

of violations, when compared to the size of the firm's total options business, is "reasonable." As a result, many SRO compliance personnel believe that no disciplinary action should be taken so long as the number of customer accounts with record-keeping defects (for example, no options agreement, no ROP approval, no essential customer information) does not exceed a tolerable percentage of a test sample of the firm's accounts. The Options Study's review of the routine SRO examinations which resulted in informal disciplinary action revealed that the "manageable" level often appears to be between 10 and 15 percent of the accounts sampled.

SROs are also lenient towards firms that appear to be trying to remedy violations, often irrespective of whether real progress is being made. For example, one senior SRO compliance official stated that if he examined a firm one year and found 40 percent of the option accounts not to have been approved by a ROP, and the following year the figure was reduced to 30 percent, he would not recommend formal disciplinary action because it would be apparent that the firm was taking effective remedial steps. According to this individual, "so long as the firm is not falling behind," that is, the scope of the violations is not increasing, he would recommend that only a letter of caution be sent to the firm.

The Options Study also found that one SRO restricts the coverage of future proceedings if there has been a prior disciplinary action covering the same subject matter. Between April and June 1976,

for example, this SRO conducted a sales practice examination of a large national firm which uncovered numerous violations of the SRO's rules relating to the opening of new accounts and failure of the firm to exercise due diligence to obtain essential customer information. In November, 1976, the firm received a letter of caution. During this period, in August, 1976, the SRO received a complaint from a customer of the firm who alleged that a registered representative had executed transactions without the customer's authorization and that the customer had never executed a new account card. This complaint was not investigated as part of the proceeding then in preparation, but was investigated separately and at a slower pace. The investigation eventually established that indeed the customer had not executed an options agreement until approximately four months after the initial options transaction, that his new account card "did not contain any information concerning [his] investment objectives", and that the customer had lost \$14,200 in 10 months. Ultimately, the SRO staff recommended that:

since the violation noted in this investigation
related to the violation [previously] noted . . .
for which the firm was issued a letter of caution . . .
no new action [should] be taken . . .

This practice may be inconsistent with the SRO's statutory obligations, particularly if a violation is serious or recurrent.

D. SRO internal supervision

Many routine examination files reviewed by the Options Study did not contain adequate documentation regarding the procedures followed in the examination and the findings of the examiner. In addition, disciplinary boards of SROs and senior administrative SRO officials are not always apprised of all relevant data in the SROs' files pertaining to a routine or cause examination. Sometimes, even the important decision whether to bring an action is left to the discretion of the SRO investigative staff, rather than to a committee of members or senior staff officials. ^{73/} In such instances cases are closed without proper review. At some SROs, supervisory procedures are inadequate to detect such situations. Moreover, many cases involving apparent violations are closed or informal disciplinary actions initiated without any documentation stating the underlying reasons for such action. The absence of written records makes effective supervision very difficult.

^{73/} See Chapter IV.

Accordingly, the Options Study recommends:

EACH SRO SHOULD RETAIN A RECORD OF THE RESULTS OF EACH ROUTINE OR CAUSE EXAMINATION, WHICH SETS FORTH REASONS WHY NO ACTION WAS TAKEN WHEN APPARENT VIOLATIONS WERE DETECTED OR WHY ONLY INFORMAL DISCIPLINARY ACTION WAS INITIATED, AND THAT SUCH RECORDS BE REVIEWED PERIODICALLY BY THE SRO'S GOVERNING BOARD OR COMMITTEE. 74/

E. restitution as a sanction.

A public investor who sustains an injury due to the misconduct of a salesman or his firm must generally resort to litigation or arbitration to recover his losses, although, at times, a firm may pay damages to a customer in anticipation that this action will be taken into consideration by an SRO in deciding whether to take disciplinary action or in imposing sanctions. In many instances, litigation is expensive and impractical for the customer, 75/ and arbitration, while somewhat less expensive, is frequently time consuming and inconvenient. SROs do not order restitution to injured investors as a sanction in a formal disciplinary action, primarily because they believe that they do not have the authority to do so.

Where an SRO has already conducted an investigation and decided to institute formal disciplinary action, a public investor harmed by the conduct which forms the basis for the disciplinary action should not have to duplicate the SRO's work and proceed in another forum. Several senior SRO staff members concede that the power

74/ See recommendation in Chapter IV with respect to AMEX investigation and enforcement.

75/ See Report from the Office of Consumer Affairs to the Commission, December, 1976, pp. I-24 - I-31.

to order restitution would be a strong incentive for retail firms and their salesmen to initiate meaningful remedial action or refrain from abusive practices. As one SRO official stated: "I wish we had that tool in our bag."

Recent amendments to the Exchange Act permit all SROs to impose "any fitting sanction," including restitution. ^{76/} To the extent, however, that an SRO, by rule, has restricted the scope of sanctions which it may impose, for example, to expulsion or suspension from membership or association with a member, a censure, or a fine, such rules would have to be amended to permit the SRO to award restitution.

Accordingly, the Options Study recommends:

EACH SRO SHOULD AMEND ITS RULES IN ORDER SPECIFICALLY TO PERMIT THE AWARD OF RESTITUTION AS A DISCIPLINARY SANCTION, WHENEVER SUCH A SANCTION WOULD BE APPROPRIATE.

F. SRO disciplinary proceedings: a final note

SRO disciplinary efforts with regard to options selling practices have been largely ineffective for the reasons discussed above. Many problems may be remedied by revising SRO rules and procedures.

Of more concern to the Options Study, however, was a prevailing philosophy at some SROs that options rules are "new," and thus member firms, their supervisors and registered representatives should be

^{76/} Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.299, S. Rep. No. 94-75, 94th Cong., 1st. Sess. 96 (1975).

"educated" as to their responsibilities before strong enforcement action is taken. The application of this philosophy, which still prevails, has been reflected in lax enforcement programs against selling abuses and a system of sanctions where the letter of caution is considered severe.

Such a philosophy is inconsistent with the protection of public investors, and the Commission has explicitly rejected it in the context of sales practices of retail firms:

The duty of supervision cannot be avoided by pointing to the difficulties involved where facilities are expanding or by placing the blame upon inexperienced personnel or by citing the pressures inherent in competition for new business. These factors only increase the necessity for vigorous effort. 77/

The Options Study believes that the Commission's statement is particularly applicable to the initiation and rapid growth of the options markets where special dangers to the unsophisticated or unwary investor are present.

VI. THE NEED FOR MINIMUM SRO COMPLIANCE STANDARDS

Each SRO has designed and implemented its own compliance programs. As discussed throughout this chapter, the resulting combined SRO system has many inconsistencies and voids. Compliance programs, including examination and disciplinary programs, differ

77/ In the Matter of Reynolds & Co., Securities Exchange Act Release No. 6273 (May 25, 1960).

among SROs both as to their fundamental objectives and as to each SRO's ability to acquire and effectively use relevant compliance information. These differences have adversely affected the ability of the self-regulatory organizations to oversee the conduct of member firms and their employees. Although SROs are increasingly allocating responsibilities among themselves in order to eliminate duplicative programs and minimize operating expenses, no effective steps have been taken by the SROs to ensure that each SRO's program conforms to minimum standards of performance. Moreover, in those areas where the SROs have not allocated responsibility, increased coordination and cooperation is needed to assure more effective and efficient compliance programs among SROs.

The current differences in performance and the absence of minimum standards can significantly impair the SROs' continued willingness to expand their allocation and coordination efforts. The Options Study's concern in this regard was raised with the Self-Regulatory Conference, which agreed to develop "a more standardized compliance program." The Conference also agreed that "it should be possible to establish some industry-wide objectives for the conduct of a [broker-dealer] examination so as to insure the protection of investors, avoid regulatory duplication, and eliminate regulatory voids." 78/

78/ Appendix E, letter to Richard Teberg, Director, Special Study of the Options Markets from the Self-Regulatory Conference, dated October 6, 1978 at p. 7.

Moreover, the Conference stated that "existing programs may be refined so as to increase their comprehensiveness and to facilitate their use, as deemed appropriate by each SRO."

While the Options Study is recommending that the SROs establish minimum standards, it does not recommend the establishment of uniform standards. One of the basic strengths of self-regulation has been the opportunity for innovation and fresh initiatives. The development of minimum standards should not be permitted to impair imaginative solutions to better protect the public.

The Options Study supports the Conference's undertaking and recommends:

SROs SHOULD DEVELOP STANDARDS FOR THE ESTABLISHMENT OF MINIMUM COMPLIANCE PROGRAMS FOR IMPLEMENTATION BY EACH SRO; THE PROGRAMS SHOULD PROVIDE INDUSTRY-WIDE OBJECTIVES FOR THE MONITORING, EXAMINATION AND DISCIPLINARY PROGRAMS OF THE SROs AND PROVIDE STANDARDS BY WHICH THE SUCCESS OF THE PROGRAMS WOULD BE MEASURED.

EXHIBITS TO CHAPTER VI

APPENDIX DSummary of SRO Options Related Examinations and Investigations
of Firm DEF for 1973 - 1978

Between 1973 and 1978, the SROs collectively conducted 32 options related examinations and inquiries of this firm and/or its registered representatives. The results of these inquiries are summarized below.

As this summary demonstrates, the SROs, through their extensive inquiries, should have had a comprehensive picture of the operations and sales practice procedures of this firm, which, since 1973, has had increasing sales practice problems. The disciplinary action taken to date by the SROs, however, is not consistent with the firm's total conduct.

This chart also substantiates the Options Study's conclusion that none of the SROs is aware of this firm's compliance history. This is directly attributable to the fact that SROs do not exchange relevant compliance data.

Moreover, the sanctions imposed by SROs have been ineffective in deterring violations by the firm, as evidenced by the Commission's administrative proceeding in 1978.

SRO Examinations and Investigations of firm
DEF for 1973-1978 *

<u>DATE</u>	<u>SRO</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDINGS OR ALLEGATIONS</u>	<u>DISPOSITION</u>
6/73	NYSE	Routine	No options related problems detected	No action **
10/73	NYSE	Cause	Improper reconciliation of options suspense accounts	Letter of education
12/74	NYSE	Routine	No options related problems detected	No action
12/74	NASD	Cause	Misrepresentation	No action
12/74	NASD	Cause	Unauthorized trades, false quotations; RR admitted several errors	Firm censured and assessed costs
2/75	NASD	Routine	No options related problems detected	No action
2/75	NASD	Cause	Improper handling of account; "inconsistent" recommendations to customer	No action

* This chart was prepared from summaries of SRO examinations furnished to the Options Study by the SROs. In some instances, an SRO failed to furnish certain information, as noted in the chart.

** No action means that the matter was closed without formal or informal disciplinary action because, in general, the investigating SRO did not find an apparent violation or there were disputed issues of fact which the SRO did not resolve.

<u>DATE</u>	<u>SRU</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDINGS OR ALLEGATIONS</u>	<u>DISPOSITION</u>
3/75	AMEX	Routine	Inadequate or improper account documentation; inadequate supervision; failure to verify contract lists and reconcile uncomparred trades; failure to utilize an exercise allocation procedure approved by the AMEX	Deferred to CBOE (See 8/75 CBOE routine examination below)
6/75	NYSE	Cause	Improper Rule 15c3-1 "haircuts"	Verbal caution
8/75	CBOE	Routine	Accounts not approved by ROP in reasonable time; missing customer agreements; failure to use due diligence in opening accounts	Fined - \$10,000
9/75	NYSE	Cause	No options related problems detected	No action
10/75	NYSE	routine	Unqualified supervisory personnel; inadequate or improper account documentation	Letter of education

<u>DATE</u>	<u>SRO</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDINGS OR ALLEGATIONS</u>	<u>DISPOSTION</u>
12/75	AMEX	Cause	Unsuitable trading	Admonitory letter
3/76	CBOE	Cause	Inadequate margin in customer accounts; unsuitable recommendations; unauthorized trades	No action
6/76	CBOE	Routine	Accounts not approved by ROP in reasonable time; trading prior to ROP approval	Staff interview
10/76	NYSE	Routine	Unqualified supervisory personnel; inadequate or improper account documentation; inadequate supervision	Letter of education
10/76	NYSE	Cause	Unauthorized transactions; inadequate margin	Pending

<u>DATE</u>	<u>SRO</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDINGS OR ALLEGATIONS</u>	<u>DISPOSITION</u>
11/76	CBOE	Cause	Improper handling of account; failure to explain risks of trading; account not approved for options trading	No action
1/77	CBOE	Cause	Excessive transactions; unauthorized transactions; unsuitable transactions; failure to supervise	Censure and fined \$2,500
1/77	CBOE	Cause	Excessive trades; unsuitable recommendation; failure to supervise	Censure and fined \$5,000
1/77	NYSE	Cause	(Information not furnished)	No action
2/77	NASD	Cause	Excessive trading; unsuitable recommendations	No action
5/77	AMEX	Routine	Inadequate or improper account documentation; incomplete customer confirmations; unqualified supervisory personnel	Letter of caution
6/77	NYSE	Cause	Excessive trading	No action

<u>DATE</u>	<u>SHO</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDING OR ALLEGATIONS</u>	<u>DISPOSITION</u>
6/77	AMEX	Cause	Excessive trading	Deferred to NYSE
7/77	AMEX	Cause	Disagreement with customer	No action
7/77	AMEX	Cause	(Information not furnished)	"Resolved by CBOE"
7/77	AMEX	Cause	Disagreement with customer	No action
9/77	NYSE	Cause	Misappropriated funds from customer account; conversion of customer securities; unauthorized transactions	Charges filed- case open
10/77	NYSE	Routine	No options related problems detected	No action
12/77	NYSE	Cause	Permitted options to expire without being exercised	No action
3/78	NASD	Cause	Inadequate disclosure of risks; unsuitable recommendations; misrepresentation	Pending

<u>DATE</u>	<u>SRO</u>	<u>TYPE OF EXAMINATION</u>	<u>FINDINGS OR ALLEGATIONS</u>	<u>DISPOSITION</u>
4/78	NYSE	Cause	Excessive trading; unsuitable transactions	No action due to CBOE action
7/78	NASD	Cause	Unauthorized trades; unsuitable recommendations	Pending

In 1978, the Commission concluded its own investigations of two branch offices of this firm. Commission investigators discovered numerous incidents of unsuitable recommendations, excessive trading, unauthorized transactions, option accounts trading prior to ROP approval, inadequate supervision, and various misrepresentations, particularly with regard to the risks of options trading. As a result of these violations, the firm agreed to make improvements in its compliance and supervisory procedures, and to reimburse certain customer accounts in a total amount exceeding \$200,000.

APPENDIX E

Mr. Richard Teberg, Director
Special Study of the Options Markets
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

October 6, 1978

Dear Mr. Teberg:

We are pleased to submit this letter in response to the various issues raised by the Special Study of the Options Markets (the Options Study) with respect to the need for and creation of an integrated regulatory system among the self-regulatory organizations (SRO's). We will first make a preliminary statement concerning the Option Study's objectives and discussions between the self-regulatory organizations. We will then offer substantive comments, preliminary conclusions and recommendations under four headings: (I) Interchange of Market Surveillance Information, (II) "Compliance Plan" for Member Firm Examination and Information Sharing, (III) Centralization of Compliance Data for Registration and Investigation Purposes, and (IV) Allocation of Responsibility.

Preliminary Statement

As you are aware, during August, 1978, the staff of the Options Study held several meetings with representatives of the following organizations: American Stock Exchange, Boston Stock Exchange, Chicago Board Options Exchange, Midwest Stock Exchange, National Association of Securities Dealers, New York Stock Exchange, Options Clearing Corporation, Pacific Stock Exchange, and Philadelphia Stock Exchange (hereinafter participant SRO's or the group). Also participating were representatives of the Commission's Divisions of Enforcement, Market Regulation and Consumer Affairs, and Monchik-Weber Associates, Inc. These discussions described the Commission's concerns which precipitated the request for a Proposal For A Market Surveillance System as awarded to Monchik-Weber Associates, Inc. as well as the preliminary findings of the Options Study which indicate the need for greater coordination of existing options and securities regulatory systems so as to achieve an integrated industry-wide regulatory system.

The meetings of the participants have focused upon the need for the creation of an integrated regulatory system among the SRO's which would enhance total industry regulatory capability by coordinating and interfacing existing regulatory data and programs through the sharing of available information, improvement of regulatory techniques, the allocation of regulatory responsibility and the centralization of registration data and customer complaints to facilitate access.

In particular, the Options Study has noted several areas of concern which are indicative of its findings and which should be addressed in order, in its opinion, to improve overall regulatory capability of the SRO's. The main objectives would be to eliminate overlapping efforts which may presently exist, to fill existing voids in regulatory programs and to promote the interchange of and access to information. This is especially true with respect to dual trading in options and stocks and intermarket options activities. These concerns center upon whether there is a need for the SRO's to:

- (1) share and improve existing data bases and increase inter and intra-market cooperation;
- (2) to enhance audit trails to promote intermarket reconstruction and surveillance;
- (3) enhance regulation of off-floor proprietary and customer accounts;
- (4) establish audit trails for position adjustments, "as of" transactions and Clearing Member Trade Assignment arrangements;
- (5) establish minimum uniform standards which trigger surveillance follow-up activity;
- (6) establish uniform forms and letters requesting additional information from broker-dealers with the elimination of duplicate inquiries in the case of multiply traded options and the underlying security;
- (7) receive and process relevant information from each SRO regarding registered personnel and to utilize such in preparation for regulatory examinations and investigations;

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- (8) conduct more examinations of member firms which may incorporate regulatory methods and practices which have not been routinely utilized by all SRO's in the past;
- (9) establish the method, form, and principles upon which information available to one or more SRO's will be accessed by other SRO's; and
- (10) establish uniform minimum compliance and disciplinary programs.

The Options Study also recognized the importance of enhancing regulation of broker-dealers who, though not a member of an options exchange engage in exchange listed options activity by going through a clearing member (so called "access firm"). However, this problem appears to be nearing resolution by the Commission's recent conditional approval of the NASD's "access" rule proposals. This situation would be further improved if the SEC would now adopt and approve comparable rules to regulate SECO and other broker-dealers not covered by the rules governing access firms or any other specialized options rules.

Although it is recognized by the participant SRO's that complete integration of regulatory information and systems may present technical and feasibility questions, it is acknowledged that the establishment of a more fully integrated regulatory system is both necessary and desirable as a means of establishing more efficient and effective regulation which may be cost-effective to the industry and achieve minimum standards of regulation on an industry-wide basis thus assuring the protection of public investors.

Significant progress has been made by the participants toward the creation of an integrated regulatory system. Numerous meetings and discussions have been held by the group and sub-groups formed for the purpose of focusing on specific issues including (a) interchange of market surveillance information, (b) interchange of compliance information relating to firm examinations and sales practices, (c) development of central files for registered personnel and customer complaints, (d) allocation of regulatory responsibilities, and (e) legal matters to be addressed in order to achieve an integrated regulatory system.

As a result of these discussions, the participant SRO's listed above met jointly for the purpose of defining the overall parameters of a comprehensive regulatory system based upon their complete and thorough understanding of the capabilities presently in place and, following such analysis, to make recommendations for the implementation of the system.

The group, based upon the reports and recommendations of its sub-groups, and its own deliberations to date, has achieved agreement in several specific areas and wishes to submit this preliminary report to apprise the Options Study of the material developments which have occurred and to focus attention on those areas which, although approved in principle by the various SRO's, remain to be fully resolved before consideration may be given to their later implementation. It is clear, however, that continuing efforts will be required in order to reach mutually satisfactory solutions and that further meetings of the SRO's with the Commission's staff will also be required to facilitate the implementation of desired programs.

I. Interchange of Market Surveillance Information

A sub-group was established on interchange of Market Surveillance information. This body was directed to identify all market surveillance reports and information presently available to each participant SRO in order to determine which information could be integrated into other self-regulatory organizations' programs to enhance existing regulatory efforts with respect to intermarket surveillance. This sub-group thereafter collected from and furnished to each participant SRO, including the Options Clearing Corporation, copies of all option and equity computer print-outs and certain manually prepared reports (along with explanatory materials identifying the type of data, format, frequency and purpose) which are utilized in conducting market surveillance for listed securities. In addition to disseminating examples of data base information derived from transaction and clearing streams, each organization provided copies of reports which identify activity which exceeds pre-determined parameters during a trading session.

After the analysis of this voluminous information, a better understanding of the nature of information available was achieved. There was also a consensus that the sharing of data by the various SRO's is both needed and desired. However, while certain agreements have been reached, it is yet to be deter-

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It is generally agreed that any information interchanged may be more desirable in a computer readable format rather than on microfiche or hard copy printouts for manageability and flexibility purposes.

Further, it is noted that certain data which would be useful to each organization is presently available on an on-line basis through such systems as the OTIS system for collecting and displaying option information and for stock activity from the last sale and quote information transmitted via high speed lines. This information may be captured with appropriate programming which is being explored.

During a general discussion of the adequacy of option and stock data bases and audit trails, it became apparent that a significant difficulty in an effective and efficient integrated system is the reconstruction of transaction data on the underlying security in a form which identified the broker/dealers involved in each transaction and whether they are acting as agent or principal. Various participants expressed concern that such a system might be very expensive to construct and maintain and that these costs must be weighed.

After identifying the information available, the participant SRO's expressed interest in the exchange of market surveillance information as follows:

- a) Reconciliation Clearing Sheets from markets where securities underlying options are traded.
- b) Daily Transaction Journal from all markets where securities underlying options are traded.
- c) Monthly Short Interest Reports by firm from all markets where securities underlying options are traded.
- d) Block trade reports from all markets where securities and options are traded.
- e) Notification of the initiation of investigations and reviews, as appropriate.
- f) Status reports on investigations and reviews, as appropriate.
- g) Notification of trading halts.

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- h) Notification of corporate contacts resulting from unusual trading activity.
- i) Exercise/Assignment Listing Reports from OCC.
- j) Open Interest Distribution Reports from OCC.
- k) Market Data Retrieval Reports and Matched Trade Listing Reports.

The equity exchanges indicated that they would be responsive to inquiries by the options exchanges with respect to matters which could affect trading in underlying securities and options trading thereon and would make every effort to inform other appropriate market centers of trading halts.

With respect to the interchange of information pertaining to multiply listed options, we believe that useful data is currently being disseminated to the options exchanges via the daily Options Clearing Corporation compliance tape and that modifications due to be implemented in the beginning of 1979 will enhance monitoring capabilities by providing member transactions in multiply traded classes executed on other exchanges. These modifications, as currently envisioned will consist of each participant SRO receiving the following:

- a) All positions, exercises/assignments and adjustments of their members regardless of where the options class is listed;
- b) All cleared options transactions of their market makers/specialists/registered traders; and
- c) All exercises, assignments, positions and adjustments of non-members trading in classes which are solely listed on their exchange.

There is general agreement among the participant SRO's that they are willing to share information for surveillance purposes subject to certain specific limitations, i.e. non-member specialist and marketmaker positions which would be provided on a case-by-case basis rather than as a matter of routine. It is important to note that the participant SRO's agree that all information would be available to other SRO's for specific investigations.

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It was suggested that rather than receive information from each option exchange the Options Clearing Corporation upon appropriate authorization could furnish a modified daily compliance tape to non-OCC participant SRO's which would contain the information requested except for data pertaining to non-member specialists, traders, and marketmakers.

The group recognizes that there could be problems inherent in providing an SRO information pertaining to a non-member of that participant. It remains to be resolved whether such information is to be furnished on a routine basis or only upon request.

With respect to the legal question of providing a participant with information pertaining to a non-member, the legal sub-group raised questions of legal liability. It believes, however, the potential liability of SRO's would be decreased if the action taken (a) is pursuant to legitimate regulatory objectives under the Securities Exchange Act of 1934 and does not involve excessive or gratuitous compromise of privacy or due process rights; (b) has been duly authorized by the SRO's and approved by the SEC; and (c) each SRO has implemented appropriate rule changes to the extent necessary and/or has required proper disclosure.

II. Compliance Plan for Member Firm Examinations and Information Sharing

We established a sub-group to review current industry compliance practices toward the goal of developing a more standardized compliance program. This program would utilize in part the concept of a central reporting of relevant information concerning member firms. The aims of such a program would be, among others, to promote a sharing of relevant information about broker/dealer compliance activities and to assist in the execution of complete, comprehensive and thorough examinations of such firms. In addition, the group agrees with the Options Study that it should be possible to establish some industry-wide objectives for the conduct of an examination so as to insure the protection of investors, avoid regulatory duplication, and eliminate regulatory voids.

It is agreed that a broad "Compliance Plan" would include:

- I. Continual Monitoring Programs
- II. Special Attention Programs
- III. Examination Programs
- IV. Disciplinary Programs
- V. Educational Programs

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While we acknowledge that most, if not all, of the basic components of the programs noted above are in place and presently being utilized by one or more of the SRO's, it is also agreed that certain of these programs may have to be further refined so as to increase their comprehensiveness and to facilitate their use, as deemed appropriate, by each SRO.

We therefore agreed that the sub-group would reach an understanding as to the components of each program within the compliance plan and the objectives to be achieved by each such component. In addition, the sub-group would compile a list of the particular data bases which could be utilized to accomplish the objectives of each program component. The sub-group is making progress in the above area and will submit its future recommendations on these matters to us for review and action.

In addition to the above, we have agreed that the compliance plan sub-group should include within the scope of its discussions matters such as:

- . the targeting of, and visits to, branch offices for examinations;
- . the enhancement of examination "audit trails;"
- . the uses of "intelligence" information received from other SRO's; and,
- . a comprehensive pre-examination procedure.

III. Centralization of Compliance Data for Registration and Investigation Purposes

We established a sub-group to review the feasibility and usefulness of creating a central repository for compliance information. As a result of the sub-group's recommendation we have determined that a repository could be utilized to provide each self-regulatory organization with more information than is presently utilized for purposes of registration of personnel, customer complaints, investigations and examinations. We also believe that measures should be taken in this area to decrease or eliminate duplication of efforts among self-regulatory organizations and increase the overall efficiency of such processes within the industry. The group further agrees that the adoption of these measures should not, to the extent feasible, result in increased costs to the industry.

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The group discussed the concerns of the Options Study regarding the concept of a registered representative who transferred from firm to firm and through various regulatory jurisdictions. It was agreed that a central repository of registered personnel and customer complaints may assist in following the movements of such an individual and provide SRO's with more comprehensive data by which to judge his actions.

The NYSE offered to become the central repository for general compliance information for those firms for which it is the designated examining authority. The NASD offered to include data elements relating to customer complaint information on its automated system for processing registered representative applications. Such system presently contains certain data elements of interest to the sub-group including termination for cause information and final disciplinary actions taken against registered personnel. Each SRO agreed to furnish the NASD with output requirements they would need from such central repository system with the understanding that the NASD will outline for consideration a system designed to meet their needs.

To date there has been no general agreement as to how information could be used except to provide "intelligence" for SRO's preparing for examinations and investigations. There was concern as to potential legal obstacles which could prevent information sharing, however, we have concluded that potential legal liabilities would be reduced if the procedure outlined on page 7 is pursued.

The group has agreed that, aside from the feasibility of such a plan, a central file on registered personnel which would include at least all information regarding registration and termination, customer complaints, and formal actions taken by SRO's and other regulatory bodies would be a worthwhile accomplishment. It is generally agreed that such information would assist each participant in determining whether registration was appropriate, whether closer than normal surveillance was warranted and would provide information useful in the preparation and conduct of investigations and examinations.

Additional questions were raised concerning access to such information and whether or not such a repository would include matters which have not yet reached a conclusive state at a regulatory body. Representatives on the sub-group have agreed to review the position of their organization with regard to the sharing of this information keeping in mind the goal

of accomplishing the total sharing of information whenever possible. Additionally, the sub-group has determined to address and resolve questions regarding the methods of implementing such a proposal, access, refinements in the use of information and the responsibilities of users.

IV. Allocation of Responsibility

We established an allocation of responsibility sub-group to explore the means of identifying and eliminating duplicative regulatory efforts as well as the measures necessary to improve regulatory programs. The sub group was also requested to provide the means of resolving such overlaps and shortfalls through the allocation of responsibility for investigation and enforcement and to assure, as much as possible, the uniform interpretation and application of comparable self-regulatory and Commission rules. The group focused on problems involving jurisdictional issues where membership in more than one self-regulatory organization existed and on inter-market trading activities which transcended individual SRO jurisdictional boundaries, such as insider trading activities, fraudulent and manipulative trading practices, tape racing, front-running, expiration studies and other specific inter-market transactions.

For purposes of its discussions, the participants determined that non-member broker-dealers and non-member broker-dealer customers would be treated as the same type of entity for surveillance purposes. It was also determined that where a non-member (whether a broker-dealer or customer) effects a transaction using the facilities of a member broker-dealer, the matter should be referred to the SRO that has jurisdiction over that non-member or to the SEC if a non broker-dealer customer is involved.

Of course, questions of jurisdiction over a broker-dealer which is a member of more than one self-regulatory organization and/or when a security is multiply traded encompass much broader and complex issues and consequently consumed a significant portion of the group's efforts. Based upon its discussions, the group agreed to consider the following principles of allocation: