OCTOBER 2005

Notice to Members

Notices

continued

NASD

05-71 SEC Approves NASD Interpretive Material to Rule 9216 regarding NASD's MRVP; **Effective Date: November 14, 2005**

05-72 SEC Approves Amendments to NASD Rule 3150, Regarding Reporting Requirements for Clearing Firms, and NASD Rule 3230, Regarding Requirements for Clearing Agreements; **Effective Date: February 20, 2006**

Disciplinary and Other NASD Actions

Reported for October

NASD Notices to Members is published monthly by NASD Corporate Communications, Michelle Volpe-Kohler, Editor, 1735 K Street, NW, Washington, DC 20006-1506, (202) 728-8289.

Each member firm's Executive Representative is entitled to one annual subscription to *Notices to Members* at cost ($15 per year). Additional annual subscriptions are available for $225; single issues cost $25. To order, send a check or money order (payable to NASD) to NASD MediaSource, P.O. Box 9403, Gaithersburg, MD 20898-9403; to order with a credit card (American Express, MasterCard, or Visa), call (240) 386-4200, Monday to Friday, 9 a.m. to 5 p.m., Eastern Time. Back issues may be ordered by calling MediaSource at (240) 386-4200. Subscribers with questions or concerns may contact NASD Corporate Communications at *gina.cherry@nasd.com*. To make an address change, please contact NASD's CRD Department at (301) 590-6500, or log on to the NASD Contact System at *www.nasd.com/ncs.*

Notices to Members (December 1996 to current) are also available on the Internet at *www.nasd.com*.

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Internal Audit
Legal & Compliance
Operations
Senior Management
Systems
Trading

KEY TOPICS

IM-2110-2
Limit Orders
Manning Rule

GUIDANCE

Manning Obligations

SEC Approves Amendments to IM-2110-2 to Require Members to Provide Price Improvement to Customer Limit Orders in Certain Circumstances and to Expand IM-2110-2 to Exchange-Listed Securities; **Effective Date: January 2, 2006**

Executive Summary

On August 4, 2005, the Securities and Exchange Commission (SEC) approved amendments to Interpretive Material (IM)-2110-2, Trading Ahead of Customer Limit Order (commonly referred to as the "Manning Rule"), to require members to provide price improvement to customer limit orders in certain circumstances and expand the application of IM-2110-2 to exchange-listed securities.[1] IM-2110-2, as amended, is set forth in Attachment A of this *Notice.* The amendments become effective on January 2, 2006.

Questions/Further Information

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

Background and Discussion

IM-2110-2 generally prohibits a member from trading for its own account at prices that would satisfy a customer's limit order, unless the member immediately thereafter executes the customer limit order.[2] The legal underpinnings for IM-2110-2 are a member's basic fiduciary obligations and the requirement that it must, in the conduct of its business, "observe high standards of commercial honor and just and equitable principles of trade."[3]

On August 4, 2005, the SEC approved amendments to IM-2110-2 that require members to provide price improvement to customer limit orders in certain circumstances. Specifically, the amendments require a member that has traded for its own account ahead of a customer limit order that is protected under IM-2110-2 to pass along any price improvement that the member received in the execution of its order. In other words, if the member trades ahead of a customer limit order and receives a better price than the unexecuted customer limit order price, the member must fill the customer limit order at the price at which it traded for its own account or better. For example, if a member buys 100 shares of a security at $10 per share when holding a customer limit order in the same security to buy 100 shares at $10.01 per share, the member is required to fill the customer limit order at $10 per share.

In addition, the amendments expand the application of IM-2110-2 to exchange-listed securities. Rule 6440(f)(2), which generally prohibits members from trading ahead of limit orders in exchange-listed securities, is substantially similar, but not identical to IM-2110-2. To ensure consistency in the application of limit order protection to NASDAQ and exchange-listed securities, the amendments apply IM-2110-2 to exchange-listed securities.[4]

In recognition that the amendments may alter the way that many members handle customer orders, NASD is providing 90 days from this *Notice* for implementation to provide members with adequate time to develop and implement systems to comply with the amendments. As such, the new amendments become effective January 2, 2006.

Endnotes

1 *See* Securities Exchange Act Release No. 52210 (August 4, 2005), 70 FR 46897 (August 11, 2005) (File No. SR-NASD-2004-089).

2 For example, if a member buys 100 shares of a security at $10 per share when holding customer limit orders in the same security to buy at $10 per share equaling, in aggregate, 1,000 shares, the member is required to fill 100 shares of the customer limit orders.

3 *See* NASD Rule 2110. *See also* NASD Rule 2320(a).

4 NASD intends to file a proposed rule change deleting Rule 6440(f)(2), in light of the application of IM-2110-2 to exchange-listed securities.

ATTACHMENT A

Proposed new language is underlined; proposed deletions are in brackets.

IM-2110-2. Trading Ahead of Customer Limit Order

(a) General Applications

To continue to ensure investor protection and enhance market quality, NASD's [the Association's] Board of Governors is issuing an interpretation to NASD [the] Rules [of the Association] dealing with member firms' treatment of their customer limit orders in Nasdaq and exchange-listed securities. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members acting as market makers to handle their customer limit orders with all due care so that market makers do not "trade ahead" of those limit orders. Thus, members acting as market makers that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. [Such orders shall be protected from executions at prices that are superior but not equal to that of the limit order.] In the interests of investor protection, NASD [the Association] is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.[1]

Rule 2110 [of the Association Rules] states that:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 2320, the Best Execution Rule, states that:

In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.

Interpretation

The following interpretation of Rule 2110 has been approved by the Board:

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in a Nasdaq or exchange-listed security and that continues to trade the subject security for its own market-making account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that[, until September 1, 1995, customer limit orders in excess of 1,000 shares received from another member firm shall be protected from the market maker's executions at prices that are superior but not equal to that of the limit order, and provided further, that] a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than $100,000 in value. In the event that a member acting as market maker trades ahead of an unexecuted customer limit order at a price that is better than the unexecuted limit order, such member is required to execute the limit order at the price received by the member or better. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

By rescinding the safe harbor position and adopting this interpretation, NASD [the Association] wishes to emphasize that members may not trade ahead of their customer limit orders in their market-making capacity even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. NASD [The Association] believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer's order. The terms and conditions under which institutional account or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm's market-making capacity does not occur. [For purposes of this interpretation, a member that controls or is controlled by another member shall be considered a single entity so that if a customer's limit order is accepted by one affiliate and forwarded to another affiliate for execution, the firms are considered a single entity and the market-making unit may not trade ahead of that customer's limit order.]

As outlined in NASD Notice to Members 97-57, the minimum amount of price improvement necessary in order for a market maker to execute an incoming order on a proprietary basis when holding an unexecuted limit order for a Nasdaq security trading in fractions, and not be required to execute the held limit order, is as follows:

- If actual spread is greater than 1/16 of a point, a firm must price improve an incoming order by at least a 1/16. For stocks priced under $10[,] (which are quoted in 1/32 increments), the firm must price improve by at least 1/64.

- If actual spread is the minimum quotation increment, a firm must price improve an incoming order by one-half the minimum quotation increment.

For Nasdaq securities authorized for trading in decimals pursuant to the Decimals Implementation Plan For the Equities and Options Markets, the minimum amount of price improvement necessary in order for a market maker to execute an incoming order on a proprietary basis in a security trading in decimals when holding an unexecuted limit order in that same security, and not be required to execute the held limit order, is as follows:

1) For customer limit orders priced at or inside the best inside market displayed in Nasdaq, the minimum amount of price improvement required is $0.01; and

2) For customer limit orders priced outside the best inside market displayed in Nasdaq, the market maker must price improve the incoming order by executing the incoming order at a price at least equal to the next superior minimum quotation increment in Nasdaq (currently $0.01).

NASD [The Association] also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders are executed through the member's market-making capacity or sent to another member for execution. As set out above, the Best Execution Rule requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. NASD[The Association] emphasizes that order entry firms should continue to routinely monitor the handling of their customers' limit orders regarding the quality of the execution received.

(b) and (c) No change.

1 For purposes of [the pilot program expanding]the operation of certain Nasdaq transaction and quotation reporting systems and facilities [in SR-NASD-99-57]during the period from 4 p.m. to 6:30 p.m. Eastern Time, members may generally limit the life of a customer limit order to the period of 9:30 a.m. to 4 p.m. Eastern Time. If a customer does not formally assent ("opt-in") to processing of [their]the customer's limit order(s) during the extended hours period commencing after the normal close of the Nasdaq market, limit order protection will not apply to that customer's order(s).

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

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

KEY TOPICS

Business Development Company
Direct Participation Program
Foreign Investment Company
IPO Distribution Manager
IPOs
New Issue Definition
New Issue Rule
Real Estate Investment Trust
Rule 2790

GUIDANCE

"New Issue" Rule

SEC Approves Amendments Relating to Rule 2790; **Effective Date: November 2, 2005**

Executive Summary

On August 4, 2005, the Securities and Exchange Commission (SEC) approved amendments to subparagraph (i)(9) of Rule 2790 to exclude from the definition of "new issue" securities offerings of a business development company (BDC), a direct participation program (DPP) and a real estate investment trust (REIT).[1] The SEC also approved a technical change to the exemption for foreign investment companies in subparagraph (c)(6) of Rule 2790 to clarify the scope of the exemption as reflected in an NASD staff memorandum dated August 6, 2004 (Staff Memorandum). In addition, the SEC approved amendments to Rule 2790 to codify the filing requirement for distribution information.

The rule, as amended, is set forth in Attachment A. The amendments become effective on **November 2, 2005**.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel (OGC), Regulatory Policy and Oversight (RPO), at (202) 728-8104; or Afshin Atabaki, Counsel, OGC, RPO, at (202) 728-8902.

Background and Discussion

Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities), which has been in effect on a mandatory basis since March 23, 2004 and replaces the Free-Riding and Withholding Interpretation (IM-2110-1), is designed to protect the integrity of the public offering process by ensuring that: (1) NASD members make bona fide public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including NASD members and their associated persons, do not take advantage of their insider position to purchase "new issues" for their own benefit at the expense of public customers. The rule plays an important part in maintaining investor confidence in the capital raising and public offering process.

Securities Offerings of BDCs, DPPs and REITs

Since its adoption, the definition of "new issue" in subparagraph (i)(9) of Rule 2790 has excluded, among other things, securities offerings of closed-end investment companies registered under the Investment Company Act of 1940 (the Investment Company Act). This exclusion is based on the fact that securities of closed-end investment companies typically commence trading at the public offering price with little potential for trading at a premium because the fund's assets at the time the initial public offering trades consist of the capital the fund has raised through the offering process. Moreover, if there is a premium, it is generally small. Including such offerings within the scope of Rule 2790 would do little to further the purposes of the rule and, moreover, may impair the ability of such companies to obtain capital. For similar reasons, as discussed below, NASD has amended subparagraph (i)(9) of Rule 2790 to exclude from the definition of "new issue" securities offerings of BDCs as defined in Section 2(a)(48) of the Investment Company Act,[2] DPPs as defined in NASD Rule 2810(a)(4), and REITs as defined in Section 856 of the Internal Revenue Code (the Code).[3]

BDCs

Through the passage of the Small Business Investment Incentive Act of 1980 and the corresponding amendments to the Investment Company Act, Congress enacted a regulatory structure for BDCs in an effort to encourage capital investment in small, developing businesses and financially troubled businesses.[4] A BDC is defined as a domestic, closed-end investment company that is operated for the purpose of making investments in small and developing businesses and financially troubled businesses; that must make available significant managerial assistance to certain of its portfolio companies; and that has notified the SEC of its election to be subject to the provisions of Sections 55 through 65 of the Investment Company Act.[5] While a BDC technically is not registered under the Investment Company Act, it is subject to many of the same requirements that are applicable to registered investment companies.[6] Section 55 of the Investment Company Act,[7] in part, describes the securities in which a BDC can invest. These securities generally must comprise at least 70 percent of the value of the BDC's investment assets and include securities of certain companies, cash, cash items, U.S.

government securities and high-quality debt instruments. The companies in which a BDC can invest are primarily "eligible portfolio companies" as defined in Section 2(a)(46) of the Investment Company Act,[8] which generally include small, developing businesses and financially troubled businesses. Further, BDCs are similar to registered closed-end investment companies in that a BDC's primary asset at the time its initial public offering trades is the capital it has raised through the offering process. Thus, like registered closed-end investment companies, BDCs generally commence trading at their public offering price and premiums, if any, tend to be very small.

DPPs and REITs

A DPP, as defined in Rule 2810(a)(4), is a program that provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution, including, but not limited to, oil and gas programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.

Rule 2810 excludes REITs from the definition of a DPP. A REIT is a recognized investment vehicle for income-generating real estate, and it is allowed to benefit from the tax advantages of a trust as long as certain asset, income and distribution criteria have been satisfied as set forth in the Code.[9] For instance, pursuant to the Code, at least 75 percent of a REIT's gross income must be derived from real estate, and at least 75 percent of the value of its total assets must be represented by real estate assets, cash and cash items, and government securities.[10]

Nearly all DPPs and a few REITs, at the time of their initial public offering, have no invested assets. Like registered closed-end funds, the primary asset of these DPPs and REITs immediately following the public offering is the capital raised in the offering. As such, the initial public offerings of *these* DPPs and REITs typically do not open at a premium. By contrast, most REITs making an initial public offering have invested assets upon consummation of the offering. Nevertheless, because these assets (*e.g.*, rental properties or mortgage portfolio) generally have a reasonably determinable market value, it is rare that REITs, even those with invested assets, will commence trading at a significant premium. Moreover, investors typically invest in REITs for income rather than capital appreciation, which may further limit premiums in the immediate aftermarket.

For these reasons, NASD has amended the definition of "new issue" under subparagraph (i)(9) of Rule 2790 to exclude securities offerings of all BDCs, DPPs and REITs. As noted above, NASD staff has found that historically most of these offerings have not traded at a substantial premium. If warranted by future developments in the trading pattern of such securities in the immediate secondary market, however, NASD would reconsider the appropriateness of a blanket exclusion for these types of offerings.

Foreign Investment Company Exemption

NASD also has amended the exemption for foreign investment companies in subparagraph (c)(6) of Rule 2790 to clarify the scope of the exemption as reflected in the Staff Memorandum. The Staff Memorandum was prepared in response to inquiries about whether the foreign investment company exemption would apply to various hedge funds and other funds exempt from registration under the Investment Company Act that were listed on a foreign exchange (such as the Irish Stock Exchange). In the Staff Memorandum, NASD staff explained that the foreign investment company exemption is intended to extend to foreign investment companies that are similar to U.S. registered investment companies.[11] NASD staff further explained that the exemption for foreign investment companies extends only to an investment company organized under the laws of a foreign jurisdiction that is either "listed on a foreign exchange for sale to the public" or "authorized for sale to the public," and that does not have any restricted person that beneficially owns more than 5 percent of the company's shares.

The Staff Memorandum also reiterated the position in *Notice to Members (NTM) 03-79* that a foreign investment company that is limited to select investors would not be considered as "for sale to the public." NASD staff has explained that foreign investment companies that are limited to high net worth individuals are not eligible for the foreign investment company exception. Inasmuch as U.S. registered investment companies are not limited to sale to high net worth individuals, it would be inconsistent to permit foreign investment companies to impose such requirements and still avail themselves of the exemption provided for foreign investment companies under Rule 2790. None of the reasons underlying the exemption for U.S. registered investment companies, such as broad public ownership, the difficulty in identifying beneficial owners, the ability of any public investor to purchase an interest in the investment company and the generally negligible interest of any single restricted person, are likely to be present with a foreign investment company offered only to high net worth individuals. Moreover, the purposes of Rule 2790 could easily be frustrated by purchases of large quantities of a new issue by a foreign investment company listed on a foreign exchange that is owned entirely or principally by broker-dealer personnel (or other restricted persons). A foreign investment company that is limited to select investors would, however, be eligible to purchase new issues in accordance with the *de minimis* exemption set forth in subparagraph (c)(4) of Rule 2790. While the text of Rule 2790, *NtM 03-79* and the rulemaking history of the foreign investment company provision support the interpretation provided in the Staff Memorandum, NASD has amended subparagraph (c)(6) of Rule 2790 to expressly state that the foreign investment company exemption is available to an investment company organized under the laws of a foreign jurisdiction, provided that the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority, and that no person owning more than five percent of the shares of the investment company is a restricted person.

Filing Requirement for Distribution Information

In 1996, NASD initiated a regulatory service, "NASDesk," for members to transmit underwriting commitment and retention information to NASD's Free-Riding Regulatory Database. NASD communicated with members regarding the "hot issue" status of initial public offerings using a companion system, "Compliance Desk."[12] To coincide with the implementation of Rule 2790, NASD replaced NASDesk/Compliance Desk with a new system for members to submit new issue distribution information named "IPO Distribution Manager."[13] IPO Distribution Manager is a Web-based application that permits the book-running managing underwriter to transmit distribution information to NASD through Web COBRA, the Web-based filing system that members are required to use when filing information about initial public offerings under the Corporate Financing Rule (Rule 2710). NASD has amended Rule 2790 to codify the requirement for the book-running managing underwriter to file distribution information as announced in *NtM 04-20.*

Endnotes

1 *See* Securities Exchange Act Release No. 52209 (August 4, 2005), 70 FR 46557 (August 10, 2005) (Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to NASD Rule 2790; File No. SR-NASD-2004-165).

2 15 U.S.C. 80a-2(a)(48).

3 26 U.S.C. 856.

4 *See* Investment Company Act Release No. 11493 (December 16, 1980), 45 FR 83479 (December 19, 1980).

5 *See* Section 2(a)(48) of the Investment Company Act; 15 U.S.C. 80a-2(a)(48).

6 For example, in December 2003, the SEC adopted a new rule under the Investment Company Act that requires each registered investment company as well as each BDC to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the policies and procedures. *See* Investment Company Act Release No. 26299 (December 17, 2003), 68 FR 74714 (December 24, 2003) (Final Rule Relating to Compliance Programs of Investment Companies and Investment Advisers).

7 15 U.S.C. 80a-54.

8 15 U.S.C. 80a-2(a)(46).

9 *See* Section 856 of the Code; 26 U.S.C. 856.

10 *Id.*

11 In *NTM 97-30* (May 1997), which proposed the foreign investment company exception in the Free-Riding and Withholding Interpretation, IM-2110-1 (the predecessor to Rule 2790), NASD stated that:

> Purchases of shares of investment companies registered under the Investment Company Act of 1940 (1940 Act) are exempt from the restrictions of the Interpretation. The rationale for this existing provision is that the interest of any one restricted person in an investment company ordinarily is de minimis and that, because the ownership of investment company shares generally is subject to frequent turnover, determining compliance with the Interpretation would be extremely difficult in this context. *NASD Regulation is proposing to extend this rationale to the purchase of shares of foreign entities that are similar to U.S. investment companies.* (Emphasis added.)

Likewise, in *NTM 03-79* (December 2003), which announced the SEC's approval of Rule 2790, NASD explained that "the foreign investment company exception is intended to extend benefits to foreign investment entities that are similar to U.S. mutual funds."

12 *See NTM 96-18* (March 1996).

13 *See NTM 04-20* (March 2004).

ATTACHMENT A

New language is underlined; deleted language is in brackets.

2790. Restrictions on the Purchase and Sale of Initial Equity Public Offerings

(a) through **(b)** No Change.

(c) General Exemptions

The general prohibitions in paragraph (a) of this rule shall not apply to sales to and purchases by the following accounts or persons, whether directly or through accounts in which such persons have a beneficial interest:

(1) through (5) No Change.

(6) An investment company organized under the laws of a foreign jurisdiction, provided that:

(A) the investment company is listed on a foreign exchange <u>for sale to the public</u> or authorized for sale to the public by a foreign regulatory authority; and

(B) no person owning more than 5% of the shares of the investment company is a restricted person;

(7) through (10) No Change.

(d) through **(h)** No Change.

(i) Definitions

(1) through (8) No Change.

(9) "New issue" means any initial public offering of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular. New issue shall not include:

(A) offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act of 1933, or SEC Rule 504 if the securities are "restricted securities" under SEC Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;

(B) offerings of exempted securities as defined in Section 3(a)(12) of the Act, and rules promulgated thereunder;

(C) offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;

(D) rights offerings, exchange offers, or offerings made pursuant to a merger or acquisition;

(E) offerings of investment grade asset-backed securities;

(F) offerings of convertible securities;

(G) offerings of preferred securities;

(H) offerings of an investment company registered under the Investment Company Act of 1940; [and]

(I) offerings of securities (in ordinary share form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States[.]; and

(J) offerings of a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940, a direct participation program as defined in NASD Rule 2810(a)(4), or a real estate investment trust as defined in Section 856 of the Internal Revenue Code.

(10) No Change.

(j) Information Required to be Filed

(1) The book-running managing underwriter of a new issue shall be required to file the following information in the time and manner specified by NASD with respect to new issues:

(A) the initial list of distribution participants and their underwriting commitment and retention amounts on or before the offering date; and

(B) the final list of distribution participants and their underwriting commitment and retention amounts no later than three business days after the offering date.

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Continuing Education

Legal & Compliance

Operations

Registered Representatives

Registration

Senior Management

Training

KEY TOPICS

Branch Office Registration

Central Registration Depository (CRD® or Web CRD)

Form ADV

Form BR (Uniform Branch Office Registration Form)

Form U4 (Uniform Application for Securities Industry and Transfer)

Form U5 (Uniform Termination Notice for Securities Industry Registration)

Investment Adviser Registration Depository (IARD®)

NYSE Branch Office Application Form

GUIDANCE

Branch Office Registration

SEC Approves Uniform Branch Office Registration Form (Form BR) and Conforming and Technical Changes to Forms U4 and U5; **Effective Date: October 31, 2005**

Executive Summary

The Securities and Exchange Commission (SEC) has approved the Form BR and technical changes to the Form U4 and Form U5.[1] The Form BR replaces Schedule E of the Form BD, the current New York Stock Exchange, Inc. (NYSE) Branch Office Application Form and certain state branch office forms, and will enable firms to register branch offices electronically with NASD, the NYSE and states that require branch registration or reporting via a single filing through the CRD system.

This *Notice* gives an overview of the new Form BR and revisions to the Forms U4 and U5. The *Notice* also provides members with a timetable and guidance to assist them in the transition from existing branch forms to the Form BR. Copies of the new forms are available on NASD's Web site at *www.nasd.com/crdbranchoffice*.

The new Form BR and the revised Forms U4 and U5 become effective on **October 31, 2005**. However, as described below, NASD will begin the transition process to the Form BR for branch offices in existence as of the close of business on **October 14, 2005**.

Questions/Further Information

Questions concerning this *Notice* may be directed to Chip Jones, Vice President, Registration and Disclosure (RAD), at (240) 386-4797; Richard E. Pullano, Associate Vice President/Chief Counsel, RAD, at (240) 386-4821; or Stefanie M. Watkins, Senior Counsel, RAD, at (240) 386-4824.

Background and Discussion

Branch Registration and Reporting

The Form BR replaces Schedule E of the Form BD, the current NYSE Branch Office Application Form, and certain state branch office forms. Consistent with the uniform form concept, the Form BR will enable firms to register or report[2] branch offices electronically with NASD, the NYSE, and states that require branch registration or reporting, via a single filing through the CRD system.[3] Branch office registration through the CRD system will create efficiencies for firms by, among other things, making it easier for firms to register or report branch offices and to manage their ongoing registration and/or reporting responsibilities with regard to those branch offices. For example, in addition to being able to submit a single filing to fulfill the branch office registration requirements of NASD, the NYSE and states, firms will benefit from the centralized fee collection, online work queues, electronic notifications and other features available through the CRD system.

In preparation for the transition to the Form BR, NASD has been working with participating regulators and firms to identify existing branch offices for participating SROs and jurisdictions. As further detailed below, to assist firms in making the transition to the Form BR, NASD will use data previously filed on Schedule E, the NYSE Branch Office Application Form, and/or state branch office forms to create a "conversion" Form BR on the CRD system for all branch offices in existence as of the close of business on October 14, 2005.

Timetable for the Transition to the Form BR

October 14, 2005 is the last day NASD member firms may file a new or amended Schedule E through the CRD system. The CRD system will invalidate any new Schedule E filings or amendments to Schedule E that are in a "pending" status on October 15, 2005.[4] For information regarding the NYSE's filing protocols during the Form BR transition, see *www.nyse.com*. For information on state filing protocols for transitioning to Form BR, see *www.nasaa.org*.

"Lock-out" Period (October 15, 2005 through October 30, 2005). There will be a two-week lock-out period beginning October 15, 2005 through October 30, 2005, so that NASD can begin the transition process to the Form BR for branch offices in existence as of the close of business on October 14, 2005. During the lock-out period, NASD will create a conversion Form BR on the CRD system for all branch offices in existence as of the close of business on October 14, 2005. NASD will assign a unique branch CRD number to each of these branches and pre-populate the conversion Forms BR with limited information for each of these branches.[5] During this lock-out period, the CRD system will not accept any branch office forms or amendments via any of the current forms or Form BR.

Form BR Availability (starting on October 31, 2005). Starting on October 31, 2005, the new branch office functionality will be available in the CRD system, and firms will be able to file Forms BR for each of their branch offices. Beginning on that date, firms with branch offices in existence prior to the close of business on October 14, 2005 may: (1) complete the data fields for each conversion Form BR created by NASD during the lock-out period, and (2) file the completed Forms BR through CRD.

Also, starting on October 31, 2005, firms may register any new branch offices opened during the lock-out period or thereafter (*i.e.*, branch offices established on or after October 15, 2005).

In addition, firms will be able to amend Forms U4 to assign each registered person to a registered branch office. Firms may assign registered persons to branches by means of either individual Form U4 filings or an electronic file transfer (*i.e.*, a "batch" filing) established exclusively for this purpose. See *www.nasd.com/crdbranchoffice* for more details on the available filing alternatives.

Compliance with Form BR and Form U4 Filing Requirements for Branch Offices in Existence as of the Close of Business on October 14, 2005 (May 1, 2006 deadline). Firms with branch offices in existence prior to the close of business on October 14, 2005 will have until May 1, 2006 to comply with the Form BR and Form U4 filing requirements for those branch offices. Therefore, by May 1, 2006, these firms must have: (1) completed and filed the conversion Form BR for each such branch; and (2) with respect to the registered persons employed by such branches, amended all applicable Forms U4 to assign these registered persons to the branch office(s) (or other locations) from which they work (either through individual Form U4 filings or via batch filing described above).

Compliance with Form BR and Form U4 Filing Requirements for Branch Offices Established On Or After October 15, 2005. Starting on October 31, 2005, firms must file a Form BR to register any new branch office opened on or after October 15, 2005.[6] Once a firm has filed a Form BR, the new branch will be established on the CRD system, and CRD will automatically populate the "Office of Employment Address" of the Form U4 for each person identified in Section 5 (Associated Individuals) of the Form BR. Individuals identified in this section will populate a dynamic "branch roster" of registered persons in CRD. After filing the initial Form BR, firms will be required to submit amended or new Forms U4, as appropriate, to assign additional registered persons to the branch, and the CRD system will automatically update the "branch roster" of registered persons in Web CRD.[7]

The Form BR

Types of Filings

There are three types of Form BR filings. Firms may make (1) an "initial" filing (to apply for approval of or report a branch office), (2) an "amendment" filing (to amend information previously filed), and (3) a "closing/withdrawal" filing (to terminate a branch office registration and/or to withdraw an initial filing prior to approval by a state or SRO). The Form BR *General Instructions* include electronic filing and paper filing instructions. Paper filings are permitted in certain state jurisdictions only.[8] The *Specific Instructions* describe how firms should complete each section of the Form BR. Words that are defined in the *Explanation of Terms* section are italicized throughout the Form BR for easy reference. The Form BR adopts, to the extent possible, the "explained terms" used on the existing uniform registration forms. The Form BR also includes definitions of additional terms used in the context of branch office registration and reporting, including the terms "closing," "person-in-charge," "regular branch," "small branch," "supervisor" and "withdrawal."[9]

Description of the Form BR

As described below, the Form BR consists of the following nine sections:

Section 1 (General Information):

Section 1 reports the applicant's CRD Number, name, address, billing code, branch address and telephone number. Using information provided to the CRD system on Form BD, or to IARD on Form ADV, NASD will pre-populate the applicant/firm's CRD Number and main office address. The CRD system will assign a unique CRD Branch Number. Firms must provide the physical location (*i.e.*, address), and telephone number of the branch. If the firm is an NYSE member firm, it must also provide an NYSE Branch Code Number, and may provide an internal billing code (the billing code field is optional).

Section 2 (Registration/Notice Filing/Type of Office):

Section 2 asks the applicant to state where the branch will be registered (or notice filed), the type of branch office registration and whether it is an NASD office of supervisory jurisdiction (OSJ). If it is not an OSJ, the applicant is required to provide the CRD Branch Number of the OSJ that has supervisory responsibility over the branch and the CRD Number of the supervisor in charge of that OSJ.

Based upon the applicant's current registrations as provided to CRD on Form BD or as provided to IARD on Form ADV, the CRD system will pre-populate the checkbox(es) for the applicable SRO(s) and/or jurisdiction(s) with which the applicant may be required to register or report the branch office. If the applicant is not required to register or report the branch office with an SRO and/or jurisdiction, it may remove the registration request. If a firm unchecks the NYSE registration box, the firm must attest "that it is not required under NYSE rules to register this branch information location with the NYSE." If the applicant is registering the branch with a jurisdiction, it must indicate whether it is a broker-dealer and/or investment adviser. Firms must also provide the names of all supervisors and/or persons-in-charge.

Section 3 (Types of Activities/Other Business Names/Web Sites):

Firms must name the financial industry activities conducted by the applicant and any investment-related activities conducted by associated persons at the branch location. Firms must also provide the names being used by any associated person to conduct financial industry business at the branch office other than those names disclosed on the member firm's Form BD or Form ADV. In addition, firms must provide Web site addresses used by the branch office other than the applicant's primary Web site address.

Section 4 (Branch Office Arrangements):

Firms must provide information relating to branch office arrangements, including space-sharing arrangements and liability for expenses. Section 4 does not require member firms to report insurance agency agreements with the main office pursuant to which the branch operates.

Section 5 (Associated Individuals):

Firms are required to complete this section only when making an initial Form BR filing. In such cases, firms must provide the CRD numbers of all registered individuals who will be associated with the branch. "Associated individuals" who are supervisors or persons-in-charge should be reported in Section 2 (Registration/Notice Filing/Type of Office). Individuals identified by a firm in this section will populate a dynamic branch roster of registered persons in Web CRD, which will be made available to that firm. Once the branch has been established, changes to the branch roster will be automatically made through Web CRD when (1) the "Office of Employment Address" question on a registered person's Form U4 is amended when an individual leaves a branch for another branch,[10] or (2) a Form U5 is filed to terminate the registration of that individual.

Section 6 (NYSE Branch Information):

With respect to NYSE member firms, the Form BR incorporates the information previously elicited on both the NYSE's Branch Office Application and office space-sharing forms. The CRD system will interact with the NYSE's internal branch office system when firms submit NYSE branch office registration filings and provide NYSE staff with the opportunity to review such filings. The NYSE's current protocol for requesting approval for new branch offices will not change; NYSE member firms will be required to use the Form BR to request such approvals, and the information provided by NYSE member firms will be transmitted to the NYSE, which, in turn, will communicate its determinations (*e.g.*, approvals) back through the CRD system.[11] Only NYSE member firms will be able to access (*i.e.*, view/file/complete) questions in Section 6 (NYSE Branch Information).

Section 7 (Branch Closing):

To close a branch office, firms must provide the date operations ceased (or will cease), the location of the branch's books and records and contact information. Prior to closing a branch, the CRD system will require firms to reassign the individuals associated with that branch to another branch or to terminate their registrations.

Section 8 (Branch Withdrawal/Pending Application):

To withdraw a pending request for branch office registration, firms must provide the date of withdrawal, the reason for the withdrawal, and name and telephone number of the contact person.

Section 9 (Signature):

The appropriate signatory of the firm must attest to the completeness and accuracy of the Form BR filing by executing the signature section.

Forms U4 and U5 Conforming and Technical Changes

Effective October 31, 2005, NASD also is implementing CRD system enhancements and Forms U4 and U5 changes to parallel the information reported on Form BR, and to ensure the accuracy and integrity of the link between registered representatives and their branches.[12] These changes will enable member firms to more effectively designate, and users to more easily identify, the branch office(s) to which a particular registered representative is assigned by ensuring that a registered person's Office of Employment Address in the "General Information" section of the Form U4 is a branch office established on the CRD system via Form BR. If a registered person is physically located at an office that is not required to be registered as a branch, the individual must provide the address of the non-registered location, and the branch office that supervises the non-registered location. Firms may file an amended Form U4 to reflect a change to an individual registered person's branch office assignment by noting the new branch in that person's Office of Employment Address (provided the new branch office has been previously established on the CRD system through the filing of Form BR).

NASD plans to assist firms in completing the process of linking registered persons to branch offices in the CRD system by May 1, 2006, by enabling firms to submit electronic data files (*i.e.*, batch files) through a process established by NASD exclusively for this purpose. Firms making such submissions will be asked to provide the CRD numbers of a firm's registered persons, along with the CRD branch number that corresponds to the registered person's Office of Employment Address. Because the Form U4 is being amended to include a new question eliciting whether a registered person is an independent contractor, member firms may also indicate whether the registered person is an independent contractor in this data file. For more information about these procedures, please see *www.nasd.com/crdbranchoffice.*

During the conversion (lock-out) period, individuals registered with firms that have not registered or reported any branch offices as of the close of business on October 14, 2005, will be assigned by the CRD system to the firm's main office as reported on the Form BD or Form ADV. Firms will be able to report a new Office of Employment Address for multiple registered persons assigned to a branch office that has moved to a new location by filing an amended Form BR (rather than filing Form U4 amendments for each of the registered persons affected).

The registration positions of Research Analyst (RS) and Research Principal (RP) have been added to Forms U4 and U5. In addition, the following Pacific Stock Exchange positions were added: Market Maker (44); Floor Broker (45); and Market Maker acting as a Floor Broker (46). The Forms also include reference to the National Stock Exchange (NSX) (formerly Cincinnati Stock Exchange (CSE)). Finally, Section 6 (Regulatory Requests with Affiliated Firms) on Form U4 has been revised to reorder in a more logical format the electronic filing representations for submitting a fingerprint for registration with an affiliated firm.

Endnotes

1 *See* Exchange Act Release No. 52544 (September 30, 2005) (Order Granting Approval of Proposed Rule Change Relating to Proposed Form BR (Uniform Branch Office Registration form) and Conforming Changes and Technical Revisions to the Form U4 and Form U5); File No. SR-NASD-2005-030) (SEC Approval Order).

2 Although these terms may be used interchangeably by self-regulatory organizations (SROs) and/or states, "registration" typically refers to a process that requires an approval by the SRO or state before a branch may begin doing business, whereas "reporting" typically refers to a process by which firms "notice file" or notify an SRO or state of the existence of a branch office, but an approval is not required.

3 For information on which states will accept Form BR for branch office registration, see the North American Securities Administrators Association (NASAA) Web site at *www.nasaa.org*.

4 CRD will invalidate any Schedule E filing that has been started, but not filed, through CRD by the close of business on October 14, 2005.

5 The conversion process will download the following fields from existing data in CRD or IARD, as well as data provided from the NYSE and participating states: Branch Address, NASD Branch Number, NYSE Branch Code Number, NYSE Branch Type, NASD/NYSE Supervisor/Person-In-Charge Name and CRD Number, Operational Status and NYSE/Jurisdiction Registration Status.

6 Article IV, Section 8 of the NASD By-Laws requires firms to report the opening of a branch office not later than 30 days after the branch is opened.

7 Article V, Section 2 of the NASD By-Laws requires amendments to the Form U4 to be filed within 30 days after learning of the facts or circumstances giving rise to the amendment. The Specific Instructions for completing the Form U4, as amended, address procedures for updating the Form U4 to include all branch office addresses at which the individual is employed.

8 For information on which states require or permit paper filings of Form BR, see NASAA's Web site at *www.nasaa.org*.

9 Certain of these terms were included in the NYSE Branch Office Application Form.

10 The new branch office must be one that has been established on the CRD system through the filing of a Form BR.

11 Questions concerning the NYSE's branch office procedures should be addressed to Evelyn Kriegel, Director, NYSE, at (212) 656-6444.

12 The Form U5 Specific Instructions have been amended under Section 1 (General Information) and Section 6 (Registration Requests with Affiliated Firms) to clarify that the Office of Employment address will pre-populate based on information provided on a Form U4.

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Continuing Education
Legal & Compliance
Operations
Registered Representatives
Registration
Senior Management
Training

KEY TOPICS

Branch Office Definition
Branch Office Registration
Central Registration Depository (CRD® or Web CRD)
Form BR (Uniform Branch Office Registration Form)
IM-3010-1
Internal Inspections
Rule 3010
Supervision

GUIDANCE

Branch Office Definition

SEC Approves Uniform Branch Office Definition and Related Interpretive Material; **Effective Date: May 1, 2006**

Executive Summary

On September 9, 2005, the Securities and Exchange Commission (SEC) approved (1) amendments to Rule 3010(g)(2) to revise the definition of "branch office" (Uniform Definition); and (2) adoption of IM-3010-1 to provide guidelines on factors to be considered by a member in conducting internal inspections of offices.[1] The SEC simultaneously approved amendments to the New York Stock Exchange, Inc.'s (NYSE) Rule 342 (Offices—Approval, Supervision and Control) to provide a new, uniform industry definition of the term "branch office."[2]

In addition, there has been a coordinated effort by regulators to develop a new centralized branch office registration system through the Central Registration Depository (CRD) to provide a more efficient, standardized method for members to register branch office locations as required by the rules and regulations of states and self-regulatory organizations (SROs), including NASD. To facilitate the development of this system, NASD filed a rule proposal with the SEC to adopt new Form BR, which will replace Schedule E of the Form BD, the current NYSE Branch Office Application Form, and certain state branch office forms.[3] The SEC approved such rule filing on September 30, 2005.[4] Form BR will enable firms to register or report[5] branch offices electronically with NASD, the NYSE and states that require branch registration or reporting, via a single filing through the CRD system.[6]

The amendments are part of NASD's rule modernization initiative to streamline and update NASD rules while preserving investor protections. The amendments establish a broader national standard and are the product of a coordinated effort among regulators to reduce inconsistencies in the definitions used by the SEC, NASD, the NYSE, the North American Securities Administrators Association (NASAA) and state securities regulators to identify locations where broker-dealers conduct securities or investment banking business.

A copy of the amended rule text is attached hereto as Exhibit A.

Effective Date

The amendments will become effective on **May 1, 2006**. The current definition of "branch office" as set forth in Rule 3010(g)(2) will remain in effect until **April 30, 2006**.

Questions/Further Information

Questions concerning this *Notice* may be directed to Chip Jones, Vice President, Registration and Disclosure (RAD), at (240) 386-4797; Richard E. Pullano, Associate Vice President/Chief Counsel, RAD, at (240) 386-4821; or Kosha K. Dalal, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-6903.

Background and Discussion

Background of Amendments

Historically, various regulatory bodies have defined the term "branch office" differently. The conflicting requirements that resulted from such disparate definitions created regulatory burdens on members, such as the need to file different application forms with multiple regulatory organizations in order to register or renew the registration of branch office locations, as well as having to coordinate differing registration and notification filing deadlines. The amendments are intended to alleviate these burdens by standardizing the criteria to be applied when determining whether or not a business location requires registration as a branch office.

In addition to the amendments discussed in this *Notice*, there has similarly been a coordinated effort by NASD, the NYSE and NASAA to standardize the branch office application process. Specifically, the securities industry will shortly be making the transition to a centralized, CRD-based branch office application system that will allow members, via new Form BR, to submit a single filing in order to simultaneously fulfill the branch office reporting and/or registration requirements of NASD, the NYSE and most states.[7] In this regard, firms will also benefit from online work queues, electronic notifications and other features available through the CRD system.[8]

Current Definition of "Branch Office" (in effect until April 30, 2006)

Prior to the effective date of the amendments, NASD's current definition of "branch office" continues in effect. As of May 1, 2006, the Uniform Definition becomes effective, and members must have a completed Form BR filed for each location that meets the amended definition.

NASD designates locations from which associated persons work as either branch offices or unregistered offices/locations. As currently defined, a "branch office" is any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business. The definition provides that the following activities will not be deemed "holding out" and, therefore, will not trigger registration of the location as a branch office: (1) a location identified in a telephone directory, business card or letterhead; (2) a location referred to in a member advertisement; (3) a location identified in a member's sales literature; and (4) any location where a person conducts business on behalf of the member only occasionally; provided, in each case, the phone number and address of the branch office or Office of Supervisory Jurisdiction (OSJ) that supervises the location is also identified.

A branch office is further classified under Rule 3010(g)(1) as an OSJ if any one of the following enumerated activities occurs at the location: (1) order execution and/or market making; (2) structuring of public offerings or private placements; (3) maintaining custody of customers' funds and/or securities; (4) final acceptance (approval) of new accounts on behalf of the member; (5) review and endorsement of customer orders; (6) final approval of advertising or sales literature for use by associated persons; or (7) responsibility for supervising associated persons at other branch offices.[9] An office that is designated an OSJ must have a registered principal on-site and be inspected on an annual basis.[10]

Uniform Definition (to become effective May 1, 2006)

The language of the Uniform Definition substantially mirrors the SEC's definition of "office" in its "Books and Records" rules (*see* Rules 17a-3 and 17a-4)[11] under the Securities Exchange Act of 1934.[12] The Uniform Definition does not alter or affect the obligations of a member to comply with the minimum requirements of the Books and Records Rules which specify the records broker-dealers must make, and how long those records and other documents relating to a broker-dealer's business must be kept.

The Uniform Definition defines a "branch office" as any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or that is held out as such.

Exemptions from Branch Office Registration

In developing the Uniform Definition, regulators understood the need to provide reasonable exceptions from branch office registration that take into account technological innovations and current business practices without compromising the need for investor protection. NASD believes the exceptions from branch office registration are practically based while still containing important safeguards and limitations to protect investors.

Accordingly, as further detailed below, the Uniform Definition excludes from registration as a branch office: (1) a location that operates as a non-sales location/back office; (2) a representative's primary residence provided it is not held out to the public and certain other conditions are satisfied; (3) a location, other than the primary residence, that is used for less than 30 business days annually for securities business, is not held out to the public as an office, and which satisfies certain of the conditions set forth in the primary residence exception; (4) a location of convenience used occasionally and by appointment; (5) a location used primarily for non-securities business and from which less than 25 securities transactions are effected annually; (6) the floor of an exchange; and (7) a temporary location used as part of a business continuity plan.

Non-Sales Locations/Back Offices

Rule 3010(g)(2)(A)(i) exempts non-sales locations from branch office registration. Such locations must be established solely for customer service and/or back office functions and may not be held out to the public as a branch office. No sales activities may be conducted from a non-sales location, which is to say that associated persons conducting business on behalf of a member from such locations may not recommend the purchase or sale of securities, otherwise communicate with the public, accept orders for the purchase or sale of securities or execute such orders.

Primary Residences

Rule 3010(g)(2)(A)(ii) exempts from the definition of branch office any location that is the associated person's primary residence. Only one associated person, or multiple associated persons who reside at the location and are members of the same immediate family, may conduct business from the location. Each member must maintain a current list of any such locations, which are subject to the following specific safeguards and limitations:

- The location may not be held out as an office.
- The associated person(s) may not meet with customers at the location.
- Neither customer funds nor securities may be handled at the location.
- The associated person or persons are assigned to a designated branch office, which is reflected on all business cards, stationery, advertisements and other communications to the public.

- All communications with the public must be subject to supervisory provisions pursuant to all applicable NASD rules (including, but not limited to, Rule 3010).
- Electronic communications must be transmitted through the member's electronic system.
- All orders must be entered through the designated branch office or through an electronic system established by the member that is reviewable at such branch office.
- Written procedures relating to the supervision of sales activities conducted at the location must be maintained by the member.

Locations Other than Primary Residences

Rule 3010(b)(2)(A)(iii) exempts from branch office registration any location, other than primary residences, provided it is used for securities-related activities less than 30-business days in any calendar year. These would generally include vacation or second homes and other non-primary residences. Such locations are subject to the same criteria imposed upon exempted primary residences (enumerated above).

In the context of this exemption, the term "business day" is defined to exclude any partial day, provided the associated person spends at least four hours of such business day at his or her designated branch office during the time period such office is normally open for business. This is intended to prevent associated persons from regularly conducting business from locations other than their primary residence for the majority of a business day, without such activity being counted towards the 30-business-day limit.

Where the 30-business-day exemption is utilized, members are expected to maintain records adequate to demonstrate compliance with the business day limitations. Once the 30-business day limit has been reached, members will have a 30-calendar-day window to register such locations as branch offices.

Offices of Convenience

Rule 3010(g)(2)(A)(iv) exempts from branch office registration "offices of convenience." An office of convenience is defined as a location where an associated person occasionally and exclusively by appointment meets with customers, provided such location is not held out to the public as an office. An associated person may not establish regular business hours at such location or hold out the location in any way (except for signage required at banks as discussed below). Final approval and execution of transactions must be done through the branch office.

Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations, and applicable rules and regulations of the NYSE, other self-regulatory organizations, and securities and banking regulators may be displayed and will not be deemed "holding out" for purposes of this section. This restriction is intended to prevent confusion on the part of customers who might otherwise believe that only traditional, insured bank-related investments are being offered by associated persons through such offices.

Location Used Primarily to Engage in Non-Securities Transactions

Rule 3010(g)(2)(A)(v) exempts from branch office registration locations where associated persons are primarily engaged in non-securities activities (*e.g.*, insurance sales) and from which an associated person effects no more than 25 securities transactions in a calendar year; provided that advertisements or sales literature, including business cards, identifying such location also set forth the locations from which the associated person or persons are directly supervised. All securities transactions originating from such locations must be entered through, and supervised by, the associated person's designated branch office. Once the 25 securities transaction threshold is exceeded, members will be given a 30-calendar-day window to register such locations as branch offices.

Floor of a Registered National Securities Exchange

Rule 3010(g)(2)(A)(vi) exempts from branch office registration any location on the floor of a registered national securities exchange from which a member conducts a direct access business with public customers.

Temporary Location Used as Part of a Business Continuity Plan

Rule 3010(g)(2)(A)(vii) exempts from branch office registration any temporary location established in response to the implementation of a business continuity plan.[13]

Main Offices

A member's main office will be required to register as a branch office if it falls within the definition of "branch office."[14]

Offices That Supervise Other Offices

Current Rule 3010(g)(2)(B) provides that notwithstanding the exclusions provided in paragraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more *non-branch* locations of the member is considered to be a branch office. This provision is currently effective and will remain so after the effective date of the Uniform Definition. Further, as noted above, members are reminded that pursuant to Rule 3010(g)(1), any location that is responsible for supervising the activities of persons associated with the member at one or more *branch offices* of the member is an OSJ.

IM-3010-1 (effective May 1, 2006)

NASD staff believes the adoption of the Supervisory Controls Amendments in 2004 established an industry benchmark, imposing high standards regarding member's supervision and supervisory control procedures.[15] However, to further emphasize the requirement that members already have to establish reasonable supervisory procedures and conduct reviews, NASD is adopting new interpretive material, IM-3010-1 (Standards for Reasonable Review). IM-3010-1 provides that each member must conduct a review, at least annually, of the businesses in which it engages, which must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with NASD rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the member's:

- size,
- organizational structure,
- scope of business activities,
- number and location of offices,
- the nature and complexity of products and services offered,
- the volume of business done,
- the number of associated persons assigned to a location,
- whether a location has a principal on-site,
- whether the office is a non-branch location, and
- the disciplinary history of the registered representatives or associated persons.

The IM notes that members must be especially diligent in establishing procedures and conducting reasonable reviews with respect to non-branch locations.

Interpretive Guidance

NASD expects to publish a *Notice* shortly addressing certain interpretive issues relating to the Uniform Definition.

Timeline and Branch Registration and Reporting

The following is intended to be a brief summary of the transition process to the Form BR and the new branch office registration system. Members are encouraged to refer to *Notice to Members (NTM) 05-66* for more detailed information on how to register offices using the Form BR and the new branch office registration system.

Important Dates to Remember

- **October 14, 2005:** Last day on which NASD member firms may file a new or amended Schedule E to Form BD through the CRD system.
- **October 15, 2005 to October 30, 2005:** "Lock-out" Period—There will be a two-week lock-out period beginning October 15, 2005 through October 30, 2005, so that NASD can begin the transition process to the Form BR for branch offices in existence as of the close of business on October 14, 2005. During the lock-out period, NASD will create a "conversion" Form BR on the CRD system for all branch offices in existence as of the close of business on October 14, 2005. NASD will assign a unique branch CRD number to each of these branches and pre-populate the conversion Forms BR with limited information for each of these branches.[16] During this lock-out period, the CRD system will not accept any branch office forms or amendments via any of the current branch office forms or Form BR.
- **October 31, 2005:** Starting on this date, the new branch office functionality will be available in the CRD system, and firms will be able to file Forms BR for each of their branch offices. Beginning on this date, firms with branch offices in existence prior to the close of business on October 14, 2005 may (1) complete the data fields for each conversion Form BR created by NASD during the lock-out period and (2) file the completed Forms BR through CRD. Also starting on this date, firms may register via the new Form BR any new branch offices opened during the lock-out period or thereafter (*i.e.*, branch offices established on or after October 15, 2005).
- **May 1, 2006:** Effective Date of Uniform Definition and IM-3010-1—Members must have a complete Form BR for any office that is a "branch office" under the Uniform Definition.

Endnotes

1 *See* Exchange Act Release No. 52403 (September 9, 2005); 70 FR 54782 (September 16, 2005); File No. SR-NASD-2003-104 (Order Granting Approval of Proposed Rule Change Relating to Proposed Uniform Branch Office Definition) (SEC Approval Order).

2 *See* Exchange Act Release No. 52402 (September 9, 2005); 70 FR 54788 (September 16, 2005); File No. SR-NYSE-2002-34 (Order Granting Approval of Proposed Rule Change Relating to Proposed Uniform Branch Office Definition) (SEC NYSE Approval Order).

3 *See* Exchange Act Release No. 51742 (May 25, 2005); 70 FR 32386 (June 2, 2005); File No. SR-NASD-2005-030 (Proposed Form BR (Uniform Branch Office form) and Conforming Changes and Technical Revisions to the Uniform Application for Securities Industry Registration or Transfer (Form U4) and the Uniform Termination Notice for Securities Industry Registration (Form U5)) (March 11, 2005).

4 *See* Exchange Act Release No. 52544 (September 30, 2005).

5 Although these terms may be used interchangeably by SROs and/or states, "registration" typically refers to a process that requires an approval by the SRO or state before a branch may begin doing business, whereas "reporting" typically refers to a process by which firms "notice file" or notify an SRO or state of the existence of a branch office, but an approval is not required.

6 For information on which states will accept Form BR for branch office registration, see the North American Securities Administrators Association (NASAA) Web site at *www.nasaa.org*.

7 The Form BR replaces Schedule E of the Form BD, the current NYSE Branch Office Application Form (which is currently submitted through the NYSE's Electronic Filing Platform (EFP) System), and certain state branch office forms. Consistent with the uniform form concept, the Form BR will enable firms to register or report branch offices electronically with NASD, the NYSE and states that require branch registration
or reporting, via a single filing through the CRD system. For additional information, *see* Exchange Act Release No. 51742 (May 25, 2005); 70 FR 32386 (June 2, 2005); File No. SR-NASD-2005-030 (Proposed Form BR and Conforming Changes and Technical Revisions to the Form U4 and Form U5) (March 11, 2005). *See also* SR-NYSE-2005-13 and NYSE Information Memo 04-43, dated August 9, 2004.

8 *See Notice to Members 05-66* for more detailed information regarding the new Form BR and the branch office registration system.

9 *See* Rule 3010(g)(2).

10 *See* Rules 3010(a) and (c). Rule 3010(c) further provides that each member shall inspect at least annually any branch office that supervises one or more non-branch locations, and at least every three years any branch office that does not supervise one or more non-branch locations.

11 *See* 17 CFR 240.17a-3 and 17a-4.

12 15 U.S.C. 78a et seq.

13 For additional information, see Rules 3510 (Business Continuity Plans) and 3520 (Emergency Contact Information). *See also NTM 04-37, SEC Approves Rules Requiring Members to Create Business Continuity Plans and Provide Emergency Contact Information* (May 2004).

14 This rule change supercedes any earlier statements made concerning the registration requirements applicable to members' main offices under NASD rules. NASD notes that IM-1000-4 addresses the need for members to keep their membership applications current, as well as to properly designate and register OSJs and branch offices. NASD intends to propose future amendments to IM-1000-4 to reflect the SEC's approval of the Uniform Definition and new Form BR.

15 *See* Exchange Act Release No. 49883 (June 17, 2004), 69 FR 35092 (June 23, 2004); SR-NASD-2002-162. *See also* Exchange Act Release No. 50477 (September 30, 2004), 69 FR 59972 (October 6, 2004); SR-NASD-2004-116. *See also NTM 04-71, Supervisory Controls, SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls* (October 2004).

16 The conversion process will download the following fields from existing data in CRD or the Investment Advisor Registration Advisory© (IARD), as well as the following data provided by the NYSE and participating states: Branch Address, NASD Branch Number, NYSE Branch Code Number, NYSE Branch Type, NASD/NYSE Supervisor/Person-In-Charge Name and CRD Number, Operational Status and NYSE/ Jurisdiction Registration Status.

EXHIBIT A

3010 Supervision

(g) Definitions

(2) (A) A "branch office" is any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as such, excluding:

(i) Any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;

(ii) Any location that is the associated person's primary residence; provided that:

a. Only one associated person, or multiple associated persons, who reside at that location and are members of the same immediate family, conduct business at the location;

b. The location is not held out to the public as an office and the associated person does not meet with customers at the location;

c. Neither customer funds nor securities are handled at that location;

d. The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements and other communications to the public by such associated person;

e. The associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3010;

f. Electronic communications (e.g., e-mail) are made through the member's electronic system;

g. All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office;

h. Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and

i. A list of the residence locations is maintained by the member;

(iii) Any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member complies with the provisions of paragraph (A)(2)(ii)a. through h. above;

(iv) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office;*

(v) Any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any advertisement or sales literature identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;

(vi) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers; or

(vii) A temporary location established in response to the implementation of a business continuity plan.

(B) Notwithstanding the exclusions provided in paragraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.

(C) The term "business day" as used in Rule 3010(g)(2)(A) shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

* Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of the NYSE, other self-regulatory organizations, and securities and banking regulators may be displayed and shall not be deemed "holding out" for purposes of this section.

* * * * *

IM-3010-1. Standards for Reasonable Review

In fulfilling its obligations pursuant to Rule 3010(c), each member must conduct a review, at least annually, of the businesses in which it engages, which review must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with NASD Rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm's size, organizational structure, scope of business activities, number and location of offices, the nature and complexity of products and services offered, the volume of business done, the number of associated persons assigned to a location, whether a location has a principal on-site, whether the office is a non-branch location, the disciplinary history of registered representatives or associated persons, etc. The procedures established and the reviews conducted must provide that the quality of supervision at remote offices is sufficient to assure compliance with applicable securities laws and regulations and with NASD Rules. With respect to a non-branch location where a registered representative engages in securities activities, a member must be especially diligent in establishing procedures and conducting reasonable reviews. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations and/or may need to provide for more frequent reviews of certain locations.

* * * * *

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Continuing Education
Legal & Compliance
Registration
Senior Management

KEY TOPICS

Continuing Education
Firm Element

GUIDANCE

Continuing Education

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

Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued the annual Firm Element Advisory, a guide for firms to use when developing their continuing education Firm Element training plans. The Council suggests that firms use the Firm Element Advisory as part of the Firm Element Needs Analysis to help identify relevant training topics for all covered persons, including supervisors. Such topics may include ethics and training for supervisors. Among the subjects you should consider for inclusion in Firm Element training are new rules and regulations, such as supervisory control amendments, major regulatory examination findings, ethics and professional conduct, and any new products or services the firm plans to offer.

All of the training resources found in the Firm Element Advisory may be found on the CE Council Web site at *www.securitiescep.com*, where there are also two additional Firm Element resources. The first is the Firm Element Organizer, an easy-to-use software application that enables a search of an extensive database of training resources related to specific investment products or services. The second resource comprises CDs with scenarios taken from the Regulatory Element Supervisor (S201) and General (S101) programs. Log on to the Council Web site for descriptions of the available scenarios.

Questions/Further Information

Questions concerning this *Notice* may be directed to Joseph McDonald, Associate Director, Testing and Continuing Education, at (240) 386-5065.

The Securities Industry Continuing Education Program

www.securitiescep.com

Securities Industry Continuing Education Program

Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (the Council) publishes the Firm Element Advisory to identify current 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 organizations (SRO) publications and announcements of significant events issued since the last Firm Element Advisory of October 2004. Also included among the topics are several rule proposals that have been filed with but not approved by the Securities and Exchange Commission.

The Council suggests that firms use the Firm Element Advisory as an aid in developing their Firm Element Needs Analysis to identify training topics that are relevant to the firm. Such topics may include ethics and training for supervisors. Among the subjects that you should consider for inclusion in Firm Element training are new rules or regulations, such as supervisory control amendments, major regulatory examination findings, such as those relating to mutual fund sales practices; ethics and professional conduct; and any new products or services the firm plans to offer. The need to address these topics may vary, depending upon your firm's line(s) of business and SRO membership.

The Council provides a convenient way for firms to access the training resources listed next to each topic in the Firm Element Advisory via its website, *www.securitiescep.com.* By using the Search function on the site and entering the referenced document, it is possible to review the content on the Continuing Education website.

In addition to the Firm Element Advisory material, there are two additional resources that can assist with developing Firm Element training plans. The first is the Firm Element Organizer, available at *www.securitiescep.com/TOC/Firm_Element.* This is an easy-to-use software application that enables the search of an extensive database of regulatory resources related to specific investment products or services. The results of a search can then be edited into a document that may assist in developing a Firm Element training plan. A tutorial on the website demonstrates how to use the Firm Element Organizer. The second Firm

Element resource is the Regulatory Element Scenario Library, available at *www.securitiescep.com>CEP Training Material.* The Scenario Library is composed of materials that were taken from the Regulatory Element Supervisor (S201) and General (S101) programs that have fulfilled their three-year life cycle in those programs. These materials are available on CDs and may be suitable for Firm Element training.

The Council is currently undertaking a new initiative using the materials from the Scenario Library called netCEP. NetCEP will leverage the value of the existing Scenario Library materials with the technological advantage of Web-based learning and delivery. The materials, which are currently available on CDs, will be offered as Internet-based training, providing on-demand access to content for both individuals and firms of all sizes.

Using netCEP, registered persons seeking general Regulatory Element training or preparatory materials may select and view as many scenarios from the General (S101), Investment Company Products/Variable Contracts Representatives (S106), and Supervisor (S201) Programs as desired. Firms will have access to the materials for training, to use as Firm Element Continuing Education content, or as compliance resources. Firms may allow registered persons to choose the materials they wish to view, or administrators may use the Learning and Content Management System to assign specific materials to individuals or groups, track completion of assignments, and generate reports as needed. Customization can be arranged to have firm-specific content added at the beginning of, or following, the materials. NetCEP is expected to be available in the fourth quarter of 2005.

For more information, log on to *www.securitiescep.com,* or call Joe McDonald, Associate Director, NASD Testing & Continuing Education, at (240) 386-5065; or Roni Meikle, Director, Continuing Education, New York Stock Exchange, (212) 656-2156.

Alternative Investments

New Products

An increasing number of complex products are being introduced to the market in response to the demand for higher returns or yield. Some of these products have unique features that may not be understood by investors or registered persons. Others raise concerns about suitability and potential conflicts of interest. In promoting and selling such products, firms should take a proactive approach to reviewing and improving their procedures for developing and vetting new products. At a minimum, those procedures should include clear, specific and practical guidelines for determining what constitutes a new product, ensure that the right questions are asked and answered before a new product is offered for sale, and, when appropriate, provide for post-approval follow-up and review, particularly for products that are complex or are approved only for limited distribution. *See NASD NTM (NTM) 05-26: NASD Recommends Best Practices for Reviewing New Products* (April 2005)*. See NYSE Rule 401(Business Conduct); Rule 405 (Diligence as to Accounts) and NYSE Information Memo 05-11, Customer Account Sweeps into Bank. See also NYSE regulatory information bulletin "Hedge Fund Investing: Is It a Suitable Investment for You" at* www.nyse.com>information for>individual investors. *See also NASD NTM 03-71: NASD Reminds Members of Obligations When Selling Non-Conventional Investments* (November 2003); *NASD NTM 03-07: NASD Reminds Members of Obligations When Selling Hedge Funds* (February 2003); *NASD NTM 05-50: Member Responsibilities for Supervising Sales of Unregistered Equity Indexed Annuities* (August 2005).

Non-Managed Fee-Based Account Programs (NMFBA Programs)

On June 22, 2005, the SEC approved new NYSE Rule 405A (Non-Managed Fee-Based Account Programs – Disclosure and Monitoring). Rule 405A is effective immediately, however, the Exchange will allow 90 days from the approval date (September 22, 2005) for the membership to fully adopt and establish the procedural and systems changes required by the Rule. Note, however, that during this period, the membership is in no way relieved of its existing and ongoing obligations to monitor, review, and supervise NMFBA Programs pursuant to all other applicable NYSE rules including Rules 342 (Offices-Approval, Supervision and Control) and 405 (Diligence as to Accounts).

Rule 405A(1) requires that each customer, prior to the opening of an account in a NMFBA Program, be provided with a disclosure document describing the types of NMFBA Programs available to such client. The document shall disclose, for each such Program type, sufficient information for the customer to make a reasonably informed determination as to whether the program is appropriate to suit his or her anticipated needs. Specifically, such disclosures must include, at a minimum: a description of the services provided, eligible assets, fees charged, an explanation of how costs will be computed and/or the provision of cost estimates based on hypothetical portfolios, any conditions or restrictions imposed, and a summary of the program's advantages and disadvantages.

In addition to compliance with the prescribed requirements of Rule 405A, NMFBA Programs are subject to all applicable NYSE Rules including those relating to the supervision of registered representatives. Members and member organizations are advised to take note of registered representatives who seem to have a disproportionate number of customers in NMFBA Programs, as this may increase the likelihood that such Programs may be inappropriate for a number of such customers. Registered representatives should also be monitored for improper behavior in connection with NMFBA Programs, such as temporarily transferring assets into a fee-based account on, or shortly before, the day a percentage-based fee is assessed. *See NYSE Information Memo 05-51, Non-Managed Fee-Based Account Programs (Rule 405A).*

NASD previously set forth in an *NTM* similar member obligations regarding fee-based accounts. Before opening a fee-based account for a customer, members must have reasonable grounds to believe that such an account is appropriate for that particular customer. To that end, members must make reasonable efforts to obtain information about the customer's financial status, investment objectives, trading history, size of portfolio, nature of securities held and account diversification. With that and any other relevant information in hand, members should then consider whether the type of account is appropriate in light of the services provided, the projected cost to the customer, alternative fee structures that are available, and the customer's fee structure preferences. In addition, members must disclose to the customer all material components of the fee-based program, including the fee schedule, services provided and the fact that the program may cost more than paying for the services separately.

Members must also implement supervisory procedures to require a periodic review of fee-based accounts to determine whether they remain appropriate for their respective customers. As part of that review, members should consider whether reasonable assumptions about market conditions upon which the member based its initial determination of appropriateness have changed, as well as any changes in customer objectives or financial circumstances. Finally, members should review their sales literature, marketing material and other correspondence related to fee-based programs to ensure the information is balanced and not misleading and should include in training materials guidelines regarding the establishment of fee-based accounts. *See NASD NTM 03-68: NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate* (November 2003).

Investments of Liquefied Home Equity

The rapid increase in home prices over the past several years, in combination with refinancing activity by homeowners, has lead to increasing investment activity by homeowners with equity from their homes. Members and their associated persons should be aware that recommending liquefying home equity to purchase securities may not be suitable for many investors and should perform a careful analysis to determine whether liquefying home equity is a suitable strategy for an investor. In addition, members should ensure that all communications with the public addressing a strategy of liquefying home equity are fair and balanced, and accurately depict the risks of investing with liquefied home equity. Finally, members should consider whether to employ heightened scrutiny of accounts that they know, or have reason to know, are funded with liquefied home equity. *See NASD NTM 04-89: NASD Alerts Members to Concerns When Recommending or Facilitating Investments of Liquefied Home Equity* (December 2004).

Tenants-In-Common/Rule 1031 Exchanges

In general, sales of tenants-in-common (TIC) interests in real property in connection with an exchange of real property pursuant to Section 1031 of Internal Revenue Code constitute securities for purposes of the federal securities laws and NASD and NYSE rules. Members and their associated persons are reminded that when offering to customers TIC interests, they must comply with all applicable NASD and NYSE rules, including those addressing suitability, due diligence, splitting commissions with unregistered individuals or firms, supervision and recordkeeping.

In addition, members relying on private offering exemptions from the registration requirements of the Securities Act of 1933 (Securities Act) must ensure that their manner of offering TIC interests complies with all applicable requirements, including the prohibition on general solicitation. *See NASD NTM 05-18: NASD Issues Guidance on Section 1031 Tax-Deferred Exchanges of Real Property for Certain Tenants-in-Common Interests in Real Property Offerings* (March 2005).

Anti-Money Laundering

Independent Testing

Anti-money laundering (AML) continues to be an evolving topic, as regulators adopt new rules and regulations to carry out the mandates of the USA PATRIOT Act. NASD Rule 3011 and NYSE Rule 445 require that NASD and NYSE members establish and implement anti-money laundering compliance programs designed to ensure ongoing compliance with the requirements of the Bank Secrecy Act and the regulations promulgated thereunder. In particular, the rules require, among other things, that members' AML programs provide for independent testing.

NASD and the NYSE filed with the Securities and Exchange Commission (SEC or Commission) proposed rule changes to amend NASD Rule 3011and NYSE Rule 445, and to adopt interpretive and supplementary material to these Rules. The proposed amendments would require each member to conduct independent testing of its anti-money laundering program on an annual (calendar-year) basis, with the exception of certain types of firms, which would be allowed to test every two years (on a calendar-year basis). The proposed interpretive and supplementary material includes requirements for the persons who may conduct such tests. NASD's proposal also requires members to review and update, if necessary, the accuracy of the member's anti-money laundering compliance person information on a quarterly basis. *See SEC Release No. 34-51935; Notice of Filing of Proposed Rule Change Relating to Amendments to NASD Rule 3011 and the Adoption of New Related Interpretive Material (June 29, 2005); SEC Release No. 34-51934; Notice of Filing of Proposed Rule Change to Amend NYSE Rule 445 (June 29, 2005).*

Broker-Dealer Customer Identification Program Rule

On April 29, 2003, the SEC and the Department of the Treasury jointly adopted the broker-dealer customer identification program (CIP) Rule. The CIP Rule requires broker-dealers to implement customer identification programs that include procedures for: (1) verifying the identities of customers; (2) maintaining records of the verification process; (3) comparing customers with lists of known or suspected terrorists or terrorist organizations; and (4) providing customers with notice that information is being collected to verify their identities. *See 31 C.F.R. 103.122.*

The CIP Rule permits broker-dealers to rely on certain other financial institutions to undertake the required elements with respect to shared customers. On February 10, 2005, in a letter to the Securities Industry Association (SIA), the SEC Division of Market Regulation (Division) extended the no-action relief granted in its February 12, 2004 letter (2004 No-Action Letter) regarding the ability of broker-dealers to rely on investment advisers to perform customer identification procedures, consistent with the CIP Rule. In its letter, the Division staff states that it will not recommend enforcement action to the Commission under Rule 17a-8 under the Exchange Act if a broker-dealer relies on an investment adviser to perform customer identification procedures, prior to such investment adviser becoming subject to an AML program rule, provided the other requirements in paragraph (b)(6) of the CIP Rule are met, namely that

(1) such reliance is reasonable under the circumstances; (2) the investment adviser is regulated by a Federal functional regulator; and (3) the investment adviser enters into a contract requiring it to certify annually to the broker-dealer that it has implemented an anti-money laundering program, and that it will perform (or its agent will perform) specified requirements of the broker-dealer's customer identification program. The 2004 No-Action Letter would have expired on February 12, 2005. The relief provided in the 2004 No-Action Letter and extended by the February 10, 2005 letter will be withdrawn on the earlier of (1) the date upon which an AML program rule for investment advisers becomes effective, or (2) July 12, 2006. *See SEC Division of Market Regulation: No-Action Letter to the Securities Industry Association, Feb.10, 2005. See also NASD's AML Web page at* www.nasd.com/aml; *and the SEC's Spotlight On: Anti-Money Laundering Rules at* www.sec.gov/spotlight/moneylaundering.htm. *See also NYSE Information Memo 03-32, Customer Identification Programs for Broker-Dealers (July 14, 2003)* (www.nyse.com>regulation>information memos).

Bond Sales

Mark-Ups

NASD is proposing to adopt a second interpretation to Rule 2440, to provide additional mark-up guidance for transactions in debt securities except municipal securities.

Under NASD Rule 2440, (Fair Prices and Commissions) a member is required to sell securities to a customer at a fair price. When a member acts in a principal capacity, the dealer marks up or marks down a security. IM-2440 (Mark-Up Policy) provides guidance on mark-ups and fair pricing of securities transactions with customers. Both Rule 2440 and IM-2440 apply to transactions in debt securities, and IM-2440 provides that mark-ups for transactions in common stock are customarily higher than those for bond transactions of the same size.

A key step in determining whether a mark-up (mark-down) is fair and reasonable is correctly identifying the prevailing market price of the security, which is the basis from which the mark-up (mark-down) is calculated. The proposed interpretation addresses two fundamental issues in debt securities transactions: (1) how does a dealer correctly identify the prevailing market price of a debt security; and (2) what is a "similar" security and when may it be considered in determining the prevailing market price. *See SEC Release No. 34-51338, Notice of Filing of Proposed Rule Change to Adopt an Additional Mark-up Policy for Transactions in Debt Securities Except Municipal Securities (March 9, 2005).*

Communications

Email Communications

SROs have taken seriously failures by members to maintain and preserve all required internal communications, and have recently settled actions against members for, among other things, failure to maintain email communications. Members are required to comply with record keeping requirements regarding external and internal communications to ensure that communications will be available and accessible to regulators during the course of examinations and investigations. Firms must maintain, preserve and produce on a timely basis all communications upon request of regulators, including SRO staff. In particular, when implementing new technology, firms must address maintenance, retrieval and production issues, especially in light of the increasing volume of data. *See NYSE Disciplinary Actions 05-62 dated May 19, 2005, 05-23 dated January 23, 2005; 05-01 dated January 5, 2005; and 04-190 dated December 15, 2004. See also NYSE Disciplinary Actions 04-128, dated August 2, 2004 and 02-227, 02-226, 02-225, 02-224 and 02-223, all dated November 15, 2002, regarding email retention. See also NYSE-SR-2005-17 Exemptions from pre-use review and requirements for institutional sales material. See also NASD's "Guide to the Internet for Registered Representatives" Web page at* www.nasd.com/internetguide; *(NASD Disciplinary Action No. CE2050012 (in August 2005 Report); NASD Disciplinary Action No. C11050015) (in July 2005 Report); NASD Disciplinary Action No. CE4050005) (in July 2005 Report); and NASD Disciplinary Action No. C11050004 (in April 2005 Report).*

The NYSE has formed an electronic communications task force, which includes NASD and industry representatives to analyze and address evolving technology and applications for firms in light of current SRO/SEC rule requirements.

Correspondence

NASD currently defines correspondence to include any written letter or electronic mail message distributed by a member to (1) one or more of its existing retail customers, and (2) fewer than 25 prospective retail customers within any 30-calendar-day period. The definition of correspondence is significant because firms generally are not required to have a registered principal approve correspondence prior to use or file correspondence with the NASD Advertising Regulation Department, and because some of the specific content standards applicable to other types of communications with the public do not apply to correspondence. NASD is proposing to amend Rule 2211 to require that a registered principal approve, prior to use, any correspondence that is sent to 25 or more existing retail customers within a 30-calendar-day period. *See NASD NTM 05-27: NASD Requests Comment on Proposal to Require Principal Pre-Use Approval of Member Correspondence to 25 or More Existing Retail Customers within a 30-Calendar-Day Period* (April 2005). *See NYSE Rule 342.17 (Review of Communications with the Public) and NYSE Rule 472 (Communications with the Public).*

Continuing Education

Elimination of Exemptions

In 2004, the SEC approved amendments to SRO rules on continuing education eliminating all exemptions from the Regulatory Element Program. Registered persons who had been eligible for "grandfathered" and/or "graduated" exemptions are now required to participate in the Regulatory Element Continuing Education Program. The rule changes became effective April 4, 2005. The re-entry phase for formerly exempted registered persons will occur over a three-year period. Each registered person's re-entry into the Program will be determined by using the registered person's "base date," which is usually the person's initial registration date. *See NASD NTM 04-78: SEC Approves Amendments to Rule 1120 to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements* (October 2004); *NASD NTM 05-20: NASD Announces Effective Date of April 4, 2005 for Amendments to Rule 1120 to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements* (March 2005). *See also NYSE Information Memo 04-55, Amendments to Rule 345A That Rescind All Exemptions from Participation in Continuing Education Regulatory Element Programs and Information Memo 05-20, Reminder—Amendments to Rule 345A Rescinding all Exemptions from Participation in Continuing Education Regulatory Element Programs Become effective on April 4, 2005. See also MSRB Notice 2004-34, Amendment Approved to Remove Exemptions from Regulatory Element of Continuing Education Program.*

Ethics

The CE Council introduced an ethics module as part of the Regulatory Element of the Continuing Education Program in early 2005. Firms should consider addressing ethical issues in their own Firm Element training. Such individual programs can tailor general concepts to the values, policies, culture, organization and business model of the particular firm, and allow senior management to participate in the ethics program, thereby modeling and articulating the firm's commitment to high ethical standards in daily business conduct.

Ethics programs should do more than explain industry rules and firm policies. They should provide a context for regulatory requirements by addressing the importance of upholding the firm's values (*e.g.,* integrity, trustworthiness), what *constitutes* the "right" thing, and the spirit—not only the letter—of the law. They should also help employees develop a greater awareness of ethics issues and a stronger ability to make ethical decisions, including dealing with organizational influences on such decision-making. Such programs should be based on the firm's code of ethics (if any), its supervisory procedures, mechanisms for reporting observed misconduct, and other policies that bear on the conduct of its employees—and they should be realistic.

An effective ethics curriculum could include cases illustrating ethical situations, approaches to resolving such dilemmas and strategies and resources for dealing with organizational influences, such as focusing on long-term success instead of short-term expediency, using confidential help lines. Rather than providing ethical content in isolation, firms may have employees apply ethical principles to realistic fact patterns, demonstrated in stories of people who have made the wrong ethical decisions and those who have had the courage to make the right choices, and consider the consequences of ethical decisions for customers, employees, the firm and the industry (especially with regard to investor confidence and integrity of the firm). Firms should bear in mind that experience often varies dramatically among employees of the same firm, or between supervisors and staff, and that the training needs may differ across the firm.

There are a variety of methods to deliver engaging ethics training, including the provision of instruction in person, such as utilizing outside experts, train-the-trainer methodologies, in-house personnel and electronic means. Group interaction is particularly useful in ethics training. Instead of merely providing reading material or lectures, firms should attempt to engage employees by providing an opportunity (whether online, in small discussion groups or both) by which employees can express their views and hear the views of their colleagues.

Fingerprinting

Members should review and, as necessary, update their fingerprinting procedures to help ensure that fingerprints submitted to the Federal Bureau of Investigation (FBI) as part of the hiring process belong to the employee being hired by the member. Members' internal procedures addressing the fingerprinting of prospective employees as required under Section 17(f)(2) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 17f-2 thereunder should attempt to ensure that the person being fingerprinted is the same as the person who is seeking employment with the member. NASD suggests a number of best practices to members that elect to fingerprint prospective employees in-house and those that rely on third parties in an off-site location to collect fingerprints and to verify the identity of the person being fingerprinted. *See NASD NTM 05-39: NASD Suggests Best Practices for Fingerprinting Procedures* (May 2005). *See NYSE Rule 345.11 (Investigation Records), NYSE Information Memo 03-11 (Fingerprint Processing and FBI Identification Records) and NYSE Information Memo 04-53 (Termination of Fingerprinting Processing Services).*

Hedge Funds

Hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss. Neither hedge funds nor advisers to hedge funds are currently required to register with the SEC. However, in December 2004, the SEC adopted a new rule and rule amendments under the Investment Advisers Act of 1940 (Advisers Act) that require advisers to certain hedge funds to register with the SEC. The rule and rule amendments are designed to provide the protections afforded by the Advisers Act to investors in hedge funds, and to enhance the SEC's ability to protect the securities markets. The rule became effective February 10, 2005. Advisers that will be required to register under the new rule and rule amendments must do so by February 1, 2006. *See SEC Release No. IA-2333; Registration Under the Advisers Act of Certain Hedge Fund Advisers (December 2, 2004).*

Investment Adviser Registration Requirements for Broker-Dealers

The SEC adopted Rule 202(a)(11)-1 under the Advisers Act addressing the application of the Act to broker-dealers offering certain types of brokerage programs. Under the rule, a broker-dealer providing advice that is solely incidental to its brokerage services is excepted from the Advisers Act if it charges an asset-based or fixed fee, rather than a commission, mark-up or mark-down, for its services, provided it makes certain disclosures about the nature of its services. The rule states that exercising investment discretion is not "solely incidental to" (1) the business of a broker or dealer within the meaning of the Advisers Act, or (2) brokerage services within the meaning of the rule. The rule also states that a broker or dealer provides investment advice that is not solely incidental to the conduct of its business as a broker or dealer or to its brokerage services if the broker or dealer charges a separate fee or separately contracts for advisory services.

In addition, the rule states that when a broker-dealer provides advice as part of a financial plan or in connection with providing planning services, a broker-dealer provides advice that is not solely incidental if it (1) holds itself out to the public as a financial planner or as providing financial planning services, (2) delivers to its customer a financial plan, or (3) represents to the customer that the advice is provided as part of a financial plan or financial planning services. Finally, under the rule, broker-dealers are not subject to the Advisers Act solely because they offer full-service brokerage and discount brokerage services (including electronic brokerage) for reduced commission rates. The rule became effective April 15, 2005. *See SEC Release No. 34-51523; Certain Brokers Deemed not to be Investment Advisers (April 12, 2005).*

Internal/ Supervisory Controls and CEO Certification

On June 17, 2004, the SEC approved amendments to NYSE Rules 342, 401, 408 and 410 to strengthen the supervisory procedures and internal controls of members and member organizations. The SEC also approved rule changes (Supervisory Control Amendments) by NASD that both create and amend certain rules and interpretive materials to address a member's supervisory and supervisory control procedures. The NYSE and NASD rule changes became effective January 31, 2005. The amendments prescribe general standards with respect to internal and supervisory controls including the regulatory systems and procedures and their purpose regarding supervision and control, business conduct, discretionary accounts and records of orders. See NYSE Information Memo 04-38, Amendments to Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls (July 26, 2004). *See NASD NTM 04-71: SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls* (October 2004).

NASD and NYSE issued guidance in January 2005 to assist firms in their compliance with the new rules. NASD issued additional guidelines in April 2005 for complying with NASD Rule 3012(a)(1), which requires a member to designate one or more principals who will establish, maintain, and enforce a system of supervisory control policies and procedures that tests and verifies that a member's supervisory procedures are reasonably designed to comply with applicable securities laws and regulations, and with applicable NASD rules, and to amend those supervisory procedures when the testing and verification demonstrate a need to do so. *See NASD NTM 05-08: Guidance Regarding the Application of the Supervisory Control Amendments to Members' Securities Activities, Including Members' Institutional Securities Activities* (January 2005); *NASD NTM 05-29: Guidance Regarding Rule 3012(a)(1) Requirement to Test and Verify a Member's Supervisory Policies and Procedures* (April 2005); *Transcript of December 16, 2004, 2004 Supervisory Control Telephone Workshop; see generally NASD Web page at* www.nasd.com/SupervisoryControl. *See NYSE Information Memo 05-07, Joint NYSE/NASD Memo regarding "Internal Controls" Amendments.*

The SEC also approved new NASD Rule 3013 and accompanying interpretive material that requires members to (1) designate a chief compliance officer (CCO) and (2) have the chief executive officer (CEO) or equivalent officer certify annually that the member has in place processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules, and federal securities laws and regulations. Members had to designate and identify to NASD on Schedule A of Form BD a principal to serve as CCO by December 1, 2004. The CEO certification must be executed within one year of December 1, 2004 and annually thereafter. The NYSE has proposed similar requirements to be filed as part of the annual report. *See NASD NTM 04-7: SEC Approves New Chief Executive Officer Compliance Certification and Chief Compliance Officer Designation Requirements* (November 2004). *See NYSE File No. SR-NYSE-2004-64.*

Municipal Securities

Municipal Fund Securities

Municipal fund securities, including 529 College Savings Plans, are municipal securities regulated by the MSRB. Municipal fund securities also represent investments in pools of securities, such as securities issued by registered investment companies. Therefore, sales materials for municipal fund securities must comply with the advertising rules of the MSRB, and if the sales material also refers to the underlying investment companies, the material must comply with the advertising rules of the SEC and NASD, including NASD Rule 2210. Principals supervising the sale of municipal fund securities must be appropriately registered and hold either a Series 51 (Municipal Fund Securities Limited Principal) (and either the Series 24 or Series 26) or Series 53 (Municipal Securities Principal) registration. For more information, see the section on Municipal Fund Securities on the MSRB Web site at www.msrb.org/msrb1/mfs/default.asp. *See also NASD NTM 03-17: Sales Material for Municipal Fund Securities* (March 2003); *and NASD Issues Investor Alert on 529 College Savings Plans, September 13, 2004 at* www.nasd.com/pr/091305 *regarding expenses and tax incentives associated with investments in 529 College Savings Plans.*

On May 24, 2005, the SEC approved amendments to Rule G-21, on advertising, establishing specific requirements with respect to advertisements by brokers, dealers and municipal securities dealers relating to municipal fund securities. The amendments include specific requirements regarding the calculation and display of performance data for municipal fund securities in a manner consistent with Rule 482 under the Securities Act that regulates mutual fund performance advertisements. The amendments also include general disclosure requirements regarding municipal fund securities that are similar in most respects to the disclosures required for mutual fund advertisements under Rule 482. Finally, the amendments incorporate certain prior interpretations relating to municipal fund securities. *See MSRB Notice 2005-31; SEC Approves Amendments to Rule G-21 Relating to Advertisements of Municipal Fund Securities (May 27, 2005).*

All advertisements of municipal fund securities submitted or caused to be submitted for publication by a dealer on or after September 1, 2005 must comply with these new provisions of Rule G-21, except for the provisions relating to calculation and presentation of performance data, which must be complied with on and after December 1, 2005. In addition, the SEC recently approved amendments to Rule G-21 that will require municipal fund securities performance advertisements either to disclose performance that is current as of the most recent month-end, or to indicate where such performance may be found.

Disclosure of Original Issue Discount Bonds

The MSRB published an interpretive notice reminding brokers, dealers and municipal securities dealers of their affirmative disclosure obligations when effecting transactions with customers in original issue discount bonds. An original issue discount bond, or O.I.D. bond, is a bond that was sold at the time of issue at a price that was below the par value of the bond.

The original issue discount is the amount by which the par value of the bond exceeded its public offering price at the time of its original issuance. The original issue discount is amortized over the life of the security and, on a municipal security, is generally treated as tax-exempt interest. When the investor sells the security before maturity, any profit realized on such sale is calculated (for tax purposes) on the adjusted book value, which is calculated for each year the security is outstanding by adding the accretion value to the original offering price. The amount of the accretion value (and the existence and total amount of original issue discount) is determined in accordance with the provisions of the Internal Revenue Code and the rules and regulations of the Internal Revenue Service.

The MSRB believes that the fact that a security bears an original issue discount is material information (since it may affect the tax treatment of the security); therefore, this fact should be disclosed to a customer prior to or at the time of trade. Absent adequate disclosure of a security's original issue discount status, an investor might not be aware that all or a portion of the component of his or her investment return represented by accretion of the discount is tax-exempt, and therefore might sell the securities at an inappropriately low price (i.e., at a price not reflecting the tax-exempt portion of the discount) or pay capital gains tax on the accreted discount amount. Without appropriate disclosure, an investor also might not be aware of how his or her transaction price compares to the initial public offering price of the security. Appropriate disclosure of a security's original issue discount feature should assist customers in computing the market discount or premium on their transaction. *See MSRB Notice 2005-01, Interpretive Reminder Notice Regarding Rule G-17, on Disclosure of Material Facts—Disclosure of Original Issue Discount Bonds.*

Broker-Dealer Payments to Non-Affiliated Persons Soliciting Municipal Securities

On August 17, 2005, the SEC approved substantial amendments to MSRB Rule G-38 relating to the solicitation of municipal securities business under Rule G-38. As amended, Rule G-38 prohibits a broker-dealer or a municipal securities dealer (dealer) from paying persons who are not affiliated with the dealer for soliciting municipal securities business on its behalf. In addition, new MSRB Form G-38t has been created and certain related amendments have been made to MSRB Rule G-37, on political contributions and prohibitions on municipal securities business, and MSRB Rule G-8 on recordkeeping. The amendments became effective August 29, 2005.

Former Rule G-38, which permitted outside consultants to solicit municipal securities business on behalf of dealers, was replaced in its entirety by new Rule G-38. New Rule G-38 prohibits a dealer from making any direct or indirect payment to any person who is not an affiliated person of the dealer for a solicitation of municipal securities business on behalf of the dealer. An "affiliated person" of a dealer is defined as any partner, director, officer, employee or registered person of the dealer or of an affiliated company. An affiliated company of a dealer is an entity that controls, is controlled by, or is under common control with the dealer and whose activities on behalf of the dealer are not limited solely to the solicitation of municipal securities business. Solicitation is defined as a direct or indirect communication with an issuer of municipal securities for the purpose of obtaining or retaining municipal securities business. Rule G-37 was amended to reflect that those associated persons who solicit municipal securities business and thereby are municipal finance professionals include affiliated persons under Rule G-38.

The MSRB has incorporated a transitional period permitting certain payments to consultants. A dealer is permitted to make payments to non-affiliated persons (consultants) for solicitations of municipal securities business if such payments were made with respect solely to solicitation activities undertaken by such persons on or prior to August 29, 2005, provided certain conditions are met. In particular, the dealer must disclose each item of municipal securities business for which a transitional payment remains pending and the amount of such pending payment on Form G-38t submitted to the MSRB for the third quarter of 2005 and on each subsequent quarterly Form G-38t submission until such payment is finally made.

Rule G-8 regarding recordkeeping was amended to require the retention of certain records, and Rule G-37 and related forms were amended to delete references to Rule G-38 and the reporting of consultant information. *See SEC Rel. No. 34-52278 (August 17, 2005); MSRB Notice 2005-044, SEC Approves Amendments to Rule G-38 Relating to Solicitation of Municipal Securities Business.*

Mutual Funds

The following types of mutual fund transactions are under increased scrutiny from all regulators.

Sales of Class B and C Mutual Fund Shares

NASD settled three actions against members and fined them more than $21 million for improper sales of Class B and Class C shares of mutual funds. These cases are part of a larger, ongoing investigation into mutual fund sales practices.

These cases involve recommendations and sales of Class B and Class C shares of mutual funds. In all three cases, the firms made recommendations and sales of mutual funds to their customers without considering or adequately disclosing, on a consistent basis, that an equal investment in Class A shares would generally have been more economically advantageous for their customers by providing a higher overall rate of return. The firms also had inadequate supervisory and compliance policies and procedures relating to these mutual fund sales.

In particular, NASD found that the firms did not consistently consider that large investments in Class A shares of mutual funds entitle customers to breakpoint discounts on sales charges, generally beginning at the $50,000 investment level, which are not available for investments in other share classes. Investors may be entitled to breakpoints based on the amount of a single mutual fund purchase; the total amount of multiple purchases in the same family of funds; and/or the total amount of mutual fund investments held, at the time of the new purchase, by members of the customer's "household"—typically, accounts of close family members.

Unlike Class A shares, Class B shares are not subject to a front-end sales charge, but are subject to contingent deferred sales charges (CDSCs) if the shareholder redeems his or her shares within a defined period of time, generally six years. Class B and Class C shares are also subject to higher ongoing fees than Class A shares for as long as they are held. Even though investors do not pay a front-end sales charge for Class B or Class C shares, the potential CDSCs and the higher ongoing fees significantly affect the return on mutual fund investments, particularly at higher dollar levels. *See NASD News Release, "NASD Fines Citigroup Global markets, American Express and Chase Investment Services More than $21 Million for Improper Sales of Class B and C Shares of Mutual Funds" (March 23, 2005).*

Regulation National Market System (NMS)

The SEC adopted rules under Regulation NMS and two amendments to the joint industry plans for disseminating market information. In addition to redesignating the national market system rules previously adopted under Section 11A of the Exchange Act, Regulation NMS includes new substantive rules that are designed to modernize and strengthen the regulatory structure of the U.S. equity markets.

First, the "Order Protection Rule" requires trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception. To be protected, a quotation must be immediately and automatically accessible.

Second, the "Access Rule" requires fair and non-discriminatory access to quotations, establishes a limit on access fees to harmonize the pricing of quotations across different trading centers, and requires each national securities exchange and national securities association to adopt, maintain and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross automated quotations.

Third, the "Sub-Penny Rule" prohibits market participants from accepting, ranking or displaying orders, quotations or indications of interest in a pricing increment smaller than a penny, except for orders, quotations or indications of interest that are priced at less than $1 per share.

Finally, the "Market Data Rules" and related Plan amendments update the requirements for consolidating, distributing, and displaying market information, as well as amend the joint industry plans for disseminating market information that modify the formulas for allocating plan revenues (Allocation Amendment) and broaden participation in plan governance (Governance Amendment). Regulation NMS became effective August 29, 2005. The compliance dates for the rules under Regulation NMS vary as follows. The Order Protection Rule and Access Rule will be phased-in; the first phase-in date is June 29, 2006 and the second phase-in date is August 31, 2006. The compliance date for the Sub-Penny Rule is January 31, 2006. The compliance date for the Allocation Amendment is September 1, 2006. All other compliance dates coincide with the effective date of Regulation NMS. *See SEC Release No. 34-51808, Regulation NMS (June 9, 2005).*

The NYSE has proposed to establish a Hybrid Market, which is pending review by the SEC. Assuming regulatory approvals, the NYSE will introduce the Hybrid Market in phases beginning in fourth quarter 2005, continuing into full rollout in third quarter 2006.

Research Analyst

New Qualification Requirements for Research Analysts

NASD Rule 1050 and NYSE Rule 344 have been amended to provide an exemption from the research analyst qualification requirements for certain research analysts employed by member foreign affiliates in jurisdictions that NASD and the NYSE have determined to have acceptable qualification standards and research analyst conflict of interest rules. Currently, the exemption is available to research analysts in the following jurisdictions: the United Kingdom, China, Hong Kong, Singapore, Thailand, Malaysia and Japan. Eligibility for the exemption is conditioned on several factors, including imposition of NASD Rule 2711 and NYSE Rule 472 on foreign affiliates and their research analysts in those instances where the research analyst contributes to the preparation of a member's research report. The amendment became effective on April 1, 2005. *See NASD NTM 05-24: NASD Announces Exemption from the Research Analyst Qualification Requirements for Certain Employees Who Contribute to Member Research Reports* (April 2005). *See NYSE Information Memo 05-23 Foreign Research Analyst Exemption.*

The NASD and NYSE have amended NASD Rule 1050 and NYSE Rule 344 to provide an exemption from the analysis portion of the Research Analyst Qualification Examination (Series 86) for certain applicants who prepare only "technical research reports" and have passed Levels I and II of the Chartered Market Technician (CMT) Certification Examination administered by the Market Technicians Association (MTA). *See NASD NTM 05-14: NASD Announces Exemption from the Analyst Portion of the Research Analyst Qualification Examination for Certain Applicants Who Prepare Only "Technical Research Reports"* (February 2005). *See NYSE Information Memo 05-09, Rule 344-Research Analyst Qualification Examination ("Series 86/87") for Technical Research Analysts and Information Memo 05-16, Rule 344-Research Analyst Qualification Examination (Series 86/87) for Technical Research Analysts. See SEC Release No. 34-51240 (February 23, 2005).*

The SEC has approved a new NASD rule that requires supervisors of equity research analysts to pass either the Series 87 or the NYSE Series 16 Supervisory Analyst qualification examination. This new rule augments the existing requirement that supervisors of research analysts must be registered as a General Securities Principal. Qualification requirements for supervisors must have been satisfied by August 2, 2005. *See NASD NTM 04-81: SEC Approves New NASD Qualification Requirements for Supervisors of Research Analysts* (November 2004).

Road Shows

The SEC has approved amendments to NASD Rule 2711 (Research Analysts and Research Reports) and NYSE Rule 472 (Communications to the Public) to further insulate research analysts from the potential influences of the investment banking department. The amendments prohibit (1) a research analyst from participating in a road show related to an investment banking services transaction and from engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction and (2) investment banking department personnel from directing a research analyst to engage in sales and marketing efforts and other communications with a customer about an investment banking services transaction. The rule change expressly permits analysts to educate investors and internal personnel about an investment banking services transaction, provided such communications are "fair, balanced and not misleading."

The new rule became effective June 6, 2005. *See NASD NTM 05-34: SEC Approves Amendments to Rule 2711 to Prohibit Research Analysts from Participating in a Road Show and from Communicating with Customers in the Presence of Investment Banking Personnel or Company Management About an Investment Banking Services Transaction* (May 2005). *See NYSE Information Memo 05-34, Prohibition on Research Analyst Participation in Road Shows.*

Sales Practices

Penny Stocks

The SEC amended the definition of "penny stock" as well as the requirements for providing certain information to penny stock customers. The amendments are designed to address market changes, evolving communications technology and legislative developments. The amendments became effective on September 12, 2005. *See SEC Release No. 34-51983, Amendments to the Penny Stock Rules (July 7, 2005).*

Directed Brokerage Practices

On December 20, 2004, the SEC approved amendments to NASD Rule 2830(k), which governs NASD members' execution of investment company portfolio transactions. The amended rule augments existing proscriptions on directed brokerage practices by prohibiting a member from selling the shares of, or acting as an underwriter for, any investment company if the member knows or has reason to know that the investment company or its investment adviser or underwriter have directed brokerage arrangements in place that are intended to promote the sale of investment company securities. The amendments also eliminated an existing provision in the rule that permitted a member, subject to

certain conditions, to sell or underwrite the shares of an investment company that follows a policy of considering fund sales in determining whether to send portfolio transactions to a broker-dealer. The rule change became effective February 14, 2005. *See NASD NTM 05-04: SEC Approves Amendments to NASD Rule 2830(k) to Strengthen Prohibitions on Investment Company Directed Brokerage Arrangements* (January 2005).

Sales Contests

NASD currently restricts the payment and acceptance of non-cash compensation in connection with the sale of direct participation programs (DPPs), variable insurance contracts, investment company securities, and public offerings of real estate investment trusts (REITs) and other securities. NASD also prohibits internal non-cash sales contests in connection with the sale of variable insurance contracts or investment company securities unless they meet certain criteria, including that such contests are based on principles of total production and equal weighting. NASD has proposed to expand the prohibitions of non-cash compensation to the sale and distribution of any security or type of security, rather than just those enumerated above. NASD also has proposed to prohibit all product-specific cash and non-cash sales contests as defined by the proposed rule. *See NASD NTM 05-40: NASD Requests Comment on Proposal to Prohibit All Product-Specific Sales Contests and to Apply Non-Cash Compensation Rules to Sales of All Securities* (May 2005).

Structured Products

NASD staff is concerned that members may not be fulfilling their sales practice obligations when selling these instruments, especially to retail customers. NASD provides guidance to members concerning their obligations when selling structured products, including the requirements to: (1) provide balanced disclosure in promotional efforts; (2) ascertain accounts eligible to purchase structured products; (3) deal fairly with customers with regard to derivative products; (4) perform a reasonable-basis suitability determination; (5) perform a customer-specific suitability determination; (6) supervise and maintain a supervisory control system; and (7) train associated persons. *See NASD NTM 05-59: NASD Provides Guidance Concerning the Sale of Structured Products* (September 2005).

Short Sales: Reg SHO

In July 2004, the SEC adopted new Regulation SHO under the Exchange Act to provide a new regulatory framework governing short selling of securities. Among other things, Regulation SHO (1) requires broker-dealers to mark sales in all equity securities "long," "short," or "short exempt"; (2) includes a temporary rule that establishes procedures for the SEC to suspend temporarily the operation of the current "tick" test and any short sale price test of any exchange or national securities association, for specified securities; (3) requires short sellers in all equity securities to locate securities to borrow before selling; and (4) imposes additional delivery requirements on broker-dealers for securities in which a substantial number of failures to deliver have occurred. Together with the Regulation SHO adopting release, the SEC issued an order (Pilot Order) establishing a one-year pilot suspending the provisions of Rule 10a-1(a) under the Exchange Act and any short sale price test of any exchange or national securities association for short sales of certain securities for specified periods of time. The SEC also adopted amendments to remove the shelf offering exception, and issued interpretive guidance concerning sham transactions designed to evade Regulation M. For additional information, *see the Short Sales section of the SEC's Web site at* www.sec.gov/spotlight/shortsales.htm, *and in particular, the Q&A developed by the Division of Market Regulation at* www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm. *See also CBOE Regulatory Circulars RG05-020 and RG05-046.*

The SEC Division of Market Regulation also issued two No-Action Letters granting relief from the order-marking requirements under the Regulation SHO Pilot in certain circumstances. In this regard, the NYSE and NASDAQ have established a "masking" process, as described in the SEC's No-Action Letter *(Division of Market Regulation: No-Action Letter to the Securities Industry Association, April 15, 2005). See also NASD NTM 05-33; Short Sales in Pilot Securities and Order-Marking Requirements under SEC Regulation SHO* (April 2004). In addition, members and member organizations using their own proprietary or vendor order management systems are responsible for making appropriate system changes to ensure proper handling of pilot securities.

To aid members and member organizations in complying with Regulation SHO and the Pilot Order, the NYSE and NASDAQ have posted on their Web sites their respective lists of pilot securities, as established by the Pilot Order. The NYSE has worked with the SEC in obtaining a procedure to grant specialist organizations no-action relief from the close out requirements of Rule 203(b)(3) of Regulation SHO. Also, the NYSE has enhanced its Exchange Filing Platform (EFP) system to add a new EFP contact in the membership profile information for Regulation SHO.

Finally, with respect to NASD Order Audit Trail System (OATS) requirements and NYSE books and records requirements, members and member organizations also may mark their OATS report consistent with the SEC's order-marking relief. *See NASD NTM 04-93: Issues Relating to the SEC's Adoption of Regulation SHO* (December 2004). *See also NYSE Information Memo 04-54, Adoption of New Provisions Affecting the Regulation of Short Sales, Information Memo 04-64, SEC Postpones Short Sale Pilot Program, the Exchange Proposes to Amend its Short Sale Rules (440B & 440C) and Other Regulation SHO Implementation Issues, Information Memo 05-27, Amendments to NYSE 440F and 440G to Include Short-Exempt Sales on Reports of Short Interest* (i.e., *Form SS20 & 121), Information Memo 05-30, The Exchange Publishes List of Pilot Securities Pursuant to Regulation SHO and Provides Guidance on the Regulation, Information Memo 05-33, Reg SHO Pilot – Considerations Relating to Selling Securities Short on the Floor of the Exchange and Member Education Bulletin 2005-07 Procedures for Entry and Transmission of Short Exempt CAP-DI Orders.*

Supervision

Annual Compliance Meetings

On April 25, 2005, the SEC approved amendments to NASD Rule 3010(a)(7) to require that registered principals, in addition to registered representatives, attend an annual compliance meeting. The SEC also approved amendments to NASD Rules 3010(a), 3010(a)(3), and 3010(b)(1) to clarify that the scope of these rules specifically extends to registered representatives, registered principals, and other associated persons. The amendments became effective July 25, 2005. *See NASD NTM 05-44: SEC Approves Amendments Relating to Annual Compliance Meetings* (June 2005).

Mutual Fund/Variable Annuity Sales Practice and Supervision

Disclosures made in connection with retail sales of investment company shares (mutual funds) and variable annuities have raised ongoing regulatory concerns, particularly with respect to the recently prohibited practice of directed brokerage, as well as issues involving revenue sharing and suitability. The NYSE has released an information memo clarifying requirements for disclosures and sales practices and remind my members and member organizations and associated persons of their disclosure obligations under existing NYSE and/or SEC rules. *See NYSE Information Memo 05-54, Disclosures and Sales Practices Concerning Mutual Funds and Variable Annuities.*

Customer Complaints

On April 13, 2005, the SEC approved new NYSE Rule 401(A) (Customer Complaints) regarding acknowledgements and responses to customer complaints, as well as corresponding amendment to NYSE Rule 476A (Imposition of Fines for Minor Violations(s) of Rules) to allow the Exchange to sanction members' and member organizations' less serious violations of Rule 401A. NYSE Rule 351 (Reporting Requirements) specifies certain occurrences, incidents, and period information that the Member must report to the Exchange. Rule 351(d) requires members and member organizations to report to the Exchange statistical information regarding specified verbal and written customer complaints. Exchange examiners reviewing compliance with Rule 351(d) discovered instances in which member organizations failed to acknowledge or respond to customer complaints. New Rule 401A makes acknowledging and responding to customer complaints mandatory.

Taping Rule

On May 5, 2005, the SEC approved amendments to NASD Rule 3010(b)(2) (Taping Rule). The amendments require firms that are seeking an exemption from the Rule to submit their exemption requests to NASD within 30 days of receiving notice from NASD or obtaining actual knowledge that they are subject to the provisions of the Rule. The amendments also clarify that firms that trigger application of the Taping Rule for the first time can elect to either avail themselves of the one-time "opt out provision" or seek an exemption from the Rule, but they may not seek both options. The amendments became effective August 1, 2005. *See NASD NTM 05-46: SEC Approves Amendments Relating to Taping Rule "Opt Out" and Exemption Provisions* (July 2005).

Trade Reporting

Trade Reporting and Compliance Engine (TRACE)

NASD implemented amendments to Rule 6250 requiring the immediate or delayed dissemination of information on TRACE transactions in two stages (hereinafter, Stage One and Stage Two). The amendments were approved by the SEC on September 3, 2004 and are described in detail in SR-NASD-2004-094, *NASD NTM 04-65* (September 2004), and *NASD NTM 05-02* (January 2005). The implementation dates of Stage One and Stage Two were October 1, 2004 and February 7, 2005, respectively. With the implementation of Stage Two, all transactions in TRACE-eligible securities are publicly disseminated on an immediate or a delayed basis, except transactions in TRACE-eligible securities that are issued pursuant to Section 4(2) of the Securities Act and are purchased or sold pursuant to Rule 144A under the Securities Act. On July 1, 2005, the period to report a transaction in a TRACE-eligible security was reduced to 15 minutes. TRACE data is available free of charge to investors at *www.nasdbondinfo.com.*

Municipal Securities Real-Time Transaction Reporting

On January 31, 2005, the MSRB began requiring brokers, dealers and municipal securities dealers to report transactions in municipal securities within 15 minutes of execution. The MSRB then makes this "real-time" pricing information available to the marketplace. The Bond Market Association, which represents fixed-income brokers and dealers, posts the MSRB data free of charge on *www.investinginbonds.com.* Through a searchable database at this website, investors can view municipal bonds by state, credit rating or maturity.

The MSRB published a notice to brokers, dealers and municipal securities dealers reminding them of the need to report municipal securities transactions accurately and to minimize the submission of modifications and cancellations to the Real-Time Transaction Reporting System (RTRS). Each transaction initially should be reported correctly to RTRS. Thereafter, only changes necessary to achieve accurate and complete transaction reporting should be submitted to RTRS. Changes should be rare since properly reported transactions should not need to be corrected. *See MSRB Notice 2005-13, Reminder Regarding Modification and Cancellation of Transaction Reports: Rule G-14. The MSRB also published a notice reminding dealers of trade reporting procedures with respect to "step outs" and other inter-dealer deliveries that are not the result of inter-dealer transactions. See MSRB Notice 2005-22, Notice of Comparison of Inter-Dealer Deliveries that Do Not Represent Inter-Dealer Transactions—"Step Out" Deliveries: Rules G-12(f) and G-14. In addition, the MSRB amended Rule G-34, on CUSIP numbers and new issue requirements, to facilitate real-time transaction reporting of new issue municipal securities. See MSRB Notice 2005-03, Amendments Approved to Rule G-34 to Facilitate Real-Time Transaction Reporting.*

The MSRB has devoted a section of its Web site *(www.msrb.org)* to information pertaining to transaction reporting.

To Obtain More Information

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

Self-Regulatory Organization	Address and Phone Number	Online Address
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 (800) THE-AMEX	www.amex.com www.amextrader.com
Chicago Board Options Exchange	Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 (877) THE-CBOE Email: help@cboe.com	www.cboe.com
Municipal Securities Rulemaking Board	MSRB Publications Department 1900 Duke Street, Suite 600 Alexandria, VA 22314 (703) 797-6600	www.msrb.org
NASD	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 (240) 386-4200	www.nasd.com
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street, 18th Floor New York, NY 10005 (212) 656-5273 or (212) 656-2089	www.nyse.com
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 (800) THE PHLX or (215) 496-5158	www.phlx.com

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Internal Audit
Legal & Compliance
Operations
Senior Management
Systems
Trading

KEY TOPICS

IM-2110-2
Manning Rule
Market Orders
Rule 2111

GUIDANCE

Market Order Protection

SEC Approves New Rule 2111 Prohibiting Members from Trading Ahead of Customer Market Orders Under Certain Circumstances; **Effective Date: January 9, 2006**

Executive Summary

On August 9, 2005, the Securities and Exchange Commission (SEC) approved new Rule 2111, Trading Ahead of Customer Market Orders, which prohibits a firm that accepts and holds a customer market order from trading for its own account at prices that would satisfy the customer market order, unless the firm immediately thereafter executes the customer market order.[1] Rule 2111, as adopted, is set forth in Attachment A of this *Notice*. NASD will be publishing shortly, in a separate *Notice*, questions and answers regarding the application of the new rule. The rule becomes effective on January 9, 2006.

Questions/Further Information

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

Background and Discussion

Interpretive Material 2110-2, Trading Ahead of Customer Limit Order (commonly referred to as the "Manning Rule") generally prohibits members from trading for their own account at prices that would satisfy a customer's limit order, unless the member immediately thereafter executes the customer limit order. The legal underpinnings for the Manning Rule are a member's basic fiduciary obligations and the requirement that it must, in the conduct of its business, "observe high standards of commercial honor and just and

equitable principles of trade."[2] NASD believes that the same principles on which the Manning Rule is based should apply to the treatment of customer market orders. As such, NASD proposed, and the SEC approved, new Rule 2111, which prohibits members from trading ahead of market orders under certain circumstances.

Specifically, Rule 2111 prohibits a member that accepts and holds a customer market order from trading for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, unless it immediately thereafter executes the customer market order up to the size and at the same price or better at which it traded for its own account. Similar to the application of the Manning Rule, customer market orders would include orders received from the member's own customers or customer orders received from another broker-dealer.

In addition, if a member is holding a customer market order that has not been immediately executed, Rule 2111 requires that the member make every effort to match the pending market order against any market orders, marketable limit orders or non-marketable limit orders priced better than the best bid or offer, received by the member on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the member, and consistent with the terms of the pending market order.

In the event that a member is holding multiple orders on both sides of the market that have not been executed, the member must make every effort to cross or otherwise execute such orders in a manner that is reasonable and is consistent with the objectives of the rule and with the terms of the orders.[3] Members must have a written methodology in place governing the execution priority of all such pending orders, whether the member is holding one order or multiple orders on both sides of the market, and must ensure that such methodology is consistently applied.

Rule 2111 also applies to limit orders that are marketable at the time they are received by the member or that become marketable at a later time. Once marketable, such limit orders are treated as market orders for purposes Rule 2111; however, these orders must continue to be executed at their limit price or better. If a customer limit order is not marketable when received, the limit order must be provided the full protections of the Manning Rule, as applicable. In addition, if the limit order was marketable when received and then becomes non-marketable, once the limit order becomes non-marketable, it must be provided the full protections of Manning Rule.

Rule 2111 applies to NASD members irrespective of the market or market center upon which they trade. As such, if a member were to execute a proprietary trade on an exchange while holding a customer market order on the same side of the market, the member will be deemed to have violated Rule 2111 unless (1) the member immediately provides an execution to that market order at a price equal to or better than the proprietary trade; or (2) the member's proprietary trade was in accordance with a functional role, recognized within the rules of that exchange, of acting as a liquidity provider, such as acting in the role of a specialist or some other substantially similar capacity.

Rule 2111 also incorporates several of the same types of exclusions that apply to the Manning Rule. First, Rule 2111 permits members to negotiate specific terms and conditions applicable to the acceptance of a market order with respect to a market order for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4)[4] or a market order that is for 10,000 shares or more, unless such order is less than $100,000 in value.

Second, Rule 2111 provides an exception for member proprietary trades that are part of an execution, on a riskless principal basis, of another order from a customer (whether its own customer or the customer of another member) (the "facilitated order"). This exclusion applies only if the following requirements are met: (1) the handling and execution of the facilitated order must satisfy the definition of a "riskless" principal transaction, as that term is defined in NASD rules; (2) the member must give the facilitated order the same per-share price at which the member accumulated or sold shares to satisfy the facilitated order, exclusive of any markup or markdown, commission equivalent or other fee; (3) a member must submit, contemporaneously with the execution of the facilitated order, a report as defined in NASD Rules 4632(d)(3)(B)(ii), 4642(d)(3)(B)(ii), 4652(d)(3)(B)(ii), 6420(d)(3)(B)(ii) or 4632A(e)(1)(C)(ii), or a substantially similar report; and (4) members must have written policies and procedures to assure that riskless principal transactions relied upon for this exclusion comply with applicable NASD rules.[5]

NASD is emphasizing that nothing in Rule 2111 modifies the application of Rule 2320 with respect to a member's obligations to customer orders. For example, to the extent a member does not execute a market order fully and promptly, compliance with Rule 2111 would not safeguard the member from potential liability due to non-compliance with its best execution responsibilities.

In recognition that the new rule may alter the way that many members handle customer orders, NASD is providing 90 days from this *Notice* for implementation to provide members with adequate time to develop and implement systems to comply with the new rule. As such, Rule 2111 becomes effective January 9, 2006.

Endnotes

1 *See Securities Exchange Act Release No. 52226* (August 9, 2005), 70 FR 48219 (August 16, 2005) (File No. SR-NASD-2004-045).

2 *See* NASD Rule 2110.

3 A member holding a customer market order that has not been immediately executed or a member holding multiple orders on both sides of the market may satisfy the crossing requirements under the rule by contemporaneously buying from the seller and selling to the buyer at the same price.

4 Rule 3110(c)(4) defines "institutional account" to mean the account of a bank, savings and loan, insurance company, registered investment company, registered investment adviser or the account of any other entity with total assets of at least $50 million.

5 With respect to requirement (4), the member's policies and procedures, at a minimum, must require that the customer order was received prior to the offsetting transactions, and that the offsetting transactions are allocated to a riskless principal or customer account in a consistent manner and within 60 seconds of execution. Members must have supervisory systems in place that produce records that enable the member and NASD to reconstruct accurately, readily and in a time-sequenced manner, all orders which a member relies in claiming this exemption.

ATTACHMENT A

New language is underlined.

2111. Trading Ahead of Customer Market Orders

(a) A member must make every effort to execute a customer market order that it receives fully and promptly.

(b) A member that accepts and holds a market order of its own customer or a customer of another broker-dealer in a Nasdaq or exchange-listed security without immediately executing the order is prohibited from trading that security on the same side of the market for its own account, unless it immediately thereafter executes the customer market order up to the size and at the same price at which it traded for its own account or at a better price.

(c) (1) A member that is holding a customer market order that has not been immediately executed must make every effort to cross such order with any market order, marketable limit order, or non-marketable limit order priced better than the best bid or offer, received by the member on the other side of the market up to the size of such order at a price that is no less than the best bid and no greater than the best offer at the time that the subsequent market order, marketable limit order or non-marketable limit order is received by the member and that is consistent with the terms of the orders.

(2) In the event that a member is holding multiple orders on both sides of the market that have not been executed, the member must make every effort to cross or otherwise execute such orders in a manner that is reasonable, and is consistent with the objectives of this rule and with the terms of the orders.

(3) For purposes of this paragraph (c), a member can satisfy the crossing requirement by contemporaneously buying from the seller and selling to the buyer at the same price.

(4) A member must have a written methodology in place governing the execution and priority of all pending orders that is consistent with the requirements of this rule. A member also must ensure that this methodology is consistently applied.

(d) A member may negotiate specific terms and conditions applicable to the acceptance of a market order only with respect to market orders that are: (1) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4), or (2) 10,000 shares or more, unless such orders are less than $100,000 in value.

(e) This rule applies to limit orders that are marketable at the time they are received by the member or become marketable at a later time. Such limit orders shall be treated as market orders for purposes of this rule, however, these orders must continue to be executed at their limit price or better. If a customer limit order is not

marketable when received, the limit order must be provided the full protections of IM-2110-2 or Rule 6440(f)(2), as applicable. In addition, if the limit order was marketable when received and then becomes non-marketable, once the limit order becomes non-marketable, it must be provided the full protections of IM-2110-2 or Rule 6440(f)(2), as applicable.

(f) The obligations under this rule shall not apply to a member's proprietary trade if such proprietary trade is for the purposes of facilitating the execution, on a riskless principal basis, of another order from a customer (whether its own customer or the customer of another broker-dealer) (the "facilitated order"), provided that all of the following requirements are satisfied:

(1) The handling and execution of the facilitated order must satisfy the definition of a "riskless" principal transaction, as that term is defined in NASD Rules 4632(d)(3)(B), 4642(d)(3)(B), 4652(d)(3)(B), 4632A(e)(1)(C) or 6420(d)(3)(B);

(2) A member that relies on this exclusion to the rule must give the facilitated order the same per-share price at which the member accumulated or sold shares to satisfy the facilitated order, exclusive of any markup or markdown, commission equivalent or other fee;

(3) A member must submit, contemporaneously with the execution of the facilitated order, a report as defined in NASD Rules 4632(d)(3)(B)(ii), 4642(d)(3)(B)(ii), 4652(d)(3)(B)(ii), 6420(d)(3)(B)(ii) and 4632A(e)(1)(C)(ii), or a substantially similar report to another trade reporting system; and

(4) Members must have written policies and procedures to assure that riskless principal transactions relied upon for this exclusion comply with applicable NASD rules. 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 a riskless principal or customer account in a consistent manner and within 60 seconds of execution. Members must have supervisory systems in place that produce records that enable the member and NASD to reconstruct accurately, readily, and in a time-sequenced manner all orders on which a member relies in claiming this exception.

(g) Nothing in this rule changes the application of Rule 2320 with respect to a member's obligations to customer orders.

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Legal & Compliance

Operations

Registration

Training

KEY TOPICS

Limited Principal – General Securities Sales Supervisor (Series 9/10)

Limited Principal – Registered Options (Series 4)

Limited Representative – Investment Company and Variable Contracts Products (Series 6)

Rule 1022(f)

Rule 1022(g)

Rule 1032(b)

GUIDANCE

Qualification Examinations

Revisions to the Series 4, 6 and 9/10 Examination Programs; Implementation Date: November 30, 2005

Executive Summary

NASD has revised the examination programs for the Limited Principal – Registered Options (Series 4), Limited Representative – Investment Company and Variable Contracts Products (Series 6), and Limited Principal – General Securities Sales Supervisor (Series 9/10).[1] The changes are reflected in study outlines that are available on the NASD Web site *(www.nasd.com)*. The changes will appear in examinations administered starting on November 30, 2005.

Questions/Further Information

Questions concerning this *Notice* may be directed to Joe McDonald, Associate Director, NASD Testing and Continuing Education Department (TCE), at (240) 386-5065; Elaine Warren, Lead Analyst, TCE, at (240) 386-4679; or Eva Cichy, Qualifications Specialist, TCE, at (240) 386-4680.

Background and Discussion

The Series 4, 6 and 9/10 examination programs were recently reviewed by NASD staff, committees of industry representatives and, in the case of the Series 4 and 9/10 examination programs, the staff of other self-regulatory organizations (SROs) that share those examination programs. As a result of these reviews and as discussed in greater detail below, NASD has revised the examination programs generally to reflect changes in relevant laws, rules and regulations covered by the examinations, and to reflect more accurately the duties and responsibilities of the individuals who are taking these examinations. The Series 4 and 9/10 examinations also have been modified to reflect the Securities and Exchange Commission (SEC) short sale requirements.[2]

Series 4

NASD Rule 1022(f) states that firms engaged in, or intending to engage in, transactions in security futures or put or call options with the public must have at least one registered options and security futures principal. In addition, every individual engaged in the management of the day-to-day options or security futures activities of a firm must be registered as an options and security futures principal. The Series 4 examination, an industry-wide examination, qualifies an individual to function as a registered options and security futures principal, but only for purposes of supervising a firm's options activities.[3] The Series 4 examination tests a candidate's general knowledge of options trading, the industry rules applicable to trading of option contracts, and the rules of registered clearing agencies for options. The Series 4 examination covers, among other things, equity options, foreign currency options, index options and options on government and mortgage-backed securities.

NASD has revised the Series 4 study outline to reflect changes to the laws, rules and regulations covered by the examination. NASD has further revised the study outline to reflect the SEC short sale requirements, and to align the examination more closely to the supervisory duties of a Series 4 limited principal. In addition, NASD has revised the main section headings and the number of questions on each section of the Series 4 study outline as follows: Options Investment Strategies, decreased from 35 to 34 questions; Supervision of Sales Activities and Trading Practices, increased from 71 to 75 questions; and Supervision of Employees, Business Conduct, and Recordkeeping and Reporting Requirements, decreased from 19 to 16 questions. The revised examination continues to cover the areas of knowledge required to supervise options activities.

NASD has made these changes to the entire content of the Series 4 examination, including the selection specifications and question bank. The number of questions on the Series 4 examination remains at 125, and candidates continue to have three hours to complete the exam. Also, each question continues to count one point, and each candidate must correctly answer 70 percent of the questions to receive a passing grade.

The Series 4 examination program is shared by NASD and the following SROs: the American Stock Exchange LLC (AMEX), the Chicago Board Options Exchange, Incorporated (CBOE), the New York Stock Exchange, Inc. (NYSE), the Pacific Exchange, Inc. (PCX), and the Philadelphia Stock Exchange, Inc. (PHLX). The revised Series 4 examination program reflects revisions made by all the SROs that share the examination, and not just NASD. Moreover, the revised Series 4 examination program supersedes all prior revisions to the examination.[4]

Series 6

The Series 6 examination qualifies persons seeking registration with NASD as a limited representative of investment company and variable contracts products. In accordance with NASD Rule 1032(b), registered representatives in this limited category are permitted solely to engage in transactions involving redeemable securities of companies registered under the Investment Company Act of 1940 (Investment Company Act), securities of closed-end companies registered under the Investment Company Act during the period of original distribution only, and variable contracts and insurance premium funding programs and other contracts issued by an insurance company except contracts that are exempt securities pursuant to Section 3(a)(8) of the Securities Act of 1933.

NASD has revised the Series 6 study outline to cover Regulation S-P, anti-money laundering rules, municipal fund securities (*e.g.,* 529 college savings plans), and Regulation D. NASD also has revised the study outline to align the examination more closely to the functions of a Series 6 limited representative. In addition, NASD has increased the number of sections covered by the Series 6 outline from four to six. Further, NASD has modified the section headings and the number of questions on each section of the outline as follows: Section 1, Securities Markets, Investment Securities, and Economic Factors, 8 questions; Section 2, Securities and Tax Regulations, 23 questions; Section 3, Marketing, Prospecting, and Sales Presentations, 18 questions; Section 4, Evaluation of Customers, 13 questions; Section 5, Product Information: Investment Company Securities and Variable Contracts, 26 questions; and Section 6, Opening and Servicing Customer Accounts, 12 questions.

NASD has made these changes to the entire content of the Series 6 examination, including the selection specifications and question bank. The number of questions on the Series 6 examination remains at 100, and candidates continue to have 2 hours and 15 minutes to complete the exam. Also, each question continues to count one point, and each candidate must correctly answer 70 percent of the questions to receive a passing grade.

Series 9/10

NASD Rule 1022(g) states that firms may register with NASD an individual as a general securities sales supervisor if the individual's supervisory responsibilities in the investment banking and securities business are limited to the securities sales activities of a firm, including the training of sales and sales supervisory personnel and the maintenance of records of original entry and/or ledger accounts of the firm required to be maintained in branch offices by SEC recordkeeping rules. A general securities sales supervisor is precluded from performing any of the following activities: supervision of the origination and structuring of underwritings; supervision of market-making commitments; final approval of advertisements as these are defined in NASD Rule 2210; supervision of the custody of firm or customer funds and/or securities for purposes of SEC Rule 15c3-3; or supervision of overall compliance with financial responsibility rules for broker-dealers

promulgated pursuant to the provisions of the Securities Exchange Act of 1934. The Series 9/10 examination, an industry-wide examination, qualifies an individual to function as a general securities sales supervisor. The Series 9/10 examination tests a candidate's knowledge of securities industry rules and regulations and certain statutory provisions pertinent to the supervision of sales activities.

NASD has revised the Series 9/10 study outline to cover Regulation S-P, Municipal Securities Rule Making Board (MSRB) Rules G-37 and G-38, SRO research analyst and anti-money laundering rules, municipal fund securities (*e.g.,* 529 college savings plans), and exchange traded funds. NASD has further revised the study outline to reflect the SEC short sale requirements, and to align the examination more closely to the supervisory duties of a Series 9/10 limited principal.

In addition, NASD has modified the main section headings and the number of questions on each section of the Series 9/10 study outline as follows: Section 1 – Hiring, Qualifications, and Continuing Education, 9 questions; Section 2 – Supervision of Accounts and Sales Activities, 94 questions; Section 3 – Conduct of Associated Persons, 14 questions; Section 4 – Recordkeeping Requirements, 8 questions; Section 5 – Municipal Securities Regulation, 20 questions; and Section 6 – Options Regulation, 55 questions. Sections 1 through 5 constitute the Series 10 portion of the examination. Section 6 constitutes the Series 9 portion of the examination. Series 10 covers general securities and municipal securities, and Series 9 covers options. The revised examination continues to cover the areas of knowledge required for the supervision of sales activities.

NASD has made these changes to the entire content of the Series 9/10 examination, including the selection specifications and question bank. The number of questions on the Series 9/10 examination remains at 200, and candidates continue to have four hours to complete the Series 10 portion and one and one-half hours to complete the Series 9 portion. Also, each question continues to count one point, and each candidate must correctly answer 70 percent of the questions on each series, 9 and 10, to receive a passing grade.

The Series 9/10 examination program is shared by NASD and the following SROs: the AMEX, CBOE, MSRB, NYSE, PCX and PHLX. The revised Series 9/10 examination program reflects revisions made by all the SROs that share the examination, and not just NASD.

Availability of Study Outlines

The study outlines for the revised examination programs are available on the NASD Qualifications Web page at *www.nasd.com.*

Endnotes

1 *See* Securities Exchange Act Release No. 52546 (September 30, 2005) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Revisions to the Series 4 Examination Program; File No. SR-NASD-2005-109); Securities Exchange Act Release No. 52547 (September 30, 2005) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Revisions to the Series 6 Examination Program; File No. SR-NASD-2005-110); and Securities Exchange Act Release No. 52548 (September 30, 2005) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Revisions to the Series 9/10 Examination Program; File No. SR-NASD-2005-111). The three rule filings were filed with the SEC for immediate effectiveness on September 13, 2005.

2 NASD has repealed Rules 3110(b)(1), 3210, 3370(b), and 11830 in light of the requirements of SEC Regulation SHO. *See Notice to Members 04-93* (December 2004) (Issues Relating to the SEC's Adoption of Regulation SHO). Accordingly, NASD has deleted references to these rules from the Series 4 and 9/10 examination programs.

3 A registered options and security futures principal also must complete a firm-element continuing education program that addresses security futures and a principal's responsibilities for security futures before such person can supervise security futures activities.

4 More specifically, the current revisions to the Series 4 examination program supersede, among other things, the revisions filed with the SEC for immediate effectiveness on February 9, 2005. *See* Securities Exchange Act Release No. 51216 (February 16, 2005), 70 FR 8866 (February 23, 2005) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Revisions to the Series 4 Examination Program; File No. SR-NASD-2005-025).

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Legal & Compliance

Registered Representatives

Senior Management

KEY TOPICS

IM-9216

Rule 9216(b)

Minor Rule Violation Plan (MRVP)

GUIDANCE

Minor Rule Violation Plan

SEC Approves NASD Interpretive Material to Rule 9216 regarding NASD's MRVP; **Effective Date: November 14, 2005**

Executive Summary

On August 18, 2005, the Securities and Exchange Commission (SEC) approved amendments to NASD Interpretive Material 9216-2 (IM-9216-2), regarding NASD's MRVP.[1] The new rule text is contained in Attachment A and is effective on November 14, 2005.

Questions/Further Information

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

Background

In 1984, the SEC adopted amendments to Rule 19d-1(c) under the Securities Exchange Act of 1934 to allow self-regulatory organizations to adopt, with SEC approval, plans for the disposition of minor violations of rules. In 1993, pursuant to SEC Rule 19d-1(c), NASD established an MRVP. The rules governing NASD's MRVP may be found in NASD Rule 9216(b).[2] Rule 9216(b) authorizes NASD to impose a fine of $2,500 or less on any member or associated person of a member for a violation of any of the rules specified in IM-9216.[3] NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent, to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine.

The purpose of the MRVP is to provide for a meaningful sanction for the minor or technical violation of a rule when the initiation of a disciplinary proceeding through the formal complaint process would be more costly and time-consuming than would be warranted. Inclusion of a rule in NASD's MRVP does not mean it is an unimportant rule; rather, a minor or technical violation of the rule may be appropriate for disposition under the MRVP. Once NASD has brought a minor violation of a rule against an individual or member firm, NASD may, at its discretion, issue progressively higher fines for all subsequent minor violations of rules within the next 24-month period or initiate more formal disciplinary proceedings.

Discussion

NASD has amended its MRVP as follows:

—Rules 4632, 4642, 4652, 4632A, 5430, 6130, 6170, 6130A, 6170A, 6230, 6420, 6550, 6620, and 6720—Transaction reporting in debt and equity securities.

NASD has combined in one entry all of the rule violations eligible for disposition under the MRVP that relate to transaction reporting and audit trail requirements in equity and debt securities. This entry includes violations of transaction reporting and audit trail requirements related to (1) the NASDAQ Market Center; (2) NASD's Trade Reporting and Comparison Service (TRACS);[4] and (3) the Trade Reporting and Compliance Engine (TRACE).

To effectuate this, NASD has eliminated the separate minor rule violation pertaining to Rules 6130 and 6170 and has added those rules to this entry. NASD has also added to the MRVP, and this entry, violations of Rules 4632A, 5430, 6130A and 6170A, which relate to TRACS requirements.[5] Including violations of the ADF transaction-reporting requirements in the MRVP is consistent with the current minor rule violations for transaction reporting in equity securities.

NASD has also eliminated the reference in the MRVP to a violation of the Fixed Income Pricing System (FIPS), and replaced it with a violation of Rule 6230, the TRACE transaction-reporting rule.[6] In adopting the TRACE rules in 2001, NASD eliminated FIPS, which required members to report trades for 50 high-yield debt securities. Since the TRACE system replaced and expanded upon FIPS, NASD has amended the MRVP to replace the FIPS violation with a violation of the TRACE system transaction-reporting requirement.

—Rules 2210, 2211, and 2220, and IM-2210-1, -2210-2, -2210-3, -2210-4, -2210-5, -2210-7, and -2210-8—Communications with the public.

NASD's advertising rules (Rules 2210, 2211, and 2220, and related Interpretive Materials) contain general and specific standards applicable to all member communications with the public. These standards prohibit incomplete, unbalanced, or unfair communications as well as exaggerated, unwarranted, or misleading statements or claims. The rules also enumerate specific standards for certain types of communications, including recommendations, hedge clauses and projections. In addition, the rules set forth standards for the use and disclosure of the member's name.

Prior to the adoption of these amendments, NASD could issue minor rule violations only for procedural violations of the advertising rules, such as a failure to have advertisements and sales literature approved by a principal prior to use or a failure to meet specified time limits for filing advertisements. It was NASD's experience, however, that, based on the facts and circumstances, certain content-related violations of these rules could warrant more than a Letter of Caution, yet not rise to a level requiring or meriting full disciplinary action. Accordingly, as amended, the MRVP provision concerning communications with the public allows NASD to address these minor or technical violations of content-related advertising rules, which might include, for example only, a technical violation of the provisions on the use and disclosure of members' names.

—Failure to provide or update contact information as required by NASD Rules.

NASD has expanded the MRVP to include, as a general category, a member's failure to identify to NASD and keep current information regarding any contact person that a member must provide to NASD under any current or future NASD rule. For example, a member's failure to provide or update emergency contact information under Rule 3520 or failure to provide or update its executive representative designation and contact information as required by Rule 1150 would be eligible for disposition as a minor rule violation under this category.[7]

Endnotes

1 Exchange Act Rel. No. 52294 (Aug. 18, 2005), 70 FR 49700 (Aug. 24, 2005) (SR-NASD-2004-025).

2 *See* Exchange Act Rel. No. 32383 (May 28, 1993), 58 FR 31768 (June 4, 1993) (SR-NASD-93-6); *see also Notice to Members 93-42* (July 1993).

3 In 2001, the SEC approved significant amendments to NASD's MRVP. In addition, in 2004, the SEC approved an amendment to NASD's MRVP to include failure to timely submit amendments to the Form U5 (Uniform Termination Notice for Securities Industry Registration).

4 TRACS is the trade reporting system for NASD's Alternative Display Facility (ADF).

5 NASD notes that Rule 5430 governs both TRACS and the NASDAQ Market Center transaction reporting requirements.

6 Prior to July 1, 2002, the Rule 6200 Series pertained to FIPS, and Rule 6240 governed transaction reporting in high yield fixed income securities.

7 *See also* Rule 1120(a)(7) (requirement to provide continuing education regulatory element contact person). NASD notes that it generally has sought to achieve consistency regarding the frequency in which members must review and update contact information (namely, within 17 business days after the end of each calendar quarter, which is consistent with the schedule for filing the quarterly FOCUS report).

ATTACHMENT A

New language is underlined; deletions are in brackets.

* * * * *

9200. DISCIPLINARY PROCEEDINGS

* * * * *

IM-9216. Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)

[—Rule 2210(b) and (c) and Rule 2220(b) and (c)—Failure to have advertisements and sales literature approved by a principal prior to use; failure to maintain separate files of advertisements and sales literature containing required information; and failure to file communications with NASD within the required time limits.]

—Rules 2210, 2211, and 2220, and IM-2210-1, -2210-2, -2210-3, -2210-4, -2210-5, -2210-7, and -2210-8—Communications with the public.

—Rule 3360—Failure to timely file reports of short positions on Form NS-1.

—Rule 3110—Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with [the] NASD Rules [of the Association].

—Rule 8211, Rule 8212, and Rule 8213—Failure to submit trading data as requested.

—Article IV of the NASD By-Laws—Failure to timely submit amendments to Form BD.

—Article V of the NASD By-Laws —Failure to timely submit amendments to Form U4.

—Article V of the NASD By-Laws —Failure to timely submit amendments to Form U5.

—Rule 1120—Failure to comply with the Firm Element of the continuing education requirements.

—Rule 3010(b)—Failure to timely file reports pursuant to the Taping Rule.

—Rule 3070—Failure to timely file reports.

—Rule 4619(d)—Failure to timely file notifications pursuant to SEC Regulation M.

—Rules 4632, 4642, 4652, 4632A, 5430, 6130, 6170, 6130A, 6170A, 6230[6240], 6420, 6550, 6620, and 6720—Transaction reporting in debt and equity[, convertible debt, and high yield] securities.

[—Rules 6130 and 6170—Transaction reporting to the Automatic Confirmation Transaction Service ("ACT").]

—Rules 6954 and 6955—Failure to submit data in accordance with the Order Audit Trail System ("OATS").

—Rule 11870—Failure to abide by Customer Account Transfer Contracts.

—Failure to provide or update contact information as required by NASD Rules.

—SEC Exchange Act Rule 11Ac1-4—Failure to properly display limit orders.

—SEC Exchange Act Rule 11Ac1-1(c)(5)—Failure to properly update published quotations in certain Electronic Communication Networks ("ECN[']s").

—SEC Exchange Act Rule 17a-5—Failure to timely file FOCUS reports and annual audit reports.

—SEC Exchange Act Rule 17a-10—Failure to timely file Schedule I.

—MSRB Rule A-14—Failure to timely pay annual fee.

—MSRB Rule G-12—Failure to abide by uniform practice rules.

—MSRB Rule G-14—Failure to submit reports.

—MSRB Rule G-36—Failure to timely submit reports.

—MSRB Rule G-37—Failure to timely submit reports for political contributions.

—MSRB Rule G-38—Failure to timely submit reports detailing consultant activities.

* * * * *

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Legal & Compliance

Operations

Senior Management

KEY TOPICS

Clearing Agreements

"Piggybacking" Arrangements

Rule 3150

Rule 3230

GUIDANCE

Reporting Requirements for "Piggybacking" Arrangements

SEC Approves Amendments to NASD Rule 3150, Regarding Reporting Requirements for Clearing Firms, and NASD Rule 3230, Regarding Requirements for Clearing Agreements; **Effective Date: February 20, 2006**

Executive Summary

On August 26, 2005, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 3150, regarding reporting requirements for clearing firms, and NASD Rule 3230, regarding requirements for clearing agreements.[1] The new rule text is contained in Attachment A and is effective on February 20, 2006.

Questions/Further Information

Questions concerning this *Notice* may be directed to George Walz, Vice President and Director, National Examination Program, Department of Member Regulation, at (202) 728-8462; or Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

Background

By way of background, some introducing firms choose not to contract for clearing services directly with a clearing firm. The reasons vary. For example, the firm may not do sufficient business to satisfy clearing firm financial and other requirements to support a separate clearing agreement. In such cases, the firm may contract for clearing services with an introducing, or "intermediary" firm that, in turn, contracts directly with a clearing firm for clearing services. Firms that contract for clearing services with an intermediary firm are often referred to as "piggybacking" firms, or "piggybackers."

Under this arrangement, only the intermediary firm has a contractual arrangement with the clearing firm, which clears for both the intermediary firm and the intermediary firm's piggybacking firm(s). Under current practice, the intermediary firm may assign account numbers to the piggybacker's accounts (both proprietary and customer accounts) that do not identify them to the clearing firm as belonging to a piggybacking firm. For example, the intermediary firm may assign account numbers that identify these accounts as branch offices of the intermediary firm.

Although these piggybacking arrangements may satisfy the business needs of the parties—the clearing firm, the intermediary firm, and the piggybacking firm—they may impede NASD regulatory programs and may cause problems for the clearing firm. For example, under Rule 3150, clearing firms are required to report certain data to NASD for purposes of the surveillance component of its National Examination Program (NEP). In fulfilling its reporting obligation under Rule 3150, a clearing firm whose clients include intermediary firms that have contracted with piggybackers may be reporting the combined data of the intermediary firm and its piggybackers as only belonging to the intermediary firm. In such cases, NASD staff is not able to distinguish between data belonging to the intermediary firm and data belonging to the piggybacking firm(s) for purposes of conducting surveillance.

In addition, this inability to separate the piggybacking firm data can, and already has, become a serious issue if an intermediary firm goes into SIPC (Securities Investor Protection Corporation) liquidation. If the data from the intermediary and piggybacking firms are not distinguishable, the clearing firm will be unable to facilitate the orderly transfer of accounts without doing time-intensive research and creating a special program to separate accounts belonging to the intermediary firm and its piggybacker(s).

Discussion

To resolve these issues, NASD has adopted amendments to Rule 3150 (governing reporting requirements for clearing firms) and Rule 3230 (governing clearing agreements) that would permit regulators and clearing firms to distinguish between data belonging to an intermediary firm and data belonging to its piggybacker(s).

NASD Rule 3150. The amendments to Rule 3150 require clearing firms to report data to NASD about each piggybacking firm separately from the intermediary firm's data. These requirements will apply to the data pertaining to the proprietary and customer accounts of piggybacking firms **only** if the piggybacking relationship with the intermediary firm was established on or after February 20, 2006.

NASD Rule 3230. The amendments to Rule 3230 require intermediary firms to maintain data in such a way as to enable NASD and the clearing firm to be able to identify the data pertaining to the proprietary and customer accounts of the intermediary firm and the data pertaining to the proprietary and customer accounts of any piggybacking firm. These amendments will enable NASD staff to surveil data reported by piggybacking firms as part of NASD's NEP Surveillance program and facilitate any future SIPC liquidations. These requirements will apply to the data belonging to the proprietary and customer accounts of any piggybacking firm **only** if the piggybacking relationship was established on or after February 20, 2006.

Endnote

1 Exchange Act Rel. No. 52352 (Aug. 26, 2005), 70 FR 52460 (Sept. 2, 2005) (SR-NASD-2005-058).

ATTACHMENT A

* * * * *

3150. Reporting Requirements for Clearing Firms

(a) No change.

(b) Each member that is a clearing firm is required to report prescribed data to NASD under this Rule in such a manner as to enable NASD to distinguish between data pertaining to all proprietary and customer accounts of an introducing member and data pertaining to all proprietary and customer accounts of any member for which the introducing member is acting as an intermediary in obtaining clearing services from a clearing firm. The reporting requirements of this paragraph (b) shall apply to the proprietary and customer accounts of members that have established an intermediary clearing arrangement with an introducing member on or after February 20, 2006.

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

* * * * *

3230. Clearing Agreements

(a) through (g) No change.

(h) All clearing agreements shall require each introducing member to maintain its proprietary and customer accounts and the proprietary and customer accounts of any member for which it is acting as an intermediary in obtaining clearing services from the clearing firm in such a manner as to enable the clearing firm and NASD to identify data belonging to the proprietary and customer accounts of each member. The requirements of this paragraph (h) shall apply to intermediary clearing arrangements between a member and an introducing member that are established on or after February 20, 2006.

* * * * *

Disciplinary and Other NASD Actions

REPORTED FOR OCTOBER

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of September 2005.

Firms Fined, Individuals Sanctioned

Froggatte & Company (CRD #43161, Whichita, Kansas) and Theron Lynn Froggatte (CRD #1902647, Registered Principal, Whichita, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which the firm and Froggatte were fined $25,000, jointly and severally, and Froggatte was suspended from association with any NASD member in a financial and operations principal capacity 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 Froggatte, conducted a securities business while failing to maintain minimum required net capital. The findings stated that the firm, acting through Froggatte, failed to prepare accurate general ledger, trial balance and net capital computations. The findings also stated that the firm, acting through Froggatte, participated in an underwriting on a firm commitment basis and effected transactions for its own investment account that were not permitted under the express terms of the firm's membership agreement with NASD.

Froggatte's suspension will begin November 7, 2005, and will conclude at the close of business December 6, 2005. **(NASD Case #E042004006601)**

Leonard Securities, Inc. (CRD #43176, Oklahoma City, Oklahoma), Paul Arthur Raisig (CRD #2231888, Registered Representative, Oklahoma City, Oklahoma) and Robert Leonard Savage (CRD #815336, Registered Principal, Oklahoma City, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent in which the firm and Savage were fined $10,000, jointly and severally, and ordered to pay $14,159 in restitution to public customers. Savage was suspended from association with any NASD member in a principal capacity for 10 business days. Raisig was fined $10,000 and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Raisig recommended and effected mutual fund transactions in the accounts of public customers without having a reasonable basis for the recommendation. The findings stated that the firm, acting through Savage, failed to establish, maintain and enforce a system of supervision reasonably designed to ensure compliance with NASD rule 2310.

Savage's suspension began October 3, 2005, and concluded at the close of business October 14, 2005. Raisig's suspension began October 3, 2005, and will conclude at the close of business October 21, 2005. **(NASD Case #E052004004203)**

Presidential Brokerage, Inc. (CRD #28784, Greenwood Village, Colorado), Anthony Joseph Campen (CRD #1959903, Registered Principal, Meza, Arizona) and Eric Joel Lempe (CRD #1483459, Registered Principal, San Diego, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $70,000, jointly and severally, with Campen, of which $65,083 shall be allocated as restitution to public customers and required to attest in writing that it complied with the requirements of NASD Rule 3070. Campen was suspended from association with any NASD member in a principal capacity for 15 business days. Lempe was fined $224,618 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Campen, reported customer complaints with inaccurate information and failed to report, or reported late, matters that required disclosure within 10 days pursuant to NASD Rule 3070. The findings stated that the firm, acting through Campen, reported late amendments to Forms U4 and U5 and did not disclose information required to be disclosed on a Form U5. The findings also stated that the firm, acting through Campen, failed to establish a supervisory system, and failed to establish, maintain and enforce written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules pertaining to Rule 3070, reporting the timely and accurate filing of Forms U4 and U5, and the suitability of mutual funds share class recommendations. NASD found that the firm, acting through an employee, failed to supervise the activities of registered representatives who were employing trading strategies with customers located abroad in a manner reasonably designed to achieve compliance with NASD rules. In addition, the findings stated that the firm, acting through Lempe, recommended the purchase of mutual fund "Class B" shares to customers for whom a recommendation of "Class A" shares would have been economically more beneficial.

Campen's suspension began September 19, 2005, and concluded at the close of business October 7, 2005. Lempe's suspension began September 19, 2005, and will conclude at the close of business March 18, 2006. **(NASD Case #E3A2002001601)**

Professional Investment Services, Inc. (CRD #13703, Winfield, Kansas) and Don Howard Ehling (CRD #76203, Registered Principal, Winfield, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which the firm and Ehling were censured and fined $12,500, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Ehling, acting on behalf of Professional Investment Services, Inc., failed to file an annual audit report for the year ending December 31, 2004, by the due date. **(NASD Case #2005000996601)**

White Mountain Capital, LLC (CRD #104123, Nanuet, New York) and Ruben Francisco Augusta (CRD #2217612, Registered Principal, Brooklyn, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $25,000, of which $15,000 was joint and several with Augusta. Augusta is also suspended from association with any NASD member in any principal 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 Augusta, did not discover that an associated person's Continuing Education (CE) and registration status were deficient, and that this person functioned as a representative although she was not effectively registered with the firm. The findings also stated that the firm, acting through Augusta, permitted the individual to function as a representative while her waiver application was pending. NASD found that the firm did not develop and implement a written anti-money laundering (AML) program that was reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act and the regulations promulgated thereunder.

Augusta's suspension began August 15, 2005, and concluded at the close of business August 19, 2005. **(NASD Case #E112003012401)**

Viewtrade Securities, Inc. (CRD #46987, Boca Raton, Florida) and James Joseph St. Clair, Jr., CRD #1550599, Registered Principal, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined $185,000, of which $30,000 was jointly and severally with St. Clair, and required to retain an independent consultant to conduct a complete audit of the firm's policies, practices and procedures. St. Clair was suspended from association with any NASD member in any principal capacity for 18 months.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through St. Clair, failed to establish, maintain and enforce taping procedures for supervising the telemarketing activities of all of its registered persons. The findings stated that the firm, acting through St. Clair, sent a signed "certification regarding special written supervisory procedures for compliance with NASD 3010(b)(2)" to NASD that contained material misrepresentations. The findings also stated that the firm, acting through St. Clair, failed to establish and implement policies and procedures that

were reasonably designed to achieve compliance with the Bank Secrecy Act and regulations thereunder, by failing to have procedures to monitor accounts for described red flags, and failing to identify and adequately investigate suspicious activity in customer accounts despite the existence of red flags. The firm also failed to obtain foreign bank certifications. NASD also found that the firm failed to have supervisory procedures designed to prohibit insider trading in accounts maintained for public customers. NASD found that the firm, acting through St. Clair, failed to establish, develop and implement an adequate supervisory system or procedures allowing the firm to monitor, achieve and retrieve instant messages sent and received by its registered persons, and the use by its registered representatives of email. The findings stated that the firm, acting through St. Clair, failed to establish and maintain a system of supervision reasonably designed to ensure compliance with the rules of NASD and the applicable laws and regulations.

St. Clair's suspension began October 17, 2005, and will conclude at the close of business April 16, 2007. **(NASD Case #E072003014001)**

Firms and Individuals Fined

Colonial Brokerage, Inc. (CRD #111668, Montgomery, Alabama) and Beth Phillips Johnson (CRD #4334497, Registered Principal, Lowndesboro, Alabama) submitted a Letter of Acceptance, Waiver and Consent in which the firm and Johnson were censured, and the firm was fined $15,000, of which $10,000 was jointly and severally with Johnson. Without admitting or denying the allegations, the firm and Johnson consented to the described sanctions and to the entry of findings that they engaged in a securities business when the firm's net capital was below the required minimum as prescribed by SEC rule 15c3-1. The findings stated that the firm, acting through Johnson, failed to provide notification that the member firm's net capital was below the required minimum. NASD also alleges that the firm failed to timely report transactions in debit securities reportable via the Trade Reporting and Compliance Engine (TRACE). **(NASD Case #E052004001401)**

Global Strategic Investments, LLC (CRD #117028, Miami, Florida) and Justin Ryan DalMolin (CRD #4666567, Registered Principal, Miami Beach, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm and DalMolin were censured and fined $10,000, jointly and severally. Without admitting or denying the allegations, the firm and DalMolin consented to the described sanctions and to the entry of findings that the firm, acting through DalMolin, conducted a securities business while failing to maintain the minimum net capital requirement. The findings stated that the firm, acting through DalMolin, violated SEC Rules 17a-3 and 17a-5, in that the firm's original net capital computations and its FOCUS report were materially inaccurate. **(NASD Case #E0720040143)**

Firms Fined

American Funds & Trust, Inc. (CRD #1066, Salt Lake City, Utah) 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 its anti-money laundering (AML) compliance program failed to implement procedures required by the firm's customer identification program by failing to establish and maintain records of information obtained and reviewed to verify the identity of 49 customers of 50 new accounts opened. NASD also found that the firm's independent test of its AML program was limited to certain aspects of the firm's AML program as opposed to the entire program. **(NASD Case #E3A2004003401)**

Clayton, Dunning & Company, Inc. (CRD #42533, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to develop and implement an AML program reasonably designed to achieve and monitor its compliance with the requirements by failing to implement an adequate customer identification program in that the firm did not adequately verify the identity of new customers. **(NASD Case #E1020040891-01)**

Domestic Securities, Inc. d/b/a The Attain ECN (CRD #34721, Montvale, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it incorrectly classified an order to sell short as a "covered" order in connection with the firm's Sec Rule 11ac1-5 data disclosures. **(NASD Case #2005000264801)**

Eastlake Securities, Inc. (CRD #15781, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it developed and implemented an AML program that was not reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act and the implementing regulations thereunder. The findings stated that the firm allowed a representative to maintain his registration

as a general securities representative through his purported association with the firm, when in fact he was not actively involved in the firm's securities business or otherwise functioning as a representative of the firm. **(NASD Case #E1020040133-01)**

Electronic Brokerage Systems, LLC (CRD #104031, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $40,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to timely report to the Order Audit Trail System℠ (OATS℠) reportable order events (ROEs), and submitted to OATS reports with respect to equity securities traded on NASDAQ that were not in the electronic form prescribed by NASD and were repairable. The findings stated that 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, but the firm did not correct or replace the subject reports. The findings also stated that the firm failed to enforce its written supervisory procedures that specified that the firm would conduct a weekly review to ensure that all required ROEs were submitted to OATS, and a daily review to ensure that rejected ROEs were repaired. NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations, and NASD rules concerning OATS. **(NASD Case #2004200007701)**

Fleet Securities, Inc. (CRD #13071, New York, 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 it failed, within 90 seconds after execution, to transmit through the Automated Confirmation Transaction Service℠ (ACT℠) last-sale reports of transactions, failed to designate through ACT that some of these transactions were late, and inaccurately reported to ACT that it had acted as a principal in some of these transactions. The findings stated that the firm failed to record on the order tickets the execution times in seconds. In addition, the findings stated that the firm reported transactions to the Municipal Securities Rulemaking Board (MSRB) with the incorrect executing broker symbol, and failed to timely report some of these transactions to the MSRB. **(NASD Case #E1020030187-01)**

Janco Partners, Inc. (CRD #40055, Greenwood Village, Colorado) 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, acting through individuals, it caused draft research reports to be sent to the companies that were the subjects of the reports. The findings stated that the reports contained statements of opinion, prediction and commentary, in addition to factual matters for verification, which should not have been included in the draft reports sent to the subject companies. The findings also stated that a research analyst associated with the firm purchased securities issued by a company that he covered and issued a research report concerning that company. NASD found that the firm's written supervisory procedures were not reasonably designed to achieve compliance in that they recited the rule provisions, but did not include procedures to monitor and achieve compliance with the rule. The findings further stated the firm did not submit to NASD a written attestation that the firm had adopted and implemented written supervisory procedures reasonably designed to achieve compliance. NASD determined that the firm also failed to make a notation of the time of entry and necessary terms and conditions in the memoranda of purchases and sale of securities for the firm's account and each brokerage order. **(NASD Case #E3A2004002201)**

The Jeffrey Matthews Financial Group, L.L.C. (CRD #41282, Millburn, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $75,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that its supervisory system and procedures were not reasonably designed to ensure that the required written consent was obtained before pre-registration searches on WebCRD, and that the firm retained the required documentation. **(NASD Case #E9B2004025501)**

Legacy Financial Services, Inc. (CRD #38697, Petaluma, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was fined $54,250. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to timely file disclosures for reportable events to NASD within 10 business days after learning of such events, failed to timely report complaints to NASD by the 15th day of the month following the calendar quarter in which the complaints were received, and failed to promptly update Forms U4 and U5 for events that required regulatory disclosure. The findings stated that the firm had inadequate written supervisory procedures relating to prompt reporting of events requiring regulatory disclosure filings. **(NASD Case #E012004004501)**

Nat City Investments, Inc. (CRD #17490, Cleveland, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which it 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 and maintain a supervisory system reasonably designed to review and monitor its fee-based brokerage. **(NASD Case #E8A2003084601)**

People's Securities Inc. (CRD #13704, Bridgeport, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined $125,000, and required to review its procedures regarding the preservation of electronic mail communications for compliance with NASD rules and federal securities laws and regulations. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to maintain and preserve all of its email communications in that the firm utilized an email archival system that purged all email communications after 60 days and the back-up records of the purged emails after 10 days. **(NASD Case #E112004014101)**

Prime Capital Services, Inc. (CRD #18334, Poughkeepsie, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined $200,000, and required to review the firm's written supervisory procedures regarding the preservation of electronic mail communications for compliance with NASD rules and federal securities laws and regulations. The firm was also required to offer public customers options to convert class B shares into class A shares at no cost. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm failed to establish, maintain and enforce supervisory procedures that were reasonably designed to achieve compliance with advertising rules, branch office inspections, review and approval of new brokerage and variable annuity applications, review of principals' customer transactions and mutual fund share class suitability. The findings stated that the firm failed to report customer complaints and registered representative terminations in a timely manner and neglected to preserve certain required books and records of its registered representatives including email communications. **(NASD Case #E112003006901)**

QA3 Financial Corporation (CRD #14754, Omaha, Nebraska) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm failed to establish, maintain and enforce a supervisory system reasonably designed to enable the firm and its supervisors to scrutinize mutual fund share purchases to detect and prevent unsuitable Class B share purchases. **(NASD Case #E0420040097-02)**

Robeco Securities, L.L.C. (CRD #2998, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it reported corporate bond transactions containing deficiencies to TRACE. The findings stated that the firm reported one side of the transaction to TRACE, but not both sides as required by NASD Systems and Programs Rule 6230. **(NASD Case #E1020030563-01)**

Shattuck Hammond Partners LLC (CRD #113645, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report 77 out of 97 municipal securities transactions to the MSRB. Further, the findings stated that of the trades reported to the MSRB, the firm reported five municipal securities transactions to the MSRB late, incorrectly dated, and two transactions that were reported nonreportable events. The findings also stated that the firm did not maintain adequate written supervisory procedures to ensure compliance with MSRB Rule G-14. **(NASD Case E1020040367-01)**

Summer Street Research Partners (CRD #127142, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it issued research reports that omitted certain facts and/or utilized conditional or indefinite language in making required disclosures. **(NASD Case #E112004004801)**

Wave Securities, LLC (CRD #43705, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which it 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 it failed to report the time of execution through ACT in last-sale reports of transactions in NASDAQ National Market℠ (NNM)℠ securities. The findings also stated that the firm failed to report the time of execution through ACT in last-sale reports of transactions in NASDAQ SmallCap℠ securities, and failed to report the time of execution through ACT in transactions for which the firm had recording and reporting obligations under NASD Marketplace Rules 6954 and 6955. **(NASD Case #2004200000501)**

Wm Smith Securities, Inc. (CRD #30777, Denver, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined $15,000, including $2,500 that was jointly and severally with an individual. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it issued research reports that did not include the required disclosure concerning the receipt or expected receipt of compensation for investment banking services. The findings stated that the firm permitted a continuing education (CE) inactive individual to function in a capacity that required

registration with NASD. The findings also stated that the firm's supervisory system and procedures were not reasonably designed to achieve compliance with NASD's Membership and Registration Rule 1120. **(NASD Case #E3A2003003101)**

1717 Capital Management Company (CRD #4082, Newark, Delaware) submitted a Letter of Acceptance, Waiver and Consent in which the firm 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 enforce written supervisory procedures for special supervision of registered representatives who had a history of customer complaints. **(NASD Case #E112002095801)**

Individuals Barred or Suspended

Roberto Alford (CRD #2445460, Registered Principal, Del Ray Beach, 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, Alford consented to the described sanctions and to the entry of findings that he failed to disclose a material fact on his Form U4 and failed to respond to NASD requests for information. **(NASD Case #E1020041090-01)**

John Joseph Amore (CRD #1502074, Associated Person, Manhasset, 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, Amore consented to the described sanction and to the entry of findings that he engaged in securities transactions at his member firm that required him to be registered with NASD. The findings stated that Amore failed to appear for an NASD on-the-record interview. **(NASD Case #E102004102402)**

Thomas Michael Aretz (CRD #1083897, Registered Representative Destin, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Aretz consented to the described sanctions and to the entry of findings that he borrowed $25,000 from a public customer in contravention of the firm's written procedures. The findings stated that Aretz repaid the loan with interest, but only after the customer complained to NASD and his firm.

Aretz's suspension began September 12, 2005, and will conclude at the close of business November 10, 2005. **(NASD Case #2005001180902)**

Richard Carvel Brown (CRD# 32843, Registered Representative, Cheyenne, Wyoming) 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 15 business days. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written notice to his member firm.

Brown's suspension began August 1, 2005, and concluded at the close of business August 19, 2005. **(NASD Case #E3A2004031401)**

Jan Lynn Brueggemann (CRD #2714692, Registered Representative, Irvine, California) submitted an Offer of Settlement in which he was fined $7,400 and suspended from association with any NASD member in any capacity for 30 business days. Without admitting or denying the allegations, Brueggemann consented to the described sanction and to the entry of findings that he participated in a private securities transaction without providing prior written notification to, and receiving prior written approval from, his member firm.

Brueggemann's suspension will begin October 17, 2005, and will conclude at the close of business November 28, 2005. **(NASD Complaint #E022004059104/NASD Offer #C0220050053)**

Gary Lynn Craig (CRD #874487, Registered Principal, Mercer Island, Washington) 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 four months. Without admitting or denying the allegations, Craig consented to the described sanction and to the entry of findings that he participated in the preparation and distribution of sales literature that contained unwarranted and misleading information to prospective investors on behalf of his member firm. The findings stated that Craig sent a letter on behalf of his member firm to its existing investors that failed to state material facts.

Craig's suspension began September 19, 2005, and will conclude at the close of business January 18, 2006. **(NASD Case #E3B2003026801)**

Douglas William Daniels (CRD #1345341, Registered Representative, Lynn, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Daniels consented to the described sanction and to the entry of findings that he invested $5,000 in a variable annuity that required a minimum investment of $10,000 for a public customer with the notation that it was an initial deposit and additional funds would follow. The findings stated that the insurance company failed to receive the additional $5,000,

issued a check canceling the customer's application and returned the initial deposit. The findings also stated that Daniels, without the knowledge or consent of the customer, negotiated the $5,000 check and misappropriated the proceeds to his own use and benefit. The findings further stated that Daniels failed to respond to NASD requests for information. **(NASD Case# E9B2004050101)**

Kevin John Davis (CRD #3226294, Registered Principal, Sartell, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Davis consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. **(NASD Case #20050005911-01)**

Tanya Rochelle Davis (CRD #4759997, Associated Person, Houston, Texas) submitted an Offer of Settlement in which she was suspended from association with any NASD member in any capacity for six months. In light of the financial status of Davis, no monetary sanctions have been imposed. Without admitting or denying the allegations, Davis consented to the described sanction and to the entry of findings that she willfully failed to disclose a material fact on her Form U4.

Davis's suspension began September 19, 2005, and will conclude at the close of business March 18, 2006. **(NASD Complaint #E062004018404/NASD Offer #C0620050017)**

Terry James DiMartino (CRD #1057994, Registered Representative, Newington, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any NASD member in any capacity for three months. In light of the financial status of DiMartino, no monetary sanctions have been imposed. Without admitting or denying the allegations, DiMartino consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4.

DiMartino's suspension began September 19, 2005, and will conclude at the close of business December 18, 2005. **(NASD Case #E2005001599501)**

Linda Ora Foster (CRD #2738949, Registered Representative, Spanaway, Washington) 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 one year. The fine must be paid before Foster reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Foster consented to the described sanctions and to the entry of findings that she forged the signature of a public customer on a supplement to an insurance application and, without the customer's knowledge or consent, submitted it with a check drawn on her bank account to the insurance company.

Foster's suspension will begin October 17, 2005, and will conclude at the close of business October 16, 2006. **(NASD Case #E3B2004017101)**

William Stephen Foster (CRD #3148209, Registered Representative, Norman, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $22,500 and suspended from association with any NASD member in any capacity for two months. The fine includes the disgorgement of excess commissions received in the amount of $12,500. The fine must be paid before Foster reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Foster consented to the described sanctions and to the entry of findings that he recommended and effected securities transactions in the accounts of public customers without having a reasonable basis for believing the transactions were suitable based upon the customers' investment objectives, financial situations and needs.

Foster's suspension began October 17, 2005, and will conclude at the close of business December 16, 2005. **(NASD Case #EAF0300750003)**

John Melvin Fuls (CRD #4742604, Registered Representative, Sauk Rapids, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Fuls consented to the described sanction and to the entry of findings that he received a $2,869 check from a public customer as payment for insurance policy premiums, and Fuls instead deposited the check into his bank account and converted the funds to his personal use. **(NASD Case #E0420040484-03)**

Mark Bennett Haiken (CRD #233565, Registered Financial and Operations Principal, Port Washington, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any NASD member in the capacity of a Financial and Operations Principal (FINOP) for 60 days. Without admitting or denying the allegations, Haiken consented to the described sanctions and to the entry of findings that his member firm, acting through Haiken, failed to reflect a net capital deficiency.

Haiken's suspension began September 19, 2005, and will conclude at the close of business November 17, 2005. **(NASD Case #ELI2003049503)**

Stuart Michael Hammerle (CRD #1008986, Registered Representative, Philadelphia, Pennsylvania) was barred from association with any NASD member in any capacity. The sanctions were based on findings that without the knowledge or consent of a public customer, Hammerle submitted a letter to his member firm that reflected the customer's purported signature and stated that checks totaling $15,000 from the customer's margin account be made payable to entities with which Hammerle had personal business dealings. The findings stated that the checks were issued and negotiated and were to be applied by the entities to Hammerle's benefit. The findings also stated that Hammerle failed to respond to NASD requests for documents and to appear and give testimony. **(NASD Case #C9A050017)**

Roger Dean Harper, Jr. (CRD #2646828, Registered Representative, Leawood, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $10,000, suspended from association with any NASD member in any capacity for 18 months and required to requalify by exam in all capacities. The fine must be paid before Harper reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Harper consented to the described sanctions and to the entry of findings that he knowingly notarized 401(k) rollover forms that contained non-genuine signatures.

Harper's suspension will begin October 17, 2005, and will conclude at the close of business March 16, 2007. **(NASD Case #20050006024-01)**

Richard Francis Huston (CRD #2512830, Registered Representative, Vineland, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Hurton consented to the described sanctions and to the entry of findings that he photocopied a public customer's signature onto nine trading authorization forms used in connection with penny stock transactions without the customer's knowledge or consent.

Huston's suspension began October 3, 2005 and will conclude at the close of business December 1, 2005. **(NASD Case #E9B2004018301)**

David Ray Kelsey (CRD #2826645, Registered Representative, Lawrence, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000, suspended from association with any NASD member in any capacity for six months and required to requalify in all capacities prior to reassociation with an NASD member. The fine must be paid before Kelsey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kelsey consented to the described sanctions and to the entry of findings that he asked a colleague to notarize 401(k) rollover forms, knowing that the signatures for the participants' spouses were not genuine.

Kelsey's suspension began October 17, 2005, and will conclude at the close of business April 16, 2006. **(NASD Case #20050006024-02)**

David Benjamin Lazarus (CRD #2738374, Registered Principal, Miami Beach, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $30,000, suspended from association with any NASD member in any capacity for 42 days and ordered to pay disgorgement of $1,413.35, plus interest, to public customers. Without admitting or denying the allegations, Lazarus consented to the described sanctions and to the entry of findings that he knowingly and intentionally entered priced limit orders to buy or sell shares of NASDAQ securities into an Electronic Communications Network (ECN) at prices that he knew would improve, and were intended to improve, the National Best Bid or Offer (NBBO) in such securities. The findings stated that Lazarus knowingly and intentionally bought and sold shares of these securities at prices that were lower than he would otherwise have been able to buy, thereby obtaining a financial benefit. The findings also stated that Lazarus caused to be published or circulated limit orders at prices that affected the NBBO and became quotations for the securities, without believing that those quotations represented bona fide bids or offers for the securities. NASD found that Lazarus caused to be published or circulated purchases and sales of securities that he did not believe were bona fide purchases and sales.

Lazarus's suspension began September 19, 2005, and will conclude at the close of business on October 30, 2005. **(NASD Case #2004200001804)**

Van Hung Le (CRD #4770466, Registered Representative, Arlington, Virginia) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Le consented to the described sanction and to the entry of findings that he effected unauthorized transactions in customer accounts. The findings also stated that Le failed to appear for an on-the-record interview with NASD. **(NASD Case #E9B2004057101)**

Matthew Lonskey (CRD #4669940, Registered Representative, Belmar, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lonskey consented to the described sanction and to the entry of findings that he signed the name of a public customer on

variable annuity documents without the customer's knowledge, authorization or consent. The findings stated that Lonskey failed to respond to NASD requests for information. **(NASD Case #2005001307501)**

Victor Gary Lowatchie (CRD #2203004, Registered Representative, Falmouth, Maine) submitted a Letter of Acceptance, Waiver and Consent in which he was permanently barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lowatchie consented to the described sanction and to the entry of findings that he affixed the signatures of public customers on account applications, IRA transfer forms, beneficiary forms and other documents without their knowledge or consent. **(NASD Case #E112004045001)**

Michael Jay Margolis (CRD #2532830, Registered Representative, Staten Island, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $2,500, and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Margolis consented to the described sanctions and to the entry of findings that he commingled a public customer's funds with his own in that he deposited $10,000 in cash from a customer into his personal bank account and simultaneously had the bank issue a $9,990 check, and used the check to pay the semi-annual premium for a variable life insurance policy owned by customer's wife.

Margolis's suspension began September 19, 2005, and concluded at the close of business October 7, 2005. **(NASD Case #ELI20040383-01)**

Rudolf Nepakharev (CRD #3121741, Registered Representative, Brooklyn, New York) submitted a Letter of Acceptance, Waiver and Consent in which the he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Nepakharev consented to the described sanctions and to the entry of findings that he made material misrepresentations about a company's securities and failed to disclose material, adverse facts that he was or should have been aware of, including the company's financial condition. The findings stated that he made statements about the company and its business, including stock price projections and guarantees, for which he had no basis. **(NASD Case #2005000739201)**

John Gregory Oppenheimer (CRD #3178207, Registered Representative, Raleigh, North Carolina) was barred from association with any NASD member in any capacity. The sanction was based on the findings that Oppenheimer effected transactions in the account of a public customer without the customer's authorization. The findings stated that he forged the customer's signature on documents, including annuity purchase applications, and failed to respond to NASD requests to provide testimony. **(NASD Case #C07050031)**

James Vincent Pardy (CRD #2900751, Registered Principal, Flushing, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $15,000 and suspended from association with any NASD member in any principal capacity for 30 days. Without admitting or denying the allegations, Pardy consented to the described sanctions and to the entry of findings that he failed to reasonably supervise several registered representatives and failed to report customer complaints, pursuant to NASD Conduct Rule 3070.

Pardy's suspension began September 19, 2005, and will conclude at the close of business October 18, 2005. **(NASD Case #ELI2004001101)**

Joseph Pitruzzello, Jr. (CRD #2296199, Registered Representative, San Mateo, California) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $7,500 and suspended from association with any NASD member firm in any capacity for three months. The fine must be paid before Pitruzzello reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Pitruzzello consented to the described sanctions and to the entry of findings that he forged the signature of a public customer to a retirement plan's salary reduction agreement.

Pitruzzello's suspension began October 17, 2005, and will conclude at the close of business January 16, 2006. **(NASD Case #E012004032702)**

Ralph Anthony Purpora (CRD #1077716, Registered Representative, Poughkeepsie, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $30,000 and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Purpora consented to the described sanctions and to the entry of findings that he recommended securities transactions to public customers without having reasonable grounds for believing that the recommendations were suitable, because the customers could have purchased Class A shares in each fund at a reduced sales charge by applying break points, using letters of intent and/or using rights of accumulation.

Purpora's suspension began September 19, 2005, and concluded at the close of business October 14, 2005. **(NASD Case #E112003006904)**

Gary Allen Randa (CRD #2425208, Registered Representative, Oswego, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any member in any capacity. Without admitting or denying the allegations, Randa consented to the described sanction and to the entry of findings that he fraudulently obtained a public customer's checkbook without

the consent or knowledge of the customer. The findings stated that he forged the customer's signature on deposit slips and checks totaling $60,500, made them payable to himself and deposited the funds in his bank account, thereby converting the customer's funds to his own use and benefit. **(NASD Case #E8A2004082401)**

Rita Nell Raymer (CRD #2757002, Registered Representative, Sweeden, Kentucky) 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, Raymer consented to the described sanction and to the entry of findings that she recommended and effected securities transactions in the accounts of public customers without having a reasonable basis for believing the transactions were suitable based upon customers' investment objectives, financial situations, and needs. The findings stated that Raymer made misrepresentations and omitted material facts in the sale of variable annuity contracts to public customers with the intent of deceiving the customers or with reckless disregard for the truth. **(NASD Case #E052003013101)**

Kendra Ann Reed (CRD #3181912, Registered Representative, Ruckersville, Virginia) submitted a Letter of Acceptance, Waiver and Consent in which she was fined $5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Reed consented to the described sanctions and to the entry of findings that she did not disclose to her member firm that the data on the applications for public customers' variable life insurance had been altered by her and was not the product of the paramedical examiner.

Reed's suspension will begin October 17, 2005, and will conclude at the close of business April 16, 2006. **(NASD Case #E9A2004025401)**

David Alexander Rourke, Sr. (CRD #2089364, Registered Representative, Wellesley, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $7,500 and suspended from association with any NASD member firm in any capacity for ten business days. Without admitting or denying the allegations, Rourke consented to the described sanctions and to the entry of findings that he recommended the purchase of Class B mutual funds to public customers without having reasonable grounds to believe that the Class B shares, as opposed to the Class A shares, were suitable for the customers.

Rourke's suspension began October 3, 2005, and concluded at the close of business October 14, 2005. **(NASD Case #E0420040097-01)**

John Charles Sabo (CRD #826178, Registered Principal, Wellesley, Massachusetts) 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 seven months. The fine must be paid before Sabo reassociates with any NASD member following the suspension, or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sabo 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.

Sabo's suspension will begin October 17, 2005, and will conclude at the close of business May 16, 2006. **(NASD Case #E9B2004034201)**

Glen Joseph Santangelo (CRD #2776058, Registered Representative, Ridgewood, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $50,000 and suspended from association with any NASD member in any capacity for 60 business days. Without admitting or denying the allegations, Santangelo consented to the described sanctions and to the entry of findings that he disseminated, by email, material confidential and non-public information to different institutional customers concerning stock preferences and trading for other large institutional customers. The findings stated that Santangelo improperly disseminated, by email, draft research reports to institutional customers without the prior approval of a registered principal of his member firm.

Santangelo's suspension began September 6, 2005, and will conclude at the close of business November 29, 2005. **(NASD Case #E1020031690-01)**

Trisha Joyce Smith (CRD #2796673, Registered Representative, Pace, Florida) was barred from association with any NASD member in any capacity. The sanctions were based on the findings that Smith misused public customer's funds. The findings stated that she failed to follow the customers' directions to remit premium payments to her member firm and instead held the funds for a later time prior to remitting the funds as directed. The findings also stated that Smith failed to respond to NASD requests for information. **(NASD Case #C07050007)**

Oscar Stoyanovich (CRD # 1855125, Registered Representative, Pembroke Pines, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member firm in any capacity. Without admitting or denying the allegations, Stoyanovich consented to the described sanctions and to the entry of findings that he failed to appear for an NASD on-the-record interview. **(NASD Case #E072004084601)**

Elangovan Surendran (CRD #2658729, Registered Principal, Mineola, New York) submitted an Offer of Settlement in which he was fined $2,500, suspended from association with any NASD member in any capacity for nine months, and ordered to pay $7,000 in disgorgement in partial restitution to a public customer. The fine and disgorgement must be paid before Surendran reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the allegations, Surendran consented to the described sanctions and to the entry of findings that he directly or indirectly, by the use of the means or instrumentalities of interstate commerce or of the mails, knowingly or recklessly used or employed, in connection with the purchase or sale of securities, manipulative or deceptive devices or contrivances, and knowingly or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances. NASD also found that Surendran recommended securities transactions to a public customer without having reasonable grounds for believing that such transactions were suitable for the customer in view of the size and frequency of the transactions, the nature of the account, and the customer's financial situation, investment objectives and needs.

Surendran's suspension will begin October 17, 2005, and will conclude at the close of business July 16, 2006. **(NASD Case #E9B2003035202/C9B050008)**

David James Swiat (CRD #4470758, Registered Representative, Kalamazoo, Michigan) 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, Swiat consented to the described sanction and to the entry of findings that he received $300 in cash from a public customer for investment purposes and failed to promptly use the customers funds as instructed. The findings stated that Swiat created and gave to the customer a fictitious order ticket and a fictitious receipt on which he signed his member firm's branch office manager's name without his knowledge or consent. The findings also stated that he misused customer funds by failing to follow instructions, in that he used the funds for some purpose other than the benefit of the customer. **(NASD Case #E8A2004068801)**

Andrew Tzanides (CRD #1444656, Registered Representative, Cresskill, New Jersey) 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, Tzanides consented to the described sanction and to the entry of findings that he effected transactions on behalf of public customers and charged markups or markdowns that were excessive and unfair. The findings also stated that Tzanides failed to appear for an NASD on-the-record interview. **(NASD Case #C8A050016)**

Marcus Rodney Valenzuela (CRD #4231176, Registered Representative, Plantation, Florida) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Valenzuela consented to the described sanction and to the entry of findings that he effected securities transactions in the accounts of public customers without the prior authorization, knowledge or consent of the customers. **(NASD Case #CFL050002)**

Grant Jack Vermillion (CRD #4572722, Registered Representative, Lawrence, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $10,000, including $2,330.94 in disgorgement of commissions received, and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Vermillion reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Vermillion consented to the described sanctions and to the entry of findings that he participated in business activities outside the scope of his member firm without providing prompt written notice to his firm.

Vermillion's suspension begins October 17, 2005, and will conclude at the close of business November 15, 2005. **(NASD Case #2005000590201)**

Edward Gordon Villesvik (CRD #2785214, Registered Representative, Bothell, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he fined $10,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Villesvik reassociates with any NASD member following his suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Villesvik consented to the described sanctions and to the entry of findings that he failed to report a material fact on his form U4.

Villesvik's suspension will begin October 17, 2005, and will conclude at the close of business April 16, 2006. **(NASD Case #E3B2004012001)**

David Charles Vogel (CRD #2985902, Registered Representative, Pleasant Gap, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Vogel reassociates with any NASD member following his suspension or before requesting relief from any

statutory disqualification. Without admitting or denying the allegations, Vogel consented to the described sanctions and to the entry of findings that he submitted a withdrawal application for $1,800 from a public customer's variable annuity, but failed to have the customer sign and date the withdrawal application. The findings stated that Vogel attached to the withdrawal application the signature pages of a previously signed withdrawal application containing the customer's signature, and altered the date on the page.

Vogel's suspension began October 3, 2005, and will conclude at the close of business January 2, 2006. **(NASD Case #ELI20040278-01)**

Daimon Lenier Wiley (CRD #4800796, Associated Person, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid before Wiley reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Wiley consented to the described sanctions and to the entry of findings that he failed to disclose a material fact on his Form U4.

Wiley's suspension began September 19, 2005, and will conclude at the close of business October 28, 2005. **(NASD Case #E8A2004081501)**

Brad David Wilson (CRD #1392130, Registered Principal, Sarasota, Florida) was fined $5,000 and suspended from association with any NASD member in any capacity for 60 days. The sanctions were based on findings that he affixed a notary public's signature and seal without the knowledge or authorization of the notary public.

Wilson's suspension began September 6, 2005, and will conclude at the close of business November 4, 2005. **(NASD Case #C0720040086)**

Matthew Gary Winslow (CRD #2628719, Registered Principal, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any NASD member in any capacity for 30 business days and ordered to comply with the terms and conditions of the general release and settlement agreement with a clearing firm. Without admitting or denying the allegations, Winslow consented to the described sanctions and to the entry of findings that he engaged in trading activities that resulted in negative equity balances in his accounts totaling $750,000. The findings stated that Winslow's financial inability to eliminate the negative equity balances in his accounts caused his member firm and the clearing firm to incur substantial losses.

Winslow's suspension will begin October 17, 2005, and will conclude at the close of business November 28, 2005. **(NASD Case #E062001028601)**

Complaints Filed

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

Russell Orville Hodder, Jr. (CRD #2179109, Registered Representative, Comstock Park, Michigan) was named as a respondent in an NASD complaint alleging that he effected transactions in the accounts of public customers without their knowledge or consent and in the absence of written or oral authorization to exercise discretion in their accounts. The complaint alleged that Hodder signed the customers' names or caused their names to be signed, which caused a withdrawal from their accounts, and requested that the checks be delivered to him at his branch office; that he received and signed the customers' names to the checks; and that he cashed the checks and used the funds to invest in a company, all without the knowledge or consent of the customers and in the absence of written or oral authorization to respondent to exercise discretion in their accounts or to sign the customers' names on documents. The complaint also alleged that Hodder failed to respond to NASD requests for documents and information. **(NASD Case #E8A2003076301)**

Paul R. Hunt (CRD #4304579, Registered Representative, Greenville, North Carolina) was named as a respondent in an NASD complaint alleging that he effected transactions in the account of public customers without the customers' prior knowledge or authorization. The complaint also alleged that Hunt failed to respond to NASD requests for information. **(NASD Case #2005000308801)**

Calvin Wayne McClintock (CRD #3040464, Registered Representative, Mt Vernon, Illinois) was named as a respondent in an NASD complaint alleging that he effected transactions in the accounts of public customers, without their knowledge or consent and in the absence of written or oral authorization to exercise discretion in the accounts. The complaint also alleged that McClintock failed to respond to NASD requests for information. **(NASD Case #E8A2004085901)**

Robert Christopher Patrick (CRD #2854687, Registered Principal, Ronkonkoma, New York) was named as a respondent in an NASD complaint alleging that he effected transactions in the accounts of public customers without the customer's prior knowledge, authorization or consent. (NASD Case #ELI2003032201)

Scott Howard Ross (CRD #2399201, Registered Representative, Setauket, New York) was named as a respondent in an NASD complaint alleging that, acting on behalf of his firm, he effected transactions without prior knowledge, authorization or consent of the public customers. The complaint also alleged that Ross failed to appear for an NASD on-the-record interview. (NASD Case #ELI2004022002)

John Joseph Stapleton (CRD #2791194, Registered Representative, Long Beach, New York) was named as a respondent in an NASD complaint alleging that, while exercising control over a public customer's account, he effected excessive transactions in the customer's account. The complaint alleged that Stapleton, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce or of the mails, or of any facility of any national securities exchange, knowingly or recklessly employed devices, schemes or artifices to defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made not misleading; engaged in acts, practices or courses of business that operated or would operate as a fraud or deceit upon any person; or effected transactions in, or induced the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance. The complaint also alleged that Stapleton recommended to a public customer securities transactions involving equities and options without having reasonable grounds for believing such transactions were suitable for the customer in view of the size and frequency of the transactions, the nature of the account and his financial situation. (NASD Case #E9B2003033501)

Bryan Christopher Terra (CRD #4717215, Registered Representative, Monroe, Louisiana) was named as a respondent in an NASD complaint alleging that, in his capacity as a personal banker, he came into possession of a $650 check received by the bank for deposit to an unspecified customer's bank account and converted the funds for his own use and benefit by depositing funds into his personal bank account. The complaint also alleged that Terra failed to respond to NASD requests for information. (NASD Case #2005000870801)

Otto Keith Vaughan Jr. (CRD #453757, Registered Representative, Aurora, Colorado) was named as a respondent in an NASD complaint alleging that he was appointed as trustee for a public customer testamentary trust that gave him complete authority over the trust's assets, including check writing authority on the accounts. The complaint alleges that Vaughan, acting as trustee, purchased a condominium for himself using $75,000 that he borrowed from one of the trust's accounts and did not disclose this loan to the beneficiaries of the trust. The complaint also alleges that Vaughan withdrew an additional $247,000 from the accounts and used the funds to pay for personal expenses and failed to keep any records or documents detailing such withdrawals used for personal expenses. In addition, the complaint alleges that Vaughan did not provide the beneficiaries with an account containing details of all disbursements from the trust assets and kept no records detailing the amount of fees he paid to himself. (NASD Case #E3A2003052101)

Firm Suspended for Failure to Supply Financial Information

The following firm was suspended from membership with NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 9552. 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.

Fidelity Asset Management, Inc.
Walnut, California
(September 7, 2005)

Firms Suspended Pursuant to NASD Rule 9553 for Failure to Pay Arbitration Fees

Bayou Securities, LLC
Stamford, Connecticut
(September 8, 2005)

May, Davis Group Inc.
New York, New York
(September 13, 2005 to September 26, 2005)

Milestone Group Management LLC
Lake Success, New York
(September 12, 2005)

Individual Suspended Pursuant to NASD Rule 9553 for Failure to Pay Arbitration Fees

David E. Osaba
Weirton, West Virginia
(September 9, 2005)

Individuals Revoked for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320

Robert Agueli
New York, New York
(September 15, 2005)

Angelo A. Armenta
Monrovia, California
(September 15, 2005)

Individuals Barred Pursuant to NASD Rule 9552(d)

Keith Adam Gorin
Coral Springs, Florida
(September 7, 2005)

Anny C. Moreira
New York, New York
(September 6, 2005)

Alex Livak
Astoria, New York
(August 29, 2005)

Edward George Ozimkowski
Deerfield Beach, Florida
(September 7, 2005)

Kenneth A. Smith, II
Fresno, California
(September 9, 2005)

Individuals Suspended Pursuant to NASD Rule 9552(d)

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

Ian Philmore Bynoe
Brooklyn, New York
(September 7, 2005)

Daniel Lucian Cammarano, III
West Palm Beach, Florida
(September 6, 2005)

Ellen Annette Guldenzopf
Portland, Oregon
(August 29, 2005)

David Wayne Parsons
Baldwin, New York
(June 22, 2005)

Dennis Alvin Pearson, Jr.
San Diego, California
(August 24, 2005)

Chris Michael Richardson
Sherwood, Oregon
(August 24, 2005)

Individuals Suspended Pursuant to NASD Rule Series 9554 for Failure to Comply With an Arbitration Award or a Settlement Agreement

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

Gregory Murntaz Hasho
Mineola, New York
(August 26, 2005)

Dmitry Victor Kardonski
Tenafly, New Jersey
(September 1, 2005)

Eric Peter Lesak
Wantagh, New York
(September 19, 2005)

David Osaba
Weirton, West Virginia
(June 20, 2005 to August 3, 2005)

David Wayne Parsons
Baldwin, New York
(September 1, 2005)

Max Evan Rosado
Brooklyn, New York
(September 22, 2005)

Lori Beth Seelig
West Orange, New Jersey
(September 21, 2005)

Eugene Mark Spiegel
Atlanta, Georgia
(September 1, 2005)

Patience Lane Taylor
Plymouth, Massachusetts
(July 20, 2005 to September 15, 2005)

Jorge Eduardo Villalba, Jr.
Duncanville, Texas
(September 22, 2005)

NASD Charges Eight Firms with Directed Brokerage Violations, Imposes Fines Totaling More than $7.75 Million

NASD has fined eight broker-dealers—including seven retail firms and one mutual fund distributor— more than $7.75 million for directed brokerage violations. The sanctions are the latest actions resulting from an NASD enforcement sweep focusing on the receipt or payment of directed brokerage in exchange for preferential treatment for certain mutual fund companies.

All of the cases involve violations of NASD's Anti-Reciprocal Rule, which prohibits firms from favoring the sale of shares of mutual funds on the basis of brokerage commissions received by the firm. Among other things, the rule prohibits a firm from recommending funds or establishing preferred lists of funds in exchange for receipt of directed brokerage.

"We continue to pursue conduct which puts the interests of firms ahead of the interests of customers," said Barry Goldsmith, NASD Executive Vice President and Head of Enforcement. "NASD's prohibition on the receipt of directed brokerage is designed to eliminate these conflicts of interest in the sale of mutual funds, whose costs are paid not by the mutual fund company, but by the funds' shareholders."

NASD found that the seven retail firms operated "preferred partner" or "shelf space" programs that provided benefits to specific mutual fund complexes in return for directed brokerage. The benefits to the mutual fund complexes included, in various cases, higher visibility on firms' internal Web sites, including inclusion on internal lists identifying the funds as participants in the programs; increased access to firms' sales forces; participation in "top producer" or training meetings; and promotion of the preferred funds on a broader basis than was available for other funds.

The mutual fund complexes that participated in these programs paid extra fees for the preferential treatment they received. The additional fees were usually based on a combination of sales and/or assets under management by the brokerage firm. Certain complexes participating in the preferred partner programs paid part or all of the revenue sharing fees by the use of directed brokerage—that is, by directing commissions from trades in the portfolios they managed to the firms. This included a practice of directing trades to the trading desks of designated third parties, which then remitted a portion of the trading commissions to the retail firms named in these actions, although those retail firms provided no services in connection with the trades. The commissions paid under these arrangements were sufficiently large to pay for the preferred benefits received by the funds as well as the costs of trade execution.

The retail firms generally monitored the amount of directed brokerage received to ensure that the fund complexes were satisfying their revenue sharing obligations. The use of directed brokerage allowed the fund complexes to use assets of the mutual funds instead of their own money to meet their revenue sharing obligations.

NASD also censured and fined one mutual fund distributor, Lord Abbett Distributor LLC. Lord Abbett paid for some of its shelf space obligations by having its affiliated investment adviser direct portfolio transactions to or for the benefit of firms to which the distributor owed revenue sharing fees.

The firms and their respective fines are as follows (firms noted with asterisks are wholly owned subsidiaries of National Planning Holdings, Inc.):

IFC Holdings, Inc. d/b/a INVEST Financial Corporation*	$1,520,000	Tampa, FL
Commonwealth Financial Network	$1,400,000	Waltham, MA
National Planning Corporation Inc.*	$1,308,000	Santa Monica, CA
Mutual Service Corporation	$1,300,000	W. Palm Beach, FL
Lincoln Financial Advisors Corporation	$950,000	Ft. Wayne, IN
SII Investments, Inc.*	$658,500	Appleton, WI
Investment Centers of America, Inc.*	$363,500	Appleton, WI
Lord Abbett Distributor, LLC	$255,000	Jersey City, NJ

The fine imposed on National Planning Corporation also included charges relating to violations of NASD rules relating to its use of non-cash compensation. During four months in 2002, National Planning Corporation, instead of giving equal weight to the sales of all mutual funds, as required by NASD rules, provided registered representatives with double production credits for sales of mutual funds offered by participants in its preferred partner program towards qualification for attendance at a rewards conference. The fine imposed on Commonwealth Financial Network included charges relating to its failure to retain emails as required by the federal securities laws and NASD rules.

NASD has brought 20 previous actions for similar violations.

NASD Orders ING Funds Distributor to Pay $1.5 Million Fine, $1.4 Million in Restitution for Permitting Improper Market Timing

NASD also Sanctions ING Funds Distributor Supervisor

NASD has ordered ING Funds Distributor (IFD) to pay a fine of $1.5 million for permitting improper market timing in ING funds and related violations—the largest fine NASD has imposed in a market timing case. NASD also ordered IFD to pay more than $1.4 million in restitution to the affected mutual funds, and imposed a $25,000 fine and 30-day supervisory suspension on IFD supervisor William L. Sessions.

IFD is the wholesale distributor of ING mutual funds and is owned by ING Group. In 2000, ING Group acquired Pilgrim Funds, which had entered into agreements with three different clients—two registered representatives and an independent investment advisor—to allow them to engage in market timing in their accounts. After the acquisition, language was added to ING fund prospectuses stating that the funds were not short-term trading vehicles and that excessive trading, or market timing, could harm ING funds. The new prospectus language also alerted investors that IFD could prohibit excessive exchanges of more than four per fund per year.

At about the same time, IFD adopted procedures for identifying accounts that effected more than four exchanges in a fund year and prohibiting them from making further exchanges. But NASD found that despite the fund prospectus language and IFD's own internal procedures, IFD and Sessions permitted one client to engage in excessive trading until 2001 and the other two clients to engage in excessive trading until September 2003.

Sessions was a registered principal of IFD responsible for overseeing the implementation of IFD's market timing procedures and was heavily involved in the firm's efforts to detect and prevent market timing. NASD found that Sessions sent numerous restriction letters to other brokers stating that excessive market timing activity had been detected, that such trading activity was "detrimental to the overall effectiveness of the investment objectives of the ING Funds," and that the identified accounts were prohibited from engaging in further exchanges. Sessions also placed stop transfer and stop purchase orders on identified accounts. Nevertheless, he permitted extensive market timing activity by the three clients—far in excess of the limits set by IFD and described in the prospectuses for ING funds, and through numerous accounts—to continue.

By permitting market timing activities contrary to the firm's procedures and the funds' prospectuses, IFD and Sessions violated NASD's rule requiring adherence to just and equitable principles of trade and high standards of commercial honor. NASD also found that IFD failed to implement and enforce its own internal procedures intended to detect and prevent market timing. As a result, a large number of excessive trades by customers other than the three receiving favorable treatment were allowed to occur because they went undetected.

NASD also found that, prior to August 2003, IFD did not have an adequate system for retaining email communications and failed to ensure that emails were kept for the requisite time periods, in violation of recordkeeping rules. As a result of those deficiencies, IFD was unable to produce all of its emails to NASD investigators.

NASD Fines Janney Montgomery Scott $1.2 Million for Market Timing and Other Violations; Orders Restitution of Nearly $1 Million

NASD also Sanctions Janney Managers

NASD fined Janney Montgomery Scott LLC, of Philadelphia $1.2 million for permitting improper market timing and related violations. In addition, NASD ordered the Philadelphia-based firm to pay nearly $1 million in restitution to the affected mutual funds.

NASD also suspended Kenneth Rosato—the former branch manager of Janney's Brooklyn office and the broker responsible for the misconduct—for one year and fined him $370,000, which includes disgorgement of $185,000 in commissions he received as a result of the improper market timing activities. NASD also barred Linda Rosato, the former branch operations manager of Janney's Brooklyn office and

Kenneth Rosato's sister-in-law, for refusing to testify in NASD's investigation of this misconduct.

NASD found that from May 2000 through September 2003, Janney permitted two hedge fund customers to evade attempts by mutual fund companies to block or restrict their market timing transactions. The hedge fund accounts were customers of Kenneth Rosato. Rosato opened 19 different accounts for the two hedge funds and allowed them to engage in approximately 1,600 exchange transactions with mutual funds after receiving close to 200 block notices from those mutual funds prohibiting further trading.

NASD also found that Rosato also undertook a number of efforts to assist the hedge fund customers in evading the restrictions placed on market timing by mutual funds. Among other things, Rosato opened multiple accounts for the hedge funds to enable them to market time mutual funds without detection; used different broker numbers and different addresses in an effort to shield the true ownership of the accounts, and placed trades in related accounts to escape detection by the mutual funds.

Rosato also suggested deceptive strategies the hedge funds could use to evade attempts by mutual funds to restrict market timing—such as waiting a certain number of days after the initial purchase before market timing; limiting exchanges to a certain number per month; keeping transactions under a certain dollar amount, and recommending certain mutual funds to market time because those funds' market timing monitoring efforts were viewed as being ineffective.

NASD's investigation showed that Janney was aware that the hedge funds were engaging in market timing activity. The firm had received numerous notices from the mutual funds prohibiting future market timing by these customers. Despite this, the customers continued to engage in extensive market timing activity through Janney—earning approximately $1 million in profits at the expense of long-term investors in those mutual funds.

By permitting the market timing activities of the hedge fund customers, Janney and Rosato violated NASD's rule requiring adherence to just and equitable principles of trade and high standards of commercial honor. Janney also failed to respond adequately to red flags that market timing was occurring, and failed to establish and maintain an adequate supervisory system to prevent or detect deceptive market timing practices.

NASD's investigation uncovered other violations as well. NASD found that Janney did not have an adequate supervisory system to ensure an accurate response to regulatory inquires. In October 2003, Janney responded to an NASD request for information by stating that no one at the firm had promoted or otherwise encouraged market timing activities and that the author of the letter was not aware of communications between mutual funds and Janney regarding market timing. In fact, extensive market timing activities had occurred and the firm had received numerous communications from mutual funds concerning market timing. NASD found that Janney did not have a supervisory system or written procedures to ensure that it conducted adequate due diligence or made sufficient inquiry when responding to regulatory inquires. NASD found that Janney's failure to establish an adequate supervisory system contributed to the firm's inaccurate response to NASD's request.

"NASD often begins its regulatory inquiries through written requests for information and relies upon the responses it receives to determine whether further review is necessary," said Barry Goldsmith, NASD Executive Vice President and Head of Enforcement. "It is critical that firms have effective procedures in place for responding to regulatory inquiries and conduct a comprehensive and searching review before responding."

NASD also found that Janney failed to create records reflecting the time of receipt of mutual fund orders and failed to establish and maintain an adequate supervisory system to detect and prevent late trading in mutual funds.

NASD's investigation showed that in 2003, the firm's records for more than 7,000 mutual fund orders that were processed after 4 p.m. contained no indication that the orders were actually received before 4 p.m.

In settling this matter, Janney, Kenneth Rosato and Linda Rosato neither admitted nor denied the allegations, but consented to the entry of NASD findings.

NASD Fines First Allied Securities over $400,000, Orders More Than $325,000 in Restitution for Market Timing Violations

NASD also Fines and Suspends Broker

NASD has fined First Allied Securities, Inc. of San Diego $408,000 for facilitating the deceptive efforts of three hedge fund customers to engage in improper market timing transactions. NASD also ordered First Allied to pay approximately $326,500 to reimburse the affected funds.

NASD suspended Gary Ferraro, a former First Allied salesman located in Chicago and the broker for the three customers, for nine months and fined him over $136,700. NASD found that between November 2001 and July 2003, first at another firm and then at First Allied, Ferraro negotiated or authorized so-called "sticky asset" deals with two mutual fund advisors that

enabled two hedge fund customers to execute more mutual fund trades than allowed in the funds' prospectuses. Under these secret arrangements, Ferraro's customers agreed to invest millions of dollars on a long-term basis in one mutual fund complex (the "sticky" money) in exchange for the opportunity to market time millions of dollars in other funds in the same fund family.

For example, NASD found that in one of Ferraro's deals, a customer invested $1.9 million in long-term assets in one mutual fund in exchange for the opportunity to market time up to $1.9 million in another fund in the same complex. During a six-month period, the customer engaged in 20 exchanges, well in excess of the four exchanges out per year allowed by the prospectus, thereby generating illicit profits of more than $190,000.

In addition, Ferraro and First Allied enabled another client to use related accounts to evade attempts by a mutual fund complex to restrict the customer's trading. Specifically, Ferraro opened an account for a client who proceeded to execute market timing trades in one mutual fund family. After the fund restricted trading, Ferraro opened two related accounts for the same beneficial owner, one of which was funded indirectly by a transfer of $4 million from the restricted account. Ferraro, through employees who reported to him, executed market timing trades in the two accounts in violation of the fund prospectus limits, thereby allowing the customer to earn approximately $110,000 in illicit profits.

NASD's investigation showed that before hiring Ferraro, First Allied was aware that his customers were engaged in market timing. In fact, the investment advisor to one mutual fund complex advised an officer of First Allied that it had a special market timing arrangement with Ferraro that it did not offer to investors generally. The advisor also told First Allied that "working on this side of the business is something that most fund groups do not like to discuss openly." Despite this knowledge, First Allied failed to implement a supervisory system designed to monitor the activity of Ferraro and the people who worked for him.

In settling with NASD, First Allied and Ferraro neither admitted nor denied the allegations, but consented to the entry of NASD's findings.

NASD Fines David Lerner Associates $115,000 for Misleading Advertising and Communications with the Public

Firm President David Lerner and Sales Chief also Fined; Firm Ordered Not to Conduct Public Seminars for 30 Days

NASD has fined David Lerner Associates, Inc. (DLA) of Syosset, New York $115,000 for misleading marketing materials, including radio advertising, client seminars and other communications with the public. The firm was also ordered not to conduct any public seminar for 30 days. For six months, the firm must pre-file all sales literature and advertisements with NASD's Advertising Regulation Department at least 10 days prior to their first use.

Also sanctioned were David Lerner, the firm's President; John Dempsey, the firm's Senior Vice President of Sales, and SSH Securities, Inc., an affiliate of DLA. Lerner and Dempsey are each being fined $25,000. Dempsey is being suspended from serving in a principal or supervisory capacity with any registered firm for 30 days. SSH Securities, Inc. will pay a fine of $10,000 for preparing inaccurate fact sheets distributed by DLA to promote a proprietary family of mutual funds.

"To protect investors, and to help them make the best and most appropriate investment decisions, NASD rules require firms to use accurate, fair and balanced communications when marketing their products and services," said Barry Goldsmith, NASD Executive Vice President and Head of Enforcement. "David Lerner Associates violated those rules by making statements that investors would naturally be expected to rely upon, that were widely disseminated through the media, but which were exaggerated, misleading and unsupported by the facts."

In a September 2004 complaint, NASD charged the firm and David Lerner with using 11 radio advertisements and other communications between May 2001 and May 2003 that contained numerous statements and claims that were misleading, exaggerated or unwarranted. The firm advertised heavily on New York metropolitan area radio stations with 60-second spots that ran several days a week, frequently throughout the day. DLA spent significant amounts of money on radio ads—$2.3 million during the review period, which represented 71 percent of its total marketing expenditures. As the spokesman for the firm, David Lerner narrated all of the ads.

A recurring theme of the radio advertisements was the concept of "providing returns of 10 percent and more" to "tens of thousands" of customers. For example, one advertisement stated: "For 25 years, we at David Lerner Associates have provided tens of thousands of people with investments that, even in these turbulent times, continue to pay over 10%." Another stated: "We are currently providing returns of 10 percent and more in investments that have nothing to do with the stock market." NASD charged that these and other statements, which the firm could not support, were exaggerated, unwarranted or misleading.

The firm's advertisements also suggested that individuals who invested with DLA would retain the value of their assets regardless of market conditions, or would regain prior losses sustained in the stock market downturn in 2000. For instance, one advertisement stated, "While past performance can never be a guarantee of future results, we at David Lerner Associates are proud and pleased that for 26 years, tens of thousands of our investors have been receiving high income and solid returns regardless of whether interest rates or the stock market went up or down." Another advertisement stated, "By counseling them to select value-oriented investments, our clients have not only weathered the financial storm, they have actually seen their income grow and their assets more than hold their value." NASD alleged that these and other statements were exaggerated or misleading and were improperly promissory.

Like radio advertising, investment seminars were also important to the firm's marketing efforts. During the relevant period, the firm conducted approximately 70 to 80 seminars for the public, with Lerner appearing as the principal speaker at each seminar. As with the radio ads, the firm did not have factual support for many of the claims and also failed to disclose material information.

Finally, SSH Securities prepared and DLA distributed fact sheets concerning DLA's proprietary Spirit of America mutual funds, which NASD charged contained inaccurate information. NASD charged Dempsey, the principal of DLA responsible for approving advertisements, with failing to discharge his supervisory responsibilities.

Without admitting or denying the allegations, the firms and individuals consented to NASD's findings of advertising and supervisory failures and agreed to the imposed sanctions.

Edward D. Jones Fined $300,000 for Failing to Disclose Municipal Bond Yields on Confirmations to Customers

Failures Involved More than 86,000 Transactions Totaling More than $1.6 Billion

NASD has censured and fined Edward D. Jones & Co., L.P. $300,000 for failing to disclose the yield-to-maturity on transaction confirmations issued to customers who sold municipal securities. The failures occurred in more than 86,000 transactions in the period from January 2003 to April 2004, involving total sales of over $1 billion. The firm was also charged with failing to establish a supervisory system and procedures designed to detect this failure.

The NASD settlement also requires Edward Jones to demonstrate that customer confirmations for municipal securities transactions contain the necessary disclosures, and to certify periodically for a two-year period that its customer confirmations comply with the MSRB Rule.

"Full and fair disclosure is the fundamental tenet of our industry," said Barry Goldsmith, NASD Executive Vice President and Head of Enforcement. "Disclosing the yield in municipal securities transactions—both purchases and sales—allows customers to evaluate the fairness of the price they paid or received for their bonds. The disclosure failures in this case deprived these selling customers of critical information."

The rules of the Municipal Securities Rulemaking Board (MSRB), which are enforced by NASD, require securities dealers to issue written confirmations to customers who have bought or sold municipal securities. The confirmations must include specific information regarding each transaction, including yields and dollar prices for the securities purchased or sold. For municipal bonds, the yield is generally the rate of return until the maturity date, taking into account the interest payments, the price of the bond, its redemption value and the amount of time remaining until maturity ("yield-to-maturity"). If the bond is priced on the basis of the yield to a call date or to a put date, this must be noted in the confirmation along with the date of the call or put and the dollar price on that date.

NASD found that Edward Jones included yield information in confirmations issued to customers when they purchased municipal securities. But because of a change in Edward Jones' automated systems, that information was omitted from the confirmations issued to customers who sold municipal bonds. From January 2003 until April 2004, there were approximately 86,478 such transactions involving total sales of approximately $1,650,304,650.

The MSRB has emphasized the importance of disclosing yield in municipal securities transactions. In a 1980 report, it stated:

Of the many possible relevant factors, the Board continues to be firmly of the view that the resulting yield to a customer is the most important one in determining the fairness and reasonableness of price in any given transaction. Such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market.

From May 1995 until April 2004, Edward Jones's supervisory system and its written supervisory procedures were not adequate to ensure that confirmations issued to its customers in municipal securities transactions disclosed the information required by the MSRB Rule, NASD found.

In settling this matter, Edward Jones neither admitted nor denied the charges, but consented to the entry of NASD's findings.