)**

Timothy Earl Grant Sr. (CRD #1965947, Registered Representative, Sangerville, Maine) 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, Grant consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm. **(NASD Case #C11010031)**

Duane Wilson Grenier (CRD #1049916, Registered Representative, Moline, Illinois) submitted a Letter of Acceptance,

Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for two years. In light of the financial status of Grenier, no monetary sanction has been imposed. Without admitting or denying the allegations, Grenier consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing written notice to, or receiving permission to participate from, his member firm. The NASD also found that Grenier received compensation for participating in business financing activities without providing his member firm prompt written notice of outside business activity.

Grenier's suspension began November 5, 2001, and will conclude at the close of business November 4, 2003. **(NASD Case #C3A010037)**

Richard Craig Hammill (CRD #1596644, Registered Representative, Edmond, Oklahoma) 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, Hammill consented to the described sanctions and to the entry of findings that he effected unauthorized transfers in the accounts of public customers without their knowledge or consent.

Hammill's suspension began November 5, 2001, and will conclude at the close of business November 16, 2001. **(NASD Case #C05010043)**

Mary Hendricks (CRD #4130511 and #1354303, Associated Person, Pompano Beach, Florida) was barred from association with any NASD

member in any capacity. The sanction was based on findings that Hendricks provided her member firm with a false social security number and failed to disclose past criminal charges against her on certain employment forms. The findings also stated that Hendricks failed to respond to NASD requests for information. **(NASD Case #C07010025)**

Paul William Inman, II (CRD #1724573, Registered Representative, Roseville, 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, Inman consented to the described sanction and to the entry of findings that he executed securities transactions in the accounts of public customers without their prior knowledge or consent. The findings also stated that Inman acted in the capacity of a general securities representative registered to conduct business in two states while not being registered in such capacity, thereby circumventing state registration laws. In addition, Inman intercepted a written complaint from a public customer which he failed to refer to his branch office manager. **(NASD Case #C05010041)**

Michael Charles Jones (CRD #1320040, Registered Representative, Gambrills, Maryland) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, ordered to pay \$12,000 in disgorgement, and suspended from association with any NASD member in any capacity for one year. Payment of the fine and proof of disgorgement shall be a prerequisite before Jones reassociates with any NASD

member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Jones 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.

Jones' suspension began November 5, 2001, and will conclude at the close of business November 4, 2002. **(NASD Case #C9A010038)**

Jeffrey Alan Katz (CRD #1321299, Registered Representative, Glendale, Arizona), Gennaro Chiappetta, (CRD #1933002, Registered Representative, Glendale, Arizona), and Jeffrey Schwertfeger (CRD #2719032, Registered Representative, Sun City, California) submitted Offers of Settlement in which Katz and Chiappetta each were fined \$10,000 and suspended from association with any NASD member in any capacity for 90 days. Schwertfeger was fined \$30,000, suspended from association with any NASD member in any capacity for 120 business days, and required to pay \$4,745.17, plus interest, in restitution to public customers (husband and wife). Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Katz and Chiappetta negligently employed devices in reliance on, amongst others, their compliance officer's advice, which resulted in misunderstandings regarding the sale of certificates of deposit (CDs) to public customers.

According to the findings, Katz and Chiappetta distributed to public customers a one-page document

prepared by their member firm that they should have known misrepresented to the customers that their commission would be paid by an entity identified in the document as the "institution" when, in fact, the firm deducted miscellaneous commissions and fees, including commissions ultimately paid to Katz and Chiappetta, from the total amounts paid by the customers before investing the balance of their principal investments in the CDs, and that Katz and Chiappetta did not receive any monies until after the CD at issue was purchased and issued to the customers. Katz and Chiappetta should have known that the commissions and fees charged would be taken "up front" from the customers' principal, and not from the earnings on their investments. Moreover, the NASD found that Katz and Chiappetta failed to disclose that only a portion of the customers' funds would actually be sent to the bank to be invested in the CDs, and presented an offer sheet to the customers at the time of their purchase which inferred that the full amounts given by the customers would be Federal Deposit Insurance Corporation (FDIC) insured when they should have known and should have disclosed that a portion of the full principal amounts paid by the customers would be taken out as commissions and fees which would not be FDIC insured. The NASD also determined that Katz and Chiappetta disclosed to the customers that the CD purchased would be issued in the name of the CD's issuer and would have a confirmation number on the CD that would correlate to the customers although they should have known, and failed to disclose, that the customers would most likely be incapable of giving instructions to, or making direct inquiries regarding the CD with, the issuing bank. They also failed

to disclose that any insurance proceeds paid by the FDIC would be paid directly to the issuer and not to the customers, and, if necessary, the customers would have to rely on the issuer in turn to provide any insurance proceeds to them. Furthermore, the NASD found that Katz and Chiappetta provided the customers with CD receipts that they should have known could cause customers to believe that they would earn certain yields (average annual yield), when, in fact, those yields could only be realized in the event the CDs were held to maturity, and they provided the customers with CD receipts that displayed inaccurately the customers' investment amount.

The NASD also found that Schwertfeger sold two CDs through his member firm to public customers (husband and wife) and failed to observe the high standards of commercial honor. The findings stated that, in this regard, Schwertfeger distributed member firm approved documents to the customers that he should have known were not sufficiently clear as to how the customers would pay commission, fees, and costs to the firm, the issuer of the CD, and to Schwertfeger; the exact amount of the customers' principal investment in each CD prior to maturity; certain yield information related to the interest rate for the CDs; the nature and extent of the issuer's role in the transactions; and certain yield information in advertising approved by the member firm.

Katz's suspension began October 15, 2001, and will conclude at the close of business January 11, 2002. Chiappetta's suspension will begin January 16, 2002, and will conclude at the close of business April 15, 2002. Schwertfeger's

suspension began September 18, 2001, and will conclude at the close of business March 7, 2002. **(NASD Case #C02000042)**

Neal Bruce Kearley, Jr. (CRD #1068410, Registered Representative, Clearview, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member firm in any capacity for three months. In light of the financial status of Kearley, no monetary sanction has been imposed. Without admitting or denying the allegations, Kearley consented to the described sanction and to the entry of findings that he participated in a private securities transaction without providing prior written notice to, or receiving permission to participate from, his member firm.

Kearley's suspension began October 15, 2001, and will conclude at the close of business January 14, 2002. **(NASD Case #C3A010035)**

Patrick Eugene Keeney (CRD #2259850, Registered Representative, Centreville, Maryland) 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, Keeney consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. **(NASD Case #C9A010041)**

Thomas Knudsen (CRD #4190461, Associated Person, New York, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Knudsen failed to disclose

material information on his Form U-4 and failed to respond to NASD requests for information. **(NASD Case #C10010058)**

Michael Anthony Lara (CRD #2926115, Registered Representative, Naples, 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, Lara consented to the described sanction and to the entry of findings that he caused checks totaling \$643,044.75 to be issued from the accounts of public customers without authorization. The NASD found that Lara obtained these checks, forged the endorsements of public customers, and converted the proceeds to his own use and benefit. The findings also stated that Lara failed to respond to NASD requests for information. **(NASD Case #C07010066)**

Charles Edward Ledbetter, III (CRD #1284694, Registered Representative, San Antonio, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Ledbetter consented to the described sanction and to the entry of findings that he arranged for loans totaling \$34,771.95 against the life insurance policy of a public customer, forged the customer's signature on the checks, and converted the funds to his own use and benefit without the customer's knowledge or consent. The findings also stated that Ledbetter received \$15,000 from public customers as an insurance premium payment and to increase an insurance policy.

In addition, the findings stated that Ledbetter failed and neglected to submit and apply the funds on behalf of the customers and instead misused the funds without the customers' knowledge or consent. The NASD also found that Ledbetter failed to respond to NASD requests to appear for an on-the-record interview and for information. **(NASD Case #C05010038)**

James Kevin Matter (CRD #2252552, Registered Representative, Montgomery, Alabama) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Matter consented to the described sanction and to the entry of findings that he withdrew checks totaling \$146,911.10 from the annuity accounts of public customers, forged the customers' signatures to withdrawal agreement forms, and submitted the documents to his member firm. The NASD found that Matter deposited the checks into his personal bank account, thereby converting the funds to his own use and benefit without the customers' knowledge or consent. The findings also stated that Matter received checks totaling \$153,094.82 from public customers for insurance premium payments, failed to submit the funds to his member firm, and converted the funds to his own use and benefit without the customers' knowledge or consent. In addition, the findings stated that Matter failed to respond to NASD requests for information. **(NASD Case #C05010039)**

Robert Arthur McDuffie (CRD #3128686, Registered Representative, Port Charlotte, Florida) was barred from association with any NASD member in any

capacity. The sanction was based on findings that McDuffie received a \$2,000 check from a public customer for investment purposes, and instead of investing the funds, endorsed and cashed the check, thereby converting the funds to his own use and benefit. McDuffie also failed to respond to NASD requests for information. **(NASD Case #C07010022)**

Theodore Richard Miller (CRD #2760427, Registered Representative, Madison, Wisconsin) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and required to disgorge \$49,295 in commissions earned to public customers. Satisfactory proof of payment of disgorgement must be made before Miller reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Miller consented to the described sanctions and to the entry of findings that he participated, for compensation, in private securities transactions by participating in the sale of securities in the form of promissory notes to public customers. The NASD found that Miller failed and neglected to give written notice of his intention to engage in such activities to, and receive written approval from, his member firm prior to engaging in such activities. **(NASD Case #C8A010049)**

Steven Richard Moody (CRD #3158815, Registered Representative, Yorba Linda, 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, Moody consented to the

described sanction and to the entry of findings that he obtained \$33,000 in public customer funds under false pretenses and used the funds for his own personal benefit. According to the findings, Moody told customers that his member firm was engaged in the issuance of an initial public offering (IPO) of equity securities and that by providing funds directly to him, the customers could participate in the offering through an allotment available to him. The NASD found that no such offering existed. **(NASD Case #C02010052)**

Keith Gregory Nelson (CRD #2745776, Registered Principal, Middle Village, 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, Nelson consented to the described sanction and to the entry of finding that he failed to respond to NASD requests to appear for an on-record interview. **(NASD Case #C3A010032)**

Nancy Lucille Nichols (CRD #2517723, Registered Representative, Rocky Face, Georgia) 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, Nichols consented to the described sanction and to the entry of findings that she accepted \$1,500 in cash from a public customer to open an account with a bank affiliated with her member firm. The NASD found that Nichols converted \$500 of the funds to her own use and deposited the funds in her personal bank account without authorization from the customer. **(NASD Case #C07010068)**

Elaine Lucille Pearson (CRD #4072006, Registered Representative, Elizabeth, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Pearson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Pearson consented to the described sanctions and to the entry of findings that she willfully failed to disclose material facts on her Form U-4.

Pearson's suspension began November 5, 2001, and will conclude at the close of business May 4, 2002. **(NASD Case #C9B010081)**

Brian Prendergast (CRD #825814, Registered Principal, Englewood, Colorado) was censured and barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of a July 1999 NAC decision. The sanctions were based on findings that Prendergast invested funds from the sale of securities offered pursuant to a private placement memorandum in a manner that was inconsistent with representations in the memorandum and solicited certain securities transactions using a private placement memorandum that contained material misrepresentations and omissions, and distributed communications to purchasers that failed to conform to NASD general and specific standards for sales literature. In addition, Prendergast caused an advertisement to be placed in a newspaper that constituted a general solicitation prohibited

by the SEC and the NASD. Prendergast also failed to provide proper notice to his member firm that he had opened an account with another firm and failed to inform the executing member firm that he was associated with another firm. Moreover, Prendergast failed to respond to NASD requests for information and to provide on-the-record testimony. **(NASD Case #C3A960033)**

Quentin Thomas Quintana (CRD #2317118, Registered Representative, Brooklyn, New York) was fined \$10,000 and suspended from association with any NASD member in any capacity for 90 days for the issuance of false statements and barred from association with any NASD member in any capacity and ordered to pay \$1,707.50, plus interest, in restitution for unauthorized transactions. The fine must be paid before Quintana reassociates with any NASD member or before requesting relief from any statutory disqualification. The sanctions were based on findings that Quintana effected transactions in the accounts of public customers without the customers' authorization. The findings also stated that Quintana issued a false and misleading document to a public customer indicating that a stock had been sold.

Quintana's bar became effective September 20, 2001. **(NASD Case #C10000046)**

David Wayne Rash (CRD #1560976, Registered Representative, Valencia, 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, Rash consented to the described sanction and to the

entry of findings that he completed a margin account application and an option account agreement and application for a customer, and signed the customer's name to these forms without authorization. **(NASD Case #C07010069)**

Walter Ray Reinhardt (CRD #2468084, Registered Representative, Hillsborough, North Carolina) was fined \$20,000, suspended from association with any NASD member in any capacity for two years, and ordered to requalify by exam as an investment company and variable contracts products representative before re-entering the securities industry for forgery, and barred from association with any NASD member in any capacity for engaging in private securities transactions. The fine must be paid before Reinhardt reassociates with any NASD member. The sanctions were based on findings that Reinhardt engaged in private securities transactions for compensation without giving prior written notice to, and receiving written approval from, his member firm. Reinhardt also forged the signature of a public customer on several account transfer documents without prior authorization from the customer.

Reinhardt's bar became effective September 20, 2001. **(NASD Case #C07000090)**

Bruce William Rhodes (CRD #2690462, Registered Representative, Rochester, Illinois) was barred from association with any NASD member in any capacity. The sanction was based on findings that Rhodes received \$795,500 from a public customer for investment in certificates of deposit and/or government bonds and, instead, invested some of the money in mutual funds and used

\$103,323.83 for some purpose other than to benefit the customer. In addition, Rhodes failed to respond to NASD requests for information. **(NASD Case #C8A010025)**

Zachary Mesch Samuels (CRD #2571775, Registered Representative, Denver, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. In light of the withheld profits by Samuels' former member firm, no monetary sanction has been imposed. Without admitting or denying the allegations, Samuels consented to the described sanction and to the entry of findings that he executed "backdated" purchase transactions in his variable annuity and processed corresponding money transfers between sub-accounts. Specifically, the findings stated that Samuels would transfer money from his fixed-interest sub-account to purchase shares in a fund sub-account or other stock-based sub-accounts and backdated the purchase date for the fund sub-account or other stock-based sub-accounts. Samuels would backdate the trades because he knew "yesterday's" price and "today's" price for the funds, and by backdating the purchase date at "yesterday's" price, he could lock in a risk-free profit by entering a simultaneous sell ticket at "today's" price. The NASD determined that Samuels would subsequently transfer the proceeds back to the fixed-interest sub-account, and as a result of his "backdated" transactions, he generated a gross profit of approximately \$56,738. **(NASD Case #C3A010038)**

Kenneth Eugene Schaub (CRD #1601008, Registered Representative, Gilbert, 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, Schaub consented to the described sanction and to the entry of finding that he participated in private securities transactions without providing prior written notice of his intention to participate in these transactions to his member firm. **(NASD Case #C3A010034)**

William Carl Seitz (CRD #418331, Registered Representative, Madison, Wisconsin) was barred from association with any NASD member in any capacity. The sanction was based on findings that Seitz failed to disclose material facts on his Form U-4. **(NASD Case #C8A010015)**

Richard Joseph Shanks (CRD #1470671, Registered Representative, San Diego, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for seven days. Without admitting or denying the allegations, Shanks consented to the described sanctions and to the entry of findings that, contrary to a firm's policy restricting its employees and their family members from purchasing or selling shares of the company's stock during certain periods, he entered into an agreement with a friend to purchase and sell shares of stock in the firm in which Shanks' spouse was employed, shared in the profits or losses related to the stock, and failed to obtain prior written authorization from the firm to share in the profits or losses in the account.

Shanks' suspension began November 5, 2001, and concluded November 11, 2001. **(NASD Case #CMS010151)**

Charles Joseph Smercina (CRD #1915915, Registered Representative, Solon, Ohio) submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for three months, and required to requalify by exam prior to acting again in any capacity requiring registration. The fine must be paid before Smercina reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Smercina consented to the described sanctions and to the entry of findings that he received stock certificates and checks from a public customer to establish an IRA account and failed to establish the account. The findings also stated that Smercina retained the certificates and checks, totaling \$5,435.34, until he returned them to the customer at a later date.

Smercina's suspension began November 5, 2001, and will conclude at the close of business February 4, 2002. **(NASD Case #C8B010013)**

Lawrence Elliott Smith (CRD #1139782, Registered Representative, Laguna Niguel, California) 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 10 business days. Without admitting or denying the allegations, Smith consented to the described sanctions and to the entry of findings that he made unsuitable recommendations to a public customer without having

reasonable grounds for believing that such recommendations were suitable in light of the nature of the transactions; the facts disclosed by the customer as to her other securities holdings, financial situation, circumstances, and needs; and in further light of the size and frequency of the transactions and the nature of the account.

Smith's suspension will begin November 19, 2001, and will conclude at the close of business December 3, 2001. **(NASD Case No. C02010047)**

Margot Rae Tomasella (CRD #4006221, Registered Representative, Williamsport, Pennsylvania) 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, Tomasella consented to the described sanction and to the entry of findings that she failed to respond to NASD requests for information. **(NASD Case #C9A010039)**

Deviat Ung (CRD #3113409, Associated Person, Richmond, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Ung provided false responses on his Form U-4. The findings also stated that Ung failed to respond to NASD requests for information. **(NASD Case #C02010011)**

Michael Anthony Visbal (CRD #1305080, Registered Representative, Pacific Palisades, California) submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid

before Visbal reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Visbal consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing his member firm with prior written notice of his intention to participate in the transactions, a description of the proposed transactions, his role therein, and whether or not he would receive compensation for his participation. The NASD found that Visbal established securities accounts at a member firm that was not his member firm, effected transactions in the accounts, failed to advise his member firm of the accounts in writing, and failed to advise the carrying member in writing that he was associated with a member firm.

Visbal's suspension began October 15, 2001, and will conclude at the close of business April 14, 2002. **(NASD Case #C3A000056)**

Susan Mary Waterhouse (CRD #1287276, Registered Representative, Newport, Michigan) and Barbara Andrus Grose (CRD #2180730, Registered Representative, Trenton, Michigan) submitted a Letter of Acceptance, Waiver, and Consent in which Waterhouse was fined \$6,500, which includes the disgorgement of \$1,500 commissions earned, and suspended from association with any NASD member in any capacity for 30 business days. Grose was fined \$10,250, which includes the disgorgement of \$5,250 in commissions earned, and suspended from association with any NASD member in any capacity for 45 business days.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they participated, for compensation, in private securities transactions by participating in the sale of securities in the form of promissory notes without giving written notice of their intention to engage in such activities to their member firm and failed to receive written approval from the member firm prior to engaging in such activities.

Waterhouse's suspension began November 5, 2001, and will conclude at the close of business December 17, 2001. Grose's suspension began November 5, 2001, and will conclude at the close of business January 9, 2002. **(NASD Case #C8A010064)**

Trisha Stephens Wyatt (CRD #3122798, Registered Representative, Tooele, Utah) 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, Wyatt consented to the described sanction and to the entry of findings that she accepted checks from public customers representing funds intended to be applied to the payment of insurance premiums and a check made payable to an insured drawn on the account of the insurance company with which she was affiliated, deposited the funds into a bank account she controlled, and used the funds for her personal benefit prior to making the premium payments by money orders on behalf of the insured. **(NASD Case #C3A010040)**

Individuals Fined

Robert David Mayfield (CRD #2386752, Registered Representative, Sun City, California) submitted an Offer of Settlement in which he was censured, fined \$8,451.50, and ordered to pay \$2,219.50 in restitution to public customers. Without admitting or denying the allegations, Mayfield consented to the described sanctions and to the entry of findings that he recommended to public customers the purchase and sale of securities without having reasonable grounds for believing that such recommendations were suitable for the customers in light of the nature of the transactions and the facts disclosed by the customers as to their other securities holdings, financial situation, investment objectives, circumstances, and needs. The findings also stated that Mayfield engaged in unethical conduct in that he provided the customers and his member firm with a materially false and misleading mutual fund switch form, negatively impacting their ability to assess the suitability of the transactions accurately. **(NASD Case #C02010003)**

Andrea Joyce Wagner (CRD #1096651, Registered Principal, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which she was censured and fined \$10,000. Without admitting or denying the allegations, Wagner consented to the described sanctions and to the entry of findings that she failed to ensure that individuals to whom she delegated supervisory responsibilities performed their duties diligently and failed to take adequate and appropriate supervisory action reasonably designed to prevent a representative's violations and to achieve compli-

ance with applicable securities laws, regulations, and NASD rules. **(NASD Case #C11010030)**

Decision Issued

The following decision has been issued by the DBCC or the Office of Hearing Officers and has been appealed to or called for review by the NAC as of October 5, 2001. 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*.

Manuel Martin Bello (CRD #1557140, Registered Principal, Kinnelon, New Jersey) was barred from association with any NASD member in any capacity with the condition that the bar shall become a 120-day suspension in all capacities if, within 60 days of the date the decision becomes final, Bello submits to the NASD requested wire instructions or a notarized letter from a bank officer, on bank stationery, representing that records do not exist or cannot be produced by Bello. If Bello complies with the above condition, he shall also requalify by exam for a Series 24 license. The sanctions are based on findings that Bello failed to respond completely to NASD requests for information.

This decision has been called for review by the NAC, and the sanctions are not in effect pending consideration of the review. **(NASD Case #CAF000030)**

Complaints Filed

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

as to the allegations in the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding the allegations in the complaint.

Jeffrey Charles Bruteyn (CRD #2575306, Registered Representative, Dallas, Texas) was named as a respondent in an NASD complaint alleging that he executed unauthorized transactions in the account of a public customer without the customer's prior knowledge or authorization. In addition, the complaint alleges that Bruteyn guaranteed the securities account of a customer against loss of the principal investment amount in exchange for the customer granting the respondent discretionary authority over her account. The complaint also alleges that Bruteyn failed to follow customer instructions and made misrepresentations to a customer. **(NASD Case #C06010029)**

John Perez (CRD #1093871, Registered Representative, Alhambra, California) was named as a respondent in an NASD complaint alleging that he converted to his own use and benefit \$5,000 given to him by a public customer to be invested. The complaint also alleges that Perez failed to respond to NASD requests for information. **(NASD Case #C07010067)**

Stephanie Ann Scott (CRD #3121358, Registered Representative, Oklahoma City, Oklahoma) was named as a respondent in an NASD complaint alleging that she issued corporate cashier checks to herself totaling

\$520. The complaint alleges that in order to fund these checks, Scott executed an advance in the amount of \$520 on the line of credit of a public customer without his knowledge or consent. Scott allegedly negotiated one of the cashier checks for \$260 and destroyed remaining checks prior to negotiation. The complaint also alleges that Scott debited her firm's general ledger account totaling \$200 and converted these funds to her own use and benefit. In addition, the complaint alleges that Scott failed to respond to NASD requests for information. **(NASD Case #C05010042)**

Jason Blaine Stevens (CRD #2802938, Registered Representative, Scottsdale, Arizona) was named as a respondent in an NASD complaint alleging that he made unsuitable recommendations to public customers without reasonable grounds for believing his recommendations were suitable based on the customers' securities holdings, financial situations, and needs of the customers. The complaint also alleges that Stevens made baseless price predictions regarding a speculative security to public customers without any reasonable basis for the predictions and made material omissions of fact in his recommendations of securities to public customers. **(NASD Case #C3A010039)**

Firms Suspended For Failure To Supply Financial Information

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of NASD Rule 8210 and

Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

Auerbach, Pollack & Richardson, Inc.,
New York, New York
(October 9, 2001)

Instipro, Inc.,
Mt. Clemens, Michigan
(September 10, 2001)

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.)

Bevacqua, Thomas P.,
Brick, New Jersey
(October 3, 2001)

Cavanaugh, David Blake,
Kernersville, North Carolina
(October 8, 2001)

Delia, Carl,
Hicksville, New York
(September 21, 2001)

Holliman, III, Joe Lewis,
Austin, Texas
(September 12, 2001)

Moran, Timothy James,
Buffalo, New York
(October 4, 2001)

Newton, Barry James,
Huntington Beach, California
(September 21, 2001)

Reyes-Rivera, Dilean,
Carolina, Puerto Rico
(October 1, 2001)

Rodriguez, Claus H.,
Union City, New Jersey
(October 4, 2001)

Rogers, Jason,
Rosedale, New York
(September 12, 2001)

Washington, Doris,
Glen Allen, Virginia
(September 12, 2001)

Winer, Maico Isaac,
North Miami Beach, Florida
(October 2, 2001)

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.)

Alfonseca, Jr., Pedro Julio,
Jamaica Plain, Massachusetts
(September 28, 2001)

Brouillette, Jr., Ronald D.,
La Jolla, California
(October 3, 2001)

Foster, Karl H.,
Toledo, Ohio
(September 5, 2001)

Freedman, Richard O.,
New York, New York
(September 28, 2001)

Latson, Jr., David Lee,
Miami, Florida
(September 25, 2001)

McCall, Joseph Martin,
Charlotte, North Carolina
(September 11, 2001)

Reynoso, Sujaily,
Providence, Rhode Island
(September 10, 2001)

Shiflett, Vernon W.,
Powell, Ohio
(September 24, 2001)

Yacapraro, Jr., Joseph-Anthony,
Coshocton, Ohio
(September 4, 2001)

NASD Regulation Charges Three Traders in Stock Manipulation Scheme

NASD Regulation has charged Jerome E. Rosen, with J. Alexander Securities, Inc.; Timothy R. Chamberlain, formerly at Equitrade Securities Corp.; and Robert J. Prager, formerly at Saperston Financial, Inc., with fraudulently manipulating the common stock of H & R Enterprises, Inc., a Canadian-based holding company. J. Alexander Securities, Inc. of Los Angeles, CA, and its president, James Alexander, were also charged with failing to supervise Rosen's activities.

According to NASD Regulation's complaint, Michael Mitton, a Canadian resident and U.S. fugitive, and David Heredia, a stock promoter barred from the securities industry, joined in a scheme with Rosen, Chamberlain, and Prager to manipulate the price of H & R Enterprises. Mitton obtained, for accounts under his control, nearly three million shares of H & R common stock at prices of \$0.01 and \$0.50 per share. Heredia and Mitton then sold their shares of H & R stock at inflated prices by directing the trading activity of Rosen, Chamberlain and Prager. Using Rosen, Prager, and Chamberlain, Mitton and Heredia were able to create a "daisy chain" in which H & R stock traded in a circular fashion, at ever increasing prices. The stock circulated among the three traders, other market participants, and Mitton's nominees' and associates' accounts held at Canadian brokerage firms.

The complaint further alleges that, in exchange for their participation in the fraudulent scheme, Rosen, Prager, and Chamberlain were guaranteed profits of \$0.03 to

\$0.06 per share for stock that they bought and sold at Mitton's or Heredia's direction. In addition to their guaranteed profits, Rosen and Chamberlain also accepted compensation from Mitton in the form of H & R stock that they received in nominee accounts. Sales from these nominee accounts generated profits in excess of \$317,000 for Rosen and \$43,000 for Chamberlain.

Through the circular trading of the stock, Mitton manipulated the price from about \$2.00 to \$6.75. Once this was accomplished, Mitton's nominees and associates sold their shares at the manipulated prices and refused to continue supporting the artificial price of the stock. As a result, Saperston Financial was left holding approximately 1.7 million shares that it purchased at approximately \$6.00 per share, and J. Alexander Securities was left holding approximately 600,000 shares that it bought at about \$5.50 per share. With the artificial support no longer in place, H & R's share price dropped below \$2.00 within two days. Saperston Financial could not sustain such a loss, and was forced to close because of insufficient net capital. Saperston Financial's clearing firm was obligated to cover the trades, causing it a loss of approximately \$9 million.

Earlier this year, NASD Regulation filed an enforcement action against J. Alexander Securities and James Alexander alleging that they failed to supervise two principals in the Florida branch office of the firm. The complaint in that case alleges that the firm and the two principals participated in illegal stock distributions and manipulation of the securities of 29 different shell companies, generating profits of almost \$2.75 million.

H & R Enterprises, Inc. was not charged in the complaint, and there are no allegations that it engaged in any wrongdoing.

The issuance of a disciplinary complaint represents the initiation of a formal proceeding by the NASD in which findings as to the allegations in the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, the respondents should be contacted before drawing any conclusion regarding the allegations in the complaint.

Under NASD rules, the individuals and the firms named in the complaint can file a response and request a hearing before an NASD Regulation disciplinary panel. Possible sanctions include a fine, censure, suspension, bar, or expulsion from the NASD, in addition to the request made by NASD Regulation in the complaint that the respondents give up any illegal profits and pay restitution.

For Your Information

Executive Order Targeting Terrorists

As described in *NASD Notice to Members 01-67*, President Bush issued an executive order on September 24, 2001, blocking the property of and prohibiting transactions with persons who commit, threaten to commit, or support terrorism. The order was issued through the U.S. Treasury's Office of Foreign Assets Control (OFAC); the offices of the Secretaries of State and Treasury and the Attorney General determined the persons and organizations affected. On October 12, 2001, OFAC added 39 persons and entities suspected of terrorism (or Specially Designated Global Terrorists—SDGTs). The complete list can be found on the OFAC Web Site, www.treas.gov/ofac, under "Bulletin."

Transactions are prohibited with the 39 persons and entities included in the Bulletin as well as those persons and organizations listed on the OFAC Web Site under "Terrorists," "Specially Designated Nationals and Blocked Persons," (SDN List), and the list of embargoed countries and regions.

Please check the OFAC Web Site and implement procedures to check the Web Site routinely for the names of additional persons and entities suspected of being involved in terrorism and whose accounts and transactions should be blocked. If your firm blocks or is subject to a block of the movement of cash or securities, it should report the incident and the names of the persons or organizations involved by facsimile to the OFAC Compliance Division at (202) 622-2426.

Exams Now Offered In Singapore

NASD Regulation is now offering computerized delivery of qualification exams and Continuing Education in Singapore. For additional information about the delivery location in Singapore, and how to schedule an appointment at this location, view the exam location Web Pages on the NASD Regulation Web Site at www.nasdr.com/2634.htm.

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INFORMATIONAL

INSITE Reporting Requirements

SEC Approves NASD
Rule Proposal Requiring
Member Clearing And
Self-Clearing Firms To
Report Prescribed Data;
Effective Date:
December 10, 2001

SUGGESTED ROUTING

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

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- INSITE
- Reporting Requirements

Executive Summary

On November 27, 2001, the Securities and Exchange Commission (SEC) approved proposed National Association of Securities Dealers, Inc. (NASD[®]) Rule 3150, "Reporting Requirements for Clearing Firms." Rule 3150 requires each member that is a clearing firm or self-clearing firm to report to the NASD in such format as the NASD may require prescribed data pertaining to itself and any member for which it clears.¹ This data will be used to facilitate the surveillance component of NASD Regulation's INSITE program. Through the use of INSITE's technology, NASD Regulation will enhance investor protection by identifying potentially high-risk situations as they develop.

The text of the amendments as provided in Attachment A became effective on December 10, 2001.

Questions/Further Information

Questions concerning this Notice may be directed to Frank J. McAuliffe, Member Regulation, NASD Regulation, at (240) 386-4670; Elizabeth A. Wollin, Member Regulation, NASD Regulation, at (240) 386-5156; or Shirley H. Weiss, Office of General Counsel, NASD Regulation, at (202) 728-8844.

The INSITE Program

The data gathered by NASD RegulationSM under Rule 3150 will be used to facilitate the surveillance component of INSITE (an acronym for Integrated National Surveillance and Information Technology Enhancements), a new business model that will permit NASD Regulation to use sophisticated

statistical analysis techniques to detect emerging risk patterns at member firms. Through INSITE, NASD Regulation will collect and analyze information about members and produce reports that identify "exceptions" based on historical and current comparisons of member data. The exceptions will trigger follow-up reviews and possible examinations. INSITE will permit NASD Regulation to concentrate its examinations on the higher-risk segments of the industry, focus the content of each examination on higher-risk topics, streamline the examination process for examiners and members, and better coordinate regulatory findings with other NASD Regulation departments.

Who Is Subject To The Requirements Of Rule 3150

Rule 3150 requires each member clearing and self-clearing firm to report prescribed data to NASD Regulation. Members may enter into an agreement with a third party, such as a service bureau, pursuant to which the third party agrees to fulfill the clearing or self-clearing firm's obligations under proposed Rule 3150. Notwithstanding the existence of such an agreement, each member that is a clearing or self-clearing firm will be responsible for complying with the reporting requirements of Rule 3150.

What Must Be Reported Under Rule 3150

The text of Rule 3150 does not specify the data that must be reported to NASD Regulation, but members may review the reporting requirements on the NASD Regulation Web Site at <http://www.nasdr.com/insite.asp> (INSITE Firm Data Filing Technical Specifications). The reporting

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requirements have been designed to require firms to provide summaries of information that they are already collecting, including, among other things, aggregate net liquidating equity in each clearing firm's correspondents' proprietary accounts, exchange and non-exchange transactions, options transactions, debt transactions, customer accounts, short interest, unsecured customer debits, trade cancellations (T+1 forward), and as-of trades summaries. These data elements may change over time, and NASD Regulation will continue to work with its members and their service bureaus to identify the data that is needed to operate the surveillance component of INSITE and to modify the reporting requirements as necessary. The initial data elements will be reported daily. NASD Regulation will provide clearing and self-clearing firm members with advance notice (in an *NASD Notice to Members* or by other means of communication, such as the NASD Regulation Web Site) of any changes to the required data elements or filing frequency.

What Are The Technical Reporting Requirements Under Rule 3150

Rule 3150 does not specify the method to be used by members in reporting prescribed data. The technical requirements associated with all of the processes necessary for transmitting the required data to NASD Regulation can be found on NASD Regulation's Web Site at <http://www.nasdr.com/insite.asp> (INSITE Firm Data Filing Technical Specifications). Firms may report data via NASD Regulation's Form Filing Web Site or, for firms with connectivity to the NASD OATS private network, through that file transfer protocol. Members may

obtain additional information about reporting responsibilities, technical specifications, compliance issues, and more by contacting NASD Business and Technology Support Services at (800) 321-NASD, or by sending an e-mail to nasdregfiling@nasd.com.

As with any new program or technology, systems failures may arise. When that happens, NASD Regulation expects members to report these failures, correct them as expeditiously as possible, and restart the reporting process. Generally, NASD Regulation will not view a system failure as a disciplinary matter if it has occurred in the normal course of doing business, is not part of a series of systems failures, and the member is attempting to correct it.

The NASD Regulation Web Site also features information that will aid members in making programming changes that will enable them to create the daily summaries required by INSITE. NASD Regulation is also committed to developing a system on its Web Site that will permit members to review the information that they or their service bureaus have reported.

When Will NASD Regulation Require Clearing And Self-Clearing Firms To Report Data Under Rule 3150

NASD Regulation will implement Rule 3150 reporting requirements in phases. The three clearing firms that have been part of an ongoing pilot program will be phased in first, as soon after December 10, 2001, as possible. NASD Regulation will phase in all other members in several stages. NASD Regulation will publish the schedule of phase ins as soon as it has been established, but in no event will NASD Regulation give

member firms less than six months' notice of their start-up date. NASD Regulation will take into account broker/dealers' relationships with service bureaus in establishing the phase-in schedules. NASD Regulation expects Rule 3150 to be fully implemented by the end of 2002.²

Effective Date Of Amendments

These amendments became effective on December 10, 2001.

Endnotes

- 1 See Securities Exchange Act Release No. 45109 (Nov. 27, 2001), 66 FR 63271 (Dec. 5, 2001) (File No. SR-NASD-2001-19) (SEC Approval Order).
- 2 Rule 3150 includes a provision that permits members to request an exemption from Rule 3150's reporting requirements pursuant to the Rule 9600 Series. As stated in Rule 3150(b), exemptions from any or all of the Rule 3150 reporting requirements will be granted only under exceptional and unusual circumstances.

© 2001 National Association of Securities Dealers, Inc. (NASD). All rights reserved. Notices to Members attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

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ATTACHMENT A—RULE TEXT

New language is underlined.

3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION

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 in such format as the Association 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 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.

* * *

PROCEDURES FOR EXEMPTIONS

9610. Application

(a) Where to File

A member seeking exemptive relief as permitted under Rules 1021, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3150, 3210, 3230, 3350, 8211, 8212, 8213, 11870, or 11900, Interpretive Material 2110-1, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of the Association and provide a copy of the application to the Office of General Counsel of NASD Regulation.

(b) and **(c)** No change

INFORMATIONAL

Compensation and Mixed Capacity Trading

Guidance on Compensation and Mixed Capacity Trading

SUGGESTED ROUTING

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

- Executive Representatives
- Legal & Compliance
- Registered Representatives
- Senior Management
- Training

KEY TOPICS

- Disciplinary Information

Executive Summary

The Nasdaq Stock Market, Inc. (Nasdaq®) and NASD Regulation, Inc. (NASD Regulation) believe that market rules should enhance investor protection and promote competition among market participants. The advent of decimal pricing in the Nasdaq market has caused many Nasdaq market makers to re-evaluate methods of charging for their services, as well as the manner in which they represent customer orders in the marketplace. Consequently, firms have questioned whether Nasdaq rules accommodate different methods of compensation for a market maker's services. In turn, firms have approached Nasdaq and NASD Regulation for interpretive advice concerning their regulatory obligations when executing transactions on a commission or commission-equivalent basis. In response to these and other inquiries, Nasdaq and NASD Regulation have prepared this *Notice to Members*.

The guidance relating to mixed capacity trades and the capability to change the Automated Confirmation Transaction ServiceSM (ACTSM) report capacity indicator on a post-execution basis, which are discussed below, relate principally to Nasdaq securities (Nasdaq National Market and SmallCap). Nasdaq continues to evaluate whether there is a need for similar guidance regarding securities traded in the OTC Bulletin Board, and will provide information regarding this issue in a separate document at a future date.

Questions/Further Information

Questions regarding this *Notice* may be directed to the Nasdaq

Office of General Counsel at (202) 728-8808, and the Legal Section, Market Regulation Department, NASD Regulation at (240) 386-5126.

Discussion/Background

Traditionally, the business model of Nasdaq market makers has been based on the difference between the price at which market makers were willing to buy and sell securities. The difference, or "spread," typically makes up a component of a market maker's compensation for the risk it assumes and the liquidity it supplies to the market. As a result of changes to the Nasdaq market resulting from decimalization, some market participants are seeking to alter their methods of charging and paying for market services. In many cases, this means expanding the use of a commission-based fee model.

At the outset, Nasdaq wishes to emphasize that decisions about methods of compensation should be made in arm's length negotiations between broker/dealers and their customers. Each firm and its customers must make individual, independent determinations about the fee and payment structures that are appropriate for their business relationships. Therefore, the issuance of this *Notice* does **not** obligate any market participant to impose, or accept, any particular compensation model, nor does it suggest the appropriate level of compensation. Instead, this *Notice* seeks to provide interpretive advice and guidance to firms to assist them in meeting their regulatory obligations arising from whichever manner they choose to participate (and pay or receive compensation for that participation) in Nasdaq.

Special NASD Notice to Members 01-85

I. Trade Capacity

Q. 1. What is a principal trade?

- A. A principal trade is a trade in which the broker/dealer buys or sells for an account in which the broker/dealer has a beneficial ownership interest (e.g., a proprietary account). When executing transactions from this account, the broker/dealer typically charges its customer a markup, markdown, or commission equivalent, and may also trade on a "net" basis (see Question 4).
-

Q. 2. What is an agency trade?

- A. An agency trade is a trade in which a broker/dealer, authorized to act as an intermediary for the account of its customer, buys (sells) a security from (to) a third party (e.g., another customer or broker/dealer). Such a trade is not executed in, or does not otherwise pass through, the broker/dealer's proprietary account. When executing an agency trade, the broker/dealer generally charges the customer a commission for its services.
-

Q. 3. What is a riskless principal trade?

- A. In Nasdaq, a riskless principal trade is one in which a broker/dealer, after having received an order to buy (sell) a security, purchases (sells) the security as principal, **at the same price**, to satisfy that order. The broker/dealer generally charges its customer a markup, markdown, or commission equivalent for its services, which is disclosed on the confirmation required by

Securities Exchange Act (Exchange Act) Rule 10b-10. For further guidance on riskless principal trade reporting obligations for Nasdaq securities, please see *Notice to Members 99-65*, *Notice to Members 99-66*, and *Notice to Members 00-79*.

Q. 4. What is a net trade?

- A. A net trade takes place when a market maker, at the request of a customer, while holding a customer order to buy (sell), executes a buy (sell) as principal at one price (from the street or another customer) and then executes an offsetting sell to (buy from) the customer at a different price. The difference between the price of the market maker's transaction and the price of the offsetting transaction to the customer is the market maker's compensation, and such compensation generally is not separately disclosed on the customer confirmation. To the extent that the market maker executes a transaction to facilitate the execution of the customer order it holds, such a transaction appears to be a riskless principal transaction. However, because the two transactions are effected at two different prices, the market maker is required under NASD trade reporting rules to report both legs (i.e., the street (or another customer) side and the customer side) of the transaction to the tape. The market maker's capacity for both transactions in ACT is principal (P). See *Notices to Members 95-67*, *96-10*, *99-65* and *00-79* for further guidance on net trading.¹

II. Fees In General

Q. 5. Do NASD/Nasdaq rules prohibit a member firm from charging its customer a commission or commission equivalent?

- A. No. There are no NASD/Nasdaq rules or interpretations that prohibit a member firm from charging its customers either a commission when acting as agent, or a commission equivalent when acting in a principal or riskless principal capacity. It is up to each individual NASD member firm, consistent with its regulatory obligations, to reach an independent determination as to the manner in which it seeks to be paid by its customers for services rendered.
-

Q. 6. Can a member firm charge its customer a commission when acting in a principal or riskless principal capacity?

- A. The NASD rules do not specifically address this issue. Members should, however, refer to Securities and Exchange Commission (SEC) guidance and interpretations on this issue.
-

III. Handling Orders in Mixed Capacities

7. ***Q. Can a market maker that handles orders at the same price but in different capacities (e.g., as agent, riskless principal and/or principal) combine these orders and represent them in a single quote?***

- A. Yes. A market maker can combine agency, riskless principal and/or principal orders and represent them in a single quote. When a market maker is displaying trading interest in its quotation in Nasdaq and that quote is accessed by another participant through a Nasdaq system, Nasdaq systems currently assume that the market maker traded on a principal basis, and consequently default the execution report in ACT to a principal capacity indicator. Nasdaq and NASD Regulation understand that it is possible that the accessed quote represents an agency order or a combination of agency interest and proprietary (principal or riskless principal) interest. Nasdaq and NASD Regulation also understand that a firm may wish to adjust its Nasdaq system-generated ACT report to indicate that the market maker handled all or a portion of the execution of a mixed capacity quote as agent.

As an accommodation, Nasdaq is providing a voluntary option that will allow firms to break out the agency and/or riskless principal components of a "mixed" capacity execution through an ACT Regulatory Report – similar to "Alternative 2" under

NASD riskless principal trade reporting rules. Specifically, a market maker would submit a non-clearing/non-tape report or a clearing only report (collectively, ACT Regulatory Report) to ACT for the agency and/or riskless principal portion(s) of the larger, system-reported execution. The market maker would be required to submit the ACT Regulatory Report within 15 minutes of the original mixed capacity execution. Additionally, the ACT Regulatory Report would have to include: 1) in the memo field, the ACT control number for the original trade report generated by the Nasdaq system;² and 2) in the execution time field, the time the order was **allocated** to the agency and/or principal account. As discussed in more detail below,³ the presumption is that the entire amount of such a mixed capacity execution has been done on a principal basis unless allocated to an agency account within a general time parameter of 60 seconds.⁴

Q. 8. Can a market maker handling orders at the same price in different capacities (e.g., as agent, riskless principal and/or principal) combine these orders for entry into a Nasdaq system (i.e., SelectNet or the National Market Execution System (NNMS or SuperSOES)) for execution?

- A. Yes. While it would be preferable for such orders to be entered separately into a Nasdaq system whenever possible, a market maker can combine such orders for entry into SuperSOES or SelectNet

as a single mixed capacity order.⁵ Similar to the procedure for the execution against mixed capacity quotes that is described in Question 7, Nasdaq will provide a voluntary option for firms to allocate the agency and/or riskless principal components of a "mixed" capacity execution resulting from the submission of a single "mixed order" into SuperSOES or SelectNet. As described in Question 7, this will be accomplished by the submission of an ACT Regulatory Report that identifies the agency and/or riskless principal order(s) that make up any or all of the executed mixed capacity order that was entered into the Nasdaq system.

Q. 9. Is a member required to use the ACT Regulatory Report to break out executions of agency and/or riskless principal orders, as outlined in Questions 7 and 8?

- A. No. Member firms are not required to use this voluntary option to allocate the execution of a mixed capacity quote that is accessed via a Nasdaq system to its capacity component parts. Similarly, member firms that choose to aggregate multiple orders of differing capacities into a single mixed capacity order, for entry into SuperSOES or SelectNet, or into an Electronic Communications Network (ECN) or Alternative Trading System (ATS), are not required to use this voluntary option to allocate the execution of such orders to their capacity component parts. The above-described

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approach is one, but not the only, way for firms to document the capacity in which they traded.⁶

Please see Section V for further guidance on record keeping obligations.

Additional information on this functionality will be provided in a separate Technical Update. Until that time, we have included below an example illustrating the type of reports that can be submitted to adjust portions of a mixed capacity execution.

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Example 1: MMA is at the inside offer of \$20.00 for 15,000 shares. MMA's quote is composed of a 7,500 share principal order and a 7,500 share agency order (both to sell). MMB enters a market order to buy 15,000 into SuperSOES. At 10:00:00 a.m., SuperSOES executes the incoming buy order for 15,000 shares against MMA's quote, and ACT reports the 15,000

share execution to the tape on behalf of MMA (ACT control number = 1150111111). MMA allocates the order to the agency account for a customer that is a non-NASD member (e.g., institution) within 30 seconds of execution at 10:00:30 a.m. If MMA wishes to use the ACT Regulatory Report to break out executions of the mixed capacity order, MMA

would be required to submit an ACT Regulatory Report for 7,500 shares sold, with an allocation time of 10:00:30 a.m. (in the execution time field) and an ACT control number of 1150111111 in the memo field, as set forth below, within 15 minutes of the original mixed capacity execution:⁷

Tape/Media Report Sent to ACT by SuperSOES

MMID	OEID	Volume	Price	MMA Capacity	ACT Control #	Memo	Execution Time	Tape Rpt.	Cllg
MMA	MMB	15,000	20.00	P	1150111111		10:00:00	Yes	Yes

MMA's ACT Regulatory Report

MMID	OEID	Volume	Price	MMA Capacity	ACT Control #	Memo	Execution Time	Tape Rpt.	Cllg
MMA	MMB	7,500	20.00	A	1150222222	1150111111	10:00:30	No	No

The categories in the above-referenced trade reports are for illustrative purposes only

MMID	Executing Reporting Party
OEID	Order Entry (Contra) Party
Volume	Shares executed
Price	Transaction price
MMA Capacity	Capacity indicator for Market Maker A: P = principal, A = agency, R = riskless principal
ACT Control #	Unique ACT identifier attached to each ACT report
Memo	ACT field for input of miscellaneous information. Must be used to indicate original ACT control #
Execution Time	Time of order execution. On the ACT Regulatory Report, indicated time represents the time of allocation.
Tape Rpt.	Indicates whether the ACT record is reported to the tape. For ACT Regulatory Reports, this should always be "No."
Cllg	Indicates whether the ACT record is cleared through the ACT system

Example 2: MMA is holding an agency order to buy 10,000 shares at a price not to exceed \$20.00, plus an agreed upon, separately disclosed commission. MMA then receives another agency order to sell 10,000 shares at \$20.00. MMA's system is programmed to match agency orders and report the agency crosses to ACT.

Q. 10. Can MMA cross two customer agency orders internally and report the transaction to ACT as agent?

- A. Yes, provided that the orders are not run through the market maker's proprietary account. Here, MMA would submit one trade report to ACT indicating that MMA acted as agent and effected an agency cross.
-

Q. 11. Is it permissible for a market maker to use an omnibus account to allocate executions among agency, principal, and riskless principal accounts?

- A. Yes. A firm can maintain an omnibus account, which **cannot** be the firm's proprietary account (*i.e.*, the firm cannot hold proprietary positions in the account), from which it allocates executions to sub-accounts. When allocating to an agency or riskless principal sub-account, the firm must have record keeping and supervisory systems in place that can demonstrate, on an order-by-order basis, that, prior to execution, the firm had in hand the agency or riskless principal order to which the execution in the omnibus account relates.

IV. Trade Reporting Mixed Executions

As stated previously, Nasdaq and NASD Regulation recognize that in today's market environment market makers may be representing multiple customers in multiple capacities in a single transaction. In order to assist those market participants in properly categorizing their activities for regulatory and business purposes, Nasdaq has determined to provide a voluntary mechanism for firms to break out larger mixed capacity executions into their appropriate component parts. The following questions and examples illustrate how this mechanism will work.⁸

Example 3: Assume MMA is displaying 15,000 shares to buy at \$20.00. This quotation represents two agency institutional orders of 5,000 each, along with an additional 5,000 of proprietary interest for the purpose of trading with retail customers. The market maker has been given discretion by the agency customer, subject to available best execution opportunities, to fill the customer's agency orders, or any part of them, on a principal basis. MMB accesses MMA's entire quote of 15,000 shares through SuperSOES, which automatically reports the trade to ACT with MMA's capacity as principal.

Q. 12. How does MMA split out the mixed components of the execution?

- A. MMA would submit an ACT Regulatory Report for each agency portion of the trade it desired to split out from the original execution. Individual reports can be submitted for each order executed on an agency basis (*i.e.*, two ACT Regulatory Reports of 5,000 shares each), or all orders executed in the same capacity can be combined in a single report (*i.e.*, one ACT Regulatory Report for 10,000 shares). Assuming that the initial transaction report to ACT disclosed MMA's capacity as principal, there will be no additional report required to indicate that 5,000 shares of the original 15,000 share execution were effected on a principal basis, and Nasdaq and NASD Regulation will assume, for regulatory purposes, that the remaining portion was executed as principal.

Example 4:

Market is **\$12.95 - \$13.00**

MMA
is quoting **\$12.95 - \$13.10**

MMB
is quoting **\$12.70 - \$13.00**

MMA receives an institutional order to buy 10,000 shares at a price not to exceed \$13.00, plus an agreed upon, disclosed commission. The customer requests, and MMA agrees, to handle the order on an agency basis. MMA sends an order through SuperSOES, which executes all 10,000 shares against MMB at \$13.00.

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Q. 13. MMA acted as agent and wishes to confirm the trade to the customer as agent. Is it permissible to change MMA's capacity to agency after the fact if MMA clearly documents the capacity in which it acted?

A. Yes. Although Nasdaq and NASD Regulation are of the view that, wherever possible, orders should be marked correctly for capacity purposes at the time of entry into a Nasdaq system, if a market maker is unable to accurately designate its trading capacity at that time (because, for example, it is acting in a mixed capacity), it may voluntarily adjust its capacity post-execution by using Nasdaq's new functionality.

However such a change may not be necessary in the above scenario. As the party that entered the SuperSOES order, MMA already possesses the capability of designating through SuperSOES its capacity as principal, riskless principal or agent when it enters the order that is executed against MMB.⁹ Note that, as of the date of this Notice, market participants cannot enter orders into SelectNet with a riskless principal capacity indicator.

Example 5: MMA receives an institutional order to buy 10,000 shares at a price not to exceed \$13.00, plus an agreed upon, disclosed commission. The customer instructs MMA to handle the order on an agency basis. MMA sends multiple SelectNet messages to fill the customer order. ECN 1 executes 9,000 shares and

ECN 2 executes 5,000 shares resulting in two executions totaling 14,000 shares at a price of \$13.00.

Q. 14. What happens to the "overbought" portion?

A. MMA must take the "overbought" portion into inventory. Because all 14,000 shares were executed at a price of \$13.00, it makes no difference which "portion" is allocated to the agency order, provided that the agency order is filled in its entirety. As the sender of the SelectNet orders, MMA may indicate agency (A) or principal (P) at the time of order entry. If MMA does not indicate agency at the time of order entry, it can change the capacity indicator to agency (A) for the order(s) by submitting an ACT Regulatory Report for those shares that are handled as agent. In the above scenario, therefore, the capacity indicator on the 9,000 shares that were purchased from ECN 1 would be changed to agency (A), and the 5,000 shares that were purchased from ECN 2 would be changed to reflect that only 1,000 shares were purchased as agent (with the remaining 4,000 shares of the 5,000 share execution having been purchased as principal).¹⁰

Firms should be mindful of their best execution obligations when receiving better-priced executions from ECNs at prices superior to their displayed quotations (*i.e.*, any price improvement received in such instances should be passed along to the customer).

Example 6: Assume MMA receives from Customer #1 a not held buy order for 10,000 shares at a price not to exceed \$13.00. MMA contemporaneously receives from Customer #2 a not held agency buy order for 10,000 shares at a price of \$13.00. MMA sends a SelectNet message to ECN 1 to buy 20,000 shares at \$13.00. ECN 1 executes 15,000 and moves to \$13.10.

Q. 15. How does MMA identify which portion of the execution goes to Customer #1 and which portion is allocated to Customer #2?

A. Neither Nasdaq nor NASD Regulation has mandated any particular order handling and execution priority procedures among orders. In this Example, MMA may, therefore, allocate executions among its accounts as long as it employs a reasonable methodology for allocating shares, which is adequately and properly disclosed to its customers, is fair, consistently applied, and does not unfairly discriminate against any particular class of accounts or types of orders. For example, a member could use a FIFO method for all orders, allocate to accounts on a pro-rata or an "even split" basis, or use other objective methodologies or formulae. It would be inappropriate, however, for a member's methodology to allocate shares to institutional orders over retail orders or to the orders of certain preferred accounts. To the extent a member elects to implement such an allocation methodology, the firm

must describe it in firm documentation on both a current and an historical basis.

The member must further ensure that its written supervisory procedures and supervisory system review the extent to which its chosen methodology allocates shares in a manner consistent with the duty of best execution.¹¹ Member firms should also understand that simply because they employ a methodology for allocating shares, and that methodology is followed in a particular circumstance, that it does not automatically mean that any or all customer orders executed pursuant to such a methodology received best execution. Lastly, firms are reminded that they must always treat limit orders that they have accepted in compliance with NASD Rule IM-2110-2 (the Limit Order Protection Interpretation, a.k.a. "Manning obligations").

Q. 16. In a mixed capacity trade that is, upon execution, originally allocated to an omnibus account, do Manning obligations arise at the time of execution or allocation?

- A. The presumption is that the entire amount of an execution effected in an omnibus account is effected as a principal or riskless principal transaction, and is therefore a triggering trade for the purposes of Manning obligations, at the time of execution. For mixed capacity executions, however, this presumption may be rebutted, and the amount of shares

subject to Manning protection reduced if, within a general time parameter of 60 seconds after the mixed capacity execution, all or a portion of the execution is allocated to an agency account. Allocations to an agency account more than 60 seconds after the original mixed capacity execution do not relieve a market maker of its Manning obligations to any protectable customer limit orders that it holds.

For example, MMA is displaying 10,000 shares to buy at \$20.00 in its quote. SuperSOES executes the full 10,000 shares, and MMA allocates those shares immediately to its omnibus account. Within 60 seconds of the SuperSOES executions, MMA, pursuant to its established allocation methodology, allocates 3,000 shares to an agency account for a 3,000 share not held agency order it is holding. In this hypothetical, MMA would, within a general time parameter of 60 seconds after the original mixed capacity execution, owe Manning fills up to 7,000 shares for any protectable limit orders that it was holding on its book to buy at \$20.00 or higher. In addition, any shares remaining in the omnibus account within 15 minutes of the original mixed capacity execution will be deemed to be a proprietary position of MMA and must therefore immediately be allocated by MMA from its omnibus account to its proprietary trading account (see Question 11).

V. Record Keeping Obligations

Q. 17. Does a member firm have record keeping obligations when trading in a mixed capacity basis?

- A. Yes. In addition to any applicable record keeping obligations under SEC Rules 17a-3 and 17a-4 and NASD Conduct Rule 3110, any member firm trading in a mixed capacity basis, regardless of whether they are voluntarily submitting ACT Regulatory Reports or not, must have in place systems and controls that produce records that enable the firm and NASD Regulation accurately to reconstruct, in a time-sequenced manner, the activity in accounts used to engage in mixed capacity trading. Accordingly, for any given period of time throughout the trading day, and for all accounts used to engage in mixed capacity trading, firms must be able readily to reconstruct for NASD Regulation the details of all orders worked on an agency or riskless principal basis, all trades that could have been attributed to an agency or riskless principal order and whether those trades were executed on an agency or riskless principal basis (using ACT Regulatory Reports or otherwise), or on a principal basis.

NASD Regulation will examine this activity to determine whether post-execution capacity adjustments were properly done and supported by the orders held by the firm at the time of the execution of the agency or riskless principal

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quote or order. Conversely, NASD Regulation will examine this activity to determine whether the firm improperly refrained from post-execution capacity adjustments due to these orders.

Failure to record and retain such information could result in disciplinary action. The inability to substantiate the capacity of a trade will also cause NASD Regulation to assume that the original (and potentially incorrect) capacity that it reported to ACT is its actual capacity and assess compliance with related regulatory obligations on that basis. Moreover, NASD Regulation will examine post-execution capacity adjustments (and failures to make adjustments) for possible best execution violations.

Q. 18. How can a member demonstrate that a trade was executed as “riskless principal” where the member executes both principal and riskless principal transactions?

A: The member must have written policies and procedures to assure that orders executed and reported as “riskless principal” comply with NASD Rules 4632, 4642, and 6420, which require that the transactions offsetting a customer order executed as riskless principal occur **after** the customer order is received **to satisfy** that order. At a minimum, these policies and procedures must require that the customer order was received prior to the offsetting transactions, and that the offsetting transactions are

allocated to the riskless principal account in a consistent manner and on a prompt basis. Members must have supervisory systems in place that can demonstrate order-by-order compliance with this requirement. The above standard would apply to agency transactions allocated to an omnibus account as well.

VI. Order Audit Trail Obligations (OATS)

The ability to allocate, on a voluntary basis, the components of a mixed capacity execution into its individual parts requires members to provide certain additional information to OATS. The following questions and answers have been prepared by NASD Regulation to assist member firms in this regard.

Q. 19. Are there any OATS requirements if a firm submits an ACT Regulatory Report to allocate the components of a mixed capacity execution?

A. Yes. If a firm chooses to allocate, on a voluntary basis, the components of a mixed capacity execution in ACT into its individual parts, then that firm’s OATS obligations are as follows:

For Orders Entered on Behalf of a Customer for Execution

Under current OATS requirements, a firm that enters an order into a Nasdaq system for execution must submit to OATS a Route Report indicating that the order was routed to a Nasdaq

system. However, if a member chooses to allocate, on a voluntary basis, the components of a mixed capacity execution in ACT into its individual parts, such an allocation will take place after the time of the original execution. In addition, given the post-trade allocation process envisioned by the use of ACT Regulatory Reports, which may involve allocations among several agency orders and/or principal and riskless principal accounts, it may be that a firm has executed an order before it has had an opportunity to create a Route Report for submission to OATS. Accordingly, in this instance, a firm must submit an Execution Report to OATS rather than a Route Report. If a firm is representing multiple customer orders in the same ACT Regulatory Report, it must ensure that each OATS Execution Report contains the same branch/sequence number as reported on the ACT Regulatory Report. Alternatively, the firm may submit an ACT Regulatory Report for each separate customer order that comprises the mixed capacity execution and each such entry must contain the necessary information to ensure that the OATS Execution Report(s) can be matched to the related ACT Regulatory Report(s).¹²

For Orders Displayed for Execution

Under current OATS requirements, a firm must submit to OATS a New Order Report and an Execution Report when an order it is displaying is executed against.¹³ This will still be the

case if a member chooses to allocate, on a voluntary basis, the components of a mixed capacity execution that resulted from a mixed capacity displayed order. However, if the firm does a voluntary allocation, it will be required to match the OATS Execution Report to the second ACT report (the ACT Regulatory Report) by entering a branch/sequence number in both the ACT Regulatory Report and the OATS Execution Report and omitting the Reporting Exception Code of "M" from the OATS Execution Report. If a firm is representing multiple customer orders in the same ACT Regulatory Report, it must ensure that each OATS Execution Report contains the same branch/sequence number as reported on the ACT Regulatory Report. Alternatively, the firm may submit an ACT Regulatory Report to ACT for each separate customer order that comprises the mixed capacity execution and each such entry must contain the necessary information to ensure that the OATS Execution Report(s) can be matched to the related ACT Regulatory Report(s).¹⁴

Q. 20. If a firm elects not to use the voluntary ACT Regulatory Report to break out the executions of agency orders, as outlined in Questions 7 and 8, above, but rather relies on another approach, are there any additional OATS reporting requirements for that firm?

- A. Yes. If a firm chooses to allocate, through an approach other than the use of a voluntary ACT Regulatory

Report, the components of a mixed capacity execution into its individual parts, then that firm's OATS obligations are as follows:

For Orders Entered On Behalf Of A Customer For Execution

Because such allocations will take place after the time of the original execution, it may be that the firm has executed an order before it has had an opportunity to create a Route Report for submission to OATS. In this instance, a firm must submit an Execution Report to OATS rather than a Route Report. However, unlike the case where a voluntary ACT Regulatory Report is used, there will be no related ACT report submitted that reflects the post-execution allocation. Consequently, a firm electing not to use the voluntary ACT Regulatory Report to allocate the components of a mixed capacity execution must append a Reporting Exception Code of "M" to any Execution Report(s) submitted to OATS for post-execution allocation.

For Orders Displayed On Behalf Of A Customer For Execution

The firm's OATS reporting obligations in this situation are the same as its current OATS reporting obligations when an order that is displayed in a quotation is executed. That is, an Execution Report must be submitted to OATS with a Reporting Exception Code of "M" to indicate that no ACT match will take place because the firm did not have the ability, at the time its quote was accessed, to enter a

branch/sequence number into the Nasdaq system-generated ACT report.

Q. 21. When allocating the components of a mixed capacity execution, what time should be submitted in the execution time field of an OATS Execution Report, the time of the execution or the time of allocation?

- A. The time of allocation, regardless of whether the member is using the voluntary (or any other) approach to track and record subsequent capacity adjustments to portions of mixed capacity executions.
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Q. 22. Do my OATS obligations change if I am using the Update feature in ACT to change the capacity of the entire execution rather than using the ACT Regulatory Report option?

- A. Yes. The Update feature not only allows the capacity indicator to be changed in ACT, but it also allows a change to, or the addition of, the branch/sequence number field. Therefore, if a branch/sequence number was not entered by the firm at the time of order entry, the firm must enter a branch/sequence number in the ACT Regulatory Report and include that same branch/sequence number on the related OATS Execution Report. In this case, the execution time on the OATS Execution Report must be the same as the execution time on the corresponding ACT Regulatory Report.
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Endnote(s)

- 1 Nothing in this *Notice to Members* is intended to change the rules applicable to markups, fair prices, and commissions. See, e.g., NASD Conduct Rule 2440, Interpretive Memorandum (IM) 2440, and *Notice to Members 92-16*.
- 2 The "Memo" field is available through all Nasdaq trade reporting mediums, including Computer-to-Computer Interface (CTCI), the ACT Trade Report Entry Screen on the NWII™ workstation, and the Application Program Interface (API). ACT assigns a control number to each trade report submitted to ACT. Nasdaq provides users with several methods for identifying the ACT control numbers assigned to trade reports, which will be discussed in greater detail in a later Technical Update.
- 3 See Section IV of this *Notice*.
- 4 See *Notice to Members 95-67*, at Question 5.
- 5 Nothing in this *Notice to Members* is intended to change the rules relating to the trading of Nasdaq SmallCap securities on Nasdaq's Small Order Execution System (SOES). See NASD Rules 4750-4756.
- 6 Firms may use the ACT Regulatory Report to break out the actual capacities of a mixed capacity execution in a variety of circumstances, including when they are: acting as the order sender or receiver (order-entry firm) through SuperSOES; acting as the order sender or receiver through SelectNet; and transacting through another execution venue, such as an ECN or ATS. In other words, members will have the ability to correct their capacity to a particular execution in ACT regardless of whether they are on the reporting side or the contra side to the execution and regardless of whether they received an execution through a Nasdaq system. Additionally, firms may use an ACT Regulatory Report to change the capacity on the entire original execution.
- 7 Submission of such reports is discussed in greater detail in Section IV of this *Notice*.
- 8 Nothing in this *Notice to Members* is intended to change the trade reporting requirements under the riskless principal trade reporting rules. See *NASD Notices to Members 99-65, 99-66, and 00-79*.
- 9 See Technical Update #2001-22, September 24, 2001, regarding specifications, enhancements, and modifications related to riskless principal transactions through API and CTCI. The ability to enter riskless principal transactions through NW II will go into effect first quarter 2002.
- 10 The allocation(s) to the agency account must occur within a general time parameter of 60 seconds in order to avoid potential Manning violations. Overbought shares in the proprietary account would trigger Manning obligations for any protectable limit orders the market maker was holding to buy at \$13 or higher. See Question 17.
- 11 See *Notices to Members 98-96 and 99-45*.
- 12 In order for OATS to electronically "match" the OATS Execution Report to the related ACT Regulatory Report, the MPID, Issue Symbol, Execution Date, Execution Time Stamp to the second, and the Branch/Sequence number must match exactly on both reports. For purposes of the ACT Regulatory Reports and related OATS Execution Reports, the time of allocation is entered into the time of execution field.
- 13 For these trades, the Execution Report must be submitted with a Reporting Exception Code of "M" to indicate that no ACT match will take place because the firm did not have the ability, at the time its quote was accessed, to enter a branch/sequence number into the ACT Regulatory Report.
- 14 See footnote 12 as to which elements of the OATS Execution Report and the related ACT Regulatory Report must match.

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