



May 24-26, 2005 Chicago, IL

NASD Spring Securities Conference

Enforcement Hot Topics
Wednesday, May 25, 2005
9:30 am – 10:45 am
and
Thursday, May 26, 2005
9:15 am – 10:30 am

Using a series of hypothetical and topical vignettes, this session will explore the issues that firms are likely to face in an NASD enforcement investigation or disciplinary case. Panelists will include senior NASD enforcement staff, experienced industry compliance professionals, and prominent securities practitioners who will guide participants through the thorny issues and tough decisions that must be made in the current enforcement environment. Vignettes will cover issues that include: dealing effectively with multiple enforcement authorities, how best to manage an enforcement investigation, strategies for narrowing and focusing wide-ranging investigations, getting credit for cooperation, how and when to disclose problems to the regulators, how to constructively "push back" on information requests and onsite exams without appearing uncooperative, and successful settlement and Wells strategies. Current NASD enforcement priorities will also be discussed.

Moderator: Barry Goldsmith
Executive Vice President
NASD Enforcement

Panelists: Anne Flannery
First Vice President and General Counsel, Global Regulatory Affairs
Merrill Lynch

Ben Indek
Partner
Morgan, Lewis and Bockius LLP

Jim Shorris
Senior Vice President and Deputy
NASD Enforcement

Richard Wallace
Vice President and Chief Counsel
NASD Market Regulation



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Bibliography

- **NASD News Release: *Waddell & Reed, Inc. Agrees to Pay \$5 Million Fine, Up To \$11 Million in Restitution to Settle NASD Charges Relating to Variable Annuity Switching* (April 29, 2005)**

NASD has resolved its action against Waddell & Reed, Inc., of Overland Park, KS, arising from thousands of variable annuity exchanges made as part of the firm's national switching campaign. In a complaint filed in January 2004, NASD charged Waddell & Reed with violating its obligations under NASD's suitability rule by failing to take reasonable steps to ensure that recommended variable annuity exchanges were in the best interests of customers.

Under the terms of the settlement with NASD and a separate agreement with a coalition of state regulatory authorities, Waddell & Reed will repay up to \$11 million to more than 5,000 customers whose annuities were exchanged by the firm. The firm will pay a fine of \$5 million to NASD and a fine of \$2 million to state regulators.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013886&ssSourceNodId=1091

- **NASD News Release: *NASD Fines Raymond James \$750,000 for Fee-Based Account Violations/Settlement Also Requires \$138,000 in Restitution to Customers* (April 27, 2005)**

NASD censured and fined Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. \$750,000 for violations relating to the firms' fee-based brokerage business. The firms will also pay restitution totaling \$138,000. NASD found that, from April 2001 through December 2004, the Raymond James firms failed to establish and maintain a supervisory system, including written procedures, reasonably designed to review and monitor their fee-based brokerage business. In addition, the firms also violated NASD rules by recommending and opening fee-based brokerage accounts for customers without first determining whether these accounts were appropriate and by allowing those accounts to remain open.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013876&ssSourceNodId=551

- **NASD News Release: *Ladenburg Thalmann Agrees to Repay \$1.2 Million to Customers Overcharged in Proceeds Transactions/NASD Fines Firm \$275,000, Orders Review of Proceeds Rules Compliance Policies* (April 14, 2005)**

NASD announced that Ladenburg Thalmann & Co. of New York, NY agreed to refund \$1.2 million, plus interest, to customers who were overcharged in "proceeds transactions" - transactions in which a customer

sells securities through a broker and uses the proceeds to pay for other securities purchased at or about the same time.

NASD also fined Ladenburg \$275,000 and required the firm to retain an independent consultant to make recommendations for ensuring compliance with NASD's Proceeds Rule.

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- NASD News Release: *Florida Brokerage Firm LH Ross Expelled, Owner Franklyn Michelin Barred for Life to Settle NASD Charges of Widespread, Ongoing Fraud* (March 31, 2005)

NASD expelled Boca Raton, FL-based brokerage firm LH Ross from the securities industry and barred its owner and president, Franklyn Michelin, for life to resolve charges of manipulation, fraud, excessive markups, sales of unregistered securities, books and records violations and supervisory violations in two pending enforcement actions against the firm. Both matters were scheduled to go before NASD hearing panels in coming weeks.

As part of the settlement, LH Ross and Michelin agreed to withdraw their appeals of three previous NASD hearing panel decisions that found, among other things, that LH Ross and Michelin had engaged in widespread fraud in the sales of unregistered self-offerings and had failed to cooperate with NASD investigators. Those previous decisions imposed sanctions that included expelling LH Ross (twice), barring Michelin, ordering the payment of more than \$11.45 million in restitution and interest to harmed investors, and imposing \$550,000 in fines. With the appeals dropped, those sanctions are now final.

In recent months, NASD has used two of its emergency powers for the first time to protect investors from LH Ross's ongoing fraudulent and illegal sales activities - by issuing its first temporary cease and desist order last August, and its first summary suspension of a securities firm in February.

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- 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/Firms to Offer Remediation on Over 275,000 Transactions to Over 50,000 Households* (March 23, 2005)

NASD censured and fined Citigroup Global Markets, Inc., American Express Financial Advisors and Chase Investment Services a total of \$21.25 million for suitability and supervisory violations relating to mutual fund sales practices between January 2002 and July 2003. These cases are part of a larger, ongoing investigation into mutual fund sales practices.

The cases against Citigroup and Chase involve their recommendations and sales of Class B and Class C shares of mutual funds, while the action involving American Express relates only to Class B shares. 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 resolving these actions, the firms agreed to a remediation plan that includes over 50,000 households and more than 275,000 transactions in Class B shares, and to a lesser extent, Class C shares.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013648&ssSourceNodId=1177

- NASD News Release: *NASD Fines Spear, Leeds & Kellogg \$1 Million for Concealing Sales of IPO Shares/Firm Implemented Internal System to Prevent Detection, Reporting of Sales by DTC* (March 22, 2005)

NASD censured and fined Spear, Leeds & Kellogg, L.P. (now known as Goldman Sachs Execution & Clearing, L.P.) \$1 million for creating and implementing an internal system to conceal sales of securities allocated in initial public offerings (IPOs) from the Depository Trust Corporation (DTC).

In 1997, DTC - which provides clearance and settlement services to the securities industry - implemented a system approved by the Securities and Exchange Commission (SEC) to track sales of shares in initial public offerings.

NASD found that around the time the system was implemented, some Spear Leeds customers objected to their sales of IPO shares being identified through the IPO tracking system, citing concerns about preserving the anonymity of their trading activity, and thereby preserving their ability to obtain future IPOs. In response, Spear Leeds developed and implemented a system designed to conceal sales of IPO shares from the IPO Tracking System.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013628&ssSourceNodId=1177

- NASD News Release: *NASD Fines Former Jesup & Lamont Research Analyst for Trading Contrary to His Own Recommendations* (February 23, 2005)

NASD fined and suspended former Jesup & Lamont Securities Corporation research analyst Gary Davis for trading contrary to the recommendations in his research reports and for other violations relating to his activities as a research analyst. Davis was suspended from the industry for six months, fined \$130,000 and prohibited from acting as a research analyst for 18 months. Nearly \$117,000 of his fine represents profits Davis made through his unlawful trading.

NASD also charged Jesup & Lamont, a New York City broker-dealer, and its chief compliance officer, Robert Strong, with failing to adequately supervise Davis.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013410&ssSourceNodId=1177

- NASD Press Release: *NASD Fines Quick & Reilly, Piper Jaffray \$845,000 For Directed Brokerage Violations* (February 22, 2005)

NASD fined Quick & Reilly, Inc. (now part of Banc of America Investment Services, Inc.) \$570,000 and Piper Jaffray & Co. \$275,000 for directed brokerage violations. In imposing sanctions against Piper Jaffray, NASD took into account the fact that the firm self-reported its violative conduct after conducting its own internal review.

NASD found that both firms operated "preferred partner" or "shelf space" programs, giving favorable treatment to funds offered by certain mutual fund companies in return for brokerage commissions and other payments. That special treatment included higher visibility on the firms' internal websites, increased access to the firms' sales forces, participation in "top producer" or training meetings, and promotion of their funds on a broader basis than was available for other funds. That conduct violated NASD's "Anti-Reciprocal Rule" which prohibits firms from favoring the sale of shares of particular mutual funds on the basis of brokerage commissions.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013402&ssSourceNodId=1177

- NASD News Release: *NASD Charges American Funds Distributors, Inc. with Arranging \$100 Million in Directed Brokerage Commissions for Top Sellers of American Funds* (February 16, 2005)

NASD charged American Funds Distributors, Inc. (AFD) with violating NASD's Anti-Reciprocal Rule by directing approximately \$100 million in brokerage commissions over a three-year period to about 50

brokerage firms that were the top sellers of American Funds. The payments were made to reward the firms for past sales and to encourage future sales of American Funds' 29 mutual funds. AFD is the principal underwriter and distributor of American Funds, the third largest mutual fund family in the U.S. with more than \$450 billion in assets and approximately 25 million shareholder accounts. The commissions were payments for executing trades for the American Funds' portfolio that were directed to the brokerage firms as additional compensation for past sales of American Funds, and to ensure that American Funds would continue to receive preferential treatment at those firms.

NASD's "Anti-Reciprocal Rule," which first became effective in July 1973, is designed to prevent quid pro quo arrangements in which brokerage commissions, which are assets of the shareholders of the mutual funds, are used to compensate brokerage firms for selling the funds' shares. The rule also is designed to ensure that the execution of portfolio transactions by brokerage firms is guided by the principle of "best execution" and not by other considerations. In addition, the rule is meant to eliminate the danger that a brokerage firm, when recommending mutual funds to customers, will base its recommendations on the additional rewards the firm may receive in portfolio commissions from the funds rather than on the investment needs of the customer.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013358&ssSourceNodId=1177

- NASD News Release: *NASD Bars Todd Eberhard, Former Park South Chairman and Once-Popular Television Personality/Violations Include Fraudulent Trading, Improper Settlements with Customers, Failure to Make Required Regulatory Disclosures, Providing False and Misleading Testimony* (January 31, 2005)

NASD barred Todd M. Eberhard, the former chairman of New York's Park South Securities, LLC, from the securities industry for federal securities fraud and other, multiple violations of NASD rules. Eberhard was known to millions as a guest analyst and commentator who appeared frequently on financial television programs on CNN, CNNfn, CNBC, Fox News Channel and on PBS' Nightly Business Report.

The bar stems from NASD charges announced in October 2002 that Eberhard had committed securities fraud in connection with scores of mutual fund transactions. Park South was liquidated in 2003. In 2004, Eberhard pleaded guilty in federal court to mail and wire fraud, as well as conspiracy, investment adviser fraud and obstruction of justice.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013195&ssSourceNodId=1177

- NASD News Release: *Banc One Securities Corporation Fined \$400,000 for Supervisory Failures Relating to Late Trading – NASD Also Cites Banc One for Inaccurate Recording of Order Entry Times* (January 12, 2005)

NASD censured and fined Banc One Securities Corporation \$400,000 for failing to implement adequate supervisory systems and written procedures designed to detect and prevent "late trading" of mutual funds, and for inaccurately recording the entry time for customer orders.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012983&ssSourceNodId=1177

- NASD News Release: *NASD Fines H&R Block Financial Advisors \$500,000 for Enabling Deceptive Market Timing, Orders Payment of \$325,000 in Restitution – NASD Investigation of Individuals Involved in Scheme Continuing* (December 21, 2004)

NASD censured and fined H&R Block Financial Advisors, Inc., \$500,000 for enabling a hedge fund customer in its Orlando, FL branch office to engage in deceptive practices to market time mutual funds. NASD also ordered H&R Block to pay \$325,000 to reimburse the affected funds. NASD's investigation into the activities of particular individuals involved in this market timing scheme is continuing.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012819&ssSourceNodId=553

- NASD News Release: *NASD Orders First Command to Pay \$12 Million for Misleading Statements in Sales of Systematic Investment Plans to Military Personnel (Firm to Pay Restitution, Fund Investor Education Program for Military Community)* (December 15, 2004)

NASD censured and fined First Command Financial Planning Inc., a Fort Worth, TX broker-dealer, \$12 million for making misleading statements and omitting important information when selling mutual fund investments with up-front sales charges of up to 50 percent through a monthly installment method known as a "Systematic Investment Plan."

From that \$12 million, First Command is ordered to pay restitution to thousands of customers who purchased a Systematic Investment Plan between Jan. 1, 1999 and the present who terminated the plan and paid an effective sales charge greater than 5 percent. All money remaining will be payable to the NASD Investor Education Foundation, to be used for the investor education needs of members of the military and their families.

First Command also settled NASD charges of inappropriately confronting a customer who complained, failing to maintain e-mail, failing to maintain adequate supervisory systems and procedures and filing an inaccurate Form U-5 regulatory report. In a related action, NASD fined a First Command supervisor \$25,000 and suspended him from acting in any supervisory capacity for 30 days.

The Securities and Exchange Commission also instituted settled enforcement proceedings against First Command based on similar allegations relating to the firm's sales of systematic investment plans.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012786&ssSourceNodId=553

- NASD News Release: *NASD Fines 29 Firms Over \$9.2 Million for Late Reporting – Failures Stall Disclosure of Potential Broker Misconduct to Public, Regulators, Brokerages* (November 30, 2004)

NASD censured and fined 29 securities firms over \$9.2 million for more than 8,000 late disclosures of reportable information about their brokers – including customer complaints, regulatory actions and criminal charges and convictions.

NASD also prohibited two firms -- Merrill Lynch and Wachovia -- from registering new brokers for five business days, in view of the number of their reporting violations in this case and their previous regulatory filing histories. NASD imposed a similar prohibition and a \$2.2 million fine against Morgan Stanley in July for late reporting violations.

During the period January 2002 through March 2004, each of the 29 firms failed to timely report at least 25 percent of the required disclosures in the areas reviewed by NASD, and some firms failed to timely report over 70 percent. NASD also found that each firm failed to have supervisory systems and procedures in place reasonably designed to achieve compliance with these reporting requirements.

To resolve these actions, each firm agreed to conduct internal audits to evaluate the effectiveness of its system for ensuring compliance with these reporting obligations. In addition, an officer of each firm must certify that such audits have occurred, that recommendations from the audits have been implemented and that the firm has established systems and procedures reasonably designed to achieve compliance with NASD reporting requirements.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012595&ssSourceNodId=553

- NASD News Release: *NASD Permanently Bars Frank Quattrone from the Securities Industry for Refusal to Testify in NASD Investigation – Quattrone's Misconduct Termed "Egregious"* (November 22, 2004)

NASD's National Adjudicatory Council (NAC) permanently barred Frank Quattrone from working in the securities industry in any capacity for refusing to testify in an NASD investigation concerning his role in possible document destruction, obstruction of justice and other matters while at Credit Suisse First Boston (CSFB). The NAC overruled an earlier NASD hearing panel decision to fine Frank Quattrone \$30,000 and

suspend him for one year. In ordering the permanent bar, the NAC called Quattrone's conduct "egregious" and said it "impeded an NASD investigation and undermined the NASD's ability to carry out its regulatory mandate."

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- NASD News Release: *NASD Charges H&R Block Financial Advisors With Fraud in Sale of Enron Bonds to Hundreds of Customers – Bond Sales Just Before Enron Collapse Cost Customers Millions of Dollars* (November 8, 2004)

NASD charged H&R Block Financial Advisors, Inc., with fraud in the sale of millions of dollars worth of Enron Corporation bonds after Enron's finances, and its bond ratings, had begun to collapse. NASD charged that during the five-week period preceding the Enron bankruptcy filing – while Enron's financial crisis was unfolding publicly and official investigations were being launched – H&R Block's brokers made affirmative misrepresentations to customers, touted the supposed benefits of the Enron bonds, and failed to disclose the serious and significant risks associated with an investment in the bonds. From October 29, 2001 through November 27, 2001, approximately 200 H&R Block brokers recommended and sold over \$16 million worth of Enron bonds to more than 800 customers in approximately 40 states. As an incentive, H&R Block paid its brokers sales credits significantly higher than those typically paid for similar bonds. NASD charged that H&R Block received profits of over \$500,000.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012056&ssSourceNodId=553

- NASD News Release: *NASD Fines Sentinel Financial Services \$700,000 for Failing to Prevent Market Timing – Supervisory Inadequacies Cited; Over \$650,000 in Restitution Paid to Affected Funds* (October 7, 2004)

NASD censured and fined Sentinel Financial Services Company, of Montpelier, Vermont, \$700,000 for failing to prevent market timing in three mutual funds offered by its affiliate, Sentinel Group Funds, Inc. Sentinel also failed to establish and maintain a reasonable supervisory system designed to detect and prevent market timing in violation of the funds' trading policies. After NASD completed its investigation, Sentinel paid \$659,674 in restitution to the three affected funds - Sentinel International Equity Fund (\$645,631), Sentinel Bond Fund (\$10,098) and Sentinel High Yield Bond Fund (\$3,945).

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_011624&ssSourceNodId=553

- NASD News Release: *NASD Orders First-Ever Suspension of Mutual Fund Business and \$600,000 in Sanctions Against National Securities Corp. for Deceptive Market Timing Practices* (August 19, 2004)

For the first time, NASD has prohibited a regulated firm from opening mutual fund accounts for new clients for 30 days - for facilitating deceptive market timing practices and for failing to have an adequate supervisory system to prevent deceptive market timing and late trading.

National Securities Corp., based in Seattle, WA, was also fined \$300,000 and ordered to pay almost \$300,000 in restitution to the funds that were affected by the deceptive market timing. In addition, National was ordered to revise its supervisory systems to correct supervisory and email retention deficiencies. National's president, Michael A. Bresner, was fined \$25,000 and received a one-month supervisory suspension for the firm's supervisory failures. David M. Williams, the firm's former chief operating officer, also was fined \$25,000 and received a four-month supervisory suspension.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_010888&ssSourceNodId=553

- NASD News Release: *NASD Fines Morgan Stanley \$2.2 Million for Late Reporting, Firm Temporarily Suspended from Registering New Brokers* (July 29, 2004)

NASD censured and fined Morgan Stanley DW Inc. \$2.2 million for more than 1,800 late disclosures of reportable information about its brokers. The late reports concerned, among other things, customer complaints and disciplinary actions by regulators. NASD also charged Morgan Stanley for supervisory failures relating to the late filings.

In addition to ordering the fine, NASD prohibited Morgan Stanley from registering any new brokers for one week, required it to hire an independent consultant to assess the firm's supervisory systems and procedures in the reporting area, and imposed specific ongoing reporting obligations.

NASD concluded that the late filings by Morgan Stanley had delayed several NASD investigations. The late filings also may have hampered the investing public's ability to accurately assess the background of certain brokers through NASD's public disclosure program, BrokerCheck, and compromised the ability of state securities regulators to review applications from brokers changing firms.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_010891&ssSourceNodId=553

- NASD News Release: *NASD Fines Citigroup, Merrill Lynch and Morgan Stanley a Total of \$750,000 for Failing to Comply with Discovery Obligations in Arbitrations* (July 19, 2004)

NASD censured and fined Citigroup Global Markets, Inc., formerly Salomon Smith Barney, Merrill Lynch, Pierce, Fenner & Smith Incorporated, and Morgan Stanley DW Inc. \$250,000 each for failing to comply with their discovery obligations in 20 arbitration cases during the period 2002 through 2004. All three firms must also implement written procedures designed to ensure that future discovery violations that lead to sanctions are elevated to senior officers for review and appropriate corrective action.

These cases arise from arbitrations conducted before NASD Dispute Resolution, Inc. arbitration panels as well as arbitration panels sponsored by other regulatory forums. In these arbitrations, arbitration panels cited the firms for failing to produce documents to the claimants, as required by rules involving document discovery. After finding in each of the arbitrations that the firms failed to fully comply with their discovery obligations to produce documents - even after arbitration panels had issued orders compelling that production - the panels sanctioned the firms in amounts as high as \$52,000.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_009925&ssSourceNodId=553

- NASD News Release: *Eight Brokerage Firms Pay Over \$610,000 to Settle NASD Charges of Municipal Price Violations* (June 29, 2004)

NASD ordered eight firms to pay fines totaling \$310,000 and restitution to customers of \$300,000 in connection with certain municipal bond trades where customers did not receive a fair price for their bonds, in violation of Municipal Securities Rulemaking Board (MSRB) rules. NASD found that some customers of these firms received below-market prices when selling their municipal bonds to the eight firms, as evidenced by the fact that the bonds were subsequently resold by other dealers - often in same-day transactions - at markedly higher prices, in violation of MSRB Rules G-30 and G-17. Those rules require municipal bond dealers, regardless of the compensation received by the dealers, to deal fairly with their customers and to buy and sell bonds at fair prices.

For more detail on this and the eight firms named in these actions and the amounts they are paying in fines and restitution, see the full press release at www.nasd.com.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_011465&ssSourceNodId=553

- NASD News Release: *NASD Fines Davenport & Co. in First Case of Deceptive Market Timing in Variable Annuities* (June 1, 2004)

In the first case ever brought against a broker-dealer for facilitating deceptive market timing in variable annuities, NASD fined Davenport & Co. LLC of Richmond, VA \$450,000 and ordered the company to pay more than \$288,000 in restitution to the affected funds. The fine also includes Davenport's failure to establish and maintain a reasonable supervisory system and written supervisory procedures designed to prevent late trading of mutual funds.

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Market Regulation Information

Market Regulation Areas of Focus for 2005:

- Trading practices involving TRACE Securities and Municipal Securities.
- Completeness and accuracy of trade reports for TRACE Securities and Municipal Securities.
- Compliance and Supervision with respect to Regulation SHO.
- Accuracy and timeliness of information published pursuant to SEC Rules 11Ac1-5 (order execution) and 11Ac1-6 (order routing).
- Auto-Execution type short-term manipulations in all forms.
- Quality assurance in automated systems for trading, trade reporting, regulatory reporting (OATS, Short Interest Reporting, 11Ac1-5 and 11Ac1-6), and other areas.

Significant Market Regulation Cases in the last six months.

Knight Securities:

- NASD News Release: *SEC, NASD Sanction Knight Securities \$79 Million for Fraudulent Sales to Institutional Customers* (December 16, 2004)

The SEC and NASD found that Knight's former leading institutional sales trader priced trades in a manner contrary to customers' expectations and industry custom, using deceptive trading practices to disguise his pricing and the amount of Knight's profits.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012795&ssSourceNodId=553

- NASD News Release: *Former Knight Trader Joseph Leighton Barred, Ordered To Pay \$4 Million To Settle Charges of Fraudulent Trades With Institutional Customers* (April 20, 2005)

The Securities and Exchange Commission and NASD announced parallel enforcement actions against Joseph Leighton, formerly the leading institutional sales trader at Knight Securities, L.P. (now known as Knight Equity Markets, L.P.). Leighton was barred from the securities industry and will pay more than \$4 million to settle charges that he made millions of dollars in fraudulent trades with Knight's institutional customers.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013841&ssSourceNodId=1177

- NASD News Release: *NASD Charges Knight Securities' Kenneth Pasternak, John Leighton With Supervisory Violations in Fraudulent Sales to Institutional Customers* (March 7, 2005)

NASD and the SEC settled actions with Knight Securities and Joseph Leighton. NASD has filed a complaint against John Leighton and Kenneth Pasternak, which they are contesting.

During 1999 and 2000, Joseph Leighton generated a total of approximately \$41 million in illegal profits for Knight executing orders from his institutional customers, including managers of mutual funds. Joseph Leighton had Knight acquire a stock position after he received an institutional customer's order, and then waited until the price of the stock moved before executing trades to fill the customer's order, creating greater profits for Knight at the expense of his customer. If the price of the stock moved in favor of Knight's position, Joseph Leighton delayed executions and traded with his customers at prices reflecting the positive price movement. If the price of the stock moved against Knight's position, Joseph Leighton executed trades with customers based upon prices at an earlier time, which were more advantageous to Knight. His customers did not know when, or at what prices, Knight acquired stock pursuant to their orders, and the sales trader took advantage of that in trading with them, making tens of millions of dollars in excessive profits at their expense.

The SEC and NASD also found that Knight failed to adequately supervise the sales trader's trading. Joseph Leighton's supervisor and the former head of Knight's institutional sales department was John Leighton, Joseph Leighton's brother. The brothers had a profit-sharing arrangement, approved by Knight, which gave John Leighton half of Joseph Leighton's compensation. This profit-sharing arrangement created an inherent conflict of interest with the John Leighton's supervisory responsibilities for Joseph's trading. While Joseph was generating extraordinary profits in his trading with institutional customers, neither John nor anyone else at Knight conducted a meaningful review of Joseph's trading. No one in a supervisory role questioned the extraordinary profits that Joseph generated, or undertook any steps to see how he was making them.

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Yankee Financial:

- NASD News Release: *NASD Hearing Panel Expels Yankee Financial for Fraud, Orders Payment of More Than \$3.8 Million in Restitution; Yankee President Richard Kresge Barred From Acting as Principal or Supervisor* (January 13, 2005)

The Hearing Panel held that, "Yankee and Kresge are liable for ... [the] violations by the brokers in the Brooklyn office" because they were the brokers' employers and ultimate supervisors, with the duty to establish guidelines for brokers' conduct and to monitor brokers' adherence to those guidelines. The Hearing Panel concluded that Kresge's performance of due diligence in reviewing the backgrounds of brokers hired to staff the Brooklyn branch office was "grossly insufficient." The panel noted that his "indifference to every aspect of its operation except its financial success was reckless and failed to prevent injury to the investing public." Yankee and Kresge have appealed the decision of the Hearing Panel.

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Walter P. Piecyk, Jr.:

- NASD News Release: *NASD Fines Analyst \$75,000 for Circulating Rumor* (January 14, 2005)

Piecyk, a research analyst with Fulcrum Global Partners LLC in New York, circulated a negative rumor that RF Micro Devices' largest client, Nokia Corporation, was delaying equipment orders to the company. Piecyk did not conduct a reasonable inquiry into whether there was a basis for the rumor. He circulated the rumor via instant messages and telephone calls to at least eight of Fulcrum's institutional clients. As he circulated the rumor, Piecyk sold short a total of 3,000 shares of RF Micro Devices. Piecyk closed his short position in October 2002, earning a profit of \$7,815.

http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013005&ssSourceNodeld=1177