NASD NOTICE TO MEMBERS 93-41

SEC Approves Schedule D Amendments Permitting Excused Withdrawal or Passive Market-Making Status for Distribution Participants That Are Nasdaq Market Makers

Suggested Routing

- ■ Senior Management
- ■ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- ■ Syndicate
- □ Systems
- ■ Trading
- ■ Training

Executive Summary

On May 28, 1993, the Securities and Exchange Commission (SEC) approved amendments to Part VI, Section 8 of Schedule D to the NASD® By-Laws that will assist members in meeting their obligations under SEC rules 10b-6 and 10b-6A. The amendments require that the manager of a secondary offering of Nasdaq securities assume the responsibility for asking Nasdaq Operations to withdraw the quotations of Nasdaq market makers that are distribution participants or to identify the quotations as those of a passive market maker.

The amendments take effect June 22, 1993. The text of the amendments follows this Notice.

Background

On May 28, 1993, the SEC approved amendments to Part VI, Section 8 of Schedule D to the NASD By-Laws. The amendments were initially prompted when the SEC staff alerted the NASD that, on occasion, members engaged in the distribution of securities of companies listed in The Nasdaq Stock Market℠ are, through inadvertence or otherwise, not complying with the provisions of the two- and nine-business day cooling-off periods provided for in Rule 10b-6 adopted by the SEC under the Act.[1]

Previously, Section 8(b), as clarified in *Notice to Members 88-69* (September 1988), required each market maker to submit a written request for an excused withdrawal as a market maker to Nasdaq Operations when the market maker intended to participate in a secondary offering subject to SEC Rule 10b-6.

The NASD found that if a market maker participating in a distribution fails to withdraw its quotations from Nasdaq on a timely basis before a secondary offering, the market maker will ask the SEC staff to provide relief from the cooling-off provisions of Rule 10b-6 to enable the offering to commence on the scheduled date rather than delay the offering to comply with the rule. The market makers in these situations may argue that the violation is inadvertent and present information demonstrating that the market making by the member does not indicate a manipulative pattern. Further, SEC failure to provide relief may disrupt the offering by changing the composition of the underwriting syndicate. The NASD found that such requests for relief are a continuing problem; more so during periods of increased corporate financing activity.

The amendments are also the result of the SEC's approval of a new exception to Rule 10b-6 and new companion rule, Rule 10b-6A (passive market making rule) on April 8, 1993, to permit "passive market making" in connection with certain

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[1]SEC Rule 10b-6 prohibits persons engaged in the distribution of securities from bidding for or purchasing any security that is the subject of the distribution or related securities. The rule generally requires market makers in the security who are also participants in the distribution or affiliated purchasers to withdraw from market making, (1) two business days before commencement of offers or sales in the distribution if the securities are priced at $5 per share or more and the public float is 400,000 shares or more (10b-6(a)(4)(xi)(A)), or (2) nine business days before commencement of offers or sales in the distribution in the case of all other securities (10b-6(a)(4)(xi)(C)). *See also, Rule 10b-6: Interpretation of "Business Day"* (July 29, 1991) [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶79,751 (Business Day letter).

distributions of securities quoted in The Nasdaq Stock Market during the period when Rule 10b-6 would otherwise prohibit such activity.[2] Rule 10b-6A is only available for registered firm commitment offerings that qualify for the two-day cooling-off period under Rule 10b-6(a)(4)(xi).[3] Under 10b-6A, a passive market maker's bid is limited by the level of bids of market makers who are not participating in the distribution. One of the terms of the passive market making rule is that each market maker participant deciding to engage in passive market making must "notify the NASD in writing in advance of its intention to engage in passive market making."[4]

Description of Amendments

In order to address the problem of inadvertent violations of Rule 10b-6 and to implement the notification requirements of Rule 10b-6A, the NASD has adopted a new procedure that requires the manager of a secondary distribution subject to Rule 10b-6 to assume responsibility for requesting excused withdrawal or passive market maker status for the underwriting syndicate and selling group members known to the manager on the day before the cooling-off period under Rule 10b-6 begins.[5] The title of Section 8 is being modified to reflect that the section applies to the withdrawal of quotations and passive market making. Subsection 8(a) now encompasses requests for passive market maker status.[6]

Under new subparagraph 8(d)(1)(A), the first phase of the excused-withdrawal and passive-market-maker-status process obligates the manager of the distribution or a member acting in a similar capacity[7] to notify Nasdaq Operations in writing of the prospective distribution. The manager must supply such notification within five days of the filing of the offering documents either with the NASD's Corporate Financing Department or, if exempt from filing with the Department, within five days of filing with the appropriate regulatory authority. The manager must provide notice of the prospective distribution, indicate to Nasdaq Operations that it will manage the distribution, and identify the Nasdaq security or securities that are the subject of the distribution.

The second phase of the excused withdrawal process has two parts. Subparagraph 8(d)(1)(B) requires the manager, not later than noon Eastern Time of the business day before the cooling-off period commences,[8] to notify Nasdaq Operations in writing of the contemplated date and time that the cooling-off period begins, the identity of the participants in the distribution, and the identity of the distribution participants that intend to act as passive market makers. This authorizes Nasdaq Operations to automatically withdraw the market makers' quotations or identify the specified market makers' quotes as passive and fulfills the obligations of the market makers pursuant to Rule 10b-6(a)(4)(xi) and Rule

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[2]Securities Exchange Act Release No. 32117 (April 8, 1993); 58 F.R. 19598 (April 15, 1993). The SEC's approval of Rule 10b-6A was in response to a Petition for Rulemaking filed with the SEC by the NASD.

[3]Pursuant to exception (xi)(A) to Rule 10b-6, market makers that intend to participate in the distribution of securities are prohibited from making bids or purchases of outstanding securities of the same class as the securities to be distributed commencing two days before commencement of offers or sales of the securities to be distributed (or, for market makers that are members of the selling group, commencing at the time such market maker becomes a participant in the distribution) for securities with a minimum price of $5 per share and a minimum public float of 400,000 shares, with such prohibition continuing until the termination of the offering.

[4]Subsection (c)(7) to Rule 10b-6A. 58 F. R. 19598 (April 15, 1993), at 19607.

[5]The amendments announced in this Notice supercede prior amendments to Part VI, Section 8 of Schedule D that were approved by the SEC on a temporary basis for 60 days to provide a procedure for individual market makers to comply with the notification requirement in Rule 10b-6A. Securities Exchange Act Release No. 34-32159 (April 16, 1993); 58 F.R. 21613 (April 22, 1993).

[6]The obligation to determine whether Rule 10b-6 or Rule 10b-6A applies to the particular offering remains with the member participating in the offering. Rule 10b-6 applies to issuances of securities that meet the definition of "distribution" contained in Rule 10b-6(c)(5). Such a distribution can include a registered or unregistered offering of securities, a private placement, rights offering, or securities issued in a merger or acquisition.

[7]An offering may not have a designated manager; however, any member performing some or all of the functions of a manager, and/or who agrees to perform the notification function for the distribution participants would be a member acting in a "similar capacity" to a manager for purposes of this proposed rule change.

[8]Pursuant to the SEC's Business Day letter, cited above in footnote 1, "a business day should generally be interpreted as a twenty-four hour period determined with reference to the principal market for the securities to be distributed, and that includes a complete trading session for that market." [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at p. 78,394.

10b-6A to request withdrawal of their quotations or provide notification to Nasdaq Operations of their intent to engage in passive market making.

In addition, subparagraph 8(d)(1)(B) also requires the manager to inform each market maker that Nasdaq Operations is aware of the firm's status regarding the prospective distribution to permit a market maker that does not intend to participate in the distribution or act as a passive market maker to prevent its quotes from being deleted or identified as passive. Subparagraph (d)(3) requires a market maker, identified to Nasdaq Operations as a distribution participant, to notify Nasdaq Operations and the manager by 4:00 PM Eastern Time on the day before the cooling-off period begins that it does not intend to participate in the distribution or to engage in passive market making.

The NASD anticipates that all members of the underwriting syndicate would be known to the manager on the day before the cooling-off period begins. The foregoing procedure, however, would only cover those members of the selling group actually known to the manager on the day before the cooling-off period commences. Under Rule 10b-6, the cooling-off period commences on the later of the applicable time period (two- or nine-business days before the distribution starts) or the time the member becomes a distribution participant. Therefore, if a member receives an invitation to be a member of the selling group after the cooling-off period has commenced or if the member is an affiliated purchaser[9] of a distribution participant, a member that wishes to comply with Rule 10b-6(a)(4)(xi) or Rule 10b-6A must timely initiate its own request for excused withdrawal of its quotations or for designation as a passive market maker pursuant to Subsection 8(b).

[9]Rule 10b-6 defines the term "affiliated purchaser" to include an entity acting in concert with a distribution participant in making purchases of the securities or an entity in a control relationship.

The NASD has also amended Subsection 8(b) to provide that it cannot be relied on if the request for excused withdrawal status or passive market maker status should be made under Subsection 8(d) to comply with SEC Rules 10b-6 or 10b-6A. Previously, Subsection 8(b) permitted excused withdrawal to comply with Rule 10b-6 pursuant to the second sentence which refers to "legal or regulatory requirements." Amended subsection 8(b) provides that members can also obtain passive market maker status under that provision; however, market makers should not rely on Subsection 8(b) to obtain excused withdrawal status or passive market maker status in circumstances where Subsection 8(d) provides a procedure for notification to Nasdaq Operations.

New paragraph 8(d)(2) provides that for an offering with no registration statement filing requirement, market makers that are distribution participants must notify Nasdaq Operations of the date and time the cooling-off period begins and request withdrawal of their quotations or designation as passive market makers. This separate provision is made for unregistered offerings because it is unlikely that offering documents will be filed with any regulatory authority triggering initial notification. Further, such offerings often arise on short notice, and generally there is only one or a very few distribution participants. Imposing the full notification provisions of subparagraphs 8(d)(1)(A) and (B) for these offerings could impede capital raising through private placements and would not serve a substantial regulatory interest.

Finally, while it is anticipated that virtually all offerings of companies trading in The Nasdaq Stock Market[SM] will be managed by a member firm which is also making a market in the issuer's securities, to the extent that the manager is not a market maker, new paragraph 8(d)(4) obligates each market maker that is a distribution participant to file the required notice unless another market maker assumes the compliance obligation on its behalf. This provision is intended to permit the market makers to act either independently or in concert to comply with the notice provisions where the manager is not a market maker. The NASD anticipates that, under normal circumstances, the non-market maker distribution manager will advise the NASD of the pendency of a distribution in the manner specified in paragraph 8(d)(1).

The amendments take effect June 22, 1993. Questions concerning this Notice may be directed to Charles L. Bennett, Director, or Richard Fortwengler, Associate Director, NASD Corporate Financing Department at (202) 728-8258.

Specific questions on the identification of market makers as passive market makers and other market-maker procedures may be directed to Nasdaq Operations at (202) 509-3618 or (800) 635-6485.

Text of Amendments to Part VI, Section 8 of Schedule D

(**Note:** New text is underlined; deleted text is in brackets).

Part VI

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Sec. 8. Withdrawal of Quotations and Passive Market Making

(a) A market maker that wishes to withdraw quotations in a security or have its quotations identified as the quotations of a passive market maker shall contact [NASDAQ] Nasdaq Operations to obtain excused withdrawal status prior to withdrawing its quotations. [Excused withdrawals] Withdrawal of quotations or identification of quotations as those of a passive market maker shall be granted by [NASDAQ] Nasdaq Operations only upon satisfying one of the [demonstration of the existence of one of the circumstances set forth in paragraph (b) of] conditions specified in this S[s]ection.

(b) Excused withdrawal status based on physical circumstances beyond the market maker's control may be granted for up to five (5) business days, unless extended by [NASDAQ] Nasdaq Operations. Excused withdrawal status and passive market maker status based on demonstrated legal or regulatory requirements, supported by appropriate documentation and accompanied by a representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon written request, be granted for not more than sixty (60) days (unless such request is required to be made pursuant to paragraph (d) below). Excused withdrawal status based on religious holidays may be granted only if notice is received by the Association five business days in advance and is approved by the Association. Excused withdrawal status based on vacation may be granted only if: (1) the request for withdrawal is received by the NASD twenty (20) business days in advance, and is approved by the NASD; (2) the request includes a list of the securities for which withdrawal is requested; and (3) the request is made by a market maker with three (3) or fewer [NASDAQ] Nasdaq Level 3 terminals. Excused withdrawal status may be granted to a market maker that has withdrawn from an issue prior to the public announcement of a merger or acquisition and wishes to reregister in the issue pursuant to the same-day registration procedures contained in Section 1, above, provided the market maker has remained registered in one of the affected issues. The withdrawal of quotations because of pending news, a sudden influx of orders or price changes, or to effect transactions with competitors shall not constitute acceptable reasons for granting excused withdrawal status.

(c) Excused withdrawal status may be granted to a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction service, thereby terminating its registration as a market maker in [NASDAQ] Nasdaq/NMS issues. Provided however, that if the Association finds that the market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Part VI, Section 9 of this Schedule and the Rules of Practice and Procedures for the Small Order Execution System.

(d) Excused withdrawal status or passive market maker status may be granted to a market maker that is a distribution participant in order to comply with Rule 10b-6 or Rule 10b-6A adopted under the Securities Exchange Act of 1934, as amended, on the following conditions:

(1) A market maker acting as a manager (or a similar capacity) of a distribution shall:

(A) provide written notice to Nasdaq Operations of the prospective distribution and the fact that the market maker is a manager of the distribution and of the Nasdaq security or securities that are subject to Rule 10b-6 no later than 5 business days following the filing of a registration statement with the Association pursuant to the Corporate Financing Rule, Article III, Section 44 of the Rules of Fair Practice, or, if the member is not required to file the registration statement with the Association, no later than 5 business days following the filing of offering documents with the appropriate regulatory authority; and,

(B) no later than noon Eastern Time on the business day prior to the beginning of the cooling-off period; (i) request withdrawal of the market makers' quotations or identification of the market makers' quotations as those of a passive market maker by providing written notice to Nasdaq Operations of the identity of the market makers that are distribution participants, the contemplated date and time of the commencement of the cooling-off period, and the identity of the market makers that intend to act as passive market makers; and (ii) advise the market makers that they have been identified as distribution participants to Nasdaq Operations and that their quotations will be automatically withdrawn or identified as passive market maker quotations upon the request made by the manager unless they submit to Nasdaq Operations the notice specified in paragraph (3), below.

(2) If the security is being distributed pursuant to an offering for which no registration statement or offering

document is required to be filed, each market maker that is a distribution participant shall, no later than noon Eastern Time on the business day prior to the beginning of the cooling-off period, provide written notice to Nasdaq Operations of its participation in the distribution, the contemplated date and time of the commencement of the cooling-off period, the Nasdaq security or securities that are subject to Rule 10b-6, and request withdrawal of its quotations or identification as a passive market maker.

(3) A market maker that has been identified to Nasdaq Operations as a distribution participant shall provide written notice to Nasdaq Operations and the manager of its intention not to participate in the prospective distribution or act as a passive market maker no later than 4:00 PM Eastern Time on the business day prior to the beginning of the cooling-off period in order to avoid having its quotations withdrawn or identified as the quotations of a passive market maker.

(4) In the event the manager of a distribution is not a market maker, each market maker that is a distribution participant shall comply with Subsection (d)(1) unless another market maker has assumed responsibility for compliance.

For purposes of this section, the term "cooling-off period" refers to the periods specified in Rule 10b-6(a)(4)(xi) adopted under the Securities Exchange Act of 1934, as amended, the terms "distribution" and "distribution participant" refer to these terms as defined in Rule 10b-6(c)(5) and (c)(6) adopted under the Securities Exchange Act of 1934 and the term "passive market maker" refers to this term as defined in Rule 10b-6A adopted under the Securities Exchange Act of 1934.

NASD NOTICE TO MEMBERS 93-42

SEC Approves NASD's Minor Rule Violations Plan

Suggested Routing

- ■ Senior Management
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On May 28, 1993, the Securities and Exchange Commission (SEC) approved amendments to Article II, Section 10 of the NASD® Code of Procedure (Code) to provide for a Minor Rule Violations Plan (Plan). The Plan will permit the NASD to dispose of certain minor rule violations expeditiously and to report the violations disposed of under the Plan in summary reports submitted periodically to the SEC.

The amendments take effect October 1, 1993. The text of the amendments follows this Notice.

Description of Amendments

On May 28, 1993, the SEC approved amendments to Article II, Section 10 of the Code to provide for a Plan pursuant to SEC Rule 19d-1. The Plan allows the NASD to process and report disciplinary actions involving fines that do not exceed $2,500 and a censure in a manner that will relieve many of the administrative burdens normally associated with formal disciplinary actions.[1]

The amendments adopted by the NASD to implement the Plan are set forth in Subsections 10(b)(1) through 10(b)(4) of the Code. The Summary Complaint Procedure is being renumbered as Subsection 10(c). New subsection 10(b)(1) provides general authority to the District Business Conduct Committees and the Market Surveillance Committee (the Committee, or, together, the Committees) and the National Business Conduct Committee (NBCC) to impose a fine (not to exceed $2,500) and/or censure on any member or associated person for the rule violations set forth in the Appendix to Section 10 (the violations included in the Appendix are described separately below). The Appendix lists violations that, pursuant to Rule 19d-1, under certain factual circumstances, are appropriate for disposition under the Plan and carry a fine of $2,500 or less, and/or a censure, according to the NASD's *Sanction Guidelines.*[2] Under Rule 19d-1, the NASD may amend the Appendix to add or delete violations from the Plan. Any such amendments must be filed with the SEC for approval.

Even though a violation would qualify for Plan treatment, if the Committee reviewing a potential disciplinary action determines that the nature of the violation is too indeterminate or serious to dispose of under the Plan, the Committee will authorize formal disciplinary action. Serious violations will not be treated as "technical" or trivial infractions even if a fine of less than $2,500 might be called for and any violation that would justify a fine of more than $2,500 will not be disposed of under the Plan.

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[1]Under its Code of Procedure, the NASD may initiate disciplinary proceedings by issuing a formal complaint or by offering the respondent the opportunity to waive a hearing and accept a Summary Complaint proceeding. Before issuing a formal complaint, the NASD may conclude a disciplinary matter with a Letter of Acceptance, Waiver and Consent. These proceedings are generally referred to as "formal disciplinary actions" and are reported to the SEC by the NASD individually as "final disciplinary actions" pursuant to SEC Rule 19d-1. Disciplinary actions taken under the Plan will not be considered "final" pursuant to SEC Rule 19d-1(c)(2) and may be reported to the SEC by the NASD in quarterly or periodic summary reports.

[2]The NASD included a copy of the *Sanction Guidelines* in the May 1993 edition of *Notices to Members.*

New Subsection 10(b)(2) provides that any disciplinary action taken by the NASD under the Plan shall be accomplished through the submission of a written Minor Rule Violation Letter (Letter) to the NASD by the member or associated person specifying the nature of the violation; stating the rule, regulation, or statute violated; and consenting to the sanction for the violation. New Subsection 10(b)(2) also specifies that the Letter shall include an agreement by the member or associated person to waive the member or person's rights to a hearing or to appeal to the NBCC, the SEC, or the courts.

Subsection 10(b)(3) provides that the Letter must be submitted to and accepted by the Committee and the NBCC and, if accepted, will be reported to the SEC pursuant to the Plan. The NASD undertakes, as part of the Plan, to report minor violations to the SEC quarterly. If the Letter is rejected by the Committee or the NBCC, Subsection 10(b)(3) authorizes the Committee or NBCC to take any other appropriate disciplinary action on the violation or violations. Submission and acceptance of a Letter will constitute a "finding" of the violation(s) described in the Letter for purposes of an individual's disciplinary history[3].

Subsection 10(b)(4) provides that the submission of a Letter shall have no effect on the determination of any issues raised in a subsequent disciplinary proceeding against the same party on the same facts, matter, or transaction. This provision parallels the rule of evidence (usually codified) against using settlement offers or their equivalent as evidence to prove fault against the offering party in any subsequent proceedings on the same matter. This provision does not, however, prevent the NASD from using a Letter that has been accepted as evidence of disciplinary history for sanctions purposes in subsequent unrelated proceedings or as pattern evidence to demonstrate the occurrence of acts or omissions consistent with the pattern.

Description of Plan Violations

Following is a discussion of the violations included in the Appendix to the Plan and the limitations on the eligibility of such violations for disposition under the Plan.

• **Excess Spread Violations —** Under Schedule D, Part VI, Section 2(d) Nasdaq market makers may not enter quotations that exceed the maximum allowable spreads published in Section 2(d). The NASD established these maximum allowable spreads after evaluating average spreads and determining the appropriate maximum allowable spread in relation to the average spread. Each day that a market maker has an excess spread is counted as one violation. The first violation in any 12-month period will generally result in a Letter of Caution and the second or third violations may warrant fines of $1,000 and $2,000, respectively, each appropriate for disposition under the Plan. Subsequent violations would warrant a formal complaint.

• **Advertising Violations** — The NASD Advertising Rules require members to submit certain classes of communications with the public to the NASD for review and approval and to maintain records of their internal review and approval. Specifically, Article III, Sections 35(b) and 35A(b) of the Rules of Fair Practice and Section 8(b) of the Government Securities Rules require a principal of the member to approve each item of advertising or sales literature before use and require members to maintain separate files on such advertising and sales literature for three years. Article III, Sections 35(c) and 35A(c), and Section 8(c) of the Government Securities Rules require members to file advertising and sales literature with the NASD before or immediately after use, depending on the subject matter and the member's experience, status, and disciplinary history.

Failure to comply with the internal review and recordkeeping requirements of the advertising rule are treated in a manner similar to the recordkeeping violations discussed below. The number, egregiousness, and history of violations will determine whether they warrant fines of less than $2,500 and, therefore, may be disposed of under the plan. For the filing requirements, the first two late filings within the previous 12 months will result in a Warning Letter and a Letter of Caution, respectively. The third, fourth, and fifth late filings will warrant progressively higher fines and will exceed $2,500 for the fifth late filing. For those violations which would warrant a fine of $2,500 or less, disposition under the Plan would be appropriate; for all others, a formal complaint would be warranted.

• **Schedule H Reports** — Schedule H, Section 2 to the NASD By-Laws requires member firms to submit price and volume reports concerning principal transactions in

[3]Recent amendments to the *Form BD* exempt members from reporting disciplinary actions disposed of through a Minor Rule Violation Plan; however, an associated person disposing of a matter through a Minor Rule Violation Plan will be required to answer "Yes" to question 22F on *Form U-4* and/or questions 13, 14, and 15 on *Form U-5,* as appropriate.

Non-Nasdaq securities to the Non-Nasdaq Reporting System between 4 and 6:30 p.m. on the trade date or between 7:30 and 9:30 a.m. on the day after the trade date. Failure to either make the report or to make it within the required time for securities priced at $5 per share or more results in a Warning Letter and a Letter of Caution for the first two violations, with the third, fourth, and fifth violations resulting in fines of $250, $500, and $1,000, respectively. For securities priced at less than $5, the first violation results in a Letter of Caution, with the second, third, and fourth violations resulting in fines of $500, $1,000, and $2,000, respectively. Continuing violations would warrant a formal complaint.

• **Late Short-Sale Filings** — Article III, Section 41 of the Rules of Fair Practice requires members to report total short positions to the NASD on Form NS-1 by the second business day following the "reporting settlement date," which is the 15th of each month, or the preceding settlement date if the 15th is not a settlement date. The first late filing violation will result in a Letter of Caution. The second late filing within the previous 12 months will result in a $1,000 fine, and the third will result in a $2,500 fine. For cases where a fine of less than $2,500 is justified, disposition under the Plan is warranted; otherwise, the NASD will institute formal disciplinary proceedings.

• **Violations of Trade- and Volume-Reporting Rules.**

1. Schedule D to the By-Laws, Part VI, Sections 4 and 5, requires members to submit information and trade data in automated format to the NASD and to the Automated Confirmation Transaction (ACT℠) System within specified deadlines.

2. Schedule D to the By-Laws, Part XII, Section 2, requires members making a market in Nasdaq National Market® securities to, among other things, report transactions within 90 seconds.

3. Schedule D to the By-Laws, Part XIII, Section 2, requires members making a market in Nasdaq SmallCap Market℠ securities to, among other things, report transactions within 90 seconds.

4. Schedule G to the By-Laws, Section 2, requires members to report over-the-counter transactions in listed securities through the Nasdaq Transaction Reporting System within 90 seconds.

Violations of the above-referenced requirements, particularly for volume reports and trade data, will generally result in a Warning Letter or Letter of Caution for the first two violations in any 12-month period. Third, fourth, and fifth violations in any 12-month period will result in $250, $500, and $1,000 fines, respectively. Failure to report trades, as opposed to failure to report volume or certain trade data, is generally regarded as a more serious violation and may warrant a higher fine. Further, in egregious cases of failing to report volume, trade data, or transactions, a formal complaint may be warranted.

• **Recordkeeping Violations** — Article III, Section 21 of the NASD Rules of Fair Practice requires members to keep and preserve various books, accounts, records, memoranda, and correspondence. Minor or isolated failures to make, keep, or preserve books and records as required will generally result in a Warning Letter or Letter of Caution for the first and second violations. Subsequent or more serious first violations, especially where a pattern of careless or inadequate attention to the recordkeeping requirements is present, will result in fines starting at $500 and may result in a formal complaint.

The amendments are effective October 1, 1993. Questions concerning this notice may be directed to Elliott R. Curzon, Senior Attorney, Office of General Counsel, (202) 728-8451.

Text of Amendments to Article II, Section 10 of the Code of Procedure

(**Note:** New language is underlined.)

Disciplinary Actions by District Business Conduct Committees, the Market Surveillance Committee and Others

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Acceptance, Waiver and Consent, Minor Rule Violations, and Summary Complaint Procedures

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Sec. 10.

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Minor Rule Violations Procedure

(b)(1) Notwithstanding Article II, Sections 1 and 2 of the Code of Procedure, any Committee or the National Business Conduct Committee may, subject to the requirements set forth herein and in Rule 19d-1(c)(2) adopted under the Securities Exchange Act of 1934, as amended, impose a fine (not to exceed $2,500) and/or a censure on any member or person associated with a member with respect to any rule violation listed in the Appendix to this Section.

(2) If the Committee has reason to believe a violation has occurred, the Committee may suggest that the member or associated person submit a Minor Rule Violation Letter specifying in reasonable detail the nature of the violation or violations, including the rule, regulation or statutory provision violated, and consenting to the imposition of a specific sanction or sanctions for the violation or violations, and agreeing to waive such member or person's right to a hearing before a hearing panel, and all rights of appeal to the National Business Conduct Committee, the Securities and Exchange Commission, and the courts or to otherwise challenge the validity of the Letter if the Letter is accepted.

(3) The Letter shall be submitted to the Committee and, if accepted, the Letter shall then be submitted to the National Business Conduct Committee. If the National Business Conduct Committee accepts the Letter, the Corporation will report the violation to the Securities and Exchange Commission as required by the Commission pursuant to a plan approved under Rule 19d-1(c)(2) adopted under the Securities Exchange Act of 1934, as amended. If the Committee or National Business Conduct Committee rejects the Letter, the Committee or National Business Conduct Committee may take any other appropriate disciplinary action with respect to the violation or violations.

(4) If it becomes necessary for the Committee having jurisdiction to file a complaint against the member or person associated with a member under Article II, Section 2 of this Code, the member or person associated with a member shall not be prejudiced in any way by the submission of a Minor Rule Violation Letter under paragraph (2) of this Subsection (b) and the Letter shall have no effect and be given no consideration in any determination of the issues involved in any such complaint.

Summary Complaint Procedure

Subsection (b) is renumbered Subsection (c).

Appendix

Violations Appropriate For Disposition Under The Minor Rule Violations Plan

- Schedule D, Part VI, Section 2(d) to the NASD By-Laws — Failure to comply with the limitations on maximum allowable spreads for securities in which the member makes a market.

- Article III, Subsections 35(b) and (c) and 35A(b) and (c) of the Rules of Fair Practice and Subsections 8(b) and (c) of the Government Securities Rules — 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 advertisements with the Association within the required time limits.

- Schedule H to the NASD By-Laws — Failure to file, or filing inaccurate, price and volume reports required to be filed under Schedule H with respect to Non-Nasdaq securities.

- Article III, Section 41 of the Rules of Fair Practice — Failure to timely file reports of short positions on Form NS-1.

- Schedule D, Part VI, Sections 4 and 5, Part XII, Section 2, and Part XIII, Section 2, to the NASD By-Laws; Schedule G, Section 2 to the NASD By-Laws — Failure to timely submit required reports and other trade and volume data to the NASD and to transmit trade reports as required over the Nasdaq System.

- Article III, Section 21 of the Rules of Fair Practice — 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 rules of the Association.

NASD NOTICE TO MEMBERS 93-43

SEC Approves Modified Excess Spread Parameters for Market Makers

Suggested Routing

- [ ] Senior Management
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

Executive Summary

On June 4, 1993, the Securities and Exchange Commission (SEC) approved amendments to Part VI, Section 2 of Schedule D to the NASD®. By-Laws to reduce excess spread parameters for Nasdaq and Consolidated Quotation Service (CQS) securities. The rule change establishes new excess spread parameters for Nasdaq® and CQS securities, limiting a dealer's spread in a security to 125 percent of the average of the narrowest three dealer spreads in that security. The NASD believes that reducing excess spread parameters may reduce dealer spreads overall, which would result in a more competitive market. The amendments take effect July 26, 1993. The text of the amendments follows the discussion below.

Background and Description of Amendments

This rule change amends Schedule D to the NASD By-Laws[1] by reducing excess spread parameters for securities quoted in Nasdaq. The NASD is concerned that its current excess spread parameters are too wide, in some instances permitting spreads of 200 percent of the average dealer spread.[2] Nasdaq market makers are required to maintain continuous, two-sided quotations that are reasonably related to the transactions they are effecting. The current system of excess spread parameters, which uses all market-maker spreads in the calculation of average dealer spread, gives undue weight to spreads that may reflect one-sided buying or selling interest on the part of a few market makers. After a study of the impact on members of reducing spread parameters, the NASD determined that an average of the three best dealer spreads was an appropriate benchmark for calculating maximum allowable spreads.[3]

The rule change simplifies the current cumbersome and unwieldy system of excess spread parameters. Currently, the maximum allowable spread in a security varies, depending on the average dealer spread at that time. These excess spread parameters — set out in a chart in Part VI, Section 2 of Schedule D — vary between 125 percent and 200 percent of the average dealer spread in a security, depending on the size of the prevailing average dealer spread. The rule change eliminates the chart in Schedule D and applies a uniform standard for calculating maximum permissible spreads — 125 percent of the average of the narrowest three dealer spreads in a security. However, in no event, will a dealer be required to quote less than a 1/4 point spread.

The amendments take effect July 26, 1993. Questions regarding this Notice may be directed to Richard Coster, Manager, Market Surveillance, at (301) 590-6442 and Beth E. Weimer, Associate General Counsel, Office of General Counsel, at (202) 728-6998.

Text of Amendments to Part VI, Section 2 of Schedule D to the NASD By-Laws

(**Note:** New language is underlined; deleted language is in brackets.)

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[1]SEC Release No. 34-32419 (June 4, 1993).

[2]Excess spread parameters establish the maximum allowable bid/ask spreads that individual dealers may quote in a market.

[3]The NASD will conduct a study of dealer spreads in the Nasdaq National Market® before and after the effective date of the rule change to determine the effect of new parameters.

Part VI

Sec. 2. Character of Quotations

* * * * *

(d) Excess Spreads. A market maker shall not enter quotations in[to the NASDAQ System] Nasdaq or Consolidated Quotation Service (CQS) securities that exceed the parameters for maximum allowable spreads as approved by the NASD Board of Governors and that may be published from time to time by the Association. [*] The maximum allowable spreads shall be 125 percent of the average of the three (3) narrowest market maker spreads in each security (if there are fewer than three (3) market makers in a security, the maximum allowable spread will be 125% of the average spread); provided however, that the maximum allowable spread shall never be less than 1/4 point.

[*The following are the current maximum allowable spreads approved by the NASD Board of Governors.

Maximum Allowable Spreads

Average Spread	Maximum Allowable Spread
1/8 or less	1/4
1/4	1/2
3/8	3/4
1/2	1
5/8	1
3/4	1 1/2
7/8	1 1/2
1	1 1/2
1 1/8	1 5/8
1 1/4	1 3/4
1 3/8	1 7/8
1 1/2	2
1 5/8	2
1 3/4	3
1 7/8	3
2	3
2 1/8	3
2 1/4	3
2 3/8	3
2 1/2	3
2 5/8	4
2 3/4	4
2 7/8	4

For an average spread of 3 or more, the maximum allowable spread is 125 percent of the average spread rounded to the next highest whole number.]

* * * * *

NASD NOTICE TO MEMBERS 93-44

SEC Approves Increase In Non-Cash Sales Incentive Compensation

Suggested Routing

- ■ Senior Management
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- ■ Training

Executive Summary

On June 23, 1993, the Securities and Exchange Commission (SEC) approved an amendment to Section 5(e)(1) of Appendix F to Article III, Section 34 of the Rules of Fair Practice. The amendment raises from $50 to $100 the yearly limit on aggregate non-cash sales incentive compensation that a sponsor or affiliate of a sponsor of a public direct participation program (DPP) may pay to an associated person of a member. The rule change makes the standard in Appendix F consistent with other existing limitations on the receipt of non-cash compensation.

Background and Description of The Amendment

On December 28, 1992, the SEC approved an amendment to Article III, Section 10(a) of the Rules of Fair Practice that raised from $50 to $100 the maximum value of gratuities or gifts a member or associated person may provide to another person annually.

The NASD® Direct Participation Programs Committee subsequently recommended to the Board of Governors a corresponding change to Section 5(e) of Appendix F to Article III, Section 34 of the Rules of Fair Practice. The change was to raise from $50 to $100 per year the value of non-cash sales incentive compensation that may be accepted by each associated person of a member participating in the distribution of a public DPP. Such compensation typically involves small souvenir-type items that program sponsors provide associated persons of a member after executing a selling agreement with them. The Board concurred with raising the yearly limit to $100 to conform to existing standards and the SEC approved the change on June 23, 1993.

The rule change is also consistent with the New York Stock Exchange's (NYSE) recently approved Rule 350(a), which raised from $50 to $100 the amount of a gratuity that one NYSE member may give to another without obtaining prior written consent of the recipient's employer. This rule change simplifies compliance by NASD/NYSE member firms.

Questions concerning this Notice may be directed to Eugene Buchanan or Paul M. Mathews, Supervisors, NASD Corporate Financing Department, at (202) 728-8258.

Text of Amendment to Appendix F To Article III, Section 34 of the Rules of Fair Practice

(**Note:** New text is underlined; deleted text is in brackets.)

Sec. 5. Organization and Offering Expenses

(e) . . . Further, this section shall not prohibit a person associated with a member from accepting any non-cash sales incentive item offered directly to that person by a sponsor, affiliate of sponsor or program where:

(1) the aggregate value of all such items paid by any sponsor or affiliate of a sponsor to each associated person during any year does not exceed [$50.00] <u>$100</u>.

NASD NOTICE TO MEMBERS 93-45

SEC Approves Mandatory Book-Entry Settlement of Transactions in Depository-Eligible Securities

Suggested Routing

- ■ Senior Management
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On June 11, 1993, the Securities and Exchange Commission (SEC) approved a new Section 11 of the Uniform Practice Code (UPC) requiring book-entry settlement of transactions in depository-eligible securities effected between member firms and between member firms and certain of their customers.

The amendment takes effect August 10, 1993. The text of the amendment follows this Notice.

Background

On June 11, 1993, the SEC approved a new Section 11 of the UPC requiring book-entry settlement of transactions in depository-eligible securities. The amendment is a key element in implementing the recommendations of the U.S. Working Committee of the Group of Thirty Clearance & Settlement Project (U.S. Working Committee) regarding book-entry settlement of securities transactions.[1] The American Stock Exchange (Amex), the Boston Stock Exchange (BSE), the Midwest Stock Exchange (MSE), the New York Stock Exchange (NYSE), the Pacific Stock Exchange (PSE) and the Philadelphia (Phil) Stock Exchange (self-regulatory organizations or SROs) have each adopted a similar measure.[2]

The U.S. Working Committee recommended that:

> settlements and other movements of corporate and municipal securities must be effected only by book-entry movements within a depository for transactions among financial intermediaries (brokers, dealers, and banks) and between financial intermediaries and their institutional clients.[3]

The new rule implements such a book-entry settlement requirement, subject to certain exceptions discussed below, for securities eligible for deposit and transfer at a securities depository registered as a clearing agency with the SEC under Section 17A of the Act.

The SEC's approval of new rules by the respective SROs will result in uniform book-entry settlement requirements for not only transactions in depository-eligible securities between SRO members, but also transactions in such securities between SRO members and their clients when settlement is on a delivery-versus-payment or receipt-versus-payment basis. Approval of these rules ensures book-entry settlement for the vast majority of securities transactions

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[1]The Group of Thirty is an independent, nonpartisan, nonprofit organization established in 1978. In 1988, the Group of Thirty initiated a project to improve the state of risk, efficiency, and cost in the world's clearance and settlement systems. See *Implementing The Group of Thirty Recommendations in the United States,* I-1 (November 1990).

[2]The proposed rule was developed through the efforts of the Legal and Regulatory Subgroup of the U.S. Working Committee, which included representatives of the NASD, NYSE, Amex, Phil, MSE, PSE, BSE, the National Securities Clearing Corporation, The Depository Trust Company, the Municipal Securities Rulemaking Board, and the SEC's Division of Market Regulation.

[3]Supra, fn. 1 at I-2.

effected in the United States.

Subsection 11(a) of the new rule requires members to settle all transactions in depository-eligible securities by book-entry. Subsection 11(d) defines "depository-eligible securities" as securities eligible (1) for deposit at a securities depository and (2) for book-entry transfer. Subsection 11(c) defines "securities depository" as a depository registered with the SEC as a clearing agency.

Subsection 11(b) requires members to settle customer transactions done on a receipt-versus-payment or delivery-versus-payment basis by book-entry through a securities depository.

Pursuant to Subsection 11(e), the rule does not apply to transactions settled outside the United States, and the rule supersedes any inconsistent provisions of the UPC.

Subsection 11(g) of the new rule includes exceptions to book-entry settlement for (i) transactions for same-day settlement where the deliverer is unable to deposit the securities before a depository's cut-off time for same-day crediting of deposited securities and (ii) other special transactions (i.e., those involving corporate reorganizations or other extraordinary activities) where the deliverer is unable to deposit the securities before a depository-established cut-off date.

The new rules do not apply to or affect (a) settlement of transactions with traditional retail customers, (b) settlement of transactions in securities that are not depository-eligible, or (c) transactions where settlement occurs outside the United States.

Direct questions concerning this Notice to Dorothy L. Kennedy, Assistant Director, Uniform Practice Department, (212) 858-4340, or Elliott R. Curzon, Senior Attorney, Office of General Counsel, (202) 728-8451.

Text of Amendment to Section 11 of the Uniform Practice Code

* * * * *

Delivery of Securities

Book-entry Settlement

Sec. 11. [RESERVED]

(a) A member shall use the facilities of a securities depository for the book-entry settlement of all transactions in depository eligible securities with another member or a member of a national securities exchange or a registered securities association.

(b) A member shall not effect a delivery-versus-payment or receipt-versus-payment transaction in a depository eligible security with a customer unless the transaction is settled by book-entry using the facilities of a securities depository.

(c) For purposes of this rule, the term "securities depository" shall mean a securities depository registered as a clearing agency under Section 17A of the Securities Exchange Act of 1934.

(d) The term "depository eligible securities" shall mean securities that (i) are part of an issue of securities that is eligible for deposit at a securities depository and (ii) with respect to a particular transaction, are eligible for book-entry transfer at the depository at the time of settlement of the transaction.

(e) This rule shall not apply to transactions settled outside of the United States.

(f) The requirements of this rule shall supersede any inconsistent requirements under other sections of the Code.

(g) This rule shall not apply to any transactions where the securities to be delivered in settlement of the transaction are not on deposit at a securities depository and:

(1) if the transaction is for same-day settlement, the deliverer is unable to deposit the securities in a securities depository prior to the cut-off time established by the depository for same-day crediting of deposited securities, or;

(2) the deliverer is unable to deposit the securities in a depository prior to the cut-off date established by the depository for that issue of securities.

NASD NOTICE TO MEMBERS 93-46

SEC Provides Additional Clarifications and Interpretations to Net Capital Rule Amendments

Suggested Routing

- ■ Senior Management
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- □ Trading
- □ Training

Executive Summary

In May 1993, the NASD published *Notice to Members 93-30,* which set forth, in question and answer format, certain guidelines for compliance with recent amendments to the Securities and Exchange Commission (SEC) Net Capital Rule, Rule 15c3-1. The SEC adopted the amendments, which became effective on a staggered schedule late last year. This Notice provides additional clarifications and interpretations of these new requirements.

Background

The NASD published its initial Notice concerning the amendments to the SEC's Net Capital Rule (*Notice to Members 92-72*) in December 1992. The Notice advised that several amendments to the rule took effect January 1 with other changes slated for July 1, 1993. As of that date, the net capital ceiling for a market maker increases to $1 million. Likewise, the changes to the minimum net capital requirements will take effect in three installments beginning July 1. The SEC is still considering additional amendments to the rule, published for comment in December.

The amendments to the minimum net capital requirements increase the dollar amounts for many categories of broker/dealers. The increases are based on the nature of the firm's business and the extent to which a broker/dealer has contact with customer funds or securities. In several instances, the new requirements are significantly higher than the previous minimums.

Other adopted amendments establish one standardized method of calculating haircuts for all firms; adopt the alternative method for computing concentration charges for all firms; reduce the impact on aggregate indebtedness for two items (mutual funds payable offset by fails to deliver and corresponding stock loan/stock borrow); and permit the use of an offset when computing the open contractual commitment haircut on underwritings.

After these changes were announced in December, the NASD began to receive questions concerning the new requirements. In May 1993, the NASD issued *Notice to Members 93-30,* answering certain of these questions for the benefit of all members. Since then, the NASD has received additional clarifications and interpretations from the SEC staff and is publishing them in this Notice.

Clarifications and Interpretations

Clearing Agreements

According to the SEC staff, it will deem an introducing firm to be a clearing firm (and required to comply with the clearing firm's greater minimum net capital), *unless* the firm has in place a clearing agreement, containing a statement that, for purposes of the Securities Investors Protection Act (SIPA) and the SEC's financial responsibility rules, customers are customers of the clearing firm, not the introducing firm. The following is an example of language that the SEC accepts for use in a clearing agreement.

> "For purposes of the Securities and Exchange Commission's financial responsibility rules and the Securities Investor's Protection Act, (name of introducing firm)'s customers will be considered customers of

(name of clearing firm) and not customers of (name of introducing firm). Nothing herein shall cause (name of introducing firm)'s customers to be construed or interpreted as customers of (name of clearing firm) for any other purpose, or to negate the intent of any other section of this agreement, including, but not limited to, the delineation of responsibilities as set forth elsewhere in this agreement."

This language establishes the concept that customers must look to the clearing firm, not the introducing firm, for the payment of monies and delivery of securities.

Customer Account Statements

The SEC staff has reconsidered its previously issued interpretation concerning customer account statements that a clearing firm must send directly to the customers of an introducing firm. In the previous interpretation, each account statement had to include the name and telephone number of a responsible clearing firm employee that a customer could contact with inquiries regarding the customer's account.

In reviewing this position, the SEC noted that individuals may assume different responsibilities at their firms or may leave their employment altogether. Hence, requiring broker/dealers to name a specific individual on customer account statements, which are often preprinted, may lead to confusion for customers inquiring about their accounts. For this reason, the SEC staff determined that it is sufficient for broker/dealers to include just the pertinent telephone number. The following language is acceptable to the SEC for use on customer account statements.

"(Name of clearing firm) carries your account and acts as your custodian for funds and securities deposited with us directly by you, through (name of introducing firm) or as a result of transactions we process for your account. Inquiries concerning the position and balances in your account may be directed to our Client Service Department: (telephone number). All other inquiries regarding your account or the activity therein should be directed to (name of introducing firm).

Members should note that all customer account statements, as well as all clearing agreements, must contain language that adheres to the above interpretations on or before October 1, 1993.

Piggyback Clearing Arrangements

Some members have entered into a "piggyback clearing arrangement" and have questioned whether such an arrangement affects their status as introducing firms.

Under a piggyback clearing arrangement, introducing broker/dealer "A" enters into a clearing agreement with clearing broker/dealer "B"; then, broker/dealer "A" enters into a subagreement with one or more other broker/dealers, who introduce their business to broker/dealer "B" through broker/dealer "A." Clearing broker/dealer "B" is aware of the arrangement, but usually does not enter into a clearing agreement with these "piggybacked" firms.

The SEC staff advised that this type of arrangement has not yet been addressed with the SEC. Until it is, "piggyback" broker/dealers are introducing broker/dealers, if they have a written agreement with the middle firm (broker/dealer "A" in the example above), and broker/dealer "A" has a properly executed agreement with the clearing firm (broker/dealer "B" in the example above).

Dealer Activities

In *Notice to Members 92-72,* the NASD noted that any firm effecting more than 10 transactions in a calendar year for its own investment account would have to maintain minimum net capital of at least $100,000. After reconsideration, the SEC staff has advised that a firm making a single monthly investment of $1,000 or less into an established mutual fund account for the firm may exclude these transactions as dealer activities. Therefore, these transactions do not count toward the 10-transaction limit.

Open Contractual Commitment Charge

Notice to Members 93-30 addressed application of an open contractual commitment charge to an underwriting of a new convertible debt security immediately convertible into an existing Nasdaq National Market security for the same issuer. It noted that the haircut percentage depended on whether the security has a market value of less than par, at par, or greater than par.

However, the firm commitment underwriting deduction for an issue with a market value at par or higher needs further clarification. While the normal haircut percentage for such security would be 15 percent under paragraph (c)(2)(vi)(j) of Rule 15c3-1, the open contractual commitment charge for such securities is 30 percent "unless the class

and issue of the securities subject to the open contractual commitment deduction are listed for trading on a national securities exchange or are designated as Nasdaq National Market System Securities."

After discussion, the SEC staff advised that for an initial public offering of a debt security immediately convertible into equity shares that trade on the Nasdaq National Market or an exchange the contractual commitment charge would be the lesser of:

(i) The value of the debt securities adjusted for the 30 percent haircut, or

(ii) The market value of the equity securities into which the bonds are convertible, at a 15 percent haircut rate, plus the "premium loss" (the difference between the value of the debt security compared to the value of the converted equity security).

Example

A $2 million offering of convertible bonds at par is immediately convertible into shares of a common stock currently traded on the Nasdaq National Market. The total market value of convertible shares is $1.95 million.

Market value of the bonds
$2 million x 30% = $600,000

Market value of common stock $1.95 million x 15% =	$292,500
plus "premium loss" ($2 million - $1.95 million) =	50,000
Total	$342,500

The open contractual commitment charge would be $342,500 less the underwriting concession.

* * * * *

Questions concerning this Notice may be directed to Samuel Luque, Associate Director, Compliance, at (202) 728-8472.

NASD NOTICE TO MEMBERS 93-47

SEC Permits Use of Optical Storage Technology for Records Retention

Suggested Routing

- ■ Senior Management
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- □ Trading
- □ Training

Executive Summary

On May 18, 1993, the Securities and Exchange Commission (SEC) issued a no-action letter that permits broker/dealers to use optical storage technology(OST) to comply with the records retention requirements of SEC Rules 17a-3 and 17a-4. The letter, which was issued by the SEC Division of Market Regulation, establishes certain conditions that broker/dealers must meet to use this technology.

Background

Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 contain specific requirements for broker/dealers to follow in making and preserving books, records, and other documents relating to their business activities. Until 1970, paper was the only medium used to comply with these requirements. Over time, the SEC granted permission for broker/dealers to use microfilm and microfiche for records retention. In May 1993, the Securities Industry Association (SIA) Ad Hoc Record Retention Committee petitioned the SEC to allow the use of optical storage technology to maintain records.

In its letter, the SEC concurs with using OST if "broker/dealers immediately produce or reproduce records required under Rules 17a-3 and 17a-4, other than paper records made and kept current pursuant to paragraphs (a)(6) and (a)(7) of Rule 17a-3, on an optical disk, and maintain and preserve such records for the required time in that form," provided they meet certain specified conditions. Paragraphs (a)(6) and (a)(7) refer to order and trade tickets that are not eligible for optical storage.

Conditions for Use

Broker/dealers that use OST for recordkeeping must comply with the following conditions.

1. The broker/dealer must notify its designated examining authority before employing OST for record-retention purposes.

2. At all times, the broker/dealer must have facilities for immediate, easily readable projection of optical disks and for producing easily readable facsimile enlargements of such images so that the SEC and appropriate SROs may examine the broker/dealer records.

3. The broker/dealer must arrange the records and indexes and file the optical disks in such a manner as to permit the immediate location of any particular record.

4. The broker/dealer must be able to immediately provide at all times any facsimile enlargement that the SEC, through its examiners or other representatives, may request.

5. The broker/dealer must store separately from the original, in an off-site location, a duplicate copy of each optical disk used to store the required records, and stores such optical disk for the period required for the information preserved on the optical disk.

6. The broker/dealer must employ optical storage that:

(a) preserves records exclusively in a non-rewriteable, non-erasable format;

(b) verifies automatically the quality and accuracy of the optical storage recording process;

(c) duplicates in a separate optical disk all information originally preserved and maintained by means of OST;

(d) serializes original and duplicate optical disks containing records, and time-dates permanently the information placed on such optical disks; and

(e) has the capacity to download indexes and records preserved on optical disks into paper, microfilm, or microfiche.

7. The broker/dealer must organize and index accurately all information contained in every original and duplicate optical disk to ensure prompt access to the records.

(a) At all times, a broker/dealer must be able to have such indexes available for examination by the staffs of the SEC and the self-regulatory organizations (SROs) to which the broker/dealer belongs.

(b) Each index must be duplicated and the duplicate copies must be stored in an off-site location, separately from the original copy of each index.

(c) Original and duplicate indexes must be preserved for the time required for the indexed records.

8. The broker/dealer must have in place an audit system providing for accountability regarding all access to records maintained and preserved using OST and any changes made to every original and duplicate optical disk.

(a) At all times, a broker/dealer must be able to have the results of such audit system available for examination by the staffs of the SEC and the SROs to which the broker/dealer belongs.

(b) The results of such audit system must be preserved for the time required for the audited records.

9. The broker/dealer must maintain, keep current, and surrender promptly on request by the staffs of the SEC or the SROs to which the broker/dealer belongs all information needed to download records and indexes stored on optical disks; or place in escrow and keep current a copy of the physical and logical file format of the optical disks, the field format of all different information types written on the optical disks and the source code, together with the appropriate documentation and all information needed to download records and indexes.

10. For every broker/dealer using OST for record preservation purposes, at least one third-party who can download information from the broker/dealer's optical unit to another acceptable medium (the undersigned) shall file with the SEC or its designee the following written undertakings:

> The undersigned hereby undertakes to promptly furnish to the U. S. Securities and Exchange Commission (Commission), its designees or representatives, upon reasonable request, such information as is deemed necessary by the Commission's staff to download information kept on the broker/dealer's optical storage system to another medium acceptable to the Commission's staff.
>
> Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker/dealer's optical storage system, including, as appropriate, arrangements for the downloading of any record, required to be maintained and preserved by the broker/dealer pursuant to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 in a format acceptable to the Commission's staff. Such arrangements will provide specifically that in the event of a failure on the part of the broker/dealer to download the record into a readable format, upon being provided with the appropriate optical disks, the undersigned will undertake to do so, as the Commission's staff may request.

* * * * *

The SEC no-action letter that follows this Notice contains details regarding how the technology works and some background information concerning its advantages. Members planning to use optical storage technology should review the letter in its entirety. Questions concerning this Notice may be directed to Derick Black, Surveillance Specialist, Financial Responsibility, Compliance Department, at (202) 728-8225.

* * * * *

June 18, 1993

Michael D. Udoff, Chairman
Ad Hoc Record Retention Committee
Securities Industry Association, Inc.
120 Broadway
New York, NY 10271
Re: Optical Storage Technology

Dear Mr. Udoff:

Thank you for your letter, dated May 19, 1992, on behalf of the Securities Industry Association's ("SIA") *Ad Hoc* Record Retention

Committee ("Committee"), regarding the form by which broker-dealers may maintain records, required to be retained pursuant to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 ("Act").[1]

I. BACKGROUND

A. Preservation requirements under Rules 17a-3 and 17a-4

Rules 17a-3 and 17a-4 specify minimum requirements with respect to the business records which must be made by broker-dealers as well as the periods during which such records and other documents relating to the broker-dealer's business must be preserved. For the most part, records preserved pursuant to these Rules must be kept for up to six years, the first two years in an easily accessible place.[2] Some records, however, must be preserved for three years,[3] and records concerning the legal existence of the broker-dealer (*e.g.*, partnership articles, minute books, stock certificate books) must be preserved during the life of the broker-dealer and its successors.[4]

Until 1970, paper was the sole medium for the preservation of the records required under Rules 17a-3 and 17a-4. In 1970, Rule 17a-4 was amended to permit records to be immediately produced on microfilm for record-keeping purposes.[5] This amendment allowed for the use of microfilm for record preservation purposes provided that the conditions set forth in paragraph (f) of Rule 17a-4 were met.[6] In 1979, the staff of the Securities and Exchange Commission ("Commission") interpreted Rule 17a-4 to include microfiche as well as microfilm for record-keeping purposes, provided that the requirements of Rule 17a-4(f) were satisfied.[7]

Your letter, dated May 19, 1992, proposes to further expand the manner in which records required under Rules 17a-3 and 17a-4 may be preserved. In particular, the Committee requests that the Division of Market Regulation ("Division") not recommend that the Commission take enforcement action under Rules 17a-3 and 17a-4 if broker-dealers maintain the required records only on optical disk storage.

B. Optical storage technology

Optical storage technology allows for digital data recording in a hardware controlled, non-rewriteable format, such as write once, read many ("WORM"), which provides a non-alterable, permanent record storage medium. Non-rewriteable optical storage medium records digital information by employing a laser heat source to burn a pattern on a metallic film on a disk surface that can hold billions of bytes of data ("optical disk").[8] Once a laser permanently marks the optical disk to store information, that information can not be modified or removed from the optical disk without detection. This disk is removable from the hardware necessary for the optical storage function.

When using optical disk storage in the non-rewriteable format, any record, be it computer generated (such as a computer report) or electronically digitized (such as from paper or micrographics), can be permanently recorded for long term computer based management and access.

II. PROPOSAL

The Committee requests that the Division not recommend that the Commission take enforcement action under Rules 17a-3 and 17a-4 if a broker-dealer preserves its records by employing optical storage technology. According to the SIA, optical storage technology will provide economic as well as time-saving advantages for broker-dealers. For example, the SIA estimates that savings for space, equipment and material expenses, resulting from a change to optical disk from microfilm, range from $250,000 a year for a medium-sized firm to more than $1.6 million a year for a large firm.

The SIA asserts that optical storage

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[1] 17 C.F.R. §§ 240.17a-3 & 240.17a-4.

[2] *See* 17 C.F.R. § 240.17a-4(a).

[3] *See* 17 C.F.R. § 240.17a-4(b).

[4] 17 C.F.R. § 240.17a-4(d).

[5] Securities Exchange Act Release No. 8,875 (April 30, 1970), 35 Fed. Reg. 7,643 (May 16, 1970).

[6] 17 C.F.R. § 240.17a-4(f).

[7] Letter to Mr. Robert F. Price, Alex.Brown & Sons, from Nelson S. Kibler, Assistant Director, Division of Market Regulation, Commission (November 3, 1979).

[8] As each bit (a bit of digital information is indicated as a 0 or 1 — designating an "on" or "off" condition, respectively) of digital information is recorded on the optical medium, the reflective surface of the medium is either permanently altered by the laser heat source to indicate the bit is "on," or not altered to indicate the bit is "off." The permanent alterations, or lack thereof, in the reflectivity of the recorded locations on the medium are then used to read back the information by means of a low powered laser light source. The laser light source detects the change in the reflectivity level of a location on the medium which signifies the "on" or "off" condition of a bit of digital information.

technology offers speedier and higher quality access to records thus preserved than the current access to records preserved in microfilm, microfiche or physical format. Accordingly, the SIA asserts that the use of optical storage technology will enable broker-dealers to improve customer service. For example, according to the SIA, customers who lose account statements can be provided readily with replacement copies of equivalent quality to the original.[9]

Furthermore, the SIA asserts that optical disk storage of a firm's records would increase productivity and security. With optical storage technology an individual would not require physical access to a particular record, because access to an electronic copy would be equally available to authorized persons through a computer terminal. Access to records, however, could be restricted within a firm or individual department. Individuals could have access based solely on their employment responsibilities. Accordingly, the risk that records would be lost, misfiled or damaged through use would be reduced.

According to the SIA, optical storage technology would enhance the process of providing information more readily to the Commission. The SIA states that these benefits also would accrue to the benefit of the Commission in any record analysis done, because the Commission's staff would have the same ready, rapid access to the stored information, thus increasing the efficiency of the review process.

The SIA recognizes, however, that industry standards for the development of optical storage technology are currently being set, and that there are audit and examination concerns. Because the technology is new, optical storage systems are not always compatible (*i.e.,* information stored on an optical disk of one manufacturer may not be read by the technology developed by a second manufacturer). As a result of this lack of industry standards, the Commission or a self-regulatory organization ("SRO") inspecting a broker-dealer may encounter difficulty examining the information on an optical disk, because the technology owned by the inspecting SRO may not be compatible with the optical storage technology used by the broker-dealer to store the information. Accordingly, the Committee recommends that, upon compliance with conditions similar to those set forth below, broker-dealers be allowed to preserve records by employing optical storage technology.

III. CONCLUSION

Based on the above facts, and with regard to the issues set forth in this letter, the Division will not recommend that the Commission take enforcement action pursuant to Section 17(a)(1) of the Act[10] and Rules 17a-3 and 17a-4[11] thereunder if, under the circumstances described below, broker-dealers immediately produce or reproduce records required under Rules 17a-3 and 17a-4, other than paper records made and kept current pursuant to paragraphs (a)(6) and (a)(7) of Rule 17a-3, on an optical disk, and maintain and preserve such records for the required time in that form.

1. The broker-dealer must notify its designated examining authority prior to employing optical storage technology for record-retention purposes.

2. At all times, the broker-dealer must have available for examination of its records by the staffs of the Commission and the SROs of which it is a member, facilities for immediate, easily readable projection of optical disks and for producing easily readable facsimile enlargements of such images.

3. The broker-dealer must arrange the records and indexes, and file the optical disks in such a manner as to permit the immediate location of any particular record.

4. The broker-dealer must be ready at all times to provide, and immediately provides, any facsimile enlargement which the Commission by its examiners or other representatives may request.

5. The broker-dealer must store separately from the original, in an off-site location, a duplicate copy of each optical disk used to store the required records, and stores such optical disk for the period required for the information preserved in the optical disk.

6. The broker-dealer must employ optical storage that:

(a) preserves records exclusively in a non-rewriteable, non-erasable format;

(b) verifies automatically the quality and accuracy of the optical storage recording process;

(c) duplicates in a separate optical disk all information originally preserved and maintained by means of optical storage technology;

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[9] According to the SIA, microfilm or microfiche copies are often not as clear as optical disk copies and usually take a longer time to produce.

[10] 15 U.S.C. § 78q(a)(1).

[11] 17 C.F.R. §§ 240.17a-3 & 240.17a-4.

(d) serializes original and duplicate optical disks containing records, and time-dates permanently the information placed on such optical disks, and

(e) has the capacity to download indexes and records preserved on optical disks into paper, microfilm or microfiche.

7. The broker-dealer must organize and index accurately all information contained in every original and duplicate optical disk to ensure prompt access to the records.

(a) At all times, a broker-dealer must be able to have such indexes available for examination by the staffs of the Commission and the SROs of which the broker-dealer is a member.

(b) Each index must be duplicated and the duplicate copies must be stored in an off-site location, separately from the original copy of each index.

(c) Original and duplicate indexes must be preserved for the time required for the indexed records.

8. The broker-dealer must have in place an audit system providing for accountability regarding all access to records maintained and preserved using optical storage technology and any changes made to every original and duplicate optical disk.

(a) At all times, a broker-dealer must be able to have the results of such audit system available for examination by the staffs of the Commission and the SROs of which the broker-dealer is a member.

(b) The results of such audit system must be preserved for the time required for the audited records.

9. The broker-dealer must maintain, keep current and surrender promptly upon request by the staffs of the Commission or the SROs of which the broker-dealer is a member all information necessary to download records and indexes stored on optical disks; or place in escrow and keep current a copy of the physical and logical file format of the optical disks, the field format of all different information types written on the optical disks and the source code, together with the appropriate documentation and all information necessary to download records and indexes.

10. For every broker-dealer using optical storage technology for record preservation purposes, at least one third party who has the ability to download information from the broker-dealer's optical unit to another acceptable medium ("the undersigned"), shall file with the Commission or its designee the following written undertakings:

> The undersigned hereby undertakes to promptly furnish to the U.S. Securities and Exchange Commission ("Commission"), its designees or representatives, upon reasonable request, such information as is deemed necessary by the Commission's staff to download information kept on the broker-dealer's optical storage system to another medium acceptable to the Commission's staff.
>
> Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker-dealer's optical storage system, including, as appropriate, arrangements for the downloading of any record, required to be maintained and preserved by the broker-dealer pursuant to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 in a format acceptable to the Commission's staff. Such arrangements will provide specifically that in the event of a failure on the part of the broker-dealer to download the record into a readable format, upon being provided with the appropriate optical disks, the undersigned will undertake to do so, as the Commission's staff may request.

This is a staff position concerning enforcement action and it does not represent any legal conclusions. This position is based solely on the foregoing description and factual variations might require a different response. This position may be withdrawn or modified if the staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise, in furtherance of the purposes of the Federal securities laws.

If you have any questions regarding these matters, please do not hesitate to contact Julius R. Leiman-Carbia at (202) 272-2824.

Sincerely,
Michael A. Macchiaroli
Associate Director

NASD NOTICE TO MEMBERS 93-48

Nasdaq National Market® Additions, Changes, And Deletions as of June 22, 1993

Suggested Routing

- [ ] Senior Management
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [x] Internal Audit
- [ ] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

As of June 22, 1993, the following 54 issues joined the Nasdaq National Market,® bringing the total number of issues to 3,145:

Symbol	Company	Entry Date	SOES Execution Level
FFEX	Frozen Food Express Inds., Inc.	5/25/93	1000
STCI	Station Casinos, Inc.	5/25/93	500
ZHOM	Zaring Homes, Inc.	5/25/93	1000
HFSC	Hamilton Financial Svcs. Corp.	5/26/93	1000
HYDEB	Hyde Athletic Industries, Inc. (Cl B)	5/26/93	1000
RNDM	Random Access, Inc.	5/26/93	1000
REMI	Resource Bancshares Mtg. Grp., Inc.	5/26/93	1000
CDWC	CDW Computer Centers, Inc.	5/27/93	1000
SCOC	The Santa Cruz Operation, Inc.	5/27/93	1000
HWCC	Hollywood Casino Corp. (Cl A)	5/28/93	500
STCX	Signal Technology Corp.	5/28/93	1000
ALCD	Alcide Corporation	6/1/93	1000
CREI	Care Enterprises, Inc.	6/1/93	1000
CICS	Citizens Bancshares, Inc.	6/1/93	200
ERICR	LM Ericsson Company (6/30/93 Rts)	6/2/93	500
BKUNP	BankUnited Financial Corporation	6/3/93	200
MFIN	Metro Financial Corporation	6/3/93	200
NSTR	Northstar Health Services, Inc.	6/3/93	500
OSBNR	Osborn Communications Corp. (Rts)	6/3/93	500
ZONE	Discovery Zone, Inc.	6/4/93	1000
ALDA	Aldila, Inc.	6/8/93	1000
RAZR	American Safety Razor Company	6/8/93	1000
MRNR	Mariner Health Group, Inc.	6/8/93	1000
PISC	Pacific International Services Corp.	6/8/93	1000
PZZA	Papa John's International, Inc.	6/8/93	1000
REGA	Regional Acceptance Corporation	6/8/93	200
SEAM	Seaman Furniture Company, Inc.	6/8/93	500
ELET	Ellett Brothers, Inc.	6/9/93	1000
RAYS	Sunglass Hut International, Inc.	6/9/93	500
FMBK	F & M Bancorporation, Inc.	6/10/93	200
SSPIF	Spectrum Signal Processing Inc.	6/10/93	1000
MOND	The Robert Mondavi Corp. (Cl A)	6/10/93	1000
BNHBR	BNH Bancshares, Inc. (7/16/93 Rts)	6/11/93	500
BGALY	Banco de Galicia y Buenos Aires S.A. (ADR)	6/11/93	1000
BBSI	Barrett Business Services, Inc.	6/11/93	500
IBSC	Image Business Systems Corp.	6/11/93	200
NWSW	Northwestern Steel and Wire Co.	6/11/93	1000
ASFL	American Savings Bank of Florida, FSB	6/15/93	1000
ECCS	ECCS, Inc.	6/15/93	200
BELM	Bell Microproducts Inc.	6/16/93	1000
CBNY	Commercial Bank of New York	6/16/93	500
NPPI	Norwood Promotional Products, Inc.	6/16/93	500
DNKY	Donnkenny, Inc.	6/17/93	1000
IMAK	International Imaging Materials, Inc.	6/17/93	1000

Symbol	Company	Entry Date	SOES Execution Level
CICI	Communication Intelligence Corporation	6/18/93	1000
RXSD	Rexall Sundown, Inc.	6/18/93	1000
RHDS	Rhodes, Inc.	6/18/93	500
ALBM	Alpha 1 Biomedicals, Inc.	6/21/93	1000
ALBML	Alpha 1 Biomedicals, Inc. (2/28/97 Wts)	6/21/93	500
STFR	St. Francis Capital Corporation	6/21/93	1000
DAIG	Daig Corporation	6/22/93	200
FLIR	FLIR Systems, Inc.	6/22/93	1000
HDTC	Healthdyne Technologies, Inc.	6/22/93	1000
PRMA	Primadonna Resorts, Inc.	6/22/93	500

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since May 24, 1993:

New/Old Symbol	New/Old Security	Date of Change
HEALW/HEALW	Healthwatch, Inc. (4/30/94 Wts)/Healthwatch, Inc. (4/30/93 Wts)	4/26/93
HYDEA/HYDE	Hyde Athletic Inds, Inc. (Cl A)/Hyde Athletic Industries, Inc.	5/26/93
DOVT/DOVTV	DOVatron International, Inc./DOVatron International, Inc. (WI)	6/1/93
RHAB/NRCT	Rehability Corporation/National Rehabilitation Centers, Inc.	6/1/93
WSFS/STSS	WSFS Financial Corp./Star States Corp.	6/1/93
FCMI/FCMIV	Future Communications Inc./Future Communications Inc. (WI)	6/3/93
DUSA/DUSA	DUSA Pharmaceuticals, Inc./Deprenyl USA, Inc.	6/4/93
VLANS/VLANS	Banyan Strategic Realty Trust SBI/Banyan Strategic Land Trust SBI	6/7/93
GNSA/GNSA	Gensia, Inc./Gensia Pharamaceuticals, Inc.	6/9/93
XRAY/XRAY	Dentsply International Inc./GENDEX Corp.	6/14/93
TDCAZ/TDCZV	Therapeutic Discovery Corp. (12/31/99 Uts)/Therapeutic Discovery Corp. (12/31/99 WI)	6/14/93
KRSC/KSRI	Kaiser Resources Inc./Kaiser Steel Resources, Inc.	6/15/93
PKPSR/PKPSR	Poughkeepsie Savings Bank FSB (6/18/93 Rts)/Poughkeepsie Savings Bank FSB (6/14/93 Rts)	6/15/93
FLST/TWFS	Flagstar Companies Inc./TW Holdings Inc.	6/17/93
FLSTP/TWFSP	Flagstar Companies Inc. (Pfd)/TW Holdings Inc. (Pfd)	6/17/93
JMCG/JMCG	JMC Group, Inc./Spear Financial Services, Inc.	6/18/93

Nasdaq National Market Deletions

Symbol	Security	Date
FCIQE	F & C International, Inc.	5/25/93
ISANE	In-Store Advertising, Inc.	5/25/93
SHIP	Regency Cruises Inc.	5/26/93
RICE	American Rice, Inc.	5/28/93
MANT	Manitowoc Co. Inc.	5/28/93

Symbol	Security	Date
COLC	Colorado National Bankshares, Inc.	6/1/93
NCELW	Nationwide Cellular Service Inc. (6/1/93 Wts)	6/2/93
QLMD	Qual-Med, Inc.	6/7/93
BOST	Boston Digital Corporation	6/10/93
FINF	Financial Federal Corporation	6/10/93
MSRR	MidSouth Corp.	6/11/93
SPCLW	Spectrum Information Technologies, Inc. (6/11/93 Wts)	6/14/93
WSTF	Western Financial Corp.	6/14/93
NUCO	Nucorp, Inc.	6/16/93
SWTR	Southern California Water Company	6/17/93
STAG	Security Tag Systems, Inc.	6/18/93
PKPSR	Poughkeepsie Savings Bank, FSB (6/18/93 Rts)	6/21/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade-reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

NASD DISCIPLINARY ACTIONS

Disciplinary Actions Reported for July

The NASD® is taking disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, July 19, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this publication.

Firms Suspended, Individuals Sanctioned

Adams Securities, Inc. (Las Vegas, Nevada), James William Adams (Registered Principal, Henderson, Nevada), and **Daniel Bruce Perry (Registered Principal, Henderson, Nevada)**. The firm was fined $79,541, jointly and severally with Adams and Perry, and suspended for 60 days from market making. Adams and Perry were each fined an additional $15,000 and suspended from association with any NASD member in any capacity for 30 days.

The Securities and Exchange Commission (SEC) affirmed the sanctions following appeal of a November 1991 National Business Conduct Committee (NBCC) decision. The sanctions were based on findings that, in contravention of the Board of Governors' Interpretation with respect to the NASD's Mark-Up Policy, the firm, acting through Adams and Perry, sold securities to public customers in the secondary market at unfair prices. The markups on these transactions ranged from 17.65 to 100 percent above the firm's contemporaneous cost.

Bison Securities, Inc. (Amherst, New York) and **Michael Tripi (Registered Principal, Tonawanda, New York)** were fined $90,000, jointly and severally, and the firm was suspended from NASD membership for six months. In addition, Tripi was suspended from association with any NASD member in any capacity for six months and required to requalify by examination as a principal. The SEC affirmed the sanctions following appeal of a November 1991 NBCC decision.

The sanctions were based on findings that the firm, acting through Tripi, sold common stocks as principal to retail customers at unfair and unreasonable prices. The markups on these transactions ranged from 60 to 100 percent above the prevailing market price of the securities, in violation of the NASD's Mark-Up Policy.

The firm and Tripi also executed transactions with customers in which the offsetting side of the trade was the firm's trading account. Bison and Tripi then sent to customers confirmations that indicated the transactions had been executed on a dual-agency basis when they actually were executed on a principal basis. Furthermore, the firm, acting through Tripi, failed to prepare and maintain accurate books and records and failed to file proper FOCUS Part IIA reports with the NASD.

Firms and Individuals Fined

Bryn Mawr Investment Group, Inc. (Rosemont, Pennsylvania) and **Howard H. Flesher (Registered Principal, Rosemont, Pennsylvania)** were fined $10,000, jointly and severally and Flesher was required to pass the general securities principal examination. In addition, the firm was fined $2,000,

jointly and severally, with another registered representative. The NBCC imposed the sanctions following appeal of a District 9 District Business Conduct Committee (DBCC) decision.

The sanctions were based on findings that the firm, acting through Flesher, effected transactions in securities when it failed to maintain its minimum required net capital and filed inaccurate FOCUS Parts I and IIA reports.

In addition, the firm, acting through Flesher, failed to prepare, keep current, and preserve complete and accurate books and records and sold as principal warrants and bonds to customers at unfair and unreasonable prices. Moreover, the respondents failed to comply with SEC Rule 10b-10(a)(8) by not disclosing markups on the confirmations of eight principal transactions.

F.B. Horner & Associates, Inc. (New York, New York) and **Fred B. Horner (Registered Principal, New York, New York**) were fined $99,201.20, jointly and severally. The SEC affirmed the sanction following appeal of a November 1990 NBCC decision; a challenge to the SEC's decision was denied by the U.S. Court of Appeals for the Second Circuit on May 18, 1993. The sanction was based on findings that the firm, acting through Horner, made two sales of zero coupon bonds to an institutional customer at unfair prices. The excessive markups on the transactions were 8.09 and 6.91 percent above the prevailing market price, in violation of the NASD's Mark-Up Policy.

Van Clemens & Company, Inc. (Minneapolis, Minnesota) and **Thomas John Vanyo (Registered Principal, Robbinsdale, Minnesota)** were fined $10,400, jointly and severally. However, the fine may be reduced by $5,400 if paid in restitution to public customers. The NBCC imposed the sanctions on review of a District 4 DBCC decision. The sanctions were based on findings that the firm, acting through Vanyo, charged unfair and excessive commissions in agency transactions ranging from 7 to 9 percent.

Firms Fined

Alliance Securities Corporation (Los Angeles, California) was fined $5,000, jointly and severally with a registered representative and required jointly and severally to pay restitution to customers totaling $56,335, plus interest. The sanctions were based on findings that the firm conducted a securities business while failing to maintain its minimum required net capital. In addition, the firm effected securities transactions with retail customers in a common stock that included excessive markups above the prevailing market price, in violation of the NASD's Mark-Up Policy and Article III, Sections 1, 4, and 18 of the Association's Rules of Fair Practice.

Individuals Barred or Suspended

Robert A. Amato (Registered Representative, New Orleans, Louisiana), Charles D. Block, Jr. (Registered Representative, New Orleans, Louisiana), and **William C. Boehmer, Jr. (Registered Representative, Metairie, Louisiana)**. Amato was fined $20,000, suspended from association with any NASD member in any capacity for four weeks, and required to requalify by examination as a registered representative. Block and Boehmer were each fined $5,000, suspended from association with any NASD member in any capacity for one week, and required to requalify by examination as a registered representative.

The SEC affirmed the sanctions following appeal of an August 1991 NBCC decision. The sanctions were based on findings that, in violation of the NASD's Mark-Up Policy, the respondents engaged in securities transactions with public customers at prices that reflected unfair markups in excess of 10 percent.

Amato appealed this action to the U.S. Court of Appeals, and the sanctions as to him are not in effect pending consideration of the appeal.

Duane M. Barr (Registered Representative, Broken Arrow, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Barr consented to the described sanction and to the entry of findings that he made misrepresentations to public customers causing them to remit checks totaling $6,214 for investment and insurance purposes. The findings stated that Barr converted the funds to his own use and benefit by depositing the monies into a checking account he established.

Scot Barringer (Registered Principal, Aspen, Colorado) submitted an Offer of Settlement pursuant to which he was fined $10,000 and suspended from association with any NASD member in any capacity for 60 days. In addition, he was suspended as a general securities principal for an additional 30 days and required to requalify by examination as a general securities principal before acting in such a capacity.

Without admitting or denying the allegations, Barringer consented to the described sanctions, and to the entry of findings that he failed to deposit customer funds into a properly established escrow account in two best efforts, contingent offerings. According to the findings, Barringer caused $122,289.21 in customer funds received in one of the aforementioned offerings to be disbursed before the stated contingency was met.

The findings also stated that Barringer effected a material change in the same offering wherein he caused $658,765 received from investors to be used for purposes other than those disclosed in the offering memorandum. Of the funds improperly disbursed, only $87,966.68 was paid to his member firm.

Dante M. Bramblett (Registered Representative, Birmingham, Alabama) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for two months and required to requalify by examination as a general securities representative.

Without admitting or denying the allegations, Bramblett consented to the described sanctions and to the entry of findings that he recommended and effected transactions in the accounts of two public customers without having reasonable grounds for believing that such recommendations and transactions were suitable. In addition, the NASD found that Bramblett executed unauthorized transactions in the same accounts.

Rhonda Lee Breard (Registered Representative, Issaquah, Washington) submitted an Offer of Settlement pursuant to which she was fined $15,000 and suspended from association with any NASD member in any capacity for 10 business days. In addition, she must requalify by examination in any registered capacity that she proposes to function or is currently functioning.

Without admitting or denying the allegations, Breard consented to the described sanctions and to the entry of findings that she exercised discretion in the account of a public customer without obtaining prior written authority from the customer and without written acceptance of such discretionary account from her member firm. The findings also stated that Breard recommended securities transactions to public customers without having reasonable grounds for believing such recommendations were suitable for the customers.

Willis H. Brewer, Jr. (Registered Principal, Metairie, Louisiana) and **Scott R. Gray (Registered Principal, Metairie, Louisiana)** were each fined $5,000, suspended from association with any NASD member in any capacity for one week, and required to requalify by examination as registered representatives. The SEC affirmed the sanctions following appeal of a September 1991 NBCC decision. The sanctions were based on findings that a former member firm, acting through Brewer and Gray, effected, as principal for its own account, over-the-counter sales of a common stock to public customers at unfair prices. The markups in these transactions ranged from 18.7 to 105.2 percent over the prevailing market price, in violation of the NASD's Mark-Up Policy.

Richard S. Chancis (Registered Representative, New York, New York) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for 10 business days. Furthermore, Chancis will be barred from association with any NASD member in any capacity if he defaults on any payment due to an arbitration claimant under their agreement, with the proviso that he may apply to remove the bar upon showing that he has honored the arbitration award.

Without admitting or denying the allegations, Chancis consented to the described sanctions and to the entry of findings that he failed to pay an $11,592 NASD arbitration award. In addition, the NASD determined that Chancis failed to respond to NASD requests for information.

Chancis failed to comply with the aforementioned sanctions; therefore, he is barred from association with any NASD member in any capacity.

Ana Beatriz Concepcion (Registered Representative, Bronx, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Concepcion consented to the described sanctions and to the entry of findings that she requested a $506 loan against a public customer's insurance policy, forged the customer's signature on the check, and converted the funds to her own use by depositing the check into her personal account without the knowledge or consent of the customer.

Helen Holt Cordry (Registered Representative, San Francisco, California) and **Thomas Wallace**

Cordry (Registered Representative, San Francisco, California) submitted an Offer of Settlement pursuant to which they were fined $20,000, jointly and severally and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they failed to respond to NASD requests for information regarding allegations that funds totaling $149,702.73 were missing from a public customer's account.

Jerome J. Cusimano (Registered Representative, Hempstead, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $20,000, barred from association with any NASD member in any capacity, and required to pay $9,000 in restitution to his former member firm. Without admitting or denying the allegations, Cusimano consented to the described sanctions and to the entry of findings that he submitted applications for insurance policies with fictitious names for the purpose of obtaining commissions totaling $9,000.

James E. Enneper (Registered Representative, Green Bay, Wisconsin) submitted an Offer of Settlement pursuant to which he was fined $40,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Enneper consented to the described sanctions and to the entry of findings that he received from a public customer checks totaling $6,200.34 with instructions to use such funds to purchase hospitalization insurance. The NASD found that Enneper used only $4,560.34 as instructed and used $1,640 for other purposes. The findings also stated that Enneper requested the cash surrender value of another customer's life insurance policy, obtained a $6,886.64 check made payable to the customer, cashed the check, and forwarded $4,886.64 to the life insurance company for the customer's insurance policy without the customer's knowledge or consent. According to the findings, Enneper used $2,000 of the check proceeds for purposes other than the customer's benefit.

In addition, the NASD determined that Enneper completed and submitted to the NASD a *Uniform Application for Securities Industry Registration (Form U-4)* in which he failed to fully disclose the circumstances surrounding his termination from a member firm and customer complaints received by the member firm. Enneper also failed to respond fully to NASD requests for information.

Thomas C. Fead (Registered Representative, Englewood, Colorado) submitted an Offer of Settlement pursuant to which he was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Fead consented to the described sanctions and to the entry of findings that he participated in 57 private securities transactions without providing his member firm with prior written notice and without receiving his firm's prior approval to participate in these transactions.

Timothy Mark Haas (Registered Representative, Bozeman, Montana) was fined $100,000 and barred from association with any NASD member in any capacity. In addition, Haas must provide evidence to the NASD that restitution satisfactory to his former member firm has been paid. The sanctions were based on findings that Haas received from public customers checks totaling $45,169.33 for investment purposes. Haas deposited the checks into his personal bank accounts and failed to remit the funds for their intended purposes or to otherwise return the monies to the customers.

Michael G. Hayden (Registered Representative, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $25,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hayden consented to the described sanctions and to the entry of findings that he received from a public customer a $5,000 check to purchase mutual fund shares and, instead, deposited the funds in a bank account he owned or controlled.

Stephen F. Hickey (Registered Representative, Powell, Ohio) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $30,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hickey consented to the described sanctions and to the entry of findings that he accepted funds from a public customer for the purpose of executing securities transactions. However, the findings stated that the transactions were effected at another firm without the knowledge or approval of Hickey's member firm.

James H. Hicks (Registered Representative, Tulsa, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or

denying the allegations, Hicks consented to the described sanctions and to the entry of findings that he recommended and executed purchase transactions in the account of a public customer without having reasonable grounds for believing that such recommendations and resultant transactions were suitable for the customer based on his financial situation, objectives, and needs.

Frank S. Hiegel (Registered Principal, Little Rock, Arkansas) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000 and barred from association with any NASD member in any principal capacity, with a right to reapply for a principal license after three years. Without admitting or denying the allegations, Hiegel consented to the described sanctions and to the entry of findings that he failed to properly supervise the handling of the margin account of a public customer and to properly supervise the activities of employees at his member firm.

Kenneth Ray Hudson (Registered Representative, San Diego, California) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, Hudson consented to the described sanction and to the entry of findings that he failed to pay a $5,000 NASD arbitration award and $575 in filing fees.

Eva S. Johnson (Registered Representative, Robbins, Illinois) submitted an Offer of Settlement pursuant to which she was fined $135,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Johnson consented to the described sanctions and to the entry of findings that, without a public customer's knowledge or consent, Johnson obtained a partial surrender of the customer's insurance annuity totaling $85,000. Furthermore, the findings stated that Johnson had the customer sign a promissory note with a general partnership that was controlled, in part, by Johnson to use the funds as operating capital for the partnership.

The findings also stated that, in connection with the above, Johnson engaged in private securities transactions while failing to give written notice to her member firm of her intention to engage in such activity. Johnson also failed to respond fully to NASD requests for information.

Michael T. Kear (Registered Representative, Somerville, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $100,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Kear consented to the described sanctions and to the entry of findings that, in a private placement offering, he failed to make certain disclosures and made numerous material misrepresentations to investors and officers of the issuer. In addition, the findings stated that Kear misappropriated customer funds to his own use, and engaged in private securities transactions without notifying his member firm.

Mark T. Kent (Registered Representative, Huntsville, Alabama) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Kent consented to the described sanctions and to the entry of findings that he signed customers' names to certain account documents.

Reuben Fleece Logan, III (Registered Representative, Lombard, Illinois) submitted an Offer of Settlement pursuant to which he was fined $50,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Logan consented to the described sanctions and to the entry of findings that, without the knowledge or consent of public customers, Logan submitted to his member firm mutual fund and life insurance applications. According to the findings, Logan thereafter submitted to his member firm a request for a policy loan and withdrawals of dividends from insurance policies owned by some of the customers, and used the proceeds to pay for the aforementioned purchases.

Dan Lawrence Mauss (Registered Principal, Salt Lake City, Utah) was fined $10,000, barred from association with any NASD member as a general securities principal and in any proprietary or ownership position. The sanctions were based on findings that a member firm, acting through Mauss, engaged in a fraudulent and deceptive course of conduct which involved "parking" securities in customers' accounts to give the appearance that the firm was in compliance with the net capital requirement of SEC Rule 15c3-1.

In addition, the firm, acting through Mauss, conducted a securities business while failing to maintain minimum required net capital, failed to make required deposits into its Special Reserve Account for the Exclusive Benefit of Customers in accordance with the SEC Customer Protection Rule 15c3-3, and filed

inaccurate FOCUS Parts I and II reports.

The firm, acting through Mauss, also failed to establish adequate written supervisory procedures required to supervise the types of business in which the firm engaged, and failed to enforce its written supervisory procedures.

Ilmi Mehmedovic (Associated Person, Glendale, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Mehmedovic consented to the described sanctions and to the entry of findings that he hired an individual to take the Series 7 examination on his behalf.

Paul M. Michalovsky (Registered Representative, New York, New York) was fined $20,000, suspended from association with any member of the NASD in any capacity for 30 business days, and required to pay $56,100 in restitution to a public customer, jointly and severally with another individual. The NBCC imposed the sanctions following appeal of a District 10 DBCC decision. The sanctions were based on findings that Michalovsky received a $56,100 check from a public customer to purchase shares of an unregistered common stock, endorsed the check, deposited the funds into his brokerage account at another firm, but failed to deliver the shares to the customer.

Cynthia Renae Mulflur f/k/a Cynthia Renae Meyer (Registered Representative, Portland, Oregon) submitted an Offer of Settlement pursuant to which she was fined $5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Mulflur consented to the described sanctions and to the entry of findings that she prepared and submitted account agreements to her member firm for 18 customers and signed their names to the agreements without their knowledge, authorization, or consent.

James H. O'Bryan, Jr. (Registered Representative, Louisville, Kentucky) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $30,000, suspended from association with any NASD member in any capacity for one week, and must pay $48,000 in restitution. Without admitting or denying the allegations, O'Bryan consented to the described sanctions and to the entry of findings that he exercised discretion in the account of public customers without obtaining prior written acceptance of the account as discretionary by his member firm. In addition, the NASD found that O'Bryan engaged in a pattern of excessive trading in the same account and that the transactions were not suitable for the customers.

Robert Bruce Orkin (Registered Principal, Boca Raton, Florida) was fined $15,000 and suspended from association with any NASD member in any principal capacity for 90 days. The SEC affirmed the sanctions following appeal of a September 1991 NBCC decision. The sanctions were based on findings that a member firm, acting through Orkin, effected, as principal for its own account, over-the-counter sales of corporate securities to public customers at unfair prices. The markups on these transactions ranged from 16.67 to 100 percent over the prevailing market price, in violation of the NASD's Mark-Up Policy. Orkin appealed this action to a Court of Appeals, and the sanctions are not in effect pending consideration of the appeal.

Stephen E. Parker (Registered Principal, Little Rock, Arkansas) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, Parker consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without providing prior written notice to and approval from his member firm.

Keith Scott Phillips (Registered Representative, New York, New York) was fined $100,000 and barred from association with any NASD member in any capacity. Any amount paid in restitution to a public customer will offset against the fine. The sanctions were based on findings that Phillips executed transactions in a public customer's account without the prior authorization, knowledge, or consent of the customer.

Furthermore, Phillips recommended and caused the purchase of securities in another public customer's account without having reasonable grounds for believing that such transactions were suitable given the customer's financial situation and needs. In addition, Phillips falsely represented to this customer that he had purchased a $25,000 municipal bond for the customer's account. Phillips also failed to respond to NASD requests for information.

Brian John Quinn (Associated Person, Sandy, Utah) was fined $2,500 and barred from association with any NASD member in any capacity. The sanctions were based

on findings that Quinn submitted to a member firm a Form U-4 containing inaccurate and misleading information.

Gary Lee Robinson (Registered Representative, Denver, Colorado) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Robinson consented to the described sanctions and to the entry of findings that he caused customer records for the previously dormant account of a public customer to be changed to reflect his home address as the address of record for the customer and to reflect other erroneous information. Furthermore, the NASD determined that Robinson caused the credit balance of $2,464.64 to be withdrawn from this account, including a proceeds check for $2,298.46, which was converted to his own use and benefit.

Reece D. Rogers (Registered Representative, Memphis, Tennessee) was fined $20,000, suspended from association with any NASD member in any capacity for five years with credit given for four and one-half years that he has not been in the securities industry, and required to requalify by examination in any capacity. The NBCC imposed the sanctions following appeal of a District 5 DBCC decision. The sanctions were based on findings that Rogers exercised discretionary power in public customer accounts without their prior written authorization and prior written acceptance of the accounts as discretionary by his member firm.

Rogers also recommended and engaged in option transactions in public customer accounts without having reasonable grounds for believing that such recommendations were suitable for the customers. In addition, Rogers exercised unauthorized options transactions in public customer accounts and failed to respond to NASD requests for information.

Edward M. Stewart (Registered Representative, Birdsboro, Pennsylvania) was fined $20,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a District 9 DBCC decision. The sanctions were based on findings that Stewart failed to respond to NASD requests for information. Specifically, the NASD requested he make a written report concerning the alleged forgery of policyholder signatures on two checks and a failure to submit a mutual fund application.

David Thomas Stover (Registered Representative, Seattle, Washington) submitted an Offer of Settlement pursuant to which he was fined $20,000 and suspended from association with any NASD member in any capacity for 30 days. In addition, he must requalify by examination in any registered capacity and is required to pay $55,000 in restitution to a public customer.

Without admitting or denying the allegations, Stover consented to the described sanctions and to the entry of findings that on several occasions he made unsuitable recommendations to two public customers. The NASD also found that Stover exercised discretion in one of the aforementioned customer's account without obtaining prior written discretionary trading authority from the customer and without obtaining written acceptance of such account by his member firm.

Jim D. Swink, Jr. (Registered Principal, Little Rock, Arkansas) and **Jim D. Swink, Sr. (Associated Person, Little Rock, Arkansas)** submitted an Offer of Settlement pursuant to which Swink, Jr., was fined $15,000 and suspended from association with any NASD member in any capacity for one year. Swink, Sr., was fined $50,000 and barred from association with any NASD member in any capacity.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that a member firm, acting through Swink, Jr., and Swink, Sr., (the Swinks), opened margin accounts through its clearing firm and executed a series of municipal securities transactions without payment, in violation of the margin account requirements of its clearing firm. Such failure to maintain the required margin balances in the accounts was not detected by the clearing firm, nor was it brought to their attention by the Swinks when they knew, or should have known, it could have caused the clearing firm to violate a comparable rule of the New York Stock Exchange governing the margining of securities.

The NASD also found that the Swinks, acting for their member firm, executed a series of transactions involving municipal securities in which a joint account naming Swink, Sr., was interposed between public customers of their firm and the best inter-dealer market, to the harm and detriment of the customers. In addition, the findings stated that the Swinks executed transactions involving municipal securities at unfair and unreasonable prices, in violation of requirements of the Municipal Securities Rulemaking Board. The NASD also determined that Swink, Jr., failed to indicate on order tickets that trans-

actions executed for a joint account naming Swink, Sr., had been entered pursuant to discretionary power by Swink, Jr., and failed to evidence the order-entry time on 36 order tickets for joint accounts naming the Swinks.

Furthermore, the findings stated that Swink, Jr., acting for the same firm, failed to supervise certain individuals and to establish, maintain, and enforce a supervisory system reasonably designed to ensure compliance with all applicable securities laws and regulations and NASD rules.

Stanley L. Swoyer (Registered Representative, Frederick, Maryland) and **Kenneth E. Nightingale (Registered Representative, Towson, Maryland)** were each fined $5,000, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by examination in any capacity in which they desire to function. The NBCC imposed the sanctions following appeal of a District 9 DBCC decision. The sanctions were based on findings that Swoyer and Nightingale failed to respond to NASD requests for information concerning business records.

Robert L. Williams (Registered Representative, Jasper, Alabama) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for one year. Without admitting or denying the allegations, Williams consented to the described sanctions and to the entry of findings that, based on misrepresentations, he recommended and executed four investment transactions in public customer accounts without having reasonable grounds for believing that such recommendations and resultant transactions were suitable for the customers.

Edward R. Yaman (Registered Representative, New York, New York) submitted an Offer of Settlement pursuant to which he was fined $2,500 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Yaman consented to the described sanctions and to the entry of findings that he failed to pay a $7,303.54 NASD arbitration award.

Yaman was barred from association with any NASD member in any capacity for failure to pay the award under an agreement with the claimant. However, Yaman may apply to remove the bar upon satisfaction of the award.

Individuals Fined

Anthony Gary Galante (Registered Representative, Las Vegas, Nevada) was fined $13,875 and required to requalify by examination as a general securities representative. The fine may be reduced by any amount paid in restitution to his former member firm (not to exceed $8,875). The sanctions were based on findings that Galante extended a guarantee against loss to a customer.

Firms Suspended

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of Article IV, Section 5 of the NASD Rules of Fair Practice and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after each entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

Cattle Securities, Inc., Dallas, Texas (June 2, 1993)

Security Data Financial, New York, New York (June 2, 1993)

Wellsford Securities Corp., New York, New York (June 2, 1993 to June 9, 1993)

Suspensions Lifted

The NASD has lifted suspensions from membership on the dates shown for the following firms because they have complied with formal written requests to submit financial information.

America/Southwestern Securities Group, Inc., Fort Worth, Texas (June 14, 1993)

Boston International Group Sec., Corp., Boston, Massachusetts (May 19, 1993)

The Bostonian Group Securities Corp., Chestnut Hill, Massachusetts (May 28, 1993)

Bucchieri Asset Management, Inc., Denver, Colorado (May 20, 1993)

Collaborative Equities, Inc., Boston, Massachusetts (May 20, 1993)

Fairfax Securities Corporation, Alexandria, Virginia (June 4, 1993)

Varel, John G., Haleiwa, Hawaii (June 11, 1993)

Winthrop Investments, Indianapolis, Indiana (June 17, 1993)

Individuals Whose Registrations Were Revoked for Failure to Pay Fines and Costs in Connection With Violations

Robert Lopez, Bountiful, Utah

Marc L. Minkoff, Deerfield Beach, Florida

John S. Turbeville, Antioch, Tennessee

Gordon Scott Venters, Orlando, Florida

For Your Information

Educational Programs Added to Conference Schedule

The following educational programs are now on the 1993 NASD conference schedule:

October 13-14
Variable Insurance Products Compliance Seminar
Washington, DC
A compliance seminar emphasizing advertising and distribution of variable annuity and variable life insurance.
Contact: Carolyn Thrower
(202) 728-6977

October 21-22
CRD Conference
Rockville, Maryland
An educational program addressing key registration issues including Special Registration Review (SRR), Firm Access Query (FAQS), the 1993 renewal process, CRD redesign, and NASD quality and service teams.
Contact: Richard Sheridan
(301) 590-6523
Genevieve Fedorowicz
(301) 590-6929

Look for program details and registration information in late August.

West Virginia, Wyoming Increase Registration, Re-Registration, and Renewal Fees

Effective July 1, 1993, West Virginia and Wyoming increased their agent registration, re-registration, and renewal fees as well as broker/dealer registration and renewal fees as follows:

West Virginia: Agent registration, re-registration, and renewal fee to $55. Broker/dealer registration and renewal fee to $250.

Wyoming: Agent registration, re-registration, and renewal fee to $35. Broker/dealer registration and renewal fee to $200.

If you have any questions regarding these changes, please call the NASD® Member Services Phone Center at (301) 590-6500.

SPECIAL NASD NOTICE TO MEMBERS 93-49

Solicitation of Member Comment on Board Action to Eliminate the Disclosure Safe Harbor for Customer Limit Orders; **Comment Period Expires August 31, 1993**

Suggested Routing

- ■ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ■ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ■ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

Executive Summary

As part of its ongoing efforts to ensure investor protection and enhance market quality, the NASD® Board of Governors, at its July 16, 1993 meeting, approved issuance of a *Notice to Members* soliciting comment on its action to eliminate a "safe harbor" for those members that may trade ahead of customer limit orders. The safe harbor is available today to members that disclose to their customers that the firm may accept a limit order and then trade ahead of that customer's limit order in the firm's market-making capacity. The NASD is soliciting comment on specific issues that follow the discussion below, as well as any other concerns this action raises for members or interested parties. Comments received on or before August 31, 1993, will be considered before filing this Interpretation with the SEC. It is anticipated that the SEC will also publish this Interpretation for comment before acting on it. SEC approval of this Interpretation is required before it can become effective.

Background

The issue of limit-order protection in the Nasdaq® market was highlighted in 1985 when a customer alleged that a member firm had accepted his limit order, failed to execute it, and failed to discharge its fiduciary duties by trading ahead of the customer's order without notifying the customer that it was doing so. In the *Manning* decision, the NASD found and the SEC affirmed[1] that on accepting a customer's limit order, a member undertakes a fiduciary duty and cannot trade for its own account at prices more favorable than the customer's limit order unless the member provides clear disclosure and the customer understands the priorities that will govern the order.

Following the SEC decision and after input from a number of member firms, the Board authorized a *Notice to Members* that proposed a "safe harbor" disclosure approach for those members who wished to avail themselves of it.[2] The language set out in that proposal put customers on notice that the firm accepting a limit order would execute that order only when the inside bid or offer on Nasdaq reached the limit price and that the member might, in its market-making capacity, trade ahead of that order. After the language was approved, the NASD filed a proposed rule with the SEC.

The rule language has been pending action by the SEC since 1990, but some members have used similar disclosure notices in reliance on the exception identified by the NASD and the SEC in the *Manning* decision. The SEC has recently indicated that it views this issue to be related to topics under consideration in the *Market 2000* study.

On July 16, 1993, the NASD Board of Governors reviewed the background of the *Manning* safe harbor and voted to replace it with an Interpretation of Article III, Section 1 of the Rules of Fair Practice that would eliminate the "safe harbor" disclosure approach and effectively prohibit a member firm from trading ahead of a customer's limit order. In recommending this action to the Board, the Trading Committee indicated its belief that the proposed interpretation reflected the manner in which most integrated retail firms handle

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[1] *In the Matter of E.F. Hutton & Co.*, Release No. 34-25887 (July 6, 1988).

[2] *Notice to Members 90-37* (June 1990).

their customer limit orders. Because of the significance of this Interpretation and the concerns expressed to Board members and the staff by certain members of the trading community, the Board voted unanimously to solicit member comment on its action.

The Board particularly wishes to receive comment on how the elimination of the safe harbor and adoption of rules prohibiting trading ahead of customer limit orders will impact the operation of member firms and the treatment of investors' orders. Further, the Board is sensitive to avoiding unintended effects or unacceptable consequences of any new requirements on member firms. Accordingly, the Board solicits comments on the following points, as well as any other concerns that this action raises for members or interested parties:

• As noted above, elimination of the safe harbor would not appear to have a significant impact on the operation of integrated retail firms dealing with their own customer limit orders because the NASD understands that these firms do not trade ahead of their customer limit orders. Accordingly, members should address whether this perception is correct.

• The language of the interpretation does not differentiate between integrated retail firms dealing with their own customer limit orders and market makers who receive orders from other NASD member firms (i.e., member-to-member transactions). Members should comment on whether this consistent treatment is appropriate.

• Some members of the trading community have expressed concern regarding the impact of the action on market liquidity. In this connection, some have noted that application of the trading-ahead prohibition could significantly increase the risks of market makers' handling institutional orders. Members are requested to comment on any adverse impact on market liquidity that may result from the Board action. Members should also comment on whether any such impact on market liquidity outweighs the benefits to public investors provided by more complete limit-order protection.

Request for Comments

The Board is soliciting comments from members and interested parties so that the ramifications of the Board action may be thoroughly reviewed. Comments must be received no later than August 31, 1993, and addressed to Stephen D. Hickman, Secretary, NASD, 1735 K Street, NW, Washington DC 20006-1500. Questions regarding this Notice should be directed to Beth E. Weimer, Associate General Counsel, at (202) 728-6998.

Text of Proposed Interpretation To Article III, Section 1 of the Rules of Fair Practice

(**Note:** New language is underlined).

<u>A member firm that accepts and holds an unexecuted customer limit order in a Nasdaq 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, under the terms and conditions by which the order was accepted by the firm, without filling that customer's limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, Article III, Section 1 of the Rules of Fair Practice. Nothing in this rule, however, compels market makers to accept limit orders from their customers or from other broker/dealers, nor does the rule curtail a market maker's ability to place terms and conditions upon the pricing or acceptance of such limit orders.</u>

NASD Notice to Members 93-50

Mail Vote — Proposed New Section to the Rules of Fair Practice Relating to the Respective Obligations And Supervisory Responsibilities of Introducing and Clearing Firms; **Last Voting Date: September 27, 1993**

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The NASD invites members to vote on a proposed new section to the Rules of Fair Practice that would require members entering into clearing or carrying agreements to specify the obligations and supervisory responsibilities of both the introducing and clearing firm. The text of the proposed rule follows this Notice.

Background and Description of Proposal

The NASD is proposing to amend the Rules of Fair Practice to require that all clearing or carrying agreements entered into by a member specify the respective functions and responsibilities of each party to the agreement. The proposed rule clarifies the obligations and supervisory responsibilities of clearing and introducing firms. The Board of Governors believes it is important for the NASD to adopt a standard for such agreements that is similar to New York Stock Exchange (NYSE) Rule 382.

Further, when the Securities and Exchange Commission (SEC) considered the NYSE's Rule 382, the NASD commented to the SEC that permitting certain functions to be allocated to the introducing firm may result in compliance failures and violations resulting from the inability of the introducing member to perform those functions adequately. The NASD urged that firms should not be permitted to avoid obligations or responsibilities that would otherwise be theirs under the securities laws. In approving NYSE Rule 382, the SEC recognized the NASD's concerns and stated "no contractual arrangement for the allocation of functions between an introducing and carrying organization can operate to relieve either organization from their respective responsibilities under federal securities laws and applicable SRO [self-regulatory organzation] rules." The Board believes that the rule proposed herein reflects the principles previously asserted by the NASD and noted by the SEC.

Subsection (a) of the rule as originally proposed for member comment required that all clearing or carrying agreements entered into by any member specify, at a minimum, the respective functions and responsibilities of the parties to the agreement with regard to opening and approving customer accounts, extending credit, keeping books and records, receipt and delivery of funds and securities, safeguarding funds and securities, preparing confirmations and statements, and accepting orders and executing transactions.

Subsection (a) of the rule as currently proposed retains these seven requirements and adds two new ones. Proposed Subsection (a)(8) requires the agreement to address whether, for purposes of the Securities Investor Protection Act and the financial responsibility rules adopted under the Securities Exchange Act of 1934, customers are customers of the clearing member. If an introducing member intends to qualify for lower net capital, then the clearing or carrying agreement must clearly state that the customers are customers of the clearing member. Absent such a provision, the SEC net capital rule will treat the introducing member as a firm in possession of customer funds or securities subject to the higher net capital requirements of such a designation. Proposed Subsection (a)(9) requires the agreement to address the customer notification requirement of Subsection (d) of the proposed rule,

discussed below. Finally, Subsection (a) does not apply to the content of the agreement if either party is also subject to a comparable rule of a national securities exchange.

Subsections (b) and (c) impose *filing* requirements for new agreements or amendments to agreements. Subsection (b) requires any clearing member designated to the NASD for compliance oversight to file with the NASD for review and approval any new clearing or carrying agreement entered into with an introducing member and any amended clearing or carrying agreement that revises any item enumerated in Subsections (a)(1) through (a)(9).

Subsection (c) requires any introducing member designated to the NASD for compliance oversight to file with the introducing member's local NASD district office for *review only* any new clearing or carrying agreement entered into with a clearing member and any amended clearing or carrying agreement, entered into with a clearing member designated to another self-regulatory organization (SRO) for oversight, that revises any item enumerated in Subsections (a)(1) through (a)(9). Unlike agreements for approval, agreements submitted for review are effective when executed.

Subsection (d) requires members to notify each customer, whose account is introduced on a fully disclosed basis, of the existence of the clearing agreement when the account is opened.

Member Comments

The NASD published the proposed rule change for comment in *Notice to Members 92-32* (December 1991). In response to the comments received, the Board amended the original proposal.

Subsection (d) of the rule change as originally proposed for member comment required more specific disclosure than its analogous subsection in NYSE Rule 382(c). The Board modified Subsection (d) to make its meaning consistent with the text of NYSE Rule 382(c) to respond to commenters who argued that the disparity in disclosure requirements could lead to different disclosure standards and practices among SROs.

Other commenters argued that the proposed rule's informational and filing requirements would create necessarily duplicative filing requirements and add administrative and compliance burdens to member firms. The Board recognized the burden and amended the rule to provide that only new clearing agreements would have to be filed with the NASD by both the introducing and clearing member if the clearing member were not designated to another SRO for oversight. However, if the clearing member is designated to another SRO for oversight, an amended agreement submitted by an introducing member to the NASD will have already been submitted by the clearing firm for review and approval by the SRO, thus obviating the need for the clearing firm to submit the same agreement to the NASD. In addition, an amended agreement that does not change any of the enumerated functions in Subsection (a) of the proposed rule need not be filed. Finally, the filing by the introducing member is a submission for review only and does not require approval by the NASD before becoming effective.

Request for Vote

The Board believes that it is appropriate to add a new rule of fair practice that requires members entering into clearing or carrying agreements to specify the obligations and supervisory responsibilities of both the introducing and clearing firm. In addition to creating consistency and uniformity in the regulation of clearing arrangements by all SROs on an industry-wide basis, the proposal would reduce customer confusion regarding the identity of the responsible party when questions or concerns arise. The Board considers the proposed provision necessary and appropriate and recommends that members vote their approval.

The text of the proposed new rule that requires member vote is below. Please mark the attached ballot according to your convictions and mail it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be postmarked by **no later than September 27, 1993**. If approved by the members, the amendment will not be effective until it is filed with and approved by the SEC.

Questions regarding this Notice should be directed to Elliott R. Curzon, Senior Attorney, (202) 728-8451, and Robert J. Smith, Attorney, (202) 728-8176, at the Office of General Counsel.

Text of Proposed Rule

(**Note:** New language is underlined.)

Clearing Agreements

<u>(a) All clearing or carrying agreements entered into by a member,</u>

except where any party to the agreement is also subject to a comparable rule of a national securities exchange, shall specify the respective functions and responsibilities of each party to the agreement and shall, at a minimum, specify the responsibility of each party with respect to each of the following matters:

(1) opening, approving and monitoring customer accounts;

(2) extension of credit;

(3) maintenance of books and records;

(4) receipt and delivery of funds and securities;

(5) safeguarding of funds and securities;

(6) confirmations and statements;

(7) acceptance of orders and execution of transactions;

(8) whether, for purposes of the Securities and Exchange Commission's financial responsibility rules adopted under the Securities Exchange Act of 1934, as amended, and the Securities Investor Protection Act, as amended, and regulations adopted thereunder, customers are customers of the clearing member; and

(9) the requirement to provide customer notification under Subsection (d) of this Section.

(b) Whenever a clearing member designated to the NASD for oversight pursuant to Section 17 of the Securities Exchange Act of 1934, as amended, or a rule of the Securities and Exchange Commission adopted thereunder, amends any of its clearing or carrying agreements with respect to any item enumerated in Subsections (a)(1) through (a)(9) of this Section, or enters into a new clearing or carrying agreement with an introducing member, the clearing member shall submit the agreement to the NASD for review and approval.

(c) Whenever an introducing member designated to the NASD for oversight pursuant to Section 17 of the Securities Exchange Act of 1934, as amended, or a rule of the Securities and Exchange Commission adopted thereunder, amends its clearing or carrying agreement with a clearing member designated to another self-regulatory organization for oversight with respect to any item enumerated in Subsections (a)(1) through (a)(9) of this Section, or enters into a new clearing agreement with another clearing member, the introducing member shall submit the agreement to its local NASD district office for review.

(d) Each customer whose account is introduced on a fully disclosed basis shall be notified in writing upon the opening of his account of the existence of the clearing or carrying agreement.

NASD NOTICE TO MEMBERS 93-51

Mail Vote — Proposed Amendment to the Corporate Financing Rule Relating to Fairness and Reasonableness of Anti-Dilution Provisions in Underwriters' Warrants, Options, and Convertible Securities; **Last Voting Date: September 27, 1993**

Suggested Routing

- ■ Senior Management
- □ Advertising
- ■ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- ■ Syndicate
- □ Systems
- □ Trading
- ■ Training

Executive Summary

The NASD® invites members to vote on a proposed amendment to the Corporate Financing Rule under Article III, Section 44 of the Rules of Fair Practice that is intended to prohibit certain anti-dilution provisions of options, warrants, or convertible securities received as underwriting compensation. The amendment would provide that underwriters and related persons may not receive options, warrants, or convertible securities as compensation if the provisions of such securities include anti-dilution provisions with disproportionate rights, privileges, and economic benefits that are not provided to investors purchasing the issuer's securities in the public offering. The amendment would also prohibit the receipt by underwriters and related persons of options, warrants, or convertible securities containing provisions for the receipt or accrual of cash dividends before exercise or conversion of the securities.

Background

The NASD Corporate Financing Rule (Rule) contained in Article III, Section 44 of the Rules of Fair Practice prohibits an NASD member or associated person from participating in any manner in any public offering of securities in which the underwriting or other terms or arrangements in connection with or related to the distribution of the securities are unfair or unreasonable. Subsection (c)(6)(B) of the Rule codifies the presumption that certain arrangements are unfair and unreasonable and Subsection (c)(6)(B)(vi) sets forth unreasonable arrangements applicable to options, warrants, or convertible securities received by the underwriter and related persons as underwriting compensation.

This latter Subsection provides that terms and arrangements contained in warrants, options, or convertible securities received as underwriting compensation are unfair and unreasonable if the security: (1) has a duration of more than five years; (2) is exercisable or convertible below the public offering price or the market price at the time of receipt; (3) is not in compliance with Subsection (c)(5)(A), i.e., is different from the security offered to the public or without a bona fide independent market; (4) has more than one demand registration right at the issuer's expense; (5) has a demand registration right lasting more than five years from the effective date of the offering; (6) has a piggyback registration right lasting more than seven years from the effective date of the offering; or (7) is convertible or exercisable, or otherwise is on terms more favorable than the terms of the securities being offered to the public.

This last Subsection (7) is referred to as the "General Fairness Standard" of Subsection (c)(6)(B) to the Rule. In addition, Subsection (c)(6)(B)(ix) of the Rule prohibits the receipt of securities as underwriting compensation in an amount in excess of 10 percent of the securities sold to the public (Stock Numerical Limitation Rule).

The NASD's Corporate Finance Committee (Committee) reviewed the anti-dilution provisions contained in the contracts of underwriters and related persons for warrants received as underwriting compensation. The Committee found that certain of such warrants have included anti-dilution arrangements that appear to be unfair and unreasonable under the above General Fairness Standard by providing disproportionate benefits to the

underwriter and related persons that are not provided to investors in the public offering.

As a result of the Committee's review, the NASD has identified certain arrangements considered unfair and unreasonable with respect to warrants (as well as options and convertible securities) received by underwriters and related persons and has determined to amend the Corporate Financing Rule to prohibit the receipt of such options, warrants, or convertible securities by underwriters and related persons when such securities contain disproportionate anti-dilution provisions that are not also provided to the investors in the public offering.

In its review, the Committee also identified another arrangement related to these warrants that provided for the receipt or accrual of cash dividends before the member exercised its warrants. The NASD believes that such an arrangement is unfair and unreasonable under the Rule because it provides the underwriter and related person with economic rights, privileges, and benefits that are more favorable than the benefits received by investors in the public offering. The NASD has determined to amend the Rule to prohibit underwriters and related persons from receiving warrants, as well as options and convertible securities, that contain such a provision.

Description of the Amendment

Prohibition of Effecting Disproportionate Benefits

The proposal defines as unfair and unreasonable receipt by the underwriter and related persons of any underwriting compensation consisting of any option, warrant, or convertible security containing anti-dilution provisions that provide the underwriter and related persons with disproportionate rights, privileges, and economic benefits that are not provided to the purchasers of the securities offered to the public.

The NASD recognizes that contracts between the company and investors covering the issuance of options, warrants, and convertible securities may contain certain anti-dilution provisions designed to protect shareholders from events that dilute their economic interest in the company. The NASD has found that underwriters and related persons sometimes negotiate to receive protection from dilution in their warrant contracts through certain rights that provide them with a larger number of shares on exercise or lower exercise price than that available to shareholders of the offering when events occur that do not affect all shareholders, such as additional issuances by the company. The Committee review found different variations of how adjustments to the exercise price and number of shares occur in response to such issuances of securities. Such variations included formulas that "weight" the effect of changes in the company's capitalization and also formulas that "rachet" the adjustment without regard to the actual dilative affect of the new issuance of securities.

The NASD believes all variations of such disproportionate anti-dilution provision are unfair and unreasonable when not also provided to investors in the public offering. The NASD also notes that the receipt of such disproportionate benefits by underwriters and related persons, when such benefits are not received by other purchasers of the public securities, would result in the underwriter and related persons receiving securities as underwriting compensation in excess of 10 percent of the securities sold to the public in the offering in violation of the Stock Numerical Limitation Rule contained in Subsection (c)(6)(B)(ix) of the Rule.

In comparison, the NASD has identified certain anti-dilution provisions as not unfair and unreasonable under the Rule. These provisions contain proportionate benefits that provide anti-dilution adjustments to the exercise price and number of securities in response to events affecting all shareholders, such as, among others, stock dividends, combinations, reclassification, and recapitalizations. These provisions entitle the underwriter to participate in the corporate event as if it was a shareholder of the underlying security before the event. The benefits received under these provisions, therefore, only result from treating the warrants, options, and convertible securities as if exercised or converted, to determine any adjustments. In this case, regulatory issues are not raised under the Stock Numerical Limitation Rule because the increase in the number of securities issued to the underwriter and related persons in exercise of the warrant maintains the 10 percent relationship to the amount of securities sold in the offering to public investors.

The Rule recognizes situations where the options, warrants, and convertible securities to be received by the underwriter and related persons are different from the securities being sold in the offering. Subsection (c)(5)(A) of the Rule provides that no underwriter and related person may receive a security or a warrant for a security as compensation in the distribution of a public offering that differs from the security to be offered to the

public unless the security received as compensation has a bona fide independent market. To address circumstances where the security received by the underwriter and related persons is different from the security to be offered to the public, the proposed rule change provides that the rights, privileges, and economic benefits received by underwriters and related persons may be compared to the rights, privileges, and economic benefits of the public shareholders of the issuer whose shares have a bona fide independent market, in compliance with Subsection (c)(5)(A) of the Rule.

Prohibition Affecting Cash Dividends

The amendment would prohibit as unfair and unreasonable receipt, by the underwriter and related persons, of underwriting compensation consisting of any option, warrant, or convertible security that provides for the receipt or accrual of cash dividends before exercise or conversion of the security.

Member Comment

The proposed amendment, published for comment in *Notice to Members 93-10* in February 1993, generated six comment letters. Of these, one favored the amendment and five were generally opposed. Although discussed in the text of the Notice, the proposed rule language did not include language prohibiting arrangements that provide for the receipt or accrual of cash dividends before exercise or conversion.

Commenters argued that the higher level of risk experienced by underwriters compared to public investors justifies the receipt by the underwriter and related persons of warrants containing disproportionate anti-dilution provisions. These commenters believe that the amendment would significantly reduce the ability of underwriters to protect the value of warrants received as underwriting compensation, making it a riskier form of compensation. They believe that underwriters should not be in the same position as their customers after a public offering because, unlike the public purchasers in an offering, an underwriter must comply with Subsection (c)(7)(A) of the Rule subjecting warrants, options, and convertible securities acquired as compensation to a one-year holding period on resale, hypothecation, or assignment.

However, the NASD does not believe the risk taken by underwriters and related persons justifies receipt of disproportionate anti-dilution benefits not received by purchasers of securities of the public offering. In the NASD's view, the exercise of such disproportionate anti-dilution provisions not provided to public investors may effectively allow the underwriter to obtain more than 10 percent of the offering in circumvention of the Rule's Stock Numerical Limitation Rule. The NASD also believes that the one-year holding requirement does not place the underwriters at an undue disadvantage to their customers. One of the principle purposes of the one-year prohibition is to foster a commonality of interest among the issuer, underwriters, and the investing public by encouraging the underwriter to provide post-distribution support and advice to develop the market for the issuer's shares and to allow the public market to develop for one year before the member sells securities received as underwriting compensation.

One commenter supported the prohibition against disproportionate anti-dilution provisions that adjust the exercise price or number of securities by using a "rachet-type" formula, but opposed prohibiting weighted formulas that reflect the changes in the company's capitalization. The NASD believes provisions using weighted formulas allow an underwriter to maintain a level percentage in the total capitalization of the issuer, but, if not provided to other investors of the public offering, will result in the underwriter receiving a disproportionate benefit relative to investors in the offering. This action can result in the underwriter receiving more than 10 percent of such offering contrary to the intent of the Stock Numerical Limitation Rule.

Commenters also stated that underwriter warrants contain "disproportionate" anti-dilution provisions to discourage the company from subsequently issuing "cheap stock" to insiders. They believe that, without the distinctive effect of the anti-dilution provisions contained in the warrants, a company would be free to issue "cheap stock" without restraint. The NASD believes the terms of the underwriter's options, warrants, or convertible securities should not be designed as a vehicle to discourage additional new issuances by the company. Such provisions, based on the commenters' argument, could make it prohibitive for an issuer to seek legitimate private or public financing and would inhibit the ability of the issuer to attract quality management through the issuance of stock option plans.

One commenter stated that the proposed amendment was vague, overbroad, and would vest undue discretion to the NASD staff in determining where anti-dilution provisions are considered disproportionate. The commenter also expressed concern that the proposed amendment would result

in unwritten and unpublished policies causing hardships in terms of time and expense required in the review of public offerings by the NASD staff. The NASD believes the proposed rule language of the amendment and the explanation contained in the Notice (and to be included in the rule filing submitted to the SEC) sufficiently identifies the terms and arrangements proposed to be prohibited as unfair and unreasonable provisions in options, warrants, and convertible securities received as compensation by underwriters and related persons. Thus, the adoption of the amendment cannot be described as an "unwritten policy." As such, the proposed amendment would vest no more discretion with NASD staff than is necessary and appropriate for the staff to identify arrangements considered unfair and unreasonable. The NASD does not believe that the proposed amendment would result in delays and additional expense in the review of public offerings by the NASD staff.

One commenter argued that large underwriters generally do not receive underwriter warrants as part of their compensation because the gross proceeds of their underwritten offerings are substantially larger than the offerings of smaller underwriters and the risk is smaller due to the nature of the company and size of underwriter. The commenter, therefore, argues that the proposed amendment would discriminate against small underwriters and discourage them from participating in offerings of securities of small, early-stage companies.

The NASD does not believe the amendment discriminates against small underwriters and small companies. The NASD agrees that there are risks involved in small firm-commitment underwritings, but notes that this risk is one of the reasons why the NASD's underwriting compensation guidelines permit a greater percentage of the gross proceeds as underwriting compensation for smaller firm-commitment offerings. The fact that the NASD has only recently determined that such unfair arrangements are present in underwriters' warrants should not inhibit the NASD from amending its rules to specifically prohibit such unfair arrangements.

Two commenters argued that the amendment should be withdrawn since an underwriter's warrant is assigned a value by the NASD Corporate Financing Department and is taken in lieu of other cash compensation. Further, because this "investment" is made by giving up present compensation for potential future compensation, it should be protected through disproportionate anti-dilution arrangements. In response, the NASD believes that an underwriter's warrant, option, or convertible security, regardless of the value assigned to it in the offering review process, is adequately protected by proportionate anti-dilution rights that will continue to be permitted under the Rule. Moreover, regardless of the valuation assigned to the warrant, the NASD has traditionally prohibited a number of warrant arrangements as unfair and unreasonable.

Notice to Members 93-10 expressed the Committee's determination regarding the unfairness and unreasonableness of allowing underwriter warrants that contain provisions that provide for the receipt or accrual of cash dividends during the term of the warrant, but did not include proposed rule language covering such situations. No comments were received regarding the Committee's determination on this issue, and the text of the amendment has been amended to clarify the prohibition of such an arrangement for options, warrants, or convertible securities.

Request for Vote

The NASD Board of Governors believes that it is appropriate to amend the Rule to prohibit disproportionate anti-dilution provisions and the receipt or accrual of cash dividends by the underwriter and related persons for options, warrants, and convertible securities received as underwriting compensation and recommends that members vote their approval. Before becoming effective, the amendment must be approved by the NASD membership and thereafter by the Securities and Exchange Commission.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to the Corporate Trust Company. Ballots must be received postmarked **no later than September 27, 1993.**

Questions concerning this Notice may be directed to Paul M. Mathews, Supervisor, NASD Corporate Financing Department, at (202) 728-8258.

Text of Proposed Amendment to Article III, Section 44 of the Rules of Fair Practice

(**Note:** Proposed language is underlined.)

* * * * *

(c) Underwriting Compensation and Arrangements

(c)(1)-(c)(6)(B)(vi)(6) — no change

(7) <u>has anti-dilution terms designed</u>

to provide the underwriter and related persons with disproportionate rights, privileges and economic benefits which are not provided to the purchasers of the securities offered to the public (or the public shareholders, if in compliance with subsection (c)(5)(A) above);

(8) has anti-dilution terms designed to provide for the receipt or accrual of cash dividends prior to the exercise or conversion of the security.

Subsection (c)(6)(B)(vi)(7) of the Rule is renumbered Subsection (c)(6)(B)(vi)(9).

NASD NOTICE TO MEMBERS 93-52

Mail Vote — Proposed Amendment Exempting Money Market Mutual Funds From Disclosure Requirements; **Last Voting Date: September 27, 1993**

Suggested Routing

- ■ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ☐ Legal & Compliance
- ☐ Municipal
- ■ Mutual Fund
- ☐ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ■ Syndicate
- ☐ Systems
- ☐ Trading
- ☐ Training

Executive Summary

The NASD invites members to vote on a proposed amendment to Article III, Section 26(d)(4) of the Rules of Fair Practice to exempt money market mutual funds from the required disclosure under that Subsection that "long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charge permitted by [the rules]." The last voting date is September 27, 1993. The text of the proposed amendment follows this Notice.

Background

On July 7, 1993, new rules governing investment company sales charges took effect under Article III, Section 26(d) of the Rules of Fair Practice. The NASD has received several applications for exemption from Subsection 26(d)(4), which requires that the prospectus for an investment company with an asset-based sales charge must disclose that "long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by this section." The applications noted that the rule language is specific and requires the disclosure, even if the statement may not be true for a particular mutual fund.

The applicants pointed out that in the case of a money market mutual fund, there is a high probability that the statement will be inaccurate because such funds generally have very low asset-based sales charges and an investor would have to be a shareholder for an extremely long time before the disclosure would be true. According to one applicant, a shareholder of its fund would have to remain in the fund for more than 55 years before exceeding the maximum front-end charge. The applicants suggest that since money market mutual funds are traditionally short-term investments or cash management vehicles, it is unlikely that investors will stay in such funds for lengthy periods. As a result, they believe that the disclosure may be misleading, or at least confusing, to investors in money market mutual funds.

Request for Vote

The Board of Governors agrees with the arguments of the applicants and, accordingly, has determined to recommend amending Subsection 26(d)(4) to exempt money market mutual funds from the disclosure requirement. The Board does not believe that requiring funds to include disclosure statements in such circumstances serves any identifiable purpose nor does it advance any recognizable regulatory interest.

The Board considers the proposed amendment necessary and appropriate and recommends that members vote their approval. The text of the proposed new rule that requires member vote is below. Please mark the attached ballot according to your convictions and mail it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be postmarked by no later than September 27, 1993. The amendment would not take effect until it is filed with and approved by the SEC.

Questions regarding this Notice may be directed to R. Clark Hooper, Vice President, Investment Companies Regulation Department, (202) 728-8330, or Elliott R. Curzon, Senior Attorney, Office of General Counsel, (202) 728-8451.

Text of Proposed Amendment to Article III, Section 26 of the Rules of Fair Practice

(**Note:** New text is underlined.)

Investment Companies

Sec. 26

* * *

(d) (4) No member or person associated with a member shall offer or sell the securities of an investment company with an asset-based sales charge unless its prospectus discloses that long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by this section. Such disclosure shall be adjacent to the fee table in the front section of a prospectus. <u>This subsection shall not apply to money market mutual funds.</u>

NASD Notice to Members 93-53

SEC Approves Amendments Relating to Close Outs of Short Sales and Bona Fide Fully Hedged or Arbitraged Positions

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- ■ Trading
- □ Training

Executive Summary

On July 14, 1993, the Securities and Exchange Commission (SEC) approved a new Section 71 of the Uniform Practice Code (UPC) requiring members to close out short sales in Nasdaq® securities that meet a certain clearing short-position threshold. In addition, the SEC approved amendments to the *Interpretation of the Board of Governors relating to the Prompt Receipt and Delivery of Securities* (Interpretation) setting forth examples of fully hedged and arbitraged positions relating to exemptions from the various short-sale requirements of the NASD® rules.

The amendments take effect October 12, 1993. The text of the amendments follows this Notice.

Background

In July 1986, the NASD issued a report detailing a study of short-sale practices in Nasdaq securities (Pollack study). As a result of recommendations contained in the Pollack study, the NASD took a number of regulatory initiatives regarding short selling. The NASD now requires members to: (1) mark all sale transactions either "long" or "short"; (2) make an affirmative determination that they will receive delivery of a security from a customer or that they can borrow a security for a customer before accepting a short sale from a customer; (3) make an affirmative determination that they can borrow the security before effecting a short sale for their own account (certain transactions in corporate debt securities, bona fide market-making activities, and fully hedged or arbitraged positions are exempt); (4) buy-in for cash or guaranteed delivery Nasdaq securities, if the buyer is not an NASD member, on failure of a clearing corporation to effect delivery pursuant to a buy-in notice; and (5) report, as of the 15th of each month, aggregate short positions in all customer and proprietary accounts in securities listed on The Nasdaq Stock Market℠. In addition, the NASD has proposed a rule change to prohibit short sales of Nasdaq National Market® securities at or below the current inside bid when that bid is lower than the previous inside bid.

In addition to these changes, the Pollack study recommended that the NASD address the fail-to-deliver/fail-to-receive problem created by naked short selling.[1] The Pollack study indicated that the lack of an automatic mechanism for preventing the build-up of short positions at clearing corporations carried the potential for serious problems, especially in times of market stress. As a result of Pollock study recommendations and member comment, the NASD proposed that members close out short sales in certain securities.

Description of the Rule Change

New Section 71 of the UPC requires the short seller's broker/dealer to close out a short sale of specific securities 10 days after the normal settlement date if delivery of securities has not occurred and the transaction is not exempt. Securities subject to the close-out requirement are those with an aggregate "clearing" short position of 10,000 shares or more that equals or exceeds one half of one percent of the total shares outstanding. The NASD will identify these securities daily based on data

[1]In fail-to-deliver or fail-to-receive transactions the normal clearance and settlement process is interrupted by a failure to either receive or deliver the security in question.

from the National Securities Clearing Corporation (NSCC) and will compile a “restricted list.”[2] Any subsequent short-sale transaction in a security on the list that is not completed by delivery of shares within the prescribed time frames will be subject to mandatory close-out if a “fail-to-deliver” situation exists 10 days after normal settlement date.

The rule applies to customer and proprietary short sales, but exempts “bona fide” market-making activities and short sales that result in a “bona fide” fully hedged or arbitraged position.[3] For example, the close-out rule applies if a broker/dealer sells a restricted security short from its proprietary account to another broker/dealer and fails to deliver the security within 10 days of normal settlement date. The rule also applies if the firm makes the same transaction for a customer.[4] However, if the short sale is part of a bona fide market-making transaction or if the sale of a restricted security results in a fully hedged or fully arbitraged position, it is exempt from the mandatory close-out requirement.

In response to certain comments submitted to the SEC about persistent open clearing positions, the NASD noted that short selling isn’t the only reason certain securities have unsettled trades at clearing corporations for lengthy periods. Other reasons include a member firm’s segregation requirements under SEC Rule l5c3-3, transfer delays, or some characteristic of the security that prevents delivery.[5] The NASD concluded that nearly all stocks that develop large, persistent fails-to-deliver conditions at clearing corporations would be covered by the close-out rule because the rule focuses on persistent rather than temporary fail-to-deliver situations.

In response to concerns regarding possible evasion of the rule by selling assets used to hedge an exempted short position, the NASD found that hedged positions accounted for less than 2 percent of the total shares of reported short interest in the stocks covered by its analysis. The NASD Market Surveillance Department will monitor compliance with the rule, and previous violations of short-sale rules have been subject to disciplinary action by the Market Surveillance Committee. The close-out rule will add substantially to the ability of the NASD to eliminate naked short selling as a regulatory problem and will address the few cases where unsettled trades may create regulatory or market concern.

In response to comments concerning the restrictive warrant hedging exemptions, the NASD believes that easing the rule would create a substantial loophole. Transactions envisioned by certain commenters would enable short selling without the need to close out transactions under the rule. A warrant price near zero would permit virtually unlimited short selling, with no delivery requirement. While normally the number of shares necessary to establish a hedge could be determined by calculating a hedge ratio, only 80-90 securities will be subject to the rule on a given date and those that are subject to the rule are for the most part thinly traded, making calculation of a hedge ratio inefficient. In addition, basing the exemption on a hedge ratio would severely complicate surveillance of compliance with the rule as well as increase compliance and surveillance costs. The rule attempts to balance the need to require delivery of a certain class of securities with the desirable warrant-hedging function.

Accordingly, Section 71 provides that short positions offset by long positions in corresponding convertible debentures, options, or warrants with a “call” feature are “bona fide fully hedged,” provided the corresponding position is “in the money” (i.e., the strike/conversion price is below the current mar-

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[2]Nasdaq Level 2 and Level 3 Workstations will see a short-sale restriction indicator (“UPC 71” will appear below the name of the company) on their bid/ask screens and a list of restricted securities will be available on line. Further, the NASD will make each day's list available on request via FAX or mail to any person calling the NASD Market Operations Department at (212) 858-4340 until August 20, 1993; after August 20, 1993, call (203) 375-9609.

[3]The new rules include guidelines for the use of the exemption from the short-sale requirements for bona fide fully hedged and arbitraged transactions provided in new Section 71 and in Section 2(b) of the Interpretation. The guidelines are for illustrative purposes and are not intended to limit the NASD's ability to determine the scope of the terms “bona fide fully hedged” and “bona fide fully arbitraged.”

[4]A member firm that enters a short-sale transaction in a resticted security for a customer is obliged to inform that cusotmer of the mandatory close-out requirement. Even if the security is subsequently dropped from the restricted list, the trade must be closed out. On the other hand, if the security is placed on the list after the trade is executed, close out would not be required.

[5]An analysis of the factors affecting fails-to-deliver to the NSCC and the fluctuations in such fails-to-deliver indicated that when fails-to-deliver develop in stocks at NSCC, the dominant reasons are high average daily volume and (inversely related) the amount of float in the security. The analysis further suggested that the existence of fails-to-deliver at NSCC confirms little or nothing about short sales, unless the fail-to-deliver condition is large and persistent.

ket value of the security) and exercisable or convertible within 90 days.[6] Section 71 also provides that short positions offset by warrants that are "out of the money" are exempt from the close-out procedures up to the value of the warrant.[7]

Conclusion

As mentioned in the Pollack study, the fail-to-deliver/fail-to-receive problem could cause serious difficulties in a lengthy bear market. Large, unsettled trades can disrupt market mechanisms. Public customers' reasonable expectations that their securities have been delivered should be met. Additionally, naked short selling can present substantial manipulative concerns. While naked short sellers must deposit margin with either their broker/dealer or with a clearing corporation, they enjoy greater leverage than if they had to close out their short positions within a reasonable time frame. The ability of naked short sellers to employ this leverage to effect "bear raids" supports the decision to impose additional discipline on naked short selling via a close-out requirement.

Thus, the rule change will assist in preventing manipulation of Nasdaq securities through excessive naked short selling. As originally recommended in the Pollack study, a buy-in or close-out requirement will add to the stability of the marketplace by assuring that securities are available to cover short positions, especially in times of volatility. Such a requirement also will help enhance the integrity of The Nasdaq Stock Market. In addition, the close-out rule may help to prevent short-selling abuses that could harm investors and the public interest.

Questions concerning this Notice may be directed to Dorothy L. Kennedy, Assistant Director, Nasdaq Operations, at (212) 858-4030 until August 20, 1993; after August 23, 1993, call (203) 375-9609.

Text of New Rule to the Uniform Practice Code

(**Note:** New language is underlined.)

Sec. 71. Mandatory Close-Out for Short Sales

A contract involving a short sale in Nasdaq securities described in subparagraph (a) below, for the account of a customer or for a member's own account, which has not resulted in delivery by the broker-dealer representing the seller within 10 business days after the normal settlement date, must be closed by the broker-dealer representing the seller by purchasing for cash or guaranteed delivery securities of like kind and quantity.

(a) This requirement shall apply to Nasdaq securities, as published by the Association, which have clearing short positions of 10,000 shares or more and that are equal to at least one-half (1/2) of one percent of the issue's total shares outstanding.

(b) This mandatory close-out requirement shall not apply to bona fide market making transactions and transactions that result in bona fide fully hedged or bona fide fully arbitraged positions.

Text of Amendment to Article III, Section 1 of the NASD Rules of Fair Practice Interpretation of the Board of Governors on Prompt Receipt and Delivery of Securities

(5) "Bona Fide Fully Hedged" and "Bona Fide Fully Arbitraged"

In determining the availability of the exemption provided in Section (2)(b) above and in Section 71 of the Uniform Practice Code from short sale requirements for "bona fide fully hedged" and "bona fide fully arbitraged" transactions, the following guidelines shall apply. These guidelines are for illustrative purposes and are not intended to limit the Association's ability to determine the proper scope of the terms "bona fide fully hedged" or "bona fide fully arbitraged" pursuant to this provision, on a case-by-case basis.

(a) Bona fide fully hedged

The following transactions shall be considered bona fide fully hedged:

1. Short a security and long a convertible debenture, preferred or other security which has a conversion price at or in the money and is convertible within ninety days into the short security.

Example: Long ABCD Company 9% convertible subordinated debentures due 1998. Each debenture is convertible into common at $27.90 per share of common equal to 35.842 shares of common per IM debenture.

• With the price of the ABCD at

[6] For example, as set forth in Section 71, a short position of EFGH (44 1/8) would be exempt if the investor also holds a corresponding call option with a strike price of 40 that is exercisable within 90 days.

[7] For example, as set forth in Section 71, a short position of 100 shares of IJKL (1 1/2) offset by 100 IJKL warrants (2 1/4 - 2 3/4), each exercisable into one share of IJKL at a price of 2, would receive a partial exemption up to 16 shares (25 divided by 1 1/2).

8 3/4 - 9 and a short position of 100 shares of ABCD the short position would not be exempt.

• If the price of ABCD was $28 with a short position of 100 shares, 35 shares would be exempt and the remaining 65 shares would not be exempt.

2. Short a security and long a call which has a strike price at or in the money and which is exercisable within 90 calendar days into the underlying short security.

Example: Long 1 call of EFGH (44 1/8) with a strike price of 40 expiring within 90 calendar days.

• With the circumstances as above 100 shares would be exempt.

• If the strike price was 50 a short position of 100 shares would not be exempt.

• With any strike price and the call expiring in more than 90 days any short of the common would not be exempt.

3. Short a security and long a position in warrants or rights which are exercisable within 90 days into the short security. To the extent that the long warrants or rights are "out of the money" then the short position shall be exempt up to the market value of the long warrants or rights.

Example: Long 100 warrants of IJKL (IJKLW: 2 1/4 - 2 3/4). Each warrant is exercisable into 1 share of common at $2. (IJKL: 4 - 4 1/2).

• With the circumstances as above a short position of 100 shares would be exempt.

• If the price of IJKL is $1.50 and the market value of long warrants is 1/4, a short position of 16 shares would be exempt.

(b) Bona fide fully arbitraged

The following transactions shall be considered bona fide fully arbitraged:

1. Long a security purchased in one market together with a short position from an offsetting sale of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in price in the two markets.

Example: Purchase 100 shares of EFGH on the London Stock Exchange and simultaneously effect a short sale of 100 shares of EFGH on Nasdaq.

• Under the above circumstances, the 100 share short position would be exempt.

2. Long a security which is without restriction other than the payment of money exchangeable or convertible within 90 calendar days of the purchase into a second security together with a short position from an off-setting sale of the second security at or about the same time for the purpose of taking advantage of a concurrent disparity in the prices of the two securities.

Example: Long 100 shares of MNOP (MNOP: 51 - 51 1/4) which is being acquired by ORST Corp. (ORST: 52 1/8 - 52 3/8) at the rate of 1.15 shares per MNOP share.

• If the exchange is to take place within 90 days then a short of 115 shares of ORST would be exempt from the mandatory buy-in. Also, if the exchange was to take place at a date later than 90 days, all short positions in the above example would be subject to the mandatory buy-in.

(c) The transaction date of the short sale shall govern when a fully hedged or fully arbitraged position exists.

NASD NOTICE TO MEMBERS 93-54

SEC Approves Quotation-Size Requirements for Market Makers in OTC Equity Securities

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [ ] Systems
- [x] Trading
- [ ] Training

Executive Summary

On July 1, 1993, the Securities and Exchange Commission (SEC) approved an amendment to Schedule H to the NASD By-Laws regarding quotation-size requirements for market makers in over-the-counter (OTC) equity securities. The rule change revises the minimum-size requirements applicable to market makers displaying quotations in the OTC Bulletin Board® (OTCBB) service or any comparable inter-dealer quotation system accommodating OTC equity securities. The new size requirements take effect September 8, 1993. The text of the amendment follows this Notice.

Description of Amendment

Until now, whenever an NASD member entered a proprietary bid/offer into the OTCBB for a domestic OTC equity security,[1] the firm was required to honor that bid or offer for at least one trading unit, typically 100 shares, regardless of the price of the shares quoted. This rule change replaces the one-trading-unit requirement with a tiered structure of minimum-size requirements based on the price level of the individual bid or offer.[2] Each registered market maker that publishes a firm bid or offer in a domestic OTC equity security will be required to honor its bid or offer for individual orders up to the size prescribed for the particular price range. These requirements will apply to members' quotes displayed in the OTCBB and any other inter-dealer quotation system that supports quotation updates in OTC equity securities on a real-time basis.[3]

For example, a market maker enters a quote of $.45 bid and offer $.55. The firm must honor its displayed bid for up to 5,000 shares and its displayed offer for up to 2,500 shares. If the same firm updates its quotation to reflect a bid of $.40 and an offer of $.50, a size requirement of 5,000 shares attaches to both sides of the market maker's quotation. As is the case today, OTCBB market makers will retain the option of entering an unpriced indication of interest or a one-sided quotation. The unpriced indication triggers no obligation per se to trade the subject security at a particular price or size specified by the new requirements.[4] However, a one-sided entry obligates the market maker to honor that bid (or offer) for the size prescribed by the new rule.

After the NASD completes the necessary system enhancements, the OTCBB will display size for quotations, and will have a default feature to ensure display of the

[1] For purposes of this rule, the term "OTC equity security" means any equity security not classified as a "designated security" for purposes of Parts XII or XIII of Schedule D to the NASD By-Laws. The term does not include restricted securities, as defined by Rule 144(a)(3) under the Securities Act of 1933, or any securities designated in The PORTAL℠ Market. The new size requirement will not apply to any foreign/ADR issue in which firm quotations are not permitted to be entered into the OTCBB.

[2] SEC Release No. 34-32570 (July 1, 1993); 58 FR 36725 (July 8, 1993).

[3] At present, no electronic quotation medium other than the OTCBB accommodates real-time quotation updates in OTC equity securities.

[4] Nevertheless, a market maker displaying an unpriced indication of interest has an obligation to supply on request to another broker/dealer a bid/offer that must be firm for at least one trading unit, which is typically 100 shares.

correct minimum size if a market maker neglects to enter that size when updating quotes.[5] Meanwhile, each market maker will be responsible for determining the minimum-size requirement applicable to its bid or offer and must honor the quote for the specified size.[6] The amendment takes effect September 8, 1993.

Questions regarding this Notice may be directed to Michael J. Kulczak, Associate General Counsel, at (202) 728-8811. To obtain interpretive guidance or report potential instances of non-compliance, members should contact NASD Market Surveillance at (301) 590-6080.

Text of New Section 5 to Schedule H to the NASD By-Laws

(**Note:** New text is underlined.)

Section 5 — Minimum Quotation Size Requirements For OTC Equity Securities

Every member firm that functions as a market maker in OTC Equity Securities by entering firm quotations into the OTC Bulletin Board service (OTCBB) (or any other inter-dealer quotation system that permits quotation updates on a real-time basis) must honor those quotations for the minimum size defined in the table below. In this regard, it is the market maker's responsibility to determine the minimum size requirement applicable to its firm bid and/or offer in each of its registered securities (excluding OTC Equity Securities for which the OTCBB will not accept firm quotations). Depending on the price level of the bid or offer, a different minimum size can apply to each side of the market being quoted by the member firm in a given security.

Price (Bid or Offer)	Minimum Quote Size
0.00 - 0.50*	5,000
.51 - 1.00	2,500
1.01 - 10.00	500
10.01 - 100.00	200
100.01 - 200.00	100
200.01 +	50

For purposes of this rule, the term "OTC Equity Security" means any equity security not classified as a "designated security" for purposes of Parts XII or XIII of Schedule D to the NASD By-Laws, or as an "eligible security," for purposes of Schedule G to the NASD By-Laws. The term does not include "restricted securities," as defined by Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL℠ Market.

*The OTCBB can accept bids/offers expressed in fractions as small as 1/256 or in decimals up to six places. In applying the price test for minimum quotation size, any increment beyond an upper limit in the right hand column will trigger application of the minimum quote size for the next tier. For example, a bid (or offer) of $.505 must be firm for a size of 2,500 shares.

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[5] The NASD anticipates the OTCBB will have size-display capability and the minimum-size default feature by mid-1994.

[6] A table setting forth the tiered minimum-size requirements will be reproduced in a newsframe accessible to OTCBB market makers on the workstations they use to enter and update their quotations.

NASD NOTICE TO MEMBERS 93-55

SEC Amends and Clarifies Penny Stock Rules

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- ■ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) has adopted amendments to certain rules under the Securities Exchange Act of 1934 (Act) that apply to transactions in low-priced securities traded in the over-the-counter market. Specifically, the SEC amended Rule 15c2-6, which makes it unlawful for a broker/dealer to sell or effect the purchase of a "designated security" with a customer in a non-exempt transaction, unless the broker/dealer has specifically approved the customer's account for transactions in designated securities and has received the customer's written agreement to the transaction. The amendments conform the definition of "designated security" in Rule 15c2-6 to the definition of "penny stock" in Rule 3a51-1. With certain exceptions, the exemptions under Rule 15g-1 replace the transactional exemptions under Rule 15c2-6. The amendments redesignate Rule 15c2-6 as Rule 15g-9. The SEC also amended Rule 15g-2 and Schedule 15G under the Act to require a broker/dealer to obtain, before effecting any transaction in a penny stock, a written acknowledgment from the customer that the customer has received the *Risk Disclosure Document* required by Rule 15g-2. Finally, the SEC clarified Rule 15g-3, which mandates the disclosure to customers of current quotation prices or similar market information in penny stock transactions.

Background

On January 1, 1990, Rule 15c2-6 became effective under the Act. The rule restricts high-pressure sales tactics by broker/dealers involving certain speculative, low-priced securities traded over the counter. In particular, Rule 15c2-6 prohibits a broker/dealer from selling to or effecting the purchase of a designated security by any person, unless the broker/dealer has approved the purchaser's account for transactions in designated securities and has received the purchaser's written agreement to the transaction. In approving an account for transactions in designated securities, a broker/dealer must obtain sufficient information from the customer to make an appropriate suitability determination, provide the customer with a written statement setting forth the basis of the determination, and obtain a signed copy of a suitability statement from the customer. (See *Notice to Members 89-65*, October 1989 and *Notice to Members 90-18*, March 19, 1990).

Following adoption of Rule 15c2-6, Congress passed the *Penny Stock Reform Act* (Reform Act). The Reform Act directed the SEC to adopt rules designed to address sales-practice abuses and manipulation involving speculative, low-priced over-the-counter securities by requiring broker/dealers to provide investors with material market and other information before effecting a transaction in a penny stock. In response, the SEC adopted Rule 3a51-1 and Rules 15g-1 through 15g-6 (Disclosure Rules). Rule 3a51-1 defines the term "penny stock"; Rule 15g-1 exempts certain transactions from the disclosure rules; and Rules 15g-2 through 15g-6 generally require broker/dealers effecting transactions in penny stocks to provide their customers with a *Risk Disclosure Document* that describes the risks of investing in penny stocks, information regarding market quotations, information on the compensation of the broker/dealer and salesperson involved in the penny stock transaction, and monthly statements dis-

closing the market value of penny stocks held in the customer's account. (See *Notice to Members 92-38*, July 1992).

Rule 15c2-6 Amendments

The amendments to Rule 15c2-6 conform the rule to the scope of the disclosure rules by: (1) replacing the designated security definition of Rule 15c2-6 with the Rule 3a51-1 definition of penny stock; (2) substituting with two significant exceptions the list of exempt transactions in Rule 15g-1 for the exempt transactions in Rule 15c2-6(c); and (3) redesignating Rule 15c2-6 as Rule 15g-9. Making the scope of Rule 15c2-6 consistent with the disclosure rules will simplify compliance with all of the rules directly relating to penny stocks. The amendments to Rule 15c2-6 took effect on August 11, 1993.

Penny Stock Definition

Although the definition of penny stock is substantially the same as the definition of designated security, amended Rule 15c2-6 does cover a slightly different universe of securities transactions. For example, the definition of penny stock in Rule 3a51-1 contains an exclusion for securities whose issuer has demonstrated net tangible assets of $2 million or more, but adds a requirement that the issuer be in operation for at least three years. Issuers that have been in operation for less than three years must have at least $5 million in net tangible assets to be excluded from the definition of penny stock. In addition to the exclusion based on issuer net tangible assets, Rule 3a51-1, unlike Rule 15c2-6, includes an alternative exclusion for the securities of an issuer with average revenues of $6 million for the past three years (i.e., revenues of at least $18 million by the end of the three-year period).

Like the definition of designated security, the definition of penny stock excludes any security authorized, or approved for authorization on notice of issuance, for quotation in The Nasdaq Stock Market[SM]. It also provides an exclusion for any security registered, or approved for registration on notice of issuance, on a national securities exchange provided the current price and volume information for transactions in that security is reported and made available to vendors under the rules of the national securities exchange. This exclusion is available for regional exchange-listed securities only if the securities actually are purchased or sold through the facilities of the regional exchange or in a distribution.

Rule 15c2-6 still does not cover securities priced at $5 or more, but when calculating the price of a security, broker/dealers now have to exclude the amount of any commission, commission equivalent, markup, or markdown charged in the respective agency or principal transaction. Finally, securities that a registered investment company issues and put and call options that the Options Clearing Corporation issues remain excluded from the rule.

Exempt Transactions

With two significant exceptions relating to established customers and private offerings, the exemptions under Rule 15g-1 replace the exempt transactions of Rule 15c2-6. Specifically, although Rule 15g-1 does not exempt transactions with defined "established customers" of the broker/dealer, the SEC has retained this exemption solely for purposes of Rule 15c2-6. Also, Rule 15g-1 exempts all private offering transactions that meet the requirements of Regulation D under the Securities Act of 1933 (Securities Act), as well as transactions with an issuer not involving any public offering pursuant to section 4(2) of the Securities Act. Amended Rule 15c2-6(c)(2) does not, however, exempt transactions that meet the requirements of Rule 504. In the SEC's view, the recent expansion of the Rule 504 exemption and the removal of all of the restrictions on transferability and general solicitation require that the protections provided investors by Rule 15c2-6 should continue to apply to customers purchasing securities in a Rule 504 offering.

Because the Rule 15g-1 exemptions have replaced the exempt transactions of Rule 15c2-6, Rule 15c2-6 no longer exempts transactions with all accredited investors. The amended rule now includes the Rule 15g-1 exemption for transactions with institutional accredited investors (defined in Rule 501) as well as transactions with the penny stock issuer and any director, officer, general partner, or beneficial owner of more than 5 percent of any class of equity security of the issuer. In addition, the rule provides the frequently referred to "de minimis exemption" for transactions by non-market makers receiving less than 5 percent of their total sales-related revenue from transactions in low-priced over-the-counter securities. Transactions not recommended by the broker/dealer remain exempt under Rule 15c2-6.

De Minimis Broker/Dealer Revenue Exemption

Broker/dealers relying on the de minimis exemption will be permitted to calculate their 5 percent rev-

enue based on transactions in designated securities as originally defined in Rule 15c2-6, rather than penny stocks as defined in Rule 3a51-1, for a period of six months following publication of the SEC's adopting release in the *Federal Register* at 58 FR 37413.

Penny Stock Rule Amendments

Rule 15g-2 — Risk Disclosure Document

Rule 15g-2 makes it unlawful for a broker/dealer to effect a transaction in a penny stock with or for a customer account unless the broker/dealer distributes a *Risk Disclosure Document* to the customer before effecting the customer's first transaction in a penny stock. The *Risk Disclosure Document*, which is set forth in Schedule 15G to the disclosure rules, defines the term penny stock, identifies certain risks associated with investing in penny stocks, describes the penny stock market, provides a brief description of a broker/dealer's obligations under the disclosure rules, and informs customers of their rights and remedies under federal and state law, among other things. (See *Notice to Members 92-42*, August 1992).

To better enable broker/dealers to demonstrate, and regulators to examine for, compliance with the Rule 15g-2, the SEC adopted amendments that require a broker/dealer to obtain a signed and dated acknowledgment from its customer demonstrating that the customer has actually received the required *Risk Disclosure Document* before the customer's first transaction in a penny stock. Corresponding amendments to Schedule 15G, which take effect November 1, 1993, include a description of this new requirement. In this regard, the amended Rule 15g-2 requires that broker/dealers maintain a copy of the customer's written acknowledgment for at least three years (with the first two years in a readily accessible place) following the date on which the broker/dealer provided the *Risk Disclosure Document* to the customer.

Rule 15g-2 does not specify precisely how to obtain the customer's signature. A broker/dealer, for example, could provide the customer with two copies of the *Risk Disclosure Document*, one of which the customer could sign, date, and return to the broker/dealer. Alternatively, the broker/dealer could send the customer one *Risk Disclosure Document* with an attached receipt that the customer could sign, date, and return to the broker/dealer. For convenience, either the *Risk Disclosure Document* to be signed or the receipt could accompany the Rule 15c2-6 suitability statement and written agreement that also requires the customer's signature.

The amendments to Rule 15g-2 apply only to customers that have not received and were not required to have received the *Risk Disclosure Document* as of August 11, 1993. Accordingly, broker/dealers need not obtain a signature from customers that received the *Risk Disclosure Document* in the past year. However, broker/dealers will have to get signatures for customers entering into a penny stock transaction after August 11, 1993 (the effective date of this amendment), if they have not yet received the document from the broker/dealer effecting the transaction.

Rule 15g-3 — Clarification of Disclosure Requirements

By way of background, under Rule 15g-3 a broker/dealer may not effect a non-exempt transaction in a penny stock without first disclosing, and subsequently confirming in writing to the customer, current quotation prices or specified market information for the penny stock that is the subject of the transaction. For transactions effected on a non-riskless principal basis, Rule 15g-3 requires the broker/dealer to provide the calculated inside bid and offer quotations for a penny stock as those inside quotations appear in a Qualifying Electronic Quotation System (QEQS). The Reform Act precisely defines a QEQS and the NASD's Over-the-Counter Bulletin Board® (OTCBB) service has been granted interim designation as the only QEQS. As a result, OTCBB calculated inside quotes are qualified for use in complying with Rule 15g-3 disclosure requirements.

If QEQS inside quotation information is unavailable, the broker/dealer must then look to its own bid and offer quotes in the penny stock for disclosure to the customer. However, a broker/dealer cannot use its own quotations to satisfy Rule 15g-3 disclosure requirements unless: (1) the broker/dealer has effected at least three bona fide inter-dealer transactions consistently at its bid or offer prices over the previous five business days, (2) no less than 75 percent of these transactions have occurred consistently at such quotes, and (3) the broker/dealer reasonably believes that such quotes accurately reflect the prices at which it is prepared to trade with other dealers.[1]

[1] Simply because inside quotations appear in the NASD's OTCBB or the dealer executes a sufficient number of inter-dealer transactions at its quoted price to permit

If the security does not have a QEQS inside quotation and the dealer cannot meet the referenced inter-dealer transactions standard, Rule 15g-3 specifies that the dealer must state to the customer that it has not traded consistently at its quotes and it must disclose the price at which it last purchased the penny stock from, or sold the penny stock to, another dealer in a bona fide transaction.

Confusion has apparently surfaced in those situations where there is no QEQS inside quotation calculated and the inter-dealer activity effected represents only **one side** of the broker/dealer's quotations. Under these circumstances, the broker/dealer must disclose its own quote (bid **or** ask) which is properly supported by appropriate inter-dealer executions. For the side of the market not meeting the referenced inter-dealer transactions standard, the broker/dealer must state that it has not consistently effected inter-dealer purchases or sales of the penny stock at its quoted price, and disclose to the customer the price at which it last purchased the penny stock from, or sold the penny stock to, another dealer in a bona fide transaction.

Attached to this Notice is a copy of the amended rules, as well as the additional language to Schedule 15G. For further information regarding amended Rule 15c2-6, the disclosure rules, or this Notice, contact Daniel M. Sibears, NASD, Regulation Division, at (202) 728-8221 or (202) 728-8412.

Rule 15g-3 disclosure does not allow for automatic execution at these prices. The validation process for determining the prevailing market price for markup/markdown purposes remains necessary (See *Notice to Members 92-16*, April 1, 1992).

NASD NOTICE TO MEMBERS 93-56

Quotation and Trade-Reporting Requirements For Members Dealing in High-Yield Bonds

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- ■ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- ■ Trading
- □ Training

Executive Summary

On March 18, 1993, the Securities and Exchange Commission (SEC) approved NASD rules regarding quotation and transaction reporting requirements for members trading high-yield, fixed-income securities. The rules will become effective in the fourth quarter of this year. Members that trade high-yield bonds, especially dealers, brokers, and brokers' brokers, should contact the NASD now to find out what their new quoting and trade-reporting obligations will entail. For further information and a copy of the rules, contact Market Data Services at (301) 948-6162.

Background and Description of Requirements

The NASD has adopted regulatory requirements for members that participate in the high-yield, fixed-income securities market. The trade-reporting rules will require members to report transactions in all high-yield bonds traded over-the-counter to the NASD for regulatory purposes and will also require real-time trade reporting for securities included in the Fixed Income Pricing System (FIPS). The NASD has developed FIPS to facilitate the collection, processing, and dissemination of real-time, firm quotations for 30 to 50 of the most liquid bonds in the top tier of high-yield, fixed-income securities. FIPS also provides for hourly dissemination of high/low trading ranges and accumulated volume in each bond quoted in the system.

High-yield bonds are classified as bonds that have been rated by Standard & Poor's as BB+ or lower, and FIPS will require brokers and dealers in the top 30 to 50 high-yield bonds to participate in the quotation system. The NASD has established an advisory committee to develop a list of the top-tier securities based on volume, price, name recognition of the issue, research following, and representation from diverse industry groups. A list of the bonds selected as of May 15, 1993, appears at the end of this Notice.

The NASD will assign a unique symbol identifier to each bond quoted in FIPS and trade reported to the NASD. The identifiers will be configured as mnemonics that relate to the issuer and the specific bond series and will be available on-line to FIPS subscribers and also in hard copy from the NASD so that members may distinguish between bonds with the same or similar due dates.

Broker and Dealer Obligations For Quoting FIPS Bonds

Members holding themselves out regularly as brokers or dealers in high-yield bonds quoted in FIPS will be required to participate in FIPS and transmit their quotations to the system for dissemination to the public. Dealer quotes may be one- or two-sided but must be continuous and firm to all members submitting offers to trade at the quoted prices and sizes.

Quotations submitted by members must reflect a size of 100 bonds ($100,000 par value) and be in increments of 1/8 percentage points.

Participants may trade at prices other than those quoted, but all quotes must be reasonably related to the prices at which those executions occur.

Registered dealers may enter quotes directly into FIPS or may use a registered broker's broker. Dealer

quotations entered directly will be identified as such in FIPS; dealer quotations entered through a broker's broker will appear on the FIPS screen as the broker's quotes and the dealer's identity will remain anonymous to other participants and the public.

However, each individual dealer will be able to use FIPS to see its own quote reflected in the broker's quote. For example, if a broker received two dealer quotes for 100 bonds each, priced at 98, FIPS would reflect a single quote of 200 bonds at 98 from the broker. Both FIPS dealers would be able to "pierce" that broker quote, however, and see that 100 bonds reflected their own quote and the other 100 bonds were from another unidentified dealer.

Members will be able to view FIPS quotations through a FIPS terminal, and quotations will be disseminated to non-members through securities information processors or vendors, so that they will be generally available to investors. The operating hours of the quotation system have been established as 9:30 a.m. to 4 p.m., Eastern Time (ET), to mirror the equity market hours.

Reporting Transactions In High-Yield Bonds

Members will be required to submit trade reports on all transactions in FIPS securities (those top-tier securities quoted in FIPS) within five minutes after an execution, from 9 a.m. to 5 p.m., ET. In addition, members will be required to report information on all transactions in high-yield bonds to the NASD for surveillance purposes. Trade reporting for non-FIPS securities may be accomplished any time during the trading day, but no later than 5 p.m., ET, of trade date.

FIPS Functionality and Equipment

The NASD will make FIPS quotation and summary transaction information available to investors and the public through securities information vendors. The data feeds to these vendors will include dealer and broker quotations on the FIPS bonds as well as aggregate transaction information, including hourly and daily summaries of high and low execution prices and accumulated volume in the FIPS securities.

Brokers and dealers in FIPS securities will be required to obtain a FIPS device or terminal to input, update, and view their quotations. All members trading high-yield bonds will be required to make contact with the NASD for real-time or end-of-day reporting of trades—either through dial-up or leased-line connections, computer interface, or by using the NASD's FIPS service desk. In addition, FIPS functionality will provide specialized dealer and broker screens tailored to the high-yield market, allow members to use their existing equity computer-to-computer interface (CTCI) lines for trade reporting, and provide interfaces with member in-house trading systems.

Questions regarding members' obligations or equipment needs may be directed to S. William Broka, Vice President, Trading and Market Services at (202) 728-8050.

Members holding themselves out as brokers or dealers in these bonds will be required to participate in FIPS.

FIPS Bonds

(as of 5/15/93)

Equity Ticker Symbol	Issue	Coupon	Maturity
ADLAC	Adelphia Communications	12 1/2	5/15/02
AST	American Standard	11 3/8	5/15/04
CVC	Cablevision Systems	10 3/4	4/1/04
CTY	Century	9 3/4	2/15/02
CQB	Chiquita Brands	9 5/8	1/15/04
C	Chrysler	6	4/15/96
CLK	Clark	9 1/2	9/15//04
COT	Coltec Industries	10 1/4	4/1/02
CMCSA	Comcast Corp.	10 5/8	7/15/12
CMCSA	Comcast Corp.	10	3/5/00
CNT	Container Corp.	9 3/4	4/1/03
DWB	Del Webb	9 3/4	3/1/03
FHP	Fort Howard	10	3/15/03
FHP	Fort Howard	9 1/4	3/15/01
BU	Grand Union	12 1/4	7/15/02
BUS	Greyhound	10	7/31/01
HTI	Healthtrust	10 3/4	5/1/02
KR	Kroger	10	5/1/99
KK	K-III	10 5/8	5/1/02
ORNDA	OrNda Health Corp.	12 1/4	8/15/02
OI	Owens Illinois	11	12/1/03
PNF	Penn Traffic	10 1/4	2/15/02
CVE	Quantum Chemical Corp.	13	3/15/04
R	Ralph’s	9	4/1/03
RXR	Revco D.S.	9 1/8	1/15/00
RCMI	Rogers Cantel Mobile	10 3/4	1/1/01
SWY	Safeway	9.65	1/15/04
SLL	Southland	5	12/15/03
STO	Stone Container	11 7/8	12/1/98
E	Transco	9 3/8	8/15/01
TBSA	Turner Broadcasting	12	10/1/94
TWF	TW Food	11 1/4	11/1/04

NASD NOTICE TO MEMBERS 93-57

SOES Tier Levels Set to Change for 517 Issues On September 1, 1993

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- □ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- ■ Trading
- □ Training

On June 30, 1988, the maximum Small Order Execution System (SOES℠) order size for all Nasdaq National Market® securities was established as follows:

• A 1,000-share maximum order size was applied to those Nasdaq National Market securities that had an average daily nonblock volume of 3,000 shares or more a day, a bid price that was less than or equal to $100, and three or more market makers.

• A 500-share maximum order size was applied to those Nasdaq National Market securities that had an average daily nonblock volume of 1,000 shares or more a day, a bid price that was less than or equal to $150, and two or more market makers.

• A 200-share maximum order size was applied to those Nasdaq National Market securities that had an average daily nonblock volume of less than 1,000 shares a day, a bid price that was less than or equal to $250, and less than two market makers.

These order-size tiers were set by the NASD after extensive research and polling of all Nasdaq National Market market makers. The purpose of establishing these tiers was to provide public investors with the most efficient means of handling their small orders while ensuring that market makers were not required to assume unrealistic risks under the new mandatory SOES participation rules.

At the time tier levels were established, the NASD Trading Committee and Board of Governors decided that the tier levels applicable to each security would be reviewed periodically to determine if the trading characteristics of the issue had changed so as to warrant a SOES tier-level move. Such a review was conducted as of May 28, 1993, using the aforementioned formula. The results of this review were analyzed by the SOES Subcommittee and the NASD Trading Committee, which recommended that changes in SOES tier levels should be implemented per the formula calculation with the exception that an issue would not be permitted to move more than one level.

To further explain, if an issue previously was categorized in the 200-share tier, it would not be permitted to move to the 1,000-share tier even if the formula calculated that such a move was warranted. The issue could move only one level to the 500-share tier as a result of any single review. Likewise, a security previously assigned to the 1,000-share tier could move only to 500 shares, regardless of the formula calculation. In adopting this policy, the Committee was attempting to minimize market-maker exposure on issues for which the tier level increased and maintain adequate public investor access on issues for which the tier level decreased.

The committee also recognized that the formula used to assign the tier levels cannot always accurately reflect the trading characteristics for each issue. As such, market makers are reminded that the SOES Subcommittee will review on a case-by-case basis suggested tier-level changes if a significant number of market makers in that issue believe such a change is warranted. For more information regarding this process, please contact Nasdaq Market Listing Qualifications at (202) 728-8039.

Following is a listing of the Nasdaq National Market issues that will require a SOES tier-level change on September 1, 1993.

Nasdaq National Market SOES Changes

(Effective September 1, 1993)
All Issues in Alphabetical Order by Name

Symbol	Company Name	Old Tier Level	New Tier Level
SRCE	1ST SOURCE CORP	500	1000
A			
SKFRY	A B SKF ADR	500	1000
AELNA	A E L INDS CL A	1000	500
ALTI	A L T A I INC	500	200
AMCRY	A M C O R LTD ADR	1000	500
ARIS	A R I NETWORK SVCS	1000	500
ARONB	AARON RENTS INC CL B	1000	500
ABBK	ABINGTON SAVINGS BK	500	1000
ACLE	ACCEL INT'L CORP	1000	500
ACET	ACETO CORP	1000	500
ADLAC	ADELPHIA COMM CP CL A	500	1000
AVCR	ADVACARE INC	500	1000
LAIS	ADVAN INTERVENTIONAL	500	1000
AHLDY	AHOLD LTD ADR	500	1000
ARSN	AIRSENSORS INC	500	1000
ATNG	ALATENN RESOURCES	1000	500
SEMIW	ALL AMER SEMI WTS A	500	1000
SEMIZ	ALL AMER SEMI WTS B	500	1000
AORGB	ALLEN ORGAN CO CL B	500	200
ABCI	ALLIED BANK CAPITAL	200	500
ARELW	ALPHAREL INC WTS 94	500	1000
PDRR	ALPINE MEADOWS TAHOE	1000	500
AMBC	AMER BNCP OHIO	500	200
ACOL	AMER COLLOID CO	500	1000
ACPI	AMER CONSUMER PROD	500	200
AMFB	AMER FED BK FSB	500	1000
AIFC	AMER INDEMNITY FIN	500	1000
ANUC	AMER NUCLEAR CORP	500	1000
AMSC	AMER SUPERCONDUCTOR	500	1000
AMGD	AMER VANGUARD CORP	500	1000
AMWD	AMER WOODMARK CORP	500	1000
ATAXZ	AMERICA FRST TX 2 LP	1000	500
ASGR	AMERICA SERVICE GP	500	1000
AMOS	AMOSKEAG CO	500	1000
ANRG	ANERGEN INC	500	1000
ARGY	ARGOSY GAMING CO	500	1000
ATKM	ATEK METALS CENTER	200	500
AGLF	ATLANTIC GULF COMM	500	1000
AUFN	AUTOFINANCE GP INC	200	500
AIMM	AUTOIMMUNE INC	500	1000
TOTE	AUTOTOTE CORP CL A	500	1000
AUTR	AUTOTROL CORP	500	200
AVTR	AVATAR HLDGS INC	500	1000

Symbol	Company Name	Old Tier Level	New Tier Level
B			
BARZ	B A R R A INC	1000	500
BFEN	B F ENTERPRISES INC	500	200
BFSI	B F S BANKORP INC	500	1000
BIIEF	B I I ENTERPRISES	1000	500
BKCS	B K C SEMICONDUCTORS	500	200
BKLA	B K L A BNCP	200	500
BMRG	B M R FIN GP INC	500	200
BNHB	B N H BNSH INC	500	1000
BPMI	BADGER PAPER MILLS	500	200
BLCC	BALCHEM CORP	500	200
BTEK	BALTEK CORP	200	500
BOMS	BANCORPSOUTH INC	500	1000
BNHC	BANK OF NEW HAMP CORP	500	1000
ASAL	BANKATLANTIC FSB	500	1000
BNYN	BANYAN SYSTEMS INC	200	500
BPILF	BASIC PET INT'L LTD	200	500
BELD	BELDEN BLAKE CORP	500	1000
BNHN	BENIHANA NAT'L CORP	1000	500
BIGO	BIG O TIRES INC	500	1000
BLSC	BIO LOGIC SYS CORP	1000	500
BTGCZ	BIO-TECH GEN WTS 96	500	200
BINC	BIOSPHERICS INC	1000	500
BORAY	BORAL LTD ADS	200	500
BOSA	BOSTON ACOUSTICS INC	500	1000
BOXXA	BOX ENERGY CORP CL A	500	200
BSBC	BRANFORD SAVINGS BK	500	1000
BBIOY	BRITISH BIO-TECH ADR	500	200
BSIS	BROADWAY & SEYMOUR	200	500
BTLR	BUTLER MFG CO	500	1000
C			
LAWR	C M S/D A T A CORP	500	1000
CPAK	C P A C INC	500	1000
CSPI	C S P INC	500	1000
CRBI	CAL REP BANCORP INC	200	500
CABI	CALIFORNIA BANCSHARE	500	1000
CCLPZ	CALLON CON LP UTS	500	1000
CLZRW	CANDELA LASER CP WTS	500	200
CANO	CANONIE ENVIR SVC	1000	500
CNTBY	CANTAB PHARM PLC ADR	1000	500
CAII	CAPITAL ASSOCIATES	500	1000
CSWC	CAPITAL SOUTHWEST CP	500	200
CAVR	CARVER CORP	500	1000
CATY	CATHAY BANCORP INC	1000	500

Symbol	Company Name	Old Tier Level	New Tier Level
CEGE	CELL GENESYS INC	500	1000
CEBC	CENTENNIAL BNCP	1000	500
CEBK	CENTRAL CO-OP BANK	500	1000
CJER	CENTRAL JERSEY BNCP	1000	500
CMBI	CENTRAL MTGE BCSHS	500	1000
CPSA	CENTRAL PENN FIN CORP	500	1000
CSBC	CENTRAL SOUTHERN HLD	500	200
CRDN	CERADYNE INC	1000	500
CJGPF	CHAI-NA-TA GINS LTD	500	1000
CHLN	CHALONE WINE GP LTD	1000	500
CHANF	CHANDLER INS CO LTD	1000	500
CFED	CHARTER FSB BANCORP	1000	500
CHBC	CHATTAHOOCHEE BNCP	1000	500
CHEM	CHEMPOWER INC	500	1000
DOCKS	CHICAGO DOCK SBI	500	1000
CDCRA	CHILDRENS DIS CTRS CL A	200	500
CSFT	CHIPSOFT INC CL A	500	1000
DOSEW	CHOICE DRUG SYS WTS	1000	500
CINS	CIRCLE INCOME SHARES	1000	500
CNCN	CITIZENS NAT'L CORP FL	200	500
CHCO	CITY HOLDING CO	500	200
CLDRP	CLIFFS DRILLING PFD	500	200
CHTB	COHASSET SAVINGS BK	200	500
COLB	COLUMBIA BKNG SYS	200	500
CCOA	COMCOA INC	200	500
CBVA	COMMERCE BANK (VA)	1000	500
CBNB	COMMERCEBANCORP	1000	500
CBOR	COMMERCIAL BNCP ORE	200	500
CBKS	COMMNWLTH BCSHS	500	1000
CABL	COMM CABLE INC	500	1000
CBKI	COMMUNITY BANKS INC	500	200
CBNH	COMMUNITY BKSHS	500	1000
CBSI	COMMUNITY BK SYSTEM	500	1000
CLRI	COMPUTER LANGUAGE	500	1000
COSI	COMPUTER OUTSOURCING	500	1000
CMTL	COMTECH TELECOMM CP	500	1000
COND	CONDOR SVCS INC	500	1000
CTWS	CONN WATER SVCS INC	1000	500
CONS	CONSERVATIVE SAV CORP	200	500
COPI	CONSOLIDATED PRODS	500	1000
CSTN	CORNERSTONE FIN CORP	200	500
COSCB	COSMETIC CENTER CL B	1000	500
CSLH	COTTON STATES LIFE	200	500
CRRC	COURIER CORP	500	200
CRCC	CRAFTMATIC CONTOUR	200	500
CACC	CREDIT ACCEPTANCE CP	500	1000
CREE	CREE RESEARCH INC	500	1000
XCOM	CROSSCOMM CORP	500	1000
CRWN	CROWN BOOKS CORP	500	1000
CULP	CULP INC	500	1000
CUNB	CUPERTINO NAT'L BNCP	500	200
CTII	CYTOTHERAPEUTICS INC	500	1000
D			
DSPT	D S P TECH INC	500	1000
DMCVA	DAIRY MART STORES CL A	1000	500
DANKY	DANKA BUSINESS ADR	500	1000
DARTA	DART GROUP CORP CL A	200	500
DATX	DATA TRANSLATION INC	200	500
DKEY	DATAKEY INC	500	1000
DMAR	DATAMARINE INT'L INC	500	200
DWCHW	DATAWATCH CORP WTS	1000	500
DATM	DATUM INC	500	1000
DWSN	DAWSON GEOPHYSICAL	500	1000
DSSI	DEFENSE SOFTWARE SYS	500	1000
DLFI	DELPHI FIN GP CL A	500	1000
DIDIF	DESTRON/I D I INC	500	1000
DTRX	DETREX CORP	1000	500
DPGE	DIAL PAGE INC	500	1000
DICN	DICEON ELCTRONICS	500	1000
DIPCZ	DIGITAL PRODS WTS B	500	200
DVCR	DIVERSICARE INC	500	1000
DRCO	DYNAMICS RES CORP	500	1000
E			
EMCI	E M C INSURANCE GP	500	1000
EROQ	E N V I R O Q CORP	500	1000
EZEMA	E Z EM INC CL A	500	200
EZEMB	E Z EM INC CL B	1000	500
EDCO	EDISON CONTROL CORP	200	500
ELCN	ELCO INDS INC	500	1000
EFII	ELEC IMAGING INC	200	500
ELRC	ELECTRO RENT CORP	500	200
EFSB	ELMWOOD BANCORP	500	1000
ENNI	ENERGYNORTH INC	500	1000
ENEX	ENEX RESOURCE CORP	500	1000
EVTC	ENVIR TECHS INC	200	500
EVTCW	ENVIR TECHS INC WTS	200	500
ENVG	ENVIROGEN INC	500	1000
ENZNW	ENZON INC WTS 94	500	200
ENZY	ENZYMATICS INC	1000	500
ECGC	ESSEX COUNTY GAS CO	500	200
ESEX	ESSEX CORP	1000	500
EVAN	EVANS INC	500	1000
XLTCP	EXCEL TECH CONV PFD	500	1000
XLTC	EXCEL TECH INC	500	1000
EZCOF	EZCONY INTERAMERICA	500	1000
F			
FMBN	F & M BANCORP (MD)	500	200

Symbol	Company Name	Old Tier Level	New Tier Level
FFFG	F F O FIN GP INC	1000	500
FICI	FAIR ISAAC AND CO	500	1000
FARL	FARREL CORP	1000	500
TFSB	FEDERAL SAV BK THE	200	500
FFRV	FIDELITY FED SAV VA	200	500
FIRE	FIN INST INS GP LTD	200	500
FACT	FIRST ALBANY COS INC	1000	500
FAMA	FIRST AMARILLO BNCP	500	1000
FBII	FIRST BANCP INDIANA	500	1000
FBNKP	FIRST BKS CUM PFD C	500	200
FCNCA	FIRST CITIZENS CL A	500	1000
FCOLZ	FIRST COL BKSHS DEP	500	200
FFBA	FIRST FED SAV BK CO	200	500
FFWV	FIRST FIDELTIY BNCP	200	500
FRCC	FIRST FIN CARIB CORP	500	1000
FFHS	FIRST FRANKLIN CORP	200	500
FGHC	FIRST GEORG HLDGS	1000	500
FIBI	FIRST INTER BANCORP	500	1000
FMSB	FIRST MUTUAL SAV BK	200	500
MTCL	FIRST NAT'L BANK CORP	200	500
FOBBA	FIRST OAK BROOK CL A	500	200
FSOU	FIRST SOUTHERN BNCP	500	1000
FSFI	FIRST STATE FIN SVC	500	1000
FFSW	FIRSTFEDERAL FIN	200	500
FLSTP	FLAGSTAR COS INC PFD	200	500
FLXS	FLEXSTEEL INDS	500	1000
FFPC	FLORIDA FIRST FED	1000	500
FLBK	FLORIDABANK FSB	1000	500
FOOT	FOOTHILL INDEPENDENT	500	1000
FOILO	FOREST OIL CORP PFD	500	1000
FSBX	FRAMINGHAM SAV BK	500	1000
FSVB	FRANKLIN BK NAT ASSN	500	1000
FSVBP	FRANKLIN BK NAT PFD A	500	1000
FRML	FREYMILLER TRUCKING	500	1000
G			
GBCB	G B C BANCORP	1000	500
GWCC	G W C CORP	500	1000
GZEA	G Z A GEOENVIRONMENT	1000	500
GBND	GEN BINDING CORP	500	1000
GCOR	GENCOR INDS INC	1000	500
GENBB	GENESEE CORP CL B	200	500
GENIW	GENETICS INSTIT WTS	1000	500
GBFH	GEORGIA BONDED FIBER	500	200
GILD	GILEAD SCIENCES INC	500	1000
GBCI	GLACIER BANCORP	500	1000
GEMS	GLENAYRE TECHS INC	500	1000
CHIK	GOLDEN POULTRY CO	1000	500
GBTVK	GRANITE BRDCS NV	1000	500
GSBI	GRANITE STATE BKSHS	500	1000
GLBCP	GREAT LAKES PFD A	500	1000
GFCT	GREENWICH FIN CORP	1000	500
GSOF	GROUP I SOFTWARE INC	500	200
GMRK	GULFMARK INTL INC	500	1000
H			
HDRP	H D R POWER SYS INC	500	200
HHOT	H H OIL TOOL CO INC	200	500
HYALF	H Y A L PHARM CORP	500	1000
HACH	HACH CO	200	500
HVFD	HAVERFIELD CORP	500	200
HAVTA	HAVERTY FURNITURE CL A	200	500
HWKN	HAWKINS CHEMICAL INC	1000	500
HECHB	HECHINGER CO CL B	500	1000
HFBS	HERITAGE FED BNCSHS	500	200
HSBK	HIBERNIA SAV BK THE	200	500
HIFS	HINGHAM INSTI SAV	500	1000
HOENW	HOENIG GP WTS A	500	200
HFMD	HOME FED CORP	200	500
HFMO	HOME FEDERAL BNCP MO	500	1000
HPBC	HOME PORT BNCP INC	500	1000
HOFL	HOME SAV BANK F S B	500	1000
HTWN	HOMETOWN BNCP INC	500	200
HRZB	HORIZON BANK (WA)	500	1000
HOSP	HOSPOSABLE PROD INC	500	1000
HUFK	HUFFMAN KOOS INC	500	1000
I			
ICOC	I C O INC NEW	500	1000
MPAC	IMPACT SYSTEMS INC	500	1000
INDB	INDEP BK CORP MA	500	1000
INDE	INDEPENDENT ENTMT GP	200	500
IFDCA	INDUSTRIAL FUNDING CL A	500	200
IHIIZ	INDUSTRIAL HLDG WTS B	500	200
IHII	INDUSTRIAL HLDGS INC	500	1000
IITCF	INTERA INFO TECH A	500	200
ICBK	INTERCONTINENTAL BK	500	1000
INFB	INTERFIRST BNCP INC	200	500
INTP	INTERPOINT CORP	500	1000
IPPIF	INTERPROVIN PIPE SYS	200	500
ISLH	INTL HOLDING CAP CORP	200	500
IJIN	INTL JENSEN INC	1000	500
IROQ	IROQUOIS BNCP	200	500
ITHB	ITHACA BANCORP INC	500	1000
J			
JGIN	J G INDUSTRIES INC	500	1000
MAYS	J W MAYS INC	200	500
JCFSP	JACKSON CNTY BK PFD A	200	500
JCFS	JACKSON CNTY FED FSB	200	500

Symbol	Company Name	Old Tier Level	New Tier Level
JAYJ	JAY JACOBS INC	1000	500
JSBK	JOHNSTOWN SAV BK	200	500
K			
KLLM	K L L M TRANSPORT SV	500	1000
KINN	KINNARD INV INC	500	1000
KLRT	KLEINERTS INC	500	200
KOPN	KOPIN CORP	500	1000
KOSS	KOSS CORP	500	1000
KRUG	KRUG INT'L CORP	500	1000
L			
LXBK	L S B BANCSHARES NC	500	200
LAKE	LAKELAND INDS INC	500	1000
LPAC	LASER-PACIFIC MEDIA	1000	500
LIBHA	LIBERTY HOMES INC CL A	200	500
LQMD	LIFEQUEST MEDICAL	500	1000
LCUT	LIFETIME HOAN CORP	1000	500
LIND	LINDBERG CORP	500	1000
LIPOZ	LIPOSOME CO DEP SHRS	500	1000
LIQB	LIQUI BOX CORP	500	1000
LFUS	LITTELFUSE INC	500	1000
LFUSW	LITTELFUSE INC WTS	500	1000
LAFCB	LOAN AMER FIN CL B	500	1000
LEIX	LOWRANCE ELECTRONICS	1000	500
LUFK	LUFKIN INDS INC	1000	500
M			
MARC	M A R C INC	1000	500
MCBX	M B COMM INC	500	1000
MMIM	M M I MEDICAL INC	200	500
MLRC	MALLON RESOURCES CORP	500	1000
MAXC	MAXCO INC	1000	500
MAYF	MAYFLOWER GROUP INC	500	1000
MOIL	MAYNARD OIL CO	500	1000
MCCL	MCCLAIN INDUSTRIES	200	500
MDIN	MEDALIST INDS	500	1000
MDEV	MEDICAL DEVICES	500	1000
MDIX	MEDICAL DIAGNOSTICS	500	1000
MSYSZ	MEDICAL TECH WTS 96	500	1000
MDRXZ	MEDICIS PHARM WTS C	1000	500
MECS	MEDICUS SYS CORP	500	1000
MEDR	MEDRAD INC	500	1000
MEGX	MEGACARDS INC	500	1000
MMTCY	MEMTEC LTD ADR NEW	1000	500
MIGI	MERIDIAN INS GP INC	500	1000
MPTBS	MERIDIAN PT RLTY TR	200	500
METS	MET COIL SYSTEMS CORP	500	1000
MFCB	MICHIGAN FINL CORP	500	200
MTST	MICROTEST INC	500	1000
MIDS	MID SOUTH INS CO	500	1000
MIDC	MIDCONN BANK	500	1000
MFRI	MIDWESCO FILTER	500	1000
MILW	MILWAUKEE INS GROUP	500	200
MYTK	MITEK SURGICAL PRODS	500	1000
MODT	MODTECH INC	1000	500
MORP	MOORE PRODUCTS CO	200	500
MOTR	MOTOR CLUB OF AMER	500	1000
N			
NABC	N A B ASSET CORP	500	1000
NSCB	N B S C CORP	500	1000
BLDG	N C I BLDG SYSTEM	500	1000
NATH	NATHAN'S FAMOUS INC	500	1000
POPS	NAT'L BEVERAGE CORP	1000	500
NCMC	NAT'L CAP MGT CORP	1000	500
NCBE	NAT'L CITY BANCSHARES	200	500
NCBM	NAT'L CITY BNCP	500	1000
NCBRP	NAT'L COMM BK PFD B	1000	500
NHHC	NAT'L HOME HLTH CARE	1000	500
NIRTS	NAT'L INCOME RLT TRUST	500	1000
NLBK	NAT'L LOAN BK IN LIQ	1000	500
MBLA	NAT'L MERCANTILE BNCP	500	1000
NAVG	NAVIGATORS GP INC	500	1000
NEOZ	NEOZYME CP CALLABLE	1000	500
NIIUF	NEOZYME II UTS	1000	500
NWTH	NETWORTH INC	200	500
NRND	NORAND CORP	500	1000
NAMC	NORTH AMER NAT'L CORP	500	1000
NUHC	NU HORIZONS ELEC CORP	500	1000
NUCM	NUCLEAR METALS INC	500	1000
NYCOP	NYCOR INC PFD	1000	500
O			
OSBF	O S B FIN CORP	200	500
OHSC	OAK HILL SPORTSWEAR	500	1000
ODFL	OLD DOMINION FREIGHT	1000	500
OMEF	OMEGA FIN CORP	200	500
OPTO	OPTO MECHANIK INC	500	200
OSBN	OSBORN COMM CORP	500	200
GOSHB	OSHKOSH B'GOSH CL B	200	500
OSHM	OSHMANS SPORTING	500	1000
P			
PDKLZ	P D K LABS WTS B 97	1000	500
PDKLM	P D K LABS WTS C 97	1000	500
PABC	PACIFIC BNCP	200	500
PDLPY	PACIFIC DUNLOP ADR	500	1000
PACO	PACO PHARM SVCS INC	500	1000
PTMLY	PALMER TUBE MILL ADR	500	200

Symbol	Company Name	Old Tier Level	New Tier Level
PBCI	PAMRAPO BNCP INC	500	1000
PARC	PARK COMM INC	500	200
PARK	PARK NAT'L CORP	500	200
PVSA	PARKVALE FIN CORP	1000	500
PRLX	PARLEX CORP	200	500
PATK	PATRICK INDS INC	200	500
PMFG	PEERLESS MFG CO	500	1000
PWBC	PENNFIRST BNCP INC	200	500
PFDC	PEOPLES BANCORP	500	200
PBNB	PEOPLES SAV FIN CORP	1000	500
PCEP	PERCEPTION TECH CORP	500	1000
PLDIF	PETERSBURG LONG DIST	500	1000
PXREZ	PHOENIX RE CORP DEP SH	200	500
PHOC	PHOTO CONTROL CORP	500	1000
PICOA	PHYSICIANS INS OH CL A	1000	500
PMAN	PIEDMONT MGMT CO INC	500	1000
PKVL	PIKEVILLE NAT'L CORP	1000	500
PSBN	PIONEER BANCORP INC	1000	500
PFBC	PIONEER FED BNCP	500	1000
PSQL	PLATINUM SOFTWARE CP	500	1000
PBKC	PREMIER BKSHS	500	200
PREM	PREMIER FIN SVCS	200	500
PTRK	PRESTON CORP	1000	500
PFNC	PROGRESS FIN CORP	500	1000
PRGR	PROGROUP INC	500	1000
PCOL	PROTOCOL SYS INC	500	1000
PRBK	PROVIDENT BNCP INC	500	1000
PECN	PUBLISHERS EQUIP CORP	500	1000
PLFC	PULASKI FURNITURE CP	500	1000
PULS	PULSE BANCORP INC	200	500
PTNM	PUTNAM TRUST CO	200	500
Q			
RCORF	QUALITY DINO ENTMT	1000	500
QRST	QUANTUM RESTAURANT	500	1000
QDELW	QUIDEL CORP WTS 2000	500	1000
R			
RRMN	RAILROADMENS FED IND	500	1000
RAVN	RAVEN INDUSTRIES INC	500	1000
RDGCA	READING CO CL A	500	1000
REED	REEDS JEWELERS INC	200	500
RFTN	REFLECTONE INC	500	1000
RGEQ	REGENCY EQUITIES CORP	200	500
RESB	RELIABLE FIN CORP	500	1000
REPOW	REPOSSESSION AUCT WTS	1000	500
ARBC	REPUBLIC BANK CAL	200	500
REXI	RESOURCE AMERICA INC	500	200
REXL	REXHALL INDS INC	500	1000
RSGI	RIVERSIDE GP INC	200	500
RNRC	RIVERSIDE NAT'L BANK	500	200
RNIC	ROBINSON NUGENT INC	500	1000
RBPAA	ROYAL BANK PENN CL A	500	1000
RBCO	RYAN BECK CO INC	500	1000
S			
SCOM	S C S COMPUTE INC	1000	500
SIHS	S I HANDLING SYS INC	500	1000
SKFB	S K FAMOUS BRANDS	500	1000
SFTIF	S O F T I M A G E	500	1000
SFGD	SAFEGUARD HEALTH ENT	1000	500
SHRE	SAHARA RESORTS	200	500
SNDS	SANDS REGENT THE	500	1000
SWCB	SANDWICH CO-OP BANK	500	1000
STMI	SATELLITE TECH MGMT	500	1000
STIZ	SCIENTIFIC TECH INC	200	500
SCGN	SCIGENICS INC CLLBLE	1000	500
SCIOZ	SCIOS NOVA INC WTS D	1000	500
SHER	SCOTTISH HERITABLE	200	500
SFLD	SEAFIELD CAPITAL CORP	1000	500
FOTO	SEATTLE FILMWORKS	1000	500
SECDP	SECOND BNCP PFD A	500	200
SFBM	SECURITY FED SAV BK	500	1000
SFSL	SECURITY FIRST CORP	500	200
SNFCA	SECURITY NAT'L FIN CL A	200	500
SSVB	SECURITY SAV FSB	200	500
SENE	SENECA FOODS CP	500	200
SHMN	SHAMAN PHARM INC	500	1000
SSBC	SHELTON BNCP INC	200	500
SHOP	SHOPSMITH INC	500	1000
STBS	SIERRA TAHOE BNCP	500	1000
SFNCA	SIMMONS 1ST NAT'L CL A	200	500
FISH	SMALL'S OILFIELD	200	500
FISHW	SMALL'S OILFIELD WTS	200	500
HAMS	SMITHFIELD CO INC	500	200
SOMR	SOMERSET GP INC THE	200	500
SNSTA	SONESTA INT'L CL A	500	200
SSBB	SOUTHINGTON SAV BK	200	500
SWPA	SOUTHWEST NAT'L CORP	200	500
SWWC	SOUTHWEST WATER CO	1000	500
SPLE	SPORTS/LEISURE INC	500	1000
SBIB	STERLING BCSHS TX	500	1000
SWBC	STERLING WEST BNCP	500	200
STRB	STROBER ORGANIZATION	200	500
SUBBA	SUBURBAN BANCP CL A	500	1000
SUMI	SUMITOMO BANK OF CA	500	1000
SMMT	SUMMIT BANCORP WA	500	1000
SCSL	SUNCOAST SAV LN FSA	500	1000
SRBC	SUNRISE BNCP CA	500	1000
SYNC	SYNALLOY CORP	500	1000

Symbol	Company Name	Old Tier Level	New Tier Level
SYQT	SYQUEST TECH INC	500	1000
SYRA	SYRATECH CORP	500	1000
T			
TCII	T C I INTL INC	500	1000
TSINW	T S I CP WTS 96	500	200
TSII	T S I INC	1000	500
TVXTF	T V X GOLD INC	500	1000
TAPI	TAPISTRON INT'L INC	500	1000
TAPIW	TAPISTRON INT'L WTS	500	1000
TECN	TECHNALYSIS CORP	500	1000
TCOMB	TELE COMM INC CL B	500	1000
TFLX	TERMIFLEX CORP	500	200
WATR	TETRA TECH INC	500	1000
PRET	THE PRICE R E I T	200	500
TMSTA	THOMASTON MILLS CL A	500	1000
TMBS	TIMBERLINE SOFTWARE	500	1000
TODDA	TODD A O CORP CL A	500	200
TKIOY	TOKIO MARINE ADR	500	1000
TOPS	TOPS APPLIANCE CITY	500	1000
TTRR	TRACOR INC	500	1000
TTRRW	TRACOR INC WTS A	500	200
TLII	TRANS LEASING INT'L	500	1000
WSTEW	TRANSAMER WASTE WTS A	200	500
WSTEZ	TRANSAMER WASTE WTS B	200	500
TRNS	TRANSMATION INC	500	1000
TRCO	TRICO PRODUCTS CORP	500	200
TRIB	TRISTATE BANCORP THE	200	500
U			
UNSL	U N S L FIN CORP	200	500
USPC	U S PAGING CORP	1000	500
UPCPO	UNION PLANTERS PFD E	500	1000
UNSA	UNITED FIN CORP S C	1000	500
UMSB	UNITED MISSOURI BCSH	500	1000
UNBJ	UNITED NATL BNCP	200	500
UBMT	UNITED SAV BK F A MT	200	500

Symbol	Company Name	Old Tier Level	New Tier Level
UTVI	UNITED TELEVISION	1000	500
USAC	UNIVERSAL SEISMIC	500	1000
V			
VALN	VALLEN CORP	500	1000
VALY	VALLICORP HLDGS INC	500	1000
VCRE	VARI CARE INC	200	500
VRSY	VARITRONIC SYS INC	500	1000
VNTX	VENTRITEX INC	500	1000
VCNB	VENTURA COUNTY NAT'L	500	1000
VENT	VENTURIAN CORP	200	500
VIDE	VIDEO DISPLAY CORP	500	1000
VLGEA	VILLAGE SUPER MKT CL A	500	200
VTSS	VITESSE SEMICOND	500	1000
VOLT	VOLT INFO SCIENCES	500	1000
VOLVY	VOLVO AB CL B ADR	500	1000
W			
WSMP	W S M P INC	500	200
WAIN	WAINWRIGHT BK TR CO	500	200
WALS	WALSHIRE ASSURANCE	500	1000
WAMUO	WASHING NONCUM PFD C	500	1000
WBNC	WASHINGTON BNCP NJ	500	1000
WAMUN	WASHINGTON PFD D	200	500
WATFZ	WATERFORD PLC ADR UTS	200	500
WTRS	WATERS INSTRUMENTS	200	500
WEDC	WEDCO TECHNOLOGY INC	500	1000
WCBC	WEST COAST BNCP CA	500	1000
WSBK	WESTERN BANK OREGON	1000	500
WFRAF	WHARF RESOURCES LTD	200	500
WFMI	WHOLE FOODS MARKET	500	1000
WMSI	WILLIAMS INDS INC	500	1000
WINR	WINTHROP RESOURCE CORP	500	1000
Z			
ZEUS	ZEUS COMPONENTS INC	500	1000
ZIGO	ZYGO CORP	500	1000

NASD Notice to Members 93-58

NASD Member Buying Services Provides Members With Discounted Products And Services

Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

Executive Summary

The NASD® has created a Member Buying Services department and consolidated responsibility for the operation of its existing sponsored programs under the Member Services business line.

The mission of Member Buying Services is to provide members with group purchasing opportunities that reduce their costs and promote their efficiency.

During the coming year, the new department will focus on enhancing existing services and the value they provide to members. In early 1994, Member Buying Services will survey members to measure their satisfaction with existing programs and identify additional services that, because of its membership, the NASD can either acquire for firms or provide for firms at a deeper discount.

The existing NASD-sponsored programs under Member Buying Services are: the NASD/MCI Long-Distance Communications Program, NASD Member Firm Insurance Program, NASD Registered Representative Insurance Program, and the NASD Fidelity Bond, State Surety Bond, and Signature Guarantee Bond Programs.

Background

The NASD sponsored its first program in 1949 with a group life insurance plan for members, and in 1953 added major medical and dental. In 1982, to help members obtain the requisite fidelity bond coverage at cost effective rates, the NASD sponsored a fidelity bond program. In 1991, MCI joined with the NASD to offer members discounted rates on long-distance voice and data communications.

Placing responsibility for group purchasing programs under one business line will result in a coordinated effort to identify members' needs and in the introduction of new services. The business line will also monitor the competitiveness of sponsored programs to ensure that members continue to receive the best possible service and value. The NASD staff and its contracted agents will also mediate disputes with the service providers, if needed.

Please contact Dean Boyle at (301) 590-6525 with your questions concerning this Notice. For additional information on any of the Member Buying Services programs described below, call the number listed at the end of the program description.

NASD/MCI Long-Distance Communications Program

The NASD/MCI program offers participating NASD members savings of up to 30 percent on comprehensive voice and data telecommunications services. As an added NASD membership benefit, each participating firm also receives a rebate directly from the NASD based on their monthly MCI usage. In 1992, the NASD rebated approximately $2.4 million to the 650 participating firms.

The NASD sponsors eight different MCI services with a program to fulfill every firm's communications needs. The three most popular MCI services offered and their discounted rates before the NASD rebate are:

• MCI 800 Service provides nation

wide and international coverage, single-number dialing, choice of dedicated or switched lines, Direct Termination Overflow (automatically switches 800-line call overflow to a normal business line so that customers never get a busy signal), and routing and coverage control. MCI discounts are 21 to 27 percent off MCI's rates based on usage.

• MCI Vision gives firms the ability to customize long-distance coverage based on specific needs, including flexible access, flat-rate pricing, and the option of a single invoice for multiple locations. Discounts are 7 to 22 percent off all domestic and interstate usage.

• VNET service lets firms use part of MCI's public switched network as if it were a private network providing the benefits of customized dialing and consolidated billing, MCI network management capabilities, and reporting and configuration management. Member firm discounts are 3 to 21 percent off based on interstate rates.

In addition to MCI's regular services, a special calling card is available to member firms. The Nasdaq/MCI * Card provides members with real-time stock quotes, voice news, conference calling, speed dialing, and voice messaging capability.

For more information about the NASD/MCI special discount program, contact your local MCI account representative or call (800) 627-3276.

NASD Member Firm Insurance Program

The NASD Member Firm Insurance Plan is designed for member firms with two to 50 employees. The plan with The Travelers offers eligible firms a number of insurance options for Major Medical, Dental, Term Life, and Accidental Death and Dismemberment (AD&D). Over the past several months, revisions to the program have made it competitive across the United States based on price and options.

The NASD Member Firm Insurance Plan is available to qualified member firms in all 50 states and the District of Columbia. The plan is tailored on a state-by-state basis to ensure that it conforms to each state's laws and regulations.

The NASD plan offers members options for all major types of medical insurance to meet almost any budget. The plan currently offers three comprehensive medical options, four term life and AD&D options, and two dental programs.

The NASD's plan administrator, Seabury & Smith, is available to work with members to help assess their insurance requirements, determine eligibility for the plan, and provide quotes for comparison to existing insurance premiums and features.

For additional information on the NASD Member Firm Insurance Program, please contact Patrick Mulkey at (800) 424-9883, extension 354, or, in the District of Columbia, at (202) 457-6820.

NASD Registered Representative Insurance Program

The Registered Representative Insurance Program makes insurance available to employees of members that cannot provide coverage for their employees or for employees not qualified for the member's plan. The NASD must receive authorization to enroll employees from a member firm before its employees can participate in the program.

The plan offers competitive rates on Accidental Death and Dismemberment, Long-Term Disability, and Term-Life Insurance through CIGNA. National Casualty underwrites the Major Medical portion of the plan that is available to qualified participants.

Please contact Jeanne Law at (800) 336-0883, or, in the District of Columbia, at (202) 293-0883, for additional information on the plan and the types of coverage offered in your state.

NASD Fidelity Bond Program

The Fidelity Bond Program provides members with fidelity bond protection in coverage amounts from $25,000 to $500,000. More than 3,300 member firms are covered under the plan that provides fidelity coverage for losses resulting from destruction or fraudulent acts by employees, loss of property on premises, loss of property in transit, etc. NASD rules require fidelity bond coverage.

Seabury & Smith is the plan administrator and the fidelity bond is underwritten by National Union Fire Insurance Company.

For additional information on the plan, please contact Kathryn Jacobson at (800) 922-9242 or (202) 296-9640 in the District of Columbia.

NASD State Surety Bond Program

The NASD also sponsors a State Surety Bond Program that is available to members in all states that require a Surety Bond for broker/dealer registration. This bond pro-

vides third-party protection to the public and enables an aggrieved individual to put in a claim under the bond for a broker/dealer's non-compliance with the state's statute. Currently, more than 1,300 NASD members participate in this program.

For more information, please contact Kathy Jacobson at Seabury & Smith, (800) 922-9242 or (202) 296-9640.

Signature Guarantee Bond Program

The Signature Guarantee Bond Program is available to NASD members that serve as guarantors of signatures. This bond is required by Rule 17AD-15 of the Securities Exchange Act of 1934. Currently, more than 300 NASD members participate in the program.

For more information, please contact Kathy Jacobson at Seabury & Smith, (800) 922-9242 or (202) 296-9640.

NASD NOTICE TO MEMBERS 93-59

Labor Day: Trade Date-Settlement Date Schedule

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

The Nasdaq Stock Market[SM] and the securities exchanges will be closed on Monday, September 6, 1993, in observance of Labor Day. "Regular way" transactions made on the preceding business days will be subject to the settlement date schedule listed below.

Trade Date	Settlement Date	Reg. T Date*
Aug. 27	Sept. 3	Sept. 8
30	7	9
31	8	10
Sept. 1	9	13
2	10	14
3	13	15
6	Markets Closed	—
7	14	16

Brokers, dealers, and municipal securities dealers should use these settlement dates to clear and settle transactions pursuant to the NASD® Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding the application of these settlement dates to a particular situation may be directed to the NASD Uniform Practice Department at (212) 858-4341; after August 20, 1993, call (203) 375-9609.

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*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

NASD NOTICE TO MEMBERS 93-60

Nasdaq National Market® Additions, Changes, And Deletions as of July 22, 1993

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [x] Internal Audit
- [ ] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

As of July 22, 1993, the following 72 issues joined the Nasdaq National Market®, bringing the total number of issues to 3,186:

Symbol	Company	Entry Date	SOES Execution Level
CFBKP	Citizens Federal Bank, A Federal Savings Bank	6/23/93	200
PITC	Pittencrieff Communications, Inc.	6/23/93	1000
RCAP	Re Capital Corporation	6/23/93	1000
FNCO	Funco, Inc.	6/24/93	1000
GRXR	Ground Round Restaurants, Inc.	6/24/93	1000
MBLF	MBLA Financial Corporation	6/24/93	200
META	Metatec Corporation	6/24/93	1000
MEGZ	Megahertz Corporation	6/24/93	1000
EGLS	Electroglas, Inc.	6/25/93	1000
LOTO	Lottery Enterprises, Inc.	6/25/93	1000
RCSBP	The Rochester Community Savings Bank Series B Pfd	6/25/93	200
BLYH	Blyth Holdings, Inc.	6/28/93	1000
FFYF	FFY Financial Corp.	6/28/93	1000
SHLO	Shiloh Industries, Inc.	6/29/93	1000
ROSE	T R Financial Corp.	6/29/93	1000
ABTC	ABT Building Products Corp.	6/30/93	1000
COTN	Delta and Pine Land Company	6/30/93	500
GTWYR	Gateway Financial Corporation (7/23/93 Rts)	6/30/93	1000
HUNT	Huntco Inc. (Cl A)	6/30/93	500
ISCX	Industrial Scientific Corp.	6/30/93	500
SODK	Sodak Gaming, Inc.	6/30/93	1000
AERN	AER Energy Resources, Inc.	7/1/93	1000
BAIB	Bailey Corporation	7/1/93	1000
BBTK	BroadBand Technologies, Inc.	7/1/93	1000
FFBS	FFBS Bancorp, Inc.	7/1/93	200
GNCMA	General Communication, Inc. (Cl A)	7/1/93	1000
GMBS	George Mason Bankshares, Inc.	7/1/93	200
PNCL	Pinnacle Micro, Inc.	7/1/93	1000
REGL	Regal Cinemas, Inc.	7/1/93	1000
STLYD	Stanley Furniture Company, Inc.	7/2/93	1000
COOK	California Culinary Academy, Inc.	7/6/93	500
CYRK	Cyrk, Inc.	7/7/93	1000
HZWV	Horizon Bancorp, Inc.	7/7/93	200
MVBI	Mississippi Valley Bancshares, Inc.	7/8/93	1000
PCTV	People's Choice TV Corp.	7/8/93	1000
PRCP	Perceptron, Inc.	7/8/93	1000
TITN	Titan Holdings, Inc.	7/8/93	1000
GZTC	Genzyme Transgenics Corp.	7/9/93	1000
PBSF	Pacific Bank, N.A. (The)	7/9/93	1000
SCSLP	Suncoast Sav. and Loan Association Series A Pfd Stk ($5 P/V)	7/9/93	1000
SUNH	Sundance Homes, Inc.	7/9/93	1000
CTEA	Celestial Seasonings, Inc.	7/13/93	1000
FSFT	FOURTH SHIFT Corporation	7/14/93	1000

Symbol	Company	Entry Date	SOES Execution Level
CENT	Central Garden & Pet Company	7/15/93	1000
STEK	Steck-Vaughn Publishing Corp.	7/15/93	200
CCUR	Concurrent Computer Corp.	7/16/93	1000
CYRX	Cyrix Corporation	7/16/93	1000
EVSI	Evans Systems, Inc.	7/16/93	500
GARI	General Atlantic Resources, Inc.	7/16/93	1000
HLYW	Hollywood Entertainment Corp.	7/16/93	1000
JAII	Johnstown America Industries, Inc.	7/16/93	1000
MCLL	Metrocall, Inc.	7/16/93	1000
RURL	Rural/Metro Corporation	7/16/93	1000
CFBN	Community First Bank	7/19/93	200
KTEL	K-tel International, Inc.	7/19/93	200
DWTI	Dataware Technologies, Inc.	7/20/93	1000
FDEF	First Federal Savings and Loan	7/20/93	1000
DIVE	American Oilfield Divers, Inc.	7/21/93	1000
ACAI	Atlantic Coast Airlines, Inc.	7/21/93	1000
PNJIV	Phillips & Jacobs, Incorporated (WI)	7/21/93	500
RIMG	Rimage Corporation	7/21/93	1000
STCR	Starcraft Automotive Corporation	7/21/93	1000
ARRW	Arrow Transportation Co.	7/22/93	1000
MDLI	MDL Information Systems, Inc.	7/22/93	1000
RXTC	Renal Treatment Centers, Inc.	7/22/93	1000
STNT	Stant Corporation	7/22/93	1000
MRGN	The Morgan Group, Inc. (Cl A)	7/22/93	1000
UIHIA	United International Holdings, Inc. (Cl A)	7/22/93	1000
KTEC	Key Technology, Inc.	7/23/93	1000
MRSI	MRS Technology, Inc.	7/23/93	1000
PETM	PETsMART, Inc.	7/23/93	500
WNDR	Wonderware Corporation	7/23/93	1000

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since June 23, 1993:

New/Old Symbol	New/Old Security	Date of Change
STLTF/STLTF	Stolt-Nielsen S.A./Stolt Tankers and Terminals Holdings S.A.	6/24/93
DNKG/DNKG	Sofamor/Danek Group, Inc./Danek Group, Inc.	6/25/93
FSPG/FSPG	First Home Savings Bank, F.S.B./First Home Sav Bank, S.L.A.	6/28/93
ICFI/ICFI	ICF Kaiser International, Inc./ICF International, Inc.	6/28/93
ARGT/FISL	ArgentBank/First Interstate Bank of Southern Louisiana	6/29/93
MBNY/MBNY	Merchants New York Bancorp, Inc./Merchants Bank of New York	7/1/93
ZING/ZEUS	Zing Technologies, Inc./Zeus Components, Inc.	7/2/93
DSSI/DSSI	Data Systems & Software Inc./Defense Software & Systems, Inc.	7/12/93
ADLI/ADLI	American Dental Technologies, Inc./American Dental Laser Inc.	7/14/93
ACTYF/CALGF	Applied Carbon Technology, Inc./Cal Graphite Corp.	7/14/93
NAUT/SOME	Nautica Enterprises, Inc./State-O-Maine, Inc.	7/15/93
CRCC/CRCC	Craftmatic Industries, Inc./Craftmatic/Contour Industries, Inc.	7/19/93
GTWYR/GTWYR	Gateway Fin Corp (7-23-93 Rts)/Gateway Fin Corp (7/19/93 Rts)	7/20/93

New/Old Symbol	New/Old Security	Date of Change
INDE/INDE	Independent TeleMedia Group Inc./Independent Entmt Group Inc.	7/20/93
CALL/CALL	NEXTEL Communications, Inc. (Cl A)/Fleet Call, Inc. (Cl A)	7/23/93
MSEA/MSEA	Metropolitan Bancorp/Metropolitan Fed Savings & Loan of Seattle	7/23/93
MDBK/REGB	Medford Savings Bank/Regional Bancorp, Inc.	7/23/93
VTEL/VTEL	Vtel Corp./Videotelecom Corp.	7/23/93

Nasdaq National Market Deletions

Symbol	Security	Date
AIIC	American Integrity Corporation	6/23/93
PLTZ	Pulitzer Publishing Company	6/23/93
ERICR	LM Ericsson Telephone Company (6/30/93 Rts)	6/24/93
ARIB	Aspen Imaging International, Inc.	6/25/93
CBTF	CB & T Financial Corp.	6/28/93
HROK	Home Federal Savings Bank	7/1/93
HFIN	Horizon Financial Services, Inc.	7/1/93
ERLY	Erly Industries, Inc.	7/2/93
GACC	Great American Communications	7/2/93
HMEC	Hall-Mark Electronics	7/2/93
OPTXE	Optek Technology, Inc.	7/2/93
SWEL	Southwestern Electric Service	7/2/93
PBSFE	The Pacific Bank, N.A.	7/2/93
OSBNR	Osborn Communications Corporation (7/2/93 Rts)	7/6/93
BNHBR	BNH Banshares, Inc. (7/16/93 Rts)	7/7/93
GLTX	Goldtex, Inc.	7/9/93
PNUT	Jimbo’s Jumbos, Inc.	7/9/93
SOCS	Society for Savings Bancorp Inc.	7/12/93
GRNC	GranCare, Inc.	7/13/93
AZTR	Aztar Corporation	7/14/93
CHOS	Columbia Hospital Corporation	7/14/93
MLTF	Multibank Financial Corp.	7/14/93
UCOAE	United Coasts Corporation	7/14/93
NALR	Naylor Industries, Inc.	7/15/93
AHTS	American Health Services Corp.	7/16/93
GENIP	Genetics Institute, Inc. (Pfd)	7/16/93
PERC	Perceptronics, Inc.	7/16/93
PSSP	Price/Stern/Sloan, Inc.	7/19/93
HICI	Home Intensive Care, Inc.	7/20/93
SETC	Sierra Real Estate Equity	7/20/93
USAS	USA Waste Services, Inc.	7/21/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade-reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

NASD BOARD BRIEFS

Actions Taken by the NASD® Board of Governors in August

• **President's Report**—The NASD® recently presented the London Stock Exchange (LSE) with a comprehensive proposal to upgrade its screen-based, dealer quote-driven trading system. The NASD, which itself is in the midst of a technology migration, was invited to present a proposal after members of the LSE requested that it do so. The NASD agreed to respond to the Request for Proposal believing that the members of both organizations would be well served by the development of systems with a high degree of similarity and capability.

The LSE, which had already commissioned a vendor to develop a new system, subsequently opted to retain the original vendor but to modify the planned system in a number of ways. This resulted in a substantial reduction in the LSE's cost projections and, importantly, preservation of the dealer features of the LSE's current system.

The internal team of NASD staff members that generated this proposal did so under substantial time pressure in an outstanding manner that enhanced our reputation in the London financial community and demonstrated the deep reservoir of talent available to the NASD.

The NASD's technology migration effort, whose acronym is SMART (Securities Market Automated Regulated Trading), continues to move forward, with an acceleration of the program expected in the second half of 1993. Selection of hardware platform vendors will be made in August and additional management staff will be added to the Information Technology Group during the next several months.

Recently, the NASD completed the contemplated merger of its two subsidiaries, Nasdaq, Inc., and NASD Market Services, Inc., into a single entity, The Nasdaq Stock Market, Inc. The new subsidiary is governed by a Board of Directors composed of the members of the Boards of the merged companies and co-chaired by Anson M. Beard and Victor R. Wright, chairmen of the former subsidiary organizations.

Over the last two months, the NASD sponsored or participated in a number of well-received conferences and seminars. On May 12-14, the NASD held its 1993 Spring Securities Conference in Chicago. Attended by more than 500 member firm representatives, the program included two panels of NASD and industry representatives who discussed new directions for the securities industry as well as developments in securities regulation. In addition, the conference featured 12 workshops on various topics ranging from compliance and enforcement issues to individual securities products.

Again this year, The Nasdaq Stock Market℠ sponsored the Fastest-Growing Companies Symposium produced by *Fortune.* Held on May 20-22, this symposium consisted of presentations, panels, and workshops for CEOs from the nation's top growth companies. The conference theme was exploring the best new approaches to managing in today's competitive global marketplace. The conference itself was linked to the magazine's annual list of fastest-growing companies, which this year included 63 Nasdaq companies.

A joint Stanford University/Nasdaq program for senior executives of publicly traded companies was held on June 16-18, entitled "Tools for Executive Survival." The program was attended by executives from 63 public companies, 46 of which are listed on Nasdaq. Guest speakers and discussion leaders included

former SEC Commissioner Joseph Grundfest, NASD Governor Charles Schwab, former Secretary of State George P. Shultz, and others.

On June 23, the NASD was an active participant in the 28th Annual Awards Program of the Center for the Study of the Presidency. The Center is a non-profit, non-partisan educational institution whose programs seek to further understanding of the American constitutional system of government, as well as build better citizens, better government, and better leaders. Among the events in this year's program were a White House briefing for CEOs, the Third Annual Business Leaders Symposium, and the Annual Awards dinner at which Commerce Secretary Ron Brown, Senator Bob Dole, and Senator Jay Rockefeller were honored for their outstanding public service. The Business Leaders Symposium, in which NASD Governor and MCI Chief Executive Officer Bert Roberts was an active participant, was taped and edited into a PBS television special.

Activity in The Nasdaq Stock Market continues at record levels. Nasdaq's average daily trading volume has risen to 245.5 million shares through the first half of 1993, more than 50 million shares ahead of the 1992 figure. On May 20, Nasdaq set an all-time single-day trading record of 343.2 million shares, eclipsing the old record of 327.8 million shares on January 9, 1992. With the surge in trading volume, all Nasdaq trading services are experiencing increased use. The Nasdaq Composite Index continues to perform well on a 12-month basis, up 25 percent. On July 14, the Nasdaq Composite closed at a record high of 712.49.

• **Regulation—**The Board approved for filing with the SEC an amendment to Article III, Section 26(d)(4) of the Rules of Fair Practice to exempt money market funds from the requirement to disclose in their prospectuses that long-term shareholders may pay more than the economic equivalent of the permitted maximum front-end sales charges. Since money market funds are traditionally short-term investments or cash management vehicles, it is highly unlikely that investors will stay in such funds for a long enough period to trigger the maximum charges. To require such disclosure could mislead, or at least confuse, investors in money market mutual funds and would serve little if any regulatory purpose.

The Board authorized an NASD comment letter on a recent SEC proposal to exempt Rule 144A securities distributions from the requirements of Rules 10b-6, 10b-7, and 10b-8 (trading rules). The SEC considers this proposal appropriate because of the unique nature of Rule 144A distributions, which are neither registered under the Securities Act of 1933 nor listed on a U.S. exchange or quoted in an automated interdealer quotation system. In addition, they are limited to qualified institutional buyers and the securities, which are issued by substantial companies, have liquid markets in their home marketplaces as well as publicly available trading information. Such deep, liquid markets, in the SEC's view, make application of the trading rules less necessary.

Modifications to the Corporate Financing Rule under Article III, Section 44 of the Rules of Fair Practice, regulating the anti-dilution provisions of warrants, options, or convertible securities received as underwriting compensation, were approved by the Board. Under this proposal, underwriters and related persons may not receive warrants, options, or convertible securities as compensation if the warrant, option, or convertible security contract contains anti-dilution provisions that provide (i) disproportionate rights, privileges, and economic benefits that are not offered to existing shareholders or the investors purchasing the company's securities in a public offering or (ii) for the receipt or accrual of cash dividends during the life, and before the exercise, of the warrant, option, or convertible security. Should the members approve this provision, the NASD will file the measure with the SEC for final approval.

As a result of Board action, members would have to close-out fails resulting from most account transfers within 10 business days following settlement date. A 30-day time period would apply to certain types of securities where short time-limit close-outs are not possible. Such securities include bankers' acceptances, bond anticipation notes, certificates of deposit, commercial paper, FMAC certificates, FNMA certificates, foreign securities, GNMA certificates, limited partnership interests, municipal bonds, mutual fund shares (transferable), revenue anticipation notes, SBA certificates, and tax anticipation notes. The NASD must now file these changes with the SEC for final approval.

The Board adopted a Rule of Fair Practice related to the content and filing of clearing agreements. The rule must now be published for member vote and, if approved by the members, submitted to the SEC for final action. As adopted, the measure requires all clearing agreements entered into by any member not subject to a comparable rule of a national securities exchange to

address the respective functions and responsibilities of the parties.

The rule would further require any NASD-only member or member designated to the NASD for compliance oversight entering into a new agreement or amending an existing one to file it with the NASD for review and approval. Finally, any introducing member entering or amending an agreement with a clearing member not designated to the NASD for compliance oversight would have to file it with the local NASD office for review.

The Board authorized the NASD to draft and submit a comment letter to the SEC regarding its recent proposal to adopt new Rule 15c6-1, effective January 1, 1996, which would mandate a three-day settlement cycle. Under the proposal, unless parties to the transaction agree otherwise, a member could not enter into a transaction contract that provides for payment and delivery later than the third business day after the contract. The measure would not apply to an exempted security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills.

While the NASD supports the concept of shorter settlement periods to reduce risk and, thereby, improve the safety and soundness of the clearance and settlement system, the Board believes that it is important to put into place certain building blocks before moving to a three-day settlement cycle and to conduct a complete study of the costs associated with the implementation of a T+3 settlement cycle on all parties to a transaction.

• **Market Services—**The Board approved a measure to address pricing problems that have surfaced with the execution of open orders for securities quoted ex-dividend, ex-rights, ex-distribution, or ex-interest. Basically, the rule would require members executing such orders to increase, reduce, or adjust the price by the ex-amount except where valuation of the distribution is difficult; in such cases, the customer would have to reconfirm the order. Certain of the rule's provisions would provide for cases where the distribution is not evenly divisible, where the distribution is not in cash, or where the shareholder has the option of the medium of distribution. In addition, the rule would require cancellation of all open orders for securities subject to a reverse stock split. Finally, the rule would not apply to orders governed by the rules of a registered national securities exchange, to orders marked "do not reduce," or to orders marked "do not increase." If members approve the measure, the NASD will file it with the SEC for approval.

As part of its ongoing efforts to ensure investor protection and enhance market quality, the Board approved an Interpretation to Article III, Section 1 of the Rules of Fair Practice that eliminates a "safe harbor" for those members that may trade ahead of customer limit orders. The Board also approved issuance of a special Notice to Members (see *Notice to Members 93-49,* July 23, 1993) soliciting comment on the consequences this action may have for member firms and other interested persons. Comments received on or before August 31, 1993, will be considered before the Interpretation is filed with the SEC. It is anticipated that the SEC will also publish this Interpretation for comment before acting on it. SEC approval of this Interpretation is required before it can become effective.

Changing times have led to the demise of the NASD's local quotations program and the Board has responded by amending the NASD By-Laws to delete Part X of Schedule D, which governed the quotations program. The quotations program provided the news media in specific communities with Nasdaq quotations of local interest. Currently, most news media organizations receive bid/ask quotes and last-sale information for all Nasdaq securities from a media organization or data vendor with access to the data. These media organizations, in turn, now decide how best to use this data based on their own criteria.

A Board-approved change to the Rules of Fair Practice would require regular disclosure of inducements for order flow by members. A 1991 NASD study, *Inducements for Order Flow,* written by an ad hoc committee chaired by former SEC Chairman David S. Ruder, focused on this issue. Such inducements are currently a topic under consideration in the SEC's Market 2000 study.

A measure to mandate participation in an Automated Quotation System for Penny Stocks, designated by the SEC under the Securities Exchange Act of 1934 as a Section 17B system, has received Board approval. The proposal would affect all members that hold themselves out as market makers in "penny stocks" and would require that they participate in such an automated quotation system. With the addition of real-time reporting later this year, the OTC Bulletin Board® (OTCBB) service will satisfy the statutory requirements for such designation.

• **Member Services—**The Board authorized a delegation of Board members, National Arbitration Committee members, and NASD staff members to meet with the SEC

Commissioners and staff to discuss proposals for dealing with punitive damages in arbitration. The issues subject to discussion include a national standard for awarding punitive damages, identification of facts found to constitute a basis for awarding punitive damages, an appeal process for punitive damage awards, and an arbitrator's authority to initiate disciplinary referrals.

A measure approved by the Board for filing with the SEC would empower the Director of Arbitration or, in her absence, the Executive Vice President for Member Services, to decide the eligibility of an arbitration matter when a party to the arbitration challenges the eligibility of a claim. When responding to a filing to dismiss on the basis of eligibility, the decision maker would have to set forth the event or occurrence that gave rise to the dispute and would have to decide the matter of eligibility promptly. Any determination that a claim is not eligible for arbitration would not prevent pursuit of the underlying claim in a judicial forum.

NASD Disciplinary Actions

Disciplinary Actions Reported for August

The NASD® has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, August 16, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this publication.

Firms Expelled

TriPark Securities, Inc. (Chapel Hill, North Carolina) was fined $15,000 and expelled from NASD membership. The National Business Conduct Committee (NBCC) imposed the sanctions following appeal of an Atlanta District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that the firm engaged in activity contrary to representations contained in the private placement memoranda for three offerings of limited partnership interests. Specifically, for two of the offerings, the firm knew that the general partner had failed to purchase units that remained unsold by the termination date of the offerings, and sold these units to investors subsequent to the specified offering termination date. In addition, the firm failed to place investors' funds in escrow accounts for these offerings as required.

Firms Expelled, Individuals Sanctioned

Adams Securities, Inc. (Las Vegas, Nevada), James William Adams (Registered Principal, Henderson, Nevada), Michael Richard Waldman (Registered Representative, Henderson, Nevada), John Bassell Hayden (Registered Representative, Chico, California), and **Mark David Long (Registered Principal, Denver, Colorado).**

The firm was expelled from NASD membership and James Adams was barred from association with any NASD member in any capacity. Waldman was fined $19,000, which may be reduced by any restitution paid to customers up to $9,000. Hayden was fined $12,935, which may be reduced by any restitution paid to public customers up to $7,935. Long was fined $13,408, which may be reduced by any restitution paid to customers up to $3,408. Furthermore, Waldman and Hayden must requalify by examination as general securities representatives before acting in such capacities and Long must requalify as a general securities principal.

The sanctions were based on findings that the firm, acting through Adams, Waldman, Hayden, and Long, engaged in sales to customers of shares of stock in the secondary market at prices that were unfair, in contravention of the NASD Mark-Up Policy, in that such sales resulted in markups ranging from approximately 5.14 to 88 percent.

Firms Suspended

Hutchison Financial Corporation n/k/a Princeton American Equities Corporation (Phoenix, Arizona) was fined $25,000, suspended from membership in the NASD in any capacity for six business days, and had its operations restricted. The Securities and Exchange Commission (SEC) affirmed the sanctions following

appeal of a February 1992 NBCC decision. The sanctions were based on findings that the firm conducted a securities business while failing to maintain its minimum required net capital and filed inaccurate FOCUS Part I reports with the NASD.

This action has been appealed to the United States Court of Appeals for the Ninth Circuit and a stay was granted following the term of the suspension.

The firm's suspension commenced July 12, 1993, and concluded July 19, 1993.

Firms Fined, Individuals Sanctioned

CENPAC Securities Corp. (Phoenix, Arizona) and **Gerald Nelson Bovee (Registered Principal, Phoenix, Arizona)** were fined $20,000, jointly and severally. In addition, Bovee was suspended from association with any NASD member in any capacity for 10 business days and required to requalify by examination as a financial and operations principal. The sanctions were based on findings that the firm, acting through Bovee, conducted a securities business while failing to maintain its minimum required net capital and filed inaccurate FOCUS Part IIA reports.

First American Biltmore Securities, Inc. (Phoenix, Arizona) and **J. Gordon Nevers (Registered Principal, Phoenix, Arizona)** were fined $25,000, jointly and severally, and required, jointly and severally, to pay restitution to customers in the amount of $98,978.28, plus interest at the prime rate plus 3 percent from the date the trades were executed. In addition, Nevers was suspended from association with any NASD member in any capacity for 30 days and required to requalify by examination as a financial and operations principal before acting in that capacity with any NASD member.

The NBCC imposed the sanctions following appeal of a Denver DBCC decision. The sanctions were based on findings that the firm, acting through Nevers, conducted a securities business when it failed to maintain its minimum required net capital and effected transactions in, and induced others to effect transactions in, shares of securities at unfair prices with markup/markdowns ranging from 7.69 to 52 percent above or below the prevailing market price of the securities.

Moreover, the firm, acting through Nevers, engaged in, and induced others to engage in, deceptive and fraudulent devices and contrivances in connection with the purchases and sales of the aforementioned securities.

First Inland Securities, Inc. (Spokane, Washington) and **Glen Lamoyne Ottmar (Registered Principal, Bothell, Washington)** were fined $5,000, jointly and severally, and jointly and severally required to pay $29,393.70 in restitution to customers. Ottmar was also required to requalify by examination as a general securities principal. The NBCC imposed the sanctions following appeal of a San Francisco DBCC decision. The sanctions were based on findings that the firm, acting through Ottmar, effected 14 sales of common stock at unfair prices. Specifically, the respondents charged markups ranging from 15 to 57 percent over the prevailing market price, in violation of the NASD's Mark-Up Policy.

This action has been appealed to the SEC and the sanctions are not in effect pending consideration of the appeal.

J. W. Gant & Associates, Inc. (Englewood, Colorado), Charles F. Kirby (Registered Representative, Littleton, Colorado), and **James Patrick Driver (Registered Principal, Englewood, Colorado)**. The firm was fined $125,000, jointly and severally with one individual, fined another $125,000, jointly and severally with another individual, and fined $62,500, jointly and severally with a third individual. The firm was also required to submit satisfactory proof of payment of $687,500 in restitution, jointly and severally with an individual, to customers. Kirby was fined $5,000, jointly and severally, and suspended from association with any NASD member in any capacity for five business days. James Driver submitted an Offer of Settlement pursuant to which he was fined $10,000, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by examination in any capacity.

The sanctions were based on findings that the firm, acting through Kirby and others, dominated and controlled the market in a stock such that there was no independent, competitive market in the security in that they effected transactions in, and induced others to effect transactions in, the stock at unfair and unreasonable prices with markups ranging from 5.14 to 83.77 percent over the prevailing market price for the securities. Furthermore, the firm, Kirby, and others failed to disclose to their customers that the prices at which they were selling the stock were not fair or reasonable.

In addition, the firm engaged in excessive markups involving two

other stocks, in violation of the NASD's Mark-Up Policy, without disclosing these markups to its customers. The markups on these transactions ranged from 5.74 to 77.33 percent over the prevailing market price.

Moreover, J. W. Gant failed to establish and maintain a system to supervise the activities of its registered representatives to assure compliance with respect to markups. James Driver was responsible for the firm's compliance; however, he failed to enforce its supervisory procedures concerning excessive markups.

Driver's suspension commenced July 26, 1993, and concludes August 24, 1993.

TriPark Securities, Inc. (Chapel Hill, North Carolina) and **Jeffrey R. Boak (Registered Principal, Chapel Hill, North Carolina)** were fined $15,000, jointly and severally. Boak was barred from association with any NASD member in any principal or supervisory capacity. The NBCC imposed the sanctions following appeal of an Atlanta DBCC decision. The sanctions were based on findings that the firm, acting through Boak, failed to file its FOCUS Part I reports and its annual audited reports in a timely manner. In addition, the firm, acting through Boak, failed to designate a financial and operations principal, as required by Schedule C of the NASD's By-Laws.

Firms and Individuals Fined

La Jolla Securities Corporation (La Jolla, California) and **Bruce Alan Biddick (Registered Principal, La Jolla, California)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined $11,475, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanction and to the entry of findings that the firm, acting through Biddick, sold shares of a designated security in 18 transactions, in violation of SEC Rule 15c2-6. Specifically, the findings stated that the respondents failed to approve nine persons' accounts before each of the 18 transactions and failed to receive from each person a written agreement setting forth the identity and quantity of the designated security to be purchased.

Securities America, Inc. (Omaha, Nebraska) and **Charles Felix Tummino (Registered Representative, Rogue River, Oregon)**. The firm submitted an Offer of Settlement pursuant to which it was fined $10,000. Tummino, in a separate decision, was fined $39,139 and required to requalify by examination before registering with any NASD member in any capacity. The sanctions were based on findings that Tummino distributed to customers and to the public a sales brochure that failed to disclose material facts, made exaggerated, unwarranted or potentially misleading statements or claims, and made promises of specific results. Moreover, Tummino placed advertisements soliciting attendance to seminars he conducted, distributed a seminar invitation letter to the public, and published an advertisement in the newspaper when such material was not approved by a registered principal of his member firm before use.

Without admitting or denying the allegations, Securities America, Inc., consented to the described sanction and to the entry of findings that it failed to establish, maintain, and enforce adequate written supervisory procedures or otherwise failed to adequately supervise the activities of registered representatives of the firm to ensure compliance with applicable NASD rules.

Firms Fined

Atlanta Securities & Investments, Inc. (Atlanta, Georgia) was fined $70,000, jointly and severally with other individuals and required to pay $118,300 in restitution, plus interest, to customers. The sanctions were based on findings that the firm conducted a securities business while failing to maintain sufficient net capital and failed to make a record of customer funds received and forwarded. The firm also sold shares of common stocks, as principal, to its public customers at unfair prices with markups exceeding 128 percent.

Furthermore, the firm permitted an individual to function as president and sales representative of the firm without proper registration with the NASD as a general securities principal or registered representative. In addition, the firm failed to file documents with the NASD required by the Interpretation of the Board of Governors concerning Review of Corporate Financing, in connection with public offerings. Also, the firm made false representations concerning offering contingencies, in violation of SEC Rule 10b-9, and failed to establish, maintain, and enforce its written supervisory procedures.

Dominick & Dominick, Incorporated (New York, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which it was fined $50,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to supervise two registered

representatives properly and that its written supervisory procedures were inaccurate and failed to reasonably provide for appropriate supervision of its branch offices and account representatives. The findings also stated that the firm failed to conduct an annual examination of a branch office and an annual compliance meeting with its registered representatives of that branch.

Touchstone Capital Corporation (Dallas, Texas) was fined $20,000 and required to disgorge $16,122.63 in commissions paid to unregistered salesmen. The sanctions were based on findings that the firm permitted five individuals associated with the firm to sell nonexempt securities without proper qualification or registration with the NASD. In addition, the firm violated Section 5 of the Securities Act of 1933 and Rule 506 of Regulation D by selling unregistered, nonexempt securities to public customers who were not eligible to buy those securities.

Individuals Barred or Suspended

Henry William Abts, III (Registered Principal, Los Angeles, California), Theron Hugh Murphy (Registered Principal, Simi Valley, California), and **Jay Lynn Murphy (Registered Representative, Simi Valley, California)**. Abts was fined $15,000, suspended from association with any NASD member in the capacity of general securities principal for 90 days, and required to requalify as a general securities principal before again acting in the aforementioned capacity. Theron Murphy was fined $5,000 and suspended from association with any NASD member as a general securities principal for 30 days, and Jay Murphy was fined $10,000 and suspended from association with any NASD member in any capacity for 45 days.

The NBCC imposed the sanctions following appeal of a Los Angeles DBCC decision. The sanctions were based on findings that Jay Murphy, with the knowledge and consent of Abts and Theron Murphy, engaged in a securities business of a member firm without proper qualification or registration in any capacity whatsoever.

Donald C. Alaimo (Registered Representative, Mt. Laurel, New Jersey) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Alaimo failed to respond to NASD requests for information regarding allegations that he falsified insurance policies and related documents.

Charles King Baldwin (Registered Representative, Charlotte, North Carolina) was fined $26,250, barred from association with any NASD member in any capacity, and ordered to pay $1,250, plus interest, in restitution to a public customer. The sanctions were based on findings that Baldwin received checks from a public customer totaling $1,250 for the purchase of a security and, instead, converted the funds to his own use and benefit without the knowledge or consent of the customer. In addition, Baldwin failed to respond to an NASD request for information.

Robert J. Berry (Registered Representative, Sewell, New Jersey) was fined $30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Berry received from a public customer a $2,000 check intended for the purchase of an individual retirement account. Instead, Berry converted the funds to his own use and benefit. In addition, Berry failed to respond to NASD requests for information.

William Bezemer (Registered Representative, Gilching, Germany) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000 and suspended from association with any NASD member in any capacity for five days. Without admitting or denying the allegations, Bezemer consented to the described sanctions and to the entry of findings that he purchased shares of a common stock in the securities account of a public customer without the customer's knowledge or consent.

Brian J. Bonner (Registered Representative, Coral Springs, Florida) was fined $10,926.25 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Bonner liquidated a mutual fund account for $2,185.25 which he knew did not belong to him and misappropriated the proceeds to his own use and benefit without the owner’s knowledge or authorization.

Larry E. Brewer (Registered Representative, Germantown, Tennessee) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $13,500 and suspended from association with any NASD member in any capacity for one week. Without admitting or denying the allegations, Brewer consented to the described sanctions and to the entry of findings that he recommended and engaged in mutual fund and securities transactions in the account of a public customer without having reasonable grounds for believing that such recommenda-

tions and resultant transactions were suitable for the customer based on the customer's financial situation, investment objectives, and needs. In addition, Brewer exercised discretionary power in the same customer's account without obtaining the customer's prior written authorization or his member firm's prior written acceptance of the account as discretionary.

Don Allen Burk (Registered Principal, Delray Beach, Florida) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Burk failed to respond to an NASD request for information concerning customer complaints.

Timothy L. Burkes (Registered Representative, Pleasanton, California) was fined $16,200 and suspended from association with any NASD member in any capacity for 180 days. The SEC affirmed the sanctions following appeal of a May 1992 NBCC decision. The sanctions were based on findings that, to reach his target production for 1989, Burkes falsified customer names and account numbers so that funds totaling $16,500.54 could be transferred from his member firm's account to his commission account. As a result, Burkes received credit for funds to which he was not entitled.

Burkes has appealed this action to the U.S. Court of Appeals for the Ninth Circuit, and a stay of his sanctions was granted.

Douglas Duane Chapman (Registered Representative, Salina, Kansas) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Chapman consented to the described sanctions and to the entry of findings that he instructed public customers who wished to purchase a variable annuity to redeem shares of mutual funds, deposit the proceeds, and then purchase the annuity.

In connection with these transactions, the findings stated that Chapman made a material misstatement or omitted to state a material fact by failing to advise the customers that they could have acquired the variable annuity through a free exchange, thereby avoiding the 8.5 percent sales commission that the customers would have been charged on the anniversary dates of their purchases.

Kenneth R. Clark (Registered Representative, Laramie, Wyoming) was fined $5,000, suspended from association with any NASD member in any capacity for five business days, and required to requalify by examination in any capacity. The sanctions were based on findings that Clark effected two unauthorized transactions in the joint account of two public customers.

Richard A. Crosby (Registered Representative, Denver, Colorado) submitted an Offer of Settlement pursuant to which he was fined $10,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Crosby consented to the described sanctions and to the entry of findings that he failed to pay a $1,450 NASD arbitration award.

Gary L. Cunningham (Registered Representative, Monte Vista, Colorado) was fined $3,800 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Cunningham received from two public customers $1,000 intended for the purchase of an insurance policy. Cunningham, however, caused $760 of the funds to be deposited into a bank account over which he exercised control and failed to return these funds to the customers for approximately two months.

Antoine Doumad (Registered Representative, Rancho, California) was fined $70,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Doumad caused the issuance of 16 checks totaling $5,409.57 from 13 customers' accounts and submitted forged documents to his member firm requesting the payment of cash surrender values associated with such customers' life insurance policies (and one customer's payment of accumulated dividends) without the customers' knowledge or consent. Doumad took delivery of nine checks totaling $2,602.62, used the checks to purchase new life insurance policies, and received $2,286.69 in commissions based on the purchase of these policies.

In addition, Doumad took delivery of seven other checks totaling $2,806.95, forged the customers' signatures, deposited the funds in his personal checking account, and converted the proceeds. Doumad also failed to respond to NASD requests for information.

Cyrus B. Follmer, Jr. (Registered Representative, Greenville, North Carolina) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $53,000, plus interest, in restitution to public customers. The sanctions were based on findings that Follmer solicited and accepted from public

customers checks totaling $53,000 for the purchase of securities but, instead, deposited the funds in a bank account of a company he owned, and applied the proceeds to his own use and benefit. In addition, Follmer provided to the same customers false and misleading account statements reflecting investments when no such investments had been made.

Andrew H. Geyer (Registered Representative, Kings Park, New York) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Geyer consented to the described sanctions and to the entry of findings that he effected the purchase of shares of a common stock in the account of a public customer without the knowledge or authorization of the customer.

Casey Karen Green (Registered Representative, Huntington Beach, California) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Green consented to the described sanctions and to the entry of findings that she submitted applications for the purchase of life insurance by four fictitious customers and submitted "Requests for Redemption" forms bearing forged signatures in connection with various insurance policies owned by seven customers. According to the findings, Green used the funds so redeemed to purchase other insurance and securities products without the customers' knowledge or consent in order to generate commissions totaling $17,155.

Gilbert M. Hair (Registered Representative, Newbury Park, California) and **Vladimir Chorny (Registered Representative, Camarillo, California)**. Hair was fined $13,250 and Chorny was fined $18,500. The SEC affirmed the sanctions following appeal of a November 1991 NBCC decision. The sanctions were based on findings that Hair and Chorny participated in private securities transactions without giving prior written notification to their member firm.

Harold B. Hayes (Registered Representative, Pleasant Hill, California) was fined $300,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Market Surveillance Committee decision. The sanctions were based on findings that Hayes entered into a payment arrangement with the issuer of common stock whereby he purchased the stock offering with the proceeds from subsequent sales, in violation of SEC Rule 10b-5. Hayes then effected a series of transactions in the common stock that created actual and apparent trading activity for the purpose of inducing the purchase or sale of the stock by others. However, Hayes failed to disclose to his customers the special payment arrangement, the fact that he was paying for the stock with the proceeds of its sales at higher prices to the customers, or that his self-interest could influence recommendations to his customers. As a result of this fraudulent activity, Hayes realized profits of $277,000.

As a creditor and a customer, Hayes arranged for the extension of credit to himself in his payment arrangement with the issuer of the common stock in violation of Regulation T, and, as a borrower who caused an extension of credit, violated Regulation T, thereby violating Regulation X of the Federal Reserve Board. In furtherance of the manipulative scheme, Hayes solicited customers and recommended purchases of the aforementioned stock by making misrepresentations and omissions of material facts. In addition, he knowingly, or with reckless disregard, executed transactions in a registered representative's account without using reasonable diligence to determine that the execution of the transactions would not adversely affect the interests of the representative's member firm.

Furthermore, in his plan to manipulate the stock, Hayes was an undisclosed underwriter in the securities in that he purchased the stock from the issuer, and offered and sold the stock for the issuer, in its distribution.

Stephen F. Hinch (Registered Representative, Charlotte, North Carolina) was fined $250,000, barred from association with any NASD member in any capacity, and required to pay $99,673.13, plus interest, in restitution to his member firm. The sanctions were based on findings that Hinch effected eight unauthorized transactions in the account of a public customer, converted to his own use and benefit funds received from the same customer totaling $58,673.13 without the customer's knowledge or consent, and forged the customer's endorsement on four checks.

Hinch also opened a joint securities account with a member firm in his name and the name of the aforementioned customer using a post office box he controlled and forged the customer's signature on the customer account agreement.

Furthermore, Hinch caused the account of two other public cus-

tomers to be transferred from his member firm to another member firm by using a post office box he controlled, forged the same customers' signatures on account transfer authorization forms, and effected unauthorized transactions in these accounts. In addition, Hinch wrote several checks totaling $187,802.15 on their accounts, and attempted to negotiate the checks by forging the customers' signatures. He also converted $41,000 from one of these customers' accounts.

The NASD found that Hinch opened a joint securities account and maintained an individual securities account at a member firm without notifying the firm in writing that he was associated with another member firm and failed to notify his member firm in writing of the existence of the accounts. Hinch also failed to respond to an NASD request for information.

John M. Hulley (Registered Representative, Grafton, West Virginia) was fined $15,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Hulley forged or caused to be forged a public customer's signature on a life insurance policy application and on a request to withdraw $604.75 in accumulated dividends from the same customer's existing life insurance policy. He then caused the policy dividends to be applied to the new application without the customer's authorization or consent.

Michael J. Janik (Registered Representative, Cherry Hill, New Jersey) was fined $10,000 and suspended from association with any NASD member in any capacity for 20 business days. In addition, Janik must requalify by examination as a general securities representative before becoming associated with any member in that capacity. The sanctions were based on findings that Janik executed unauthorized transactions in the joint account of two public customers.

John Earl Law (Registered Representative, Morgan, Texas) submitted an Offer of Settlement pursuant to which he was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $657,886 in restitution to his member firm and public customers. Without admitting or denying the allegations, Law consented to the described sanctions and to the entry of findings that he converted to his own use and benefit customers' funds totaling $657,886.58 without their knowledge or consent.

Adam Stuart Levine (Registered Representative, New York, New York) was fined $40,000 and barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of a October 1992 NBCC decision. The sanctions were based on findings that Levine effected seven unauthorized transactions in public customer accounts. In addition, without the knowledge or consent of two public customers, Levine transferred their accounts from one member firm to another.

Ellen Lapin Margaretten (Registered Principal, North Miami, Florida) was fined $10,000 and suspended from association with any NASD member in any capacity for 90 days. The suspension will continue thereafter until two arbitration awards have been paid and satisfactory proof of such payments are provided to the Atlanta NASD District staff. The sanctions were based on findings that Margaretten failed to pay $12,000 in NASD arbitration awards.

Calvin Thomas McKibben (Registered Principal, Dallas, Texas) and **Hector Cristobal Carreno (Registered Principal, Dallas, Texas)**. McKibben was fined $2,500, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by examination as a principal. Carreno was fined $10,000, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by examination in any capacity. The sanctions were based on findings that a member firm, acting through McKibben, engaged in securities transactions while failing to maintain its required minimum net capital and failed to maintain accurate books and records.

In addition, the firm, acting through Carreno, fraudulently induced and recommended the purchase of promissory notes to two public customers through the use of false statements while failing to disclose material facts to the customers.

Paul A. Mochinal (Registered Representative, Arlington, Virginia) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Mochinal consented to the described sanctions and to the entry of findings that he submitted a fictitious address change for an insurance customer's life insurance policy to reflect his own address and requested a $1,048 loan against the policy. According to the findings, Mochinal forged the customer's endorsement on the check and converted its proceeds to his own use and benefit.

The NASD also determined that Mochinal submitted to his member firm a fraudulent insurance form for another insurance customer without the customer's knowledge or consent.

Charles Frances Molnar (Registered Principal, Lawrenceville, Georgia) submitted an Offer of Settlement pursuant to which he was fined $3,500 and suspended from association with any NASD member in any capacity for three business days. Without admitting or denying the allegations, Molnar consented to the described sanctions and to the entry of findings that, in violation of the NASD's Mark-Up Policy, a member firm, acting through Molnar, effected principal transactions of a common stock with public customers at prices that were unfair.

Raymond Edward Moore (Registered Representative, Santa Rosa, California) was fined $20,000, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by examination upon completion of the suspension. The NBCC imposed the sanctions following appeal of a San Francisco DBCC decision. The sanctions were based on findings that Moore effected 10 unauthorized securities transactions in a public customer's account and exercised discretion in another customer's account without obtaining the customer's prior written discretionary authority.

John R. Moysey (Registered Principal, Great Falls, Virginia) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $15,000 and barred from association with any NASD member in any principal, supervisory, or managerial capacity. In addition, Moysey was prohibited from having a proprietary interest in a member firm except that he may maintain a non-controlling interest in a member whose stock is publically traded and subject to the reporting requirements of Section 12(g) of the Securities Exchange Act of 1934. Moreover, Moysey was suspended from association with any NASD member in any capacity for 10 business days.

Without admitting or denying the allegations, Moysey consented to the described sanctions and to the entry of findings that he failed to supervise two registered representatives properly and thus failed to detect and prevent violations by these individuals.

Shahrokh Naghdi (Registered Representative, Ellicott City, Maryland) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that, on two occasions, Naghdi indicated on his *Uniform Application for Securities Industry Registration or Transfer* (Form U-4) that he was employed with a firm when, in fact, he was never associated with the firm in any capacity. Naghdi also failed to respond to NASD requests for information.

Michael J. Paetzold (Registered Representative, Carlisle, Pennsylvania) was fined $120,000 and barred from association with any NASD member in any capacity. In addition, he was ordered to pay restitution of the amounts he converted including interest from the dates of conversion. The sanctions were based on findings that Paetzold caused checks totaling $114,247.14 to be issued against customer securities accounts maintained with his member firm and negotiated such checks by depositing the funds to his personal bank account, without the customers' authorization or consent.

Paetzold also failed to respond to NASD requests for information.

Michael A. Parker (Registered Representative, Baltimore, Maryland) submitted an Offer of Settlement pursuant to which he was fined $10,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Parker consented to the described sanctions and to the entry of findings that he misrepresented to a public customer that there would not be any sales charges associated with a mutual fund investment when, in fact, there was a 4.5 percent front-end sales charge.

The findings also stated that Parker prepared for the same customer's signature a mutual fund disclosure form indicating that there would neither be a front-end nor deferred sales charge for the fund. Furthermore, the NASD determined that Parker forged the same customer's signature on another disclosure form indicating that there was a front-end sales charge of 4.5 percent totaling $893.86, and submitted the forged disclosure form to his member firm.

Claude Ray Parrish (Registered Representative, Mexico, Missouri) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Parrish consented to the described sanctions and to the entry of findings that he received from an insurance customer $4,500 to be applied to a life insurance policy premium. The findings also stated that Parrish failed to apply the funds as instructed and, instead, converted the

monies to his own use and benefit without the customer's knowledge or consent.

Robert Lloyd Patrick (Registered Representative, Chesterfield, Missouri) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions are based on findings that Patrick failed to respond to NASD requests for information concerning his termination from a member firm.

Richard R. Perkins (Registered Representative, Englewood, Colorado) and **Michael D. Pittman (Registered Representative, Aurora, Colorado)**. Perkins was fined $97,500 and Pittman was fined $44,500. In addition, Perkins and Pittman were suspended from association with any NASD member in any capacity for two years. The SEC affirmed the sanctions following appeal of a March 1992 NBCC decision.

The sanctions were based on findings that Perkins and Pittman caused over 250 securities transactions to be effected with retail customers at unfair prices, in violation of the NASD's Mark-Up Policy. In addition, Perkins caused the distribution of sales literature regarding such securities that contained misleading information or failed to contain material information. Specifically, the literature failed to discuss the risks involved, contained promissory statements, and failed to disclose that Perkins' firm was a market maker in the securities. Furthermore, Perkins failed to have this literature approved for use by his member firm before its distribution.

Michael D. Pittman (Registered Principal, Aurora, Colorado) was fined $33,547 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions on review of a Denver DBCC decision. The sanctions were based on findings that Pittman effected principal sales of securities to public customers at unfair and excessive prices ranging from 6.52 to 58.73 percent above the firm's contemporaneous cost for the securities. Moreover, Pittman knew, or should have known, that the prices being charged to customers were unfair and unreasonable.

Robert L. Prohaska (Registered Representative, Wheeling, West Virginia) was fined $30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Prohaska received from an insurance customer $126.32 in payment of a life insurance premium and, thereafter, retained the money and failed to remit it to the insurer. In addition, Prohaska received from another insurance customer $77 in payment of an automobile insurance premium, retained the money, and failed to remit it to the insurer. Moreover, Prohaska provided the customer with a falsified certificate of insurance bearing a nonexistent policy number.

Prohaska also failed to respond to NASD requests for information.

William Frederick Rembert (Registered Representative, Torrance, California) was fined $10,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Los Angeles DBCC decision. The sanctions were based on findings that Rembert submitted to his member firm falsified records relating to the purchase by 55 customers of tax-sheltered annuities. Specifically, the documents reported inflated total annual payments to be made by the customers, resulting in commission overpayments to Rembert totaling $24,502.01.

Randy Romero (Registered Representative, Englewood, Colorado) was fined $100,000 and barred from association with any NASD member in any capacity. In addition, he is required to disgorge $200,000 in gross commissions and must offer rescission to customers.

The sanctions were based on findings that Romero effected securities transactions through an unregistered broker/dealer and failed to provide written notification of these transactions to his member firm. Furthermore, Romero effected transactions in the securities of a corporation without providing customers involved in these transactions with material information regarding the risks, merits, and nature of these investments, as well as the current financial condition of the corporation.

Stanley S. Schlorholtz (Registered Representative, Palm Harbor, Florida) was fined $135,000, barred from association with any NASD member in any capacity, and required to pay $16,080.17, plus interest, in restitution to a public customer. The sanctions were based on findings that Schlorholtz engaged in private securities transactions with two public customers without providing prior written notification to his member firm. In addition, Schlorholtz solicited and accepted from a public customer four checks totaling $16,080.17 for investment purposes and, instead, applied the proceeds to his own use and benefit. Schlorholtz also failed to respond to an NASD request for information.

Keith T. Willett (Registered Representative, Louisville,

Kentucky) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $90,000 in restitution to public customers. Without admitting or denying the allegations, Willett consented to the described sanctions and to the entry of findings that he engaged in the sale of unregistered securities, in violation of Section 5 of the Securities Act of 1933.

In addition, the NASD determined that Willett failed to exercise due diligence and examine the operations and assets of an entity before offering and selling the subject investments in the form of shares of collateral to be posted by the entity. The NASD also found that Willett failed to disclose to investors that he had not exercised due diligence and had not verified certain claims made by an individual negotiating a collateralized loan for the entity. Furthermore, the findings stated that Willett engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Scott F. Yermish (Registered Representative, Chevy Chase, Maryland) was fined $100,000 and barred from association with any NASD member in any capacity. In addition, Yermish must pay restitution to all aggrieved customers. The sanctions were based on findings that Yermish received from two public customers checks totaling $41,490.81 intended for the purchase of securities. Yermish, instead, negotiated the checks and converted the funds to his own use and benefit.

In addition, Yermish received from another customer a $19,123 check intended as payment on an Individual Retirement Account. Yermish applied only $9,000 of the funds to the account and converted the balance of $10,123 to his own use and benefit. Yermish also received from the same customer a $7,000 wire transfer into his account for the intended purpose of purchasing municipal securities. Yermish never purchased any securities and converted the funds to his own use and benefit.

Furthermore, Yermish operated as an off-site representative through an entity and represented to a customer that the entity was a subsidiary of his member firm when, in fact, it was never a subsidiary or affiliate of the member. Yermish also prepared and delivered to another customer at least two account statements indicating that the customer had an account at his member firm; however, no such account had ever been established.

Yermish also failed to respond to NASD requests for information.

Individuals Suspended and Fined

Stuart J. D. Mills (Registered Principal, Englewood, Colorado) and **Vincent J. Albanese (Registered Representative, Commack, New York).** Mills was fined $10,000 and suspended from association with any NASD member in any capacity for one year, and Albanese was fined $11,624. In addition, Mills and Albanese were required to requalify by examination before acting in any capacity with any member firm. The NBCC imposed the sanctions following appeal of a Denver DBCC decision. The sanctions were based on findings that Mills and Albanese either solicited, or otherwise caused customer orders to be received and processed for purchases of securities, at unfair and unreasonable prices with gross commissions ranging from 23.08 to 40 percent of the total price paid by customers. Moreover, the respondents failed to disclose to their customers that these prices were unfair and unreasonable.

Mills has appealed this action to the SEC, and the sanctions imposed against him are not in effect pending consideration of the appeal.

Firms Expelled for Failure to Pay Fines and Costs In Connection With Violations

People's Discount Stockbrokers, Inc., Wellesley Hills, Massachusetts

Suspensions Lifted

The NASD has lifted suspensions from membership on the dates shown for the following firms, because they have complied with formal written requests to submit financial information.

IICC-Tradeco, Inc., New York, New York (June 25, 1993)

West-Rim Securities, Inc., Los Angeles, California (July 16, 1993)

Individual Barred For Failure To Comply With Sanctions Imposed

Frank P. Ravenna, Jr., Pomona, New York

Individuals Whose Registrations Were Revoked for Failure to Pay Fines And Costs in Connection With Violations

Charles D. Block, Jr., New Orleans, Louisiana

William C. Boehmer, Jr., Metairie, Louisiana

Willis H. Brewer, Jr., Metairie, Louisiana

Thomas J. Cooke, Charleston, South Carolina

Scott R. Gray, Matairie, Louisiana

Robert H. Griffith, Bayshore, New York

Richard A. Hernandez, Torrance, California

Thomas G. Kibler, Circle Pines, Minnesota

Larry L. Lanier, Atlanta, Georgia

David A. Ledden, Aurora, Colorado

Daniel B. Perry, Henderson, Nevada

Anthony Lee Rick, Niagara Falls, New York

Dean E. Walker, Kezar Falls, Maine

Robert W. Weed, Wilson, Wyoming

Michael C. Woloshin, New York, New York

FOR YOUR INFORMATION

Colorado and Maine Increase Registration, Re-Registration, and Renewal Fees

Effective July 1, 1993, Colorado increased its agent registration, re-registration, and renewal fees to $23 and broker/dealer registration and renewal fees to $104. In addition, Maine increased its broker/dealer registration and renewal fees to $200. Maine's agent fees remained unchanged at $40.

If you have any questions regarding these changes, please call the NASD Member Services Phone Center at (301) 590-6500.

NASD Member Voting Results

As a member service, the NASD publishes the result of member votes on issues presented to them for approval in the monthly *Notices to Members.* Most recently, members voted on the following issue:

• ***Notice to Members 93-35 —*** Proposed Amendment to the Procedures for Filling Vacancies on NASD Nominating Committees. Ballots For: 1,964; Against 122; and Unsigned: 11.

Questions regarding this item should be directed to Stephen Hickman, President's Office, at (2020) 728-8381.

NASD Notice to Members 93-61

Mail Vote — NASD Solicits Member Vote on New Rule Governing the Pricing of Open Orders; **Last Voting Date: October 29, 1993**

Suggested Routing

- ■ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ☐ Systems
- ■ Trading
- ☐ Training

Executive Summary

The NASD invites members to vote on a proposed new section to the Rules of Fair Practice that would require a member holding an open order to adjust the order by the amount of any dividend, payment, or distribution on the day that the security is quoted ex-dividend, ex-rights, ex-distribution, or ex-interest. The text of the proposed amendment follows this Notice. The last date for member vote is October 29, 1993.

Background and Description of The Proposal

The NASD is proposing to amend Article III of the Rules of Fair Practice to require a member holding an open order to adjust the price and, if necessary, the size of the order by the amount of any dividend, payment, or distribution on the day that the security is quoted ex-dividend, ex-rights, ex-distribution, or ex-interest. An open order is one that remains in effect until it is executed, canceled, or expires. Such orders are also known as "good 'til canceled," "limit," or "stop limit."

Because no current NASD rule governs open orders, members holding such orders adjust them according to their own procedures unless the rules of another self-regulatory organization apply to the transaction. These procedures can vary from automatic adjustment, automatic withdrawal, reconfirmation of the order with the customer, or no action. Further, the procedures may vary among orders entered at the same firm because the orders are routed to different firms for execution. As a result, investors may find that their open orders are executed without adjustment after the ex-date at a higher cost per share than they intended based on their valuation of the security. For example, an investor that enters a limit order for a security at $10 per share before the dividend date may have evaluated the security based on the impending dividend declaration. If the investor's order remains open after the ex-dividend date, the investor may find the order "in the money" and executed at a price that assumed a dividend even though he would not be entitled to the dividend.

Moreover, the fact that some members might adjust open orders on ex-dates while others do not, creates confusion for customers and is inconsistent with the high quality and confidence the NASD has sought to promote in The Nasdaq Stock Market℠ and the markets for securities traded over-the-counter. Therefore, the NASD Board of Governors has determined to recommend the adoption of a Rule of Fair Practice to set forth a standard for business practices and ethics in dealing with customer open orders.

Proposed subsection (a) of the new Rule of Fair Practice would require a member holding an open order from a customer or broker/dealer, before executing or permitting the order to be executed, to adjust the price of the order by the amount of any dividend, payment, or other distribution on the ex-date. Paragraphs (a)(i) through (a)(iii) specify the adjustment procedures for certain situations. Paragraph (a)(i) provides that, in the case of a cash dividend or distribution, the price of the order shall be reduced by subtracting the dollar amount of the dividend or distribution from the price of the order and rounding the result to the next lower 1/8 of a dollar. For example, if an issuer declares a $.30 per share dividend, on the ex-dividend date the price of

an investor's open order to purchase 100 shares of that security at $10 per share would be reduced by $.30, which, when rounded down to the nearest variation in trading units, results in a price of 9 5/8 per share. Thus, the investor's initial valuation at $10 per share before the ex-dividend date is proportionately maintained by revising the order to 9 5/8 per share after the ex-date, reflecting the diminished post-dividend value of the security.

Paragraph (a)(ii) provides that for stock dividends or splits, the price of the order shall be reduced by rounding the dollar value of the dividend or split to the next higher 1/8 of a dollar and subtracting that amount from the price of the order. Another method of calculating the price adjustment is to express it as a mathematical formula where the new price per share (rounded to the next lower 1/8) is equal to the number of shares being exchanged for new shares multiplied by the current price per share and is then divided by the number of new shares.

Where:
n = resulting or new price,
D = number of new shares being distributed,
C = number of shares being exchanged for new shares,
P = current price per share;

Then: n = (P x C)/D.

Example #1 — For an open order @ $10 per share and a 3 for 2 distribution, the resulting price per share is:

n = (10 x 2)/3 = 20/3 = $6.67, rounded down to the nearest 1/8 = 6 5/8 per share.

Example #2 — For an open order @ $10 per share and a 5 for 3 distribution, the resulting price per share is:

n = (10 x 3)/5 = 30/5 = $6, which does not require rounding = 6.

Paragraph (a)(ii) also provides for increasing the size of the order to maintain its proportionality with the dollar amount of the original order, taking into account the price reduction. This is accomplished by multiplying the number of shares of the original order by the number of shares to be distributed for each share. The result is then divided by the number of shares to be exchanged for new shares in the distribution. For example, in a 3 for 2 distribution, multiply the size of the original order by 3 and divide the result by 2. Finally, round the resulting number of shares to the next lower round lot. Expressing this as a formula:

Where:
n = the resulting number of shares,
O = the number of shares in the original order,
D = number of new shares being distributed,
C = number of shares being exchanged for new shares;

Then: n = (O x D)/C.

Example #1 — For a 100-share open order and a 3 for 2 distribution, the resulting number of shares is:

n = (100 x 3)/2 = 150 shares, which when rounded down to the next lower round lot = 100 shares, the size of the original order.

Example #2 — For a 1,000-share open order and a 3 for 2 distribution, the resulting number of shares is:

n = (1,000 x 3)/2 = 1,500 shares, which is equal to a round lot and therefore does not require rounding.

Example #3 — For a 1,000-share open order and a 5 for 3 distribution the resulting number of shares is:

n = (1,000 x 5)/3 = 1,666 shares, which when rounded down to the next lower round lot = 1,600 shares.

Paragraph (a)(iii) provides that when a dividend is payable at the option of the stockholder in either cash or securities, the order shall be reduced by the dollar value of the cash or securities, whichever is greater, according to the formulas in Paragraphs (a)(i) and (a)(ii) of the proposed rule. Moreover, if the stockholder opts for securities, the size of the order shall be increased according to the formula in Paragraph (a)(ii).

Proposed subsection (b) requires the member to reconfirm an open order before execution if the value of the distribution cannot be determined. Proposed subsection (c) requires open orders to be cancelled where the security is the subject of a reverse split. Proposed subsection (d) defines the term "open order" as an order to buy that remains in effect for a definite or indefinite period of time until it is either executed, canceled, or expires, including, but not limited to, orders marked "good 'til canceled," "limit," or "stop limit."

Finally, proposed subsection (e) exempts: (1) open orders subject to the rules of a registered national securities exchange, (2) open stop orders to buy, and (3) open sell orders, as well as orders marked "do not reduce" or "do not increase." Open stop orders to buy and open sell orders are exempt because the assumptions underlying such an order may not include the value of an upcoming dividend and the combination of stop and limit prices in such an order makes the effect of repricing unpredictable.

Orders marked “do not reduce” or “do not increase” are the method for the customer to state that he is aware of the implications of not adjusting the order on the ex-date.

Request for Vote

The Board of Governors believes that the adoption of a single method of handling the adjustment of open orders after the ex-date is important to enhancing the quality of The Nasdaq Stock Market and the over-the-counter marketplace. In addition to eliminating the basic unfairness associated with the failure to adjust such orders, the incorporation of a uniform standard contributes to the order and predictability that form the basis for investor confidence and participation. The Board considers the proposal necessary and appropriate and recommends that members vote their approval.

The text of the proposed new section that requires member vote is below. Please mark the enclosed ballot according to your convictions and mail it in the enclosed, stamped envelope to The Corporation Trust Company. Ballots must be postmarked **no later than October 29, 1993**. The amendment will not be effective until it is filed with and approved by the Securities and Exchange Commission.

Questions concerning this Notice should be directed to Elliott R. Curzon, Senior Attorney, at (202) 728-8451, and Robert J. Smith, Attorney, (202) 728-8176 at the Office of General Counsel.

Text of Proposed Rule of Fair Practice

(**Note:** New language is underlined.)

Sec. ____

(a) A member holding an open order from a customer or another broker/dealer shall, before executing or permitting the order to be executed, reduce, increase, or adjust the price and the number of shares of such order by an amount equal to the dividend, payment, or distribution, on the day that the security is quoted ex-dividend, ex-rights, ex-distribution, or ex-interest, as follows:

(i) In the case of a cash dividend or distribution, the price of the order shall be reduced by subtracting the dollar amount of the dividend or distribution from the price of the order and rounding the result to the next lower 1/8 of a dollar;

(ii) In the case of a stock dividend or split, the price of the order shall be reduced by rounding the dollar value of the stock dividend or split to the next higher 1/8 of a dollar and subtracting that amount from the price of the order; provided, further, that the size of the order shall be increased by (1) multiplying the size of the original order by the numerator of the ratio of the dividend or split, (2) dividing the result by the denominator of the ratio of the dividend or split, and (3) rounding the result to the next lower round lot; and

(iii) In the case of a dividend payable in either cash or securities at the option of the stockholder, the price of the order shall be reduced by the dollar value of the cash or securities, whichever is greater, according to the formulas in (a)(i) or (a)(ii), above; provided, that if the stockholder opts for securities, the size of the order shall be increased pursuant to the formula in (a)(ii), above.

(b) If the value of the distribution cannot be determined, the member shall not execute or permit such order to be executed without reconfirming the order with the customer.

(c) If a security is the subject of a reverse split, all open orders shall be canceled.

(d) The term “open order” means an order to buy or an open stop order to sell, including but not limited to “good ’til canceled,” “limit,” or “stop limit” orders which remain in effect for a definite or indefinite period until executed, canceled, or expired.

(e) The provisions of this rule shall not apply to orders: (1) governed by the rules of a registered national securities exchange; (2) marked “do not reduce”; (3) marked “do not increase”; (4) open stop orders to buy; or (5) open sell orders.

NASD NOTICE TO MEMBERS 93-62

Requirements Governing Real-Time Trade Reporting in Over-the-Counter Equity Securities

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

Executive Summary

On July 16, 1993, the Securities and Exchange Commission (SEC) approved an NASD rule change to implement real-time trade reporting for members' over-the-counter transactions in equity securities that were not previously reportable to the NASD in this manner.[1] The equity securities covered by this rule change are those for which members now submit aggregate volume and price range data pursuant to Schedule H to the NASD By-Laws. Regional listings that are ineligible for transaction reporting over the Consolidated Tape are also covered. The new reporting requirements closely track those applicable to Nasdaq-listed securities and will replace the existing reporting procedure under Schedule H. This rule change takes effect on December 20, 1993. The text of the rule change follows this Notice.

Background and Description of Rule Change

The SEC recently approved an NASD rule change (File No. SR-NASD-92-48) that will require real-time reporting of members' over-the-counter transactions in OTC equity securities which are those not classified as a "designated security" for purposes of the reporting requirements contained in Parts XI and XII of Schedule D, or as an "eligible security" in Schedule G to the NASD By-Laws. The securities covered by this rule change are those for which members now submit aggregate volume and price range data pursuant to Section 2 of Schedule H to the NASD By-Laws. When this rule change takes effect on December 20, 1993, Schedule H reporting will be eliminated for these securities.

Today, many OTC equity securities are quoted in the NASD's OTC Bulletin Board® service (OTCBB) and/or in a printed quotation medium such as the Pink Sheets™ publication. It should be noted that the new reporting requirements extend to members' over-the-counter transactions in all issues classified as OTC equity securities regardless of whether they are quoted in any particular quotation medium.[2] Additionally, the requirements will encompass over-the-counter trades in a small number of equities that are listed on one or more regional stock exchanges, but do not qualify for transaction reporting via the Consolidated Tape facility. Members' principal trades in such securities currently fall within the scope of Schedule H reporting.[3] Hence, the new reporting rules will supplant Schedule H reporting for these transactions as well.

The NASD will implement the new trade-reporting regime in two phases. Beginning in December, the NASD will collect and process transaction reports of OTC equity securities exclusively for regulatory purposes. During the first half of 1994, the second phase will commence with real-time dissemination of these transaction reports via the

[1]SEC Release No. 34-32647 (July 16, 1993) 58 FR 39262 (July 22, 1993).

[2]The term "OTC equity security" excludes "restricted securities," as defined by Rule 144(a)(3) under the Securities Act of 1933, as well as any securities designated in The PORTAL℠ Market. Such securities are currently excluded from Schedule H reporting as well.

[3]The reporting of price and volume information pursuant to Section 2 of Schedule H is limited to a member's principal transactions. Under the new reporting rule for OTC equity securities, a member will be required to report dual-agency and principal trades within 90 seconds of execution.

Nasdaq network and the networks of commercial vendors.[4] At that point, member firms and their customers will be able to access last-sale price and volume information for OTC equity securities throughout the business day.

The requirements governing trade-by-trade reporting for OTC equity securities — within 90 seconds of execution — mirror the requirements that members have observed for many years respecting issues listed on the Nasdaq National Market®. For example, the data elements comprising a transaction report for an OTC equity security will be identical to those now required for reporting trades in Nasdaq securities through the Automated Confirmation Transaction (ACT℠) service: security symbol, number of shares, transaction price, and a symbol indicating whether the trade is a buy, sell, or cross.[5] Similarly, the reported price must exclude any markup, markdown, or commission associated with the transaction. Trade reports may be entered through the Nasdaq Workstation® service or a Computer-to-Computer Interface (CTCI) with the ACT processor.[6] The comparison and risk management functions offered by ACT will be available for transactions in OTC equity securities provided they are eligible for processing through the facilities of the National Securities Clearing Corporation.

These new requirements distinguish between an "OTC market maker" and a "non-market maker" for purposes of fixing the reporting obligation in a given situation. The term "OTC market maker" is defined as an NASD member that holds itself out as a market maker by entering proprietary quotations or indications of interest for a particular OTC equity security in any inter-dealer quotation system (e.g., the Pink Sheets or OTCBB). A firm is classified as a "non-market maker" based on the absence of a market-making commitment in any inter-dealer quotation system for the particular OTC equity security. Thus, a firm may be an OTC market maker in some issues and a non-market maker in others.

In transactions between two firms qualified as an OTC market maker in the OTC equity security, only the member representing the sell side reports. If the transaction is between an OTC market maker and a non-market maker in the security, the OTC market maker must always report the transaction. If both members are non-market makers, only the member on the sell side reports the transaction. In transactions between a member and a non-member (e.g., a customer), the member must report.

When implemented, this rule change will materially enhance the NASD's regulatory data base and permit automated surveillance comparable to The Nasdaq Stock Market. The collection of transactional data for OTC equity securities through ACT will also allow the NASD to eliminate Schedule H price/volume reporting for these issues. From an operational standpoint, the new reporting rules will provide consistent trade-reporting and audit-trail requirements across all market segments that the NASD regulates. Finally, development of a facility for collecting and disseminating transaction price and volume data for OTC equity securities will support the NASD's efforts to gain SEC designation of the OTCBB as an automated quotation system for penny stocks pursuant to Securities Exchange Act Section 17B.

Questions regarding this Notice may be directed to Michael J. Kulczak, Associate General Counsel, NASD Office of General Counsel at (202) 728-8811 or NASD Market Surveillance at (800) 925-8156 or (301) 590-6080.

Text of New Part XIII to Schedule D To the NASD By-Laws

(**Note:** New text is underlined; deleted text is in brackets.)

<u>Reporting Transactions in Over-the-Counter Equity Securities</u>

<u>Part XIII</u>

<u>This Part has been adopted pursuant to Article VII of the Corporation's By-Laws and sets forth the trade reporting requirements applicable to members' transactions in equity securities for which real-time trade reporting is not otherwise required (hereinafter referred to as "OTC Equity Securities"). Members shall</u>

[4]However, OTC equity securities trade reports submitted for foreign/ADR issues will not be disseminated. These transaction reports will be captured solely for regulatory purposes. This limitation traces to SEC concerns relating to the trading of unregistered foreign securities (either directly or in ADR form) in the U.S. over-the-counter markets. Nevertheless, such trade reports would still be required to be submitted within 90 seconds following execution.

[5]Entry of counter-party information is mandated under paragraph (d)(4) of the ACT Rules for trade comparison and audit trail purposes.

[6]Additionally, the ACT service desk is available to receive transactional reports by telephone in the event of system failure. The service desk will also accept transaction reports in OTC equity securities from firms that do not have Nasdaq Workstation service, provided that the level of such trading activity remains *de minimis*.

utilize the Automated Confirmation Transaction Service ("ACT") for trade reporting in OTC Equity Securities.

Section 1 — Definitions

(a) Terms used in this Part shall have the same meaning as those defined in the Association's By-Laws and Rules of Fair Practice unless otherwise specified herein.

(b) "OTC Equity Security" means any equity security not classified as a "designated security," for purposes of Parts XI and XII of Schedule D to the Corporation's By-Laws. This term also includes certain exchange-listed securities that do not otherwise qualify for real-time trade reporting because they are not "eligible securities" as defined by Section 1(d) of Schedule G to the NASD By-Laws. The term "OTC Equity Security" shall not include "restricted securities," as defined by Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market.

(c) "Automated Confirmation Transaction Service" or ACT is the service that, among other things, accommodates reporting and dissemination of last sale reports in OTC Equity Securities. Regarding those OTC Equity Securities that are not eligible for clearance and settlement through the facilities of the National Securities Clearing Corporation, the ACT comparison function will not be available. However, ACT will support the entry and dissemination of last sale data on such securities.

(d) "OTC Market Maker" means a member of the Association that holds itself out as a market maker by entering proprietary quotations or indications of interest for a particular OTC Equity Security in any inter-dealer quotation system, including any system that the Securities and Exchange Commission has qualified pursuant to Section 17B of the Securities Exchange Act of 1934. A member is an OTC Market Maker only in those OTC Equity Securities in which it displays market making interest via an inter-dealer quotation system.

(e) "Non-Market Maker" means a member of the Association that is not an OTC Market Maker with respect to a particular OTC Equity Security.

Section 2 — Transaction Reporting

(a) When and How Transactions are Reported

(1) OTC Market Makers shall, within 90 seconds after execution, transmit through ACT last sale reports of transactions in OTC Equity Securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late.

(2) Non-Market Makers shall, within 90 seconds after execution, transmit through ACT or the ACT service desk (if qualified pursuant to Part IX of Schedule D to the By-Laws), or if ACT is unavailable due to system or transmission failure, by telephone to the Market Operations Department, last sale reports of transactions in OTC Equity Securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late.

(3) Last sale reports of transactions in OTC Equity Securities executed between 9:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Last sale reports of transactions in OTC Equity Securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall also be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4 p.m. Eastern Time shall be designated as ".T" to denote their execution outside normal market hours.

(4) All members shall report weekly to the Market Operations Department, on a form designated by the Board of Governors, last sale reports of transactions in OTC Equity Securities that are executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.

(5) A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Article III, Section 1 of the Rules of Fair Practice.

(b) Which Party Reports Transaction

(1) In transactions between two OTC Market Makers, only the member representing the sell side shall report.

(2) In transactions between an OTC Market Maker and a Non-Market Maker, only the OTC Market Maker shall report.

(3) In transactions between two Non-Market Makers, only the member representing the sell side shall report.

(4) In transactions between a member and a customer, the mem-

ber shall report.

(c) Information To Be Reported

Each last sale report shall contain the following information:

(1) Symbol of the OTC Equity Security;

(2) Number of shares;

(3) Price of the transaction as required by paragraph (d) below; and

(4) A symbol indicating whether the transaction is a buy, sell, or cross.

(d) Procedures for Reporting Price and Volume

Members that are required to report pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in OTC Equity Securities in the following manner:

(1) For agency transactions, report the number of shares and the price excluding the commission charged.

(2) For dual agency transactions, report the number of shares only once, and report the price excluding the commission charged.

(3) For principal transactions, except as provided below, report each purchase and sale transaction separately and report the number of shares and the price. For principal transactions that are executed at a price which includes a mark-up, markdown or service charge, the price reported shall exclude the mark-up, mark-down or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the OTC Equity Security, the number of shares involved in the transaction, the published bids and offers with size displayed in any inter-dealer quotation system at the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction.

Exception: A "riskless" principal transaction in which a Non-Market Maker, after having received from a customer an order to buy, purchases the security as principal from another member or customer to satisfy the order to buy or, after receiving from a customer an order to sell, sells the security as principal to another member or customer to satisfy the order to sell, shall be reported as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions which are part of a primary distribution by an issuer or a registered secondary distribution (other than "shelf distributions") or of an unregistered secondary distribution;

(2) Transactions made in reliance on Section 4(2) of the Securities Act of 1933;

(3) Transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security;

(4) Purchases or sales of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market.

Interpretation of the Board of Governors

The Corporation seeks to emphasize the obligations of members to report transactions in OTC Equity Securities within 90 seconds after execution. All transactions in OTC Equity Securities not reported within 90 seconds after execution shall be reported as late, and the Corporation routinely monitors members' compliance with the 90 second requirement. If the Corporation finds a pattern or practice of unexcused late reporting, that is, repeated reports of executions in OTC Equity Securities after 90 seconds without reasonable justification or exceptional circumstances, the member may be found to be in violation of Article III, Section 1 of the Corporation's Rules of Fair Practice. Exceptional circumstances will be determined on a case-by-case basis and may include conditions such as extreme volatility in an OTC Equity Security, or in the market as a whole. Timely reporting of all transactions in OTC Equity Securities is necessary and appropriate for the fair and orderly operation of the marketplace, and to ensure the collection of adequate information for surveillance purposes; the Corporation will, therefore, view noncompliance as a rule violation.

Part [XIII] XIV

Mutual Fund Quotation Program

NASD NOTICE TO MEMBERS 93-63

SEC Approves Changes To Make All Arbitration Awards Publicly Available: Effective October 1, 1993

Suggested Routing

- [x] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [ ] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [ ] Systems
- [ ] Trading
- [ ] Training

Executive Summary

On August 12, 1993, the Securities and Exchange Commission (SEC) approved an amendment to Part III, Section 41(f) of the Code of Arbitration Procedure (Code) making all NASD arbitration awards publicly available. The amendment is effective October 1, 1993. The text of the amendment follows this Notice.

Background

On August 12, 1993, the SEC approved an amendment to Section 41(f) of Part III of the Code making all arbitration awards, their contents, and the names of the arbitrators publicly available. Subsection 41(f), adopted May 10, 1989, made customer arbitration awards publicly available, but with the names of the arbitrators deleted. Industry arbitration awards, including awards involving employment disputes have not previously been available to the public. Parties to an arbitration may, however, obtain copies of awards previously rendered by the arbitrators selected to decide their case.

The amendment to Section 41(f) announced here deletes reference to awards involving public customers, thereby making all awards publicly available; deletes the requirement of removing arbitrators' names from such awards; and deletes the provision for obtaining awards by the arbitrators chosen to hear a particular case involving a public customer, since all awards will now be available. Customer awards issued after May 10, 1989, will include the names of the arbitrators, while industry awards issued after October 1, 1993, including employment cases, will include arbitrators' names.

The amendment was prompted because the current system has become burdensome to both the parties and the Arbitration Department staff. Further, the amendment will make the Code consistent with all other securities industry self-regulatory organizations, some of which make customer awards publicly available without deletion of arbitrators' names, and others that make all awards, including awards in employment cases, available.

Upon implementation of the rule, the NASD will provide parties to an NASD arbitration with a list of all publicly available NASD awards rendered by each arbitrator selected for the case. Listings will include the case name and number, as well as whether the arbitrator concurred or dissented in the decision. The NASD's office in Rockville, Maryland will handle requests and will distribute awards by mail or, in certain instances, by facsimile.

Finally, a party to an arbitration that makes a request will receive, at no cost, either the last five awards rendered by each arbitrator or all the awards rendered by the arbitrator in the last 12 months, whichever is the greater number. Any additional awards will be provided at a cost of $5 per award up to a maximum of $70 per case. Persons not a party to an arbitration will be charged $5 per award, with no ceiling on total charges.

Questions concerning this Notice may be directed to the NASD Arbitration Department at (212) 480-4881.

Text of Amendment to Part III, Section 41 of the Code of Arbitration Procedure

(**Note:** Deletions are in brackets.)

Part III — Uniform Code of Arbitration

* * * * *

Awards

Sec. 41.

* * * * *

(f) All awards [involving public customers] and their contents[, excluding the names of the arbitrators,] shall be made publicly available. [A party to an arbitration involving a public customer may request that the Director of Arbitration provide copies of all awards rendered by the arbitrator(s) chosen to decide its case. A party wishing to obtain such information must notify the Director of Arbitration within three (3) business days of receipt of notification of the identity of the person(s) named to the panel.]

* * * * *

NASD NOTICE TO MEMBERS 93-64

SEC Approves Amendments Concerning Arbitration of Employment-Related Disputes: Effective October 1, 1993

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On August 25, 1993, the Securities and Exchange Commission (SEC) approved amendments to Part I, Section 1, and Part II, Sections 8 and 9, of the Code of Arbitration Procedure (Code) to clarify that employment-related disputes are arbitrable and to provide that employment discrimination or employment claims involving public policy issues should be heard by a panel composed of a majority of public arbitrators.

The amendment is effective October 1, 1993. The text of the amendment follows this Notice.

Background

On August 25, 1993, the SEC approved amendments to Part I, Section 1, and Part II, Sections 8 and 9, of the Code. The amendments clarify that employment-related disputes are arbitrable under the Code and provide that in cases involving employment discrimination or employment claims involving public policy issues, the panel should consist of a majority of public arbitrators.

Amended Section 1 of the Code provides that disputes, claims, or controversies arising out of the employment or termination of employment of an associated person are eligible for submission to arbitration. This change insures that a party to such disputes may compel arbitration. The amendment to Section 8 specifies that matters arising out of the "employment or termination of employment" of an associated person are arbitrable. The amendments cure an existing ambiguity between the language of Section 8, which requires the arbitration of disputes "eligible for submission under Part I between or among members and/or associated persons," and Part I, Section 1, which does not refer to employment disputes as eligible for submission. A new subsection 2 to Section 1 also clarifies that such employment-related disputes are eligible for submission if they are between or among members and associated persons. Finally, amendments to subsection 1(3) clarify that disputes between or among associated persons and public customers are eligible for submission to arbitration.

The NASD has amended Section 8 to clarify that employment disputes are arbitrable through language which parallels the language of the New York Stock Exchange's arbitration code. Amended Section 8 requires the submission of a claim arising out of the employment or termination of employment of an associated person by and with a member.

The NASD also amended Section 9(a) to provide that claims arising out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes, receipt of commissions, or wrongful discharge, the panel of arbitrators shall be made up of industry arbitrators as provided by Sections 9(b)(i), (b)(ii), or 10 of the Code. In all other instances, including age, sex, or race discrimination, sexual harassment claims, or other public policy issues would govern selection of Section 13 or 19, the panel of arbitrators. This would result in a panel with either a single public arbitrator or a majority of public arbitrators. These amendments reflect the NASD's view that disputes involving employment contracts, promissory notes, receipt of commissions, and wrongful discharge implicate industry practice and require industry experience.

Other disputes, however, involving public policy issues such as employment discrimination and sexual harassment require little industry expertise and the interests of the parties are better served by a panel consisting of a majority of public arbitrators.

Questions concerning this Notice may be directed to the NASD Arbitration Department at (212) 480-4881.

Text of Amendments to Part I, Section 1, and Part II, Sections 8 And 9 of the Code of Arbitration Procedure

(**Note:** New language is underlined; deletions are in brackets.)

Part I. Administrative Provisions

Matters Eligible for Submission

Sec. 1. This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(3) of the By-Laws of the National Association of Securities Dealers, Inc., (the Association) for the arbitration of any dispute, claim or controversy arising out of or in connection with the business of any member of the Association, or arising out of the employment or termination of employment of associated person(s) with any member, with the exception of disputes involving the insurance business of any member which is also an insurance company:

(1) between or among members;

(2) between or among members and associated persons;

[2](3) between or among members or associated persons and public customers, or others; and

[3](4) between or among members, registered clearing agencies with which the Association has entered into an agreement to utilize the Association's arbitration facilities and procedures, and participants, pledgees or other persons using the facilities or a registered clearing agency, as these terms are defined under the rules of such a registered clearing agency.

* * * * *

Part II. Industry and Clearing Controversies

Required Submission

Sec. 8. (a) Any dispute, claim or controversy eligible for submission under Part I of this Code between or among members and/or associated persons, and/or certain others, arising in connection with the business of such member(s) or in connection with the activities of such associated persons(s), or arising out of the employment or termination of employment of such associated person(s) by and with such member, shall be arbitrated under this Code, at the instance of:

(1) a member against another member;

(2) a member against a person associated with a member or a person associated with a member against a member; and,

(3) a person associated with a member against a person associated with a member.

* * * * *

Composition of Panels

Sec. 9. (a) In disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions the panel of arbitrators shall be appointed as provided by Sections 9(b)(i), (b)(ii) or 10 of the Code, whichever is applicable. In all other disputes arising out of the employment or termination of employment of an associated person, the panel of arbitrators shall be appointed as provided by Sections 13 or 19 of the Code, whichever is applicable.

[(a)] (b)(i) Except as otherwise provided in Section 9(a) or 10 of the Code, in all arbitration matters between or among members and/or persons associated with members, and where the amount in controversy does not exceed $30,000, the Director of Arbitration shall appoint a single arbitrator to decide the matter in controversy. The arbitrator chosen shall be from the securities industry. Upon the request of a party in its initial filing or the arbitrator, the Director of Arbitration shall appoint a panel of three (3) arbitrators, all of whom shall be from the securities industry.

[(b)] (ii) Except as otherwise provided in Section 9(a), in [In] all arbitration matters between or among members and/or persons associated with members and where the amount in controversy exceeds $30,000, a panel shall consist of three arbitrators, all of whom shall be from the securities industry.

NASD NOTICE TO MEMBERS 93-65

Columbus Day: Trade Date-Settlement Date Schedule

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Columbus Day, Monday, October 11, 1993. On this day, The Nasdaq Stock Market[SM] and the securities exchanges will be open for trading. However, it will not be a settlement date since many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Reg. T Date*
Sept. 30	Oct. 7	Oct. 11
Oct. 1	8	12
4	12	13
5	13	14
6	14	15
7	15	18
8	18	19
11	18	20
12	19	21

Note: October 11, 1993, is considered a business day for receiving customer payments under Regulation T of the Federal Reserve Board.

Transactions made on Monday, October 11, will be combined with transactions made on the previous business day, October 8, for settlement on October 18. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on October 11.

Brokers, dealers, and municipal securities dealers should use these settlement dates to clear and settle transactions pursuant to the NASD® Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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

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*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

NASD NOTICE TO MEMBERS 93-66

Nasdaq National Market® Additions, Changes, And Deletions as of August 24, 1993

Suggested Routing

- [ ] Senior Management
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [x] Internal Audit
- [ ] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

As of August 24, 1993, the following 66 issues joined the Nasdaq National Market®, bringing the total number of issues to 3,238:

Symbol	Company	Entry Date	SOES Execution Level
OMEG	Omega Environmental, Inc.	7/26/93	1000
MPFC	Mountain Parks Financial Corp.	7/27/93	500
XLTCW	Excel Technology, Inc. (2/8/98 Wts)	7/28/93	500
OMGR	Omni Insurance Group, Inc.	7/29/93	1000
QDRMY	Servicios Financieros Quadrum, S.A. (ADR)	7/29/93	500
CEUS	Cairn Energy USA, Inc.	7/30/93	1000
CYDS	Cygne Designs, Inc.	7/30/93	1000
GFII	Greenfield Industries, Inc.	7/30/93	1000
SGHT	StarSight Telecast, Inc.	7/30/93	1000
NWSS	Network Solutions, Inc.	8/2/93	1000
VALFA	Valley Fashions Corp. (Cl A)	8/2/93	1000
VICF	Victoria Financial Corporation	8/2/93	1000
ZALEV	Zale Corporation (WI)	8/2/93	1000
ZALWV	Zale Corporation (7/29/98 Wts) (WI)	8/2/93	1000
ACTL	Actel Corporation	8/3/93	1000
COBI	CoBancorp, Inc.	8/3/93	200
BPTI	Best Power Technology, Inc.	8/4/93	1000
MOCNF	Mid Ocean Limited	8/4/93	1000
ARTHF	Arethusa (Off-Shore) Limited	8/5/93	500
CDTS	Conductus, Inc.	8/5/93	1000
EPTK	EP Technologies, Inc.	8/5/93	1000
MADGF	Madge, N.V.	8/5/93	1000
NSDB	NSD Bancorp, Inc.	8/5/93	200
NRMI	National Record Mart, Inc.	8/5/93	1000
PREF	Preferred Entertainment, Inc.	8/5/93	500
QRSI	QuickResponse Services, Inc.	8/5/93	500
UNIF	Uniflex, Inc.	8/5/93	500
AIRM	Air Methods Corporation	8/6/93	500
AHCC	Arbor Health Care Company	8/6/93	1000
DUAL	Dual Drilling Company	8/6/93	1000
LAUR	Laurel Bancorp, Inc.	8/6/93	500
MCRI	Monarch Casino & Resort, Inc.	8/6/93	1000
RFSI	RFS Hotel Investors, Inc.	8/6/93	1000
PRETB	The Price REIT, Inc. (Ser B)	8/6/93	1000
ATRM	Aetrium Incorporated	8/10/93	1000
DVCO	DavCo Restaurants, Inc.	8/10/93	1000
INOD	Innodata Corporation	8/10/93	1000
INODW	Innodata Corporation (8/9/97 Wts)	8/10/93	1000
WHFI	Wholesome and Hearty Foods, Inc.	8/10/93	1000
CACS	Casino & Credit Services, Inc.	8/11/93	1000
CACSW	Casino & Credit Services, Inc. (8/10/98 Wts)	8/11/93	1000
CCAL	CenCall Communications Corp.	8/11/93	1000
FAHNF	Fahnestock Viner Holdings, Inc. (Cl A)	8/11/93	1000

Symbol	Company	Entry Date	SOES Execution Level
HEII	HEI, Inc.	8/11/93	1000
IMAG	Image Industries, Inc.	8/11/93	1000
TRIP	Triangle Pacific Corp.	8/11/93	500
EZCIA	EZ Communications, Inc. (Cl A)	8/12/93	1000
HOMS	Home State Holdings, Inc.	8/12/93	1000
WELL	The WellCare Management Group, Inc.	8/12/93	500
ELEK	Elek-Tek, Inc.	8/13/93	500
MANU	Manugistics Group, Inc.	8/13/93	500
NGCOV	National Gypsum Company (WI)	8/16/93	1000
NGCWV	National Gypsum Company (7/1/00 Wts) (WI)	8/16/93	1000
KURZ	Kurzweil Applied Intelligence, Inc.	8/17/93	1000
OLHC	Old Lyme Holding Corporation	8/17/93	1000
PROI	CFI ProServices, Inc.	8/18/93	1000
LCIIP	LCI International, Inc. (Pfd)	8/18/93	500
SPSS	SPSS Inc.	8/18/93	1000
FMDAY	Futuremedia Public Limited Company (ADR)	8/19/93	1000
FMDYW	Futuremedia Public Limited Company (ADR) (8/19/96 Wts)	8/19/93	1000
LDRY	Landry's Seafood Restaurants, Inc.	8/19/93	1000
LEVL	Level One Communications Incorporated	8/19/93	500
MLTI	The Multicare Companies, Inc.	8/19/93	1000
TGIS	Thomas Group, Inc.	8/19/93	200
GAMBY	Gambro Incorporated (ADR)	8/23/93	1000
SGIH	Scientific Games Holding Corp.	8/24/93	1000

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since July 23, 1993:

New/Old Symbol	New/Old Security	Date of Change
RPIC/RPICA	Republic Pictures Corp./Republic Pictures Corp. (Cl A)	7/28/93
HTEC/DTMD	Hydron Technologies, Inc./Dento-Med Industries, Inc.	7/30/93
PNJI/PNJIV	Phillips & Jacobs, Inc./Phillips & Jacobs, Inc. (WI)	8/6/93
TDSC/TDSSF	3-D Systems Corp./3-D Systems Inc.	8/16/93
SNRS/SNRS	Sunrise Technologies International Inc./Sunrise Technologies Inc.	8/18/93
FSBI/FSVA	Fidelity Bancorp, Inc./Fidelity Savings Bank	8/20/93

Nasdaq National Market Deletions

Symbol	Security	Date
LPAI	La Petite Academy, Inc.	7/26/93
LPAIG	La Petite Academy, Inc. (Conv Dbs)	7/26/93
CRFC	Crestar Financial Corporation	7/28/93
DAHL	Dahlberg, Inc.	8/2/93
PCEP	Perception Technology Corp.	8/2/93
SCLNW	SciClone Pharmaceuticals Inc. (3/16/97 Wts)	8/9/93
PFBC	Pioneer Fed BanCorp, Inc.	8/10/93

Symbol	Security	Date
PTRK	Preston Corp.	8/11/93
DMED	Diametrics Medical, Inc.	8/12/93
NCBR	National Community Banks Inc.	8/12/93
NCBRP	National Community Banks Inc. (Pfd)	8/12/93
VIFS	Village Financial Services Ltd.	8/12/93
CFBKO	Citizens Federal Bank (Ser 93 Pfd)	8/17/93
ENCL	Enclean, Inc.	8/19/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

NASD DISCIPLINARY ACTIONS

Disciplinary Actions Reported for September

The NASD® is taking disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, September 20, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this publication.

Firms Expelled

General Bond & Share Co. (Denver, Colorado) was fined $45,750 and expelled from NASD membership. The Securities and Exchange Commission (SEC) modified the sanctions following appeal of a February 1992 National Business Conduct Committee (NBCC) decision. The sanctions were based on findings that General Bond accepted $25,750 from 45 issuers in consideration for listing the firm as a market maker in the National Quotation Bureau, Inc.'s "Pink Sheets." However, General Bond did not provide bona-fide market-making services in these issues as evidenced by its lack of trading in the securities. Furthermore, the firm continued to accept payments from or for issuers after being advised by the NASD staff that the payments were not permissible and after representing to the NASD that it would cease such practices.

In addition, General Bond failed to demonstrate that financial information in its files for two issuers was reasonably current, in violation of Exchange Act Rule 15c2-11. Moreover, the firm failed to respond fully to NASD requests for information concerning the firm's practices.

Firms Suspended

Gliksman Securities Corp. (Marina Del Rey, California) was fined $5,000 and suspended from NASD membership until it pays a $134,184 arbitration award. The NBCC imposed the sanctions following appeal of a Los Angeles District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that the firm failed to pay a $92,000 arbitration award and $42,184 in costs and attorneys' fees.

Firms and Individuals Fined

B.R. Stickle & Co. (Chicago, Illinois) and **Bruce R. Stickle (Registered Principal, Chicago, Illinois)** were fined $15,000, jointly and severally. The NBCC imposed the sanction following appeal of a Chicago DBCC decision. The sanction was based on findings that the firm, acting through Stickle, conducted a securities business while failing to maintain its minimum required net capital and while failing to employ an appropriately qualified and registered Limited Principal-Introducing Broker/Dealer Financial and Operations. In addition, Bruce Stickle acted in the aforementioned capacity without passing the appropriate qualification examination.

The respondents have appealed this action to the SEC, and the sanctions are not effective pending consideration of the appeal.

Individuals Barred or Suspended

Crystal Renee Adjani-Williams (Registered Representative, Los Angeles, California) was fined $32,000, which may be reduced by $2,000 in restitution to be paid to a customer, and barred from association with any NASD member in any capacity. The sanctions were based on findings that Adjani-Williams engaged in fraudulent activity by instructing a public customer to wire transfer to her personal bank account $2,000 intended for the purchase of securities for the customer. However, Adjani-Williams did not purchase the securities for the customer nor return the funds, instead, she converted the funds to her own use and benefit. In addition, Adjani-Williams failed to respond to NASD requests for information.

Jose Aguilar (Registered Representative, Cochella, California) was fined $166,493, which may be reduced by $46,493 in restitution paid to a member firm, and barred from association with any NASD member in any capacity. The sanctions were based on findings that Aguilar engaged in a scheme to convert customer funds totaling $46,493 to his own use and benefit. Specifically, Aguilar withdrew funds from client accounts, diverted incoming client checks, and deposited such funds into his personal money market securities account. In addition, Aguilar failed to respond to NASD requests for information.

Adam Barkow (Registered Representative, Philadelphia, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $10,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Barkow consented to the described sanctions and to the entry of findings that he created two life insurance policy applications for two fictitious individuals and submitted such applications to his member firm.

Barry A. Bates (Registered Principal, Aurora, Colorado) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Bates consented to the described sanctions and to the entry of findings that as president of a member firm he failed to establish, maintain, and enforce written supervisory procedures which would have enabled him to properly supervise the activities of the firm's associated persons concerning compliance with the NASD's guidelines for charging markups and markdowns.

Edward W. Bohm (Registered Representative, Atlanta, Georgia) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Bohm failed to respond to NASD requests for information concerning a customer complaint.

Ray A. Booth (Registered Representative, Myrtle Beach, South Carolina) was fined $120,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Booth solicited and accepted from four public customers $23,740 for the purchase of annuities and, instead, converted the monies to his own use and benefit. In addition, Booth failed to respond to NASD requests for information.

Roger M. Brooks (Registered Representative, New York, New York) submitted an Offer of Settlement pursuant to which he was fined $15,000 and suspended from association with any NASD member in any capacity for 15 business days. In addition, Brooks must pay $16,983.50 in restitution plus interest to customers. Without admitting or denying the allegations, Brooks consented to the described sanctions and to the entry of findings that he sold securities to public customers at unfair and unreasonable prices with gross sales credit charges that ranged from 13.6 to 20 percent of the total cost for the transactions.

In addition, the findings stated that Brooks made misrepresentations, unsuitable recommendations, and omissions of material facts to a public customer in the purchase of the aforementioned securities.

Robert F. Brophy (Registered Representative, Aston, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $30,000 and barred from association with any NASD member in any capacity. In addition, he was ordered to pay restitution of the funds misappropriated from insurance customers. Without admitting or denying the allegations, Brophy consented to the described sanctions and to the entry of findings that he converted to his own use and benefit checks totaling $20,697.01 issued to policyholders.

Gary E. Bryant (Registered Principal, Costa Mesa, California) was fined $150,000 and suspended from association with any NASD member in any capacity for two years. The SEC affirmed the sanctions following appeal of an August 1991 NBCC decision.

The sanctions were based on findings that Bryant engaged in an unregistered distribution of shares of a newly created company formed by a merger of a privately held corporation and a publicly traded shell. The securities were unlawfully sold without registration under the Securities Act, and the distribution involved manipulation of the stock's price and excessive markups. Specifically, Bryant manipulated the price of the stock from $.50 to $1 during a two-day period, and overcharged his firm's customers more than $20,000 with markups on the transactions ranging from 10.8 to 100 percent. Furthermore, Bryant failed to develop procedures to accomplish sufficient supervision of a registered representative and failed to enforce his firm's existing procedures.

Daniel L. Dailey (Registered Representative, Delray Beach, Florida) was fined $21,186 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following review of an Atlanta DBCC decision. The sanctions were based on findings that Dailey exercised discretion in the account of a public customer without prior written authorization from the customer or written acceptance of the account as discretionary by his member firm. In addition, Dailey effected 34 options transactions in a public customer's account without authorization and failed to respond to NASD requests for information.

John Sinclair Davidson, Jr. (Registered Principal, Troy, Michigan) submitted an Offer of Settlement pursuant to which he was fined $15,000 and required to requalify by examination as a general securities principal. Without admitting or denying the allegations, Davidson consented to the described sanctions and to the entry of findings that a former member firm, acting through Davidson, conducted a securities business while failing to maintain minimum required net capital and failed to file its FOCUS Parts I and IIA reports on a timely basis.

The findings also stated that the firm, acting through Davidson, failed to maintain a cash receipts and disbursements blotter, a securities received and delivered blotter, and failed to maintain at its main office copies of monthly mutual fund account statements for its customers. In addition, the NASD determined that the firm, acting through Davidson, failed to abide by the terms of its restrictive agreement by conducting an options and a municipal securities business despite the prohibition of each such activity.

Furthermore, the NASD found that the firm, acting through Davidson, conducted a securities business while failing to have an appropriately qualified and registered Limited Principal-Financial and Operations designated by the firm, and Davidson acted in the aforementioned capacity but failed and neglected to become so registered or to pass the qualification examination required to act in such capacity.

George P. Demakos (Registered Representative, Hauppauge, New York) was fined $25,000, barred from association with any NASD member in any capacity, and required to pay $89,000 in restitution to a public customer. The sanctions were based on findings that Demakos made an unsuitable recommendation to a public customer considering her financial situation, investment experience, and needs. In addition, Demakos' false representation to the same customer that the recommendation was a safe investment constituted fraud. Demakos also engaged in private securities transactions without providing prior written notice to his member firm.

Richard A. DeMoss (Registered Representative, Lower Burrell, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that, in 17 instances, DeMoss, acting without the authorization or consent of policyholders, caused their addresses of record to be changed to a post office box under his control. Furthermore, the findings stated that DeMoss caused policy loan checks totaling $30,737.63 to be issued by his member firm to the order of the policyholders. According to the findings, DeMoss forged the policyholders' endorsements on the checks, negotiated the checks, and retained the proceeds thereof.

David Alan Dodge (Registered Representative, Santa Cruz, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Dodge submitted to a member firm and filed with the NASD a *Uniform Application for Securities Industry Registration or Transfer* (Form U-4) which falsely represented that he had not been convicted of any felony.

Mark Allen Elliott (Registered Representative, Independence, Missouri) was fined $7,500 and suspended from association with any NASD member in any capacity for two years. The NBCC imposed the sanctions following appeal of a Kansas City DBCC decision. The sanctions were based on findings

that Elliott failed to respond to NASD requests for information concerning a customer complaint.

Elliott appealed this action to the SEC, and the sanctions are not in effect pending consideration of the appeal.

Paul H. Fried (Registered Representative, Boston, Massachusetts) was fined $10,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Fried failed to respond to NASD requests for information concerning a customer complaint.

Max Friedlander II (Registered Representative, Brooklandville, Maryland) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Friedlander consented to the described sanctions and to the entry of findings that he misrepresented on a Limited Trading Authorization form and to an investor that he was associated with a firm when, in fact, he was never associated with such firm in any capacity.

Michael J. Gaffey (Registered Representative, Salix, Iowa) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Gaffey consented to the described sanctions and to the entry of findings that he received $100 from a public customer for a life insurance contract but, instead, converted the monies to his own use and benefit.

Steven A. Gesualdi (Registered Representative, Danbury, Connecticut) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for five business days. In addition, Gesualdi must pay $2,390.63 in restitution plus interest to customers. Without admitting or denying the allegations, Gesualdi consented to the described sanctions and to the entry of findings that he sold securities to public customers at unfair and unreasonable prices. The gross sales credit charges for the transactions ranged from 15 to 21 percent of the total cost to the customers.

Alan M. Goldstein (Registered Representative, Morton, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $30,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Goldstein consented to the described sanctions and to the entry of findings that, without an insurance customer's knowledge or consent, Goldstein forged an application for a life insurance policy and submitted the application to his member firm. Goldstein also failed to respond to NASD requests for information, according to the findings.

Frederic Peter Gray (Registered Principal, Long Beach, New York), Richard Archer (Registered Principal, Bethpage, New York) and **Robert Kahan (Registered Principal, Rockville Centre, New York)** submitted an Offer of Settlement pursuant to which Gray and Kahan were each fined $7,500 and suspended from association with any NASD member as general securities principals for 30 business days. Archer was fined $2,500 and suspended from association with any NASD member as a general securities principal for 45 business days.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they made misrepresentations to customers concerning the risks of arbitrage investing. The findings also stated that Gray, Archer, and Kahan failed to timely advise their customers that the corporate recapitalization underlying the arbitrage would not take place, which permitted certain favored accounts to unwind their arbitrage positions at more favorable prices than other customers received.

The NASD also found that Gray, Archer, and Kahan failed to investigate the facts surrounding the aforementioned investment to public customers and, therefore, did not have a reasonable basis for recommending it to their respective customers. In addition, the NASD determined that Gray, Archer, and Kahan also favored certain customer accounts while other customer orders went unexecuted.

Mark A. Griffin (Registered Principal, Bethany, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was suspended from association with any NASD member in any capacity for one week, suspended from association with any NASD member in any principal capacity for six months, and required to requalify by examination as a general securities representative within 90 days and as an options principal before acting in that capacity. Without admitting or denying the allegations, Griffin consented to the described sanctions and to the entry of findings that he exercised discretion in the account of a public customer without prior written authorization from

the customer or prior written acceptance of the account as discretionary by his member firm.

Katherine V. Hart (Registered Representative, Norway, Michigan) submitted an Offer of Settlement pursuant to which she was fined $29,000, barred from association with any NASD member in any capacity, and required to pay $8,566.84 in restitution to customers or her former member firm. Without admitting or denying the allegations, Hart consented to the described sanctions and to the entry of findings that she received from public customers monies with instructions to purchase mutual funds. The NASD found that Hart failed to follow the customers' instructions, and used $8,566.84 of the funds for some purpose other than the benefit of the customers.

Richard Wilburt Klindworth, Sr. (Registered Representative, Oronoco, Minnesota) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $7,016.15 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Klindworth consented to the described sanctions and to the entry of findings that he received from two public customers checks totaling $1,407.23 for insurance purposes and, instead, deposited the checks in his personal bank account and converted the proceeds therefrom to his own use and benefit.

Kreskin Norman Lee (Associated Person, San Diego, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Lee received assistance while taking a qualification examination by leaving the examination room, going to his car, and reviewing notes before returning to the examination room.

Jeffrey Ray Ludes (Registered Representative, Novato, California) was fined $5,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Ludes prepared, signed, and sent a letter on his member firm's stationery to a customer using a fictitious name. The letter falsely informed the customer to ignore a notice of policy lapse because the policy had been reinstated.

Mike K. Lulla (Registered Representative, Oklahoma City, Oklahoma) was fined $220,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Kansas City DBCC decision. The sanctions were based on findings that Lulla engaged in fraudulent activity in that he received from a public customer checks totaling $200,000 for investment purposes and, instead, deposited the funds in his personal account and converted the funds to his own use and benefit.

Lulla has appealed the action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Curtis W. Manning (Registered Principal, Park Ridge, Illinois) submitted an Offer of Settlement pursuant to which he was fined $15,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Manning consented to the described sanctions and to the entry of findings that he prepared and delivered to members of the public sales literature that failed to contain material information and/or contained exaggerated, unwarranted, or misleading statements regarding performance reports or summaries on securities owned by members of the public. According to the findings, Manning disseminated the aforementioned sales literature without obtaining prior approval by a designated registered principal of either of his member firms.

The findings also stated that Manning engaged in outside business activities while failing to give prompt written notice of his participation in such activities to his member firm.

William C. Matthews (Registered Principal, Walnut, Michigan) was fined $20,000, barred from association with any NASD member in any capacity, and required to pay $6,000, plus interest, in restitution to a registered representative. The NBCC imposed the sanctions following review of a New Orleans DBCC decision. The sanctions were based on findings that Matthews received from a registered representative checks totaling $6,000 for investment in mutual funds. However, instead of investing the funds, Matthews induced the representative to loan him the funds by promising an inordinate rate of return.

Jerome Anthony Messana (Registered Representative, Staten Island, New York) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for three business days. Without admitting or denying the allegations, Messana consented to the described sanction and to the entry of findings that he failed to pay a $20,756.73 arbitration award.

Roy Michael Mohr (Associated Person, Rushville, Indiana) was

fined $25,000, barred from association with any NASD member in any capacity, and ordered to pay $229 in restitution to a customer. The sanctions were based on findings that Mohr made unauthorized use of a public customer's credit card by making 11 personal charges totaling $229 without the customer's knowledge or consent. Mohr also failed to respond to NASD requests for information.

Laura Ann Montgomery (Registered Representative, Indianapolis, Indiana) was fined $115,000, barred from association with any NASD member in any capacity, and required to pay $19,000 in restitution to a member firm. The sanctions were based on findings that Montgomery caused $19,000 to be withdrawn from a public customer's account without the customer's knowledge or consent, deposited the funds in an account in which she had a beneficial interest, and used all but $2,817.74 for purposes other than for the benefit of the customer. Montgomery also failed to respond to NASD requests for information.

Michael J. Parker (Registered Representative, Oklahoma City, Oklahoma) submitted an Offer of Settlement pursuant to which he was fined $522,000, barred from association with any NASD member in any capacity, and must pay $472,000 in restitution. Without admitting or denying the allegations, Parker consented to the described sanctions and to the entry of findings that by means of manipulative, deceptive, and fraudulent devices, he misappropriated funds totaling $472,000 from six public customers. In addition, the NASD determined that Parker failed to respond to NASD requests for information.

Michael D. Pittman (Registered Principal, Aurora, Colorado) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Pittman consented to the described sanctions and to the entry of findings that he acted as trader for his member firm and effected transactions in common stocks. Specifically, the findings stated that he dominated and controlled the market for the stocks and charged fraudulently excessive markups in excess of 10 percent over the prevailing market prices of the firm's contemporaneous cost for the securities.

Anthony Salvatore Quattrochi (Associated Person, Naperville, Illinois) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $11,000, barred from association with any NASD member in any capacity, and required to pay $2,200 in restitution to the appropriate party.

Without admitting or denying the allegations, Quattrochi consented to the described sanctions and to the entry of findings that he obtained from two public customers a $2,200 check payable to his member firm. According to the findings, the check was intended as insurance premium payments. However, instead of depositing the check as instructed, and without the customers' knowledge or consent, the NASD found that Quattrochi deposited the funds in an account in which he had a controlling interest and misappropriated the monies for his own use and benefit.

Carlos B. Quirino (Associated Person, El Cerrito, California) was fined $100,000, barred from association with any NASD member firm in any capacity, and ordered to pay $33,122 in restitution to a member firm. The sanctions were based on findings that Quirino forged the signature of the president of a member firm on 21 checks totaling $33,122, and misappropriated and converted the proceeds to his own use and benefit.

Nathaniel Randolph (Registered Representative, Santa Ana, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Randolph failed to respond to NASD requests for information concerning an investigation of his termination of employment and complaints of unauthorized trading in three customer accounts.

Edward G. Ratyniak (Registered Representative, Bayonne, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $100,000, barred from association with any NASD member in any capacity, and must pay $29,092.63 in restitution to his member firm. Without admitting or denying the allegations, Ratyniak consented to the described sanctions and to the entry of findings that he requested two loan checks and cash surrender checks totaling $29,092.63 from the insurance policies of three public customers, forged two of their signatures, deposited the funds into his bank account, and converted the monies to his own use.

Frank Paul Ravenna, Jr. (Registered Representative, Pomona, New York) was fined $10,000, suspended from association with any NASD member in any capacity for 30 days, and will be barred from association with any NASD member in any capacity if he fails to pay a $189,596 arbitra-

tion award within 30 days. The sanctions were based on findings that Ravenna failed to pay a $189,596 NASD arbitration award.

Ravenna did not comply with the aforementioned sanction; therefore, he is barred in any capacity.

Carol Ann Rhoads (Registered Principal, Little Rock, Arkansas) was fined $6,700, suspended from association with any NASD member in any capacity for one week, and barred from association with any NASD member in any principal capacity. The NBCC imposed the sanctions following appeal of a New Orleans DBCC decision. The sanctions were based on findings that, acting for an insurance customer, Rhoads sent correspondence to a financial institution that did not disclose certain information and misrepresented material facts that would have directly affected the decision of the lending institution in favor of her customer.

Rhoads also sent correspondence to another insurance customer without obtaining prior written approval of her member firm's designated principal, in accordance with restrictions placed on her by the firm.

Ray C. Rivera, Jr. (Registered Representative, Buffalo Grove, Illinois) was fined $120,000, barred from association with any NASD member in any capacity, and required to pay $9,434.88 in restitution to customers.

The sanctions were based on findings that Rivera violated Section 5 of the Securities Act of 1933 by offering and selling unregistered shares of a common stock to public customers on a solicited basis. Rivera also charged customers fraudulently excessive markups and markdowns in principal transactions in the same stock ranging from 10 to 63 percent, and totaling $148,000. In addition, Rivera charged his retail customers unfair prices on the same stock in that gross sales credits ranged from 10 to 33 percent of the total cost to the customers. Furthermore, Rivera violated SEC's cold-call rule, Rule 15c2-6, by effecting retail sales of a designated security without completing certain required forms.

Robert Maximillian Saar (Registered Representative, Ozone Park, New York) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $123,250 in restitution to his member firm. The sanctions were based on findings that Saar converted customer funds totaling $123,250 intended for investment in an entity by falsely representing to investors that the entity was a division of his member firm when, in fact, it was based at his home address. In addition, Saar failed to respond to NASD requests for information.

William Michael Sanders (Registered Representative, Belton, Missouri) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $13,807.85 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sanders consented to the described sanctions and to the entry of findings that he received from a public customer a $3,362.57 check for the purchase of an insurance policy. Instead, the NASD found that Sanders deposited the check in his agency account, made 11 monthly premium payments, and converted the remaining $2,761.57 to his own use and benefit without the knowledge or consent of the customer.

William John Seymour (Registered Representative, Bakersfield, California) was fined $167,821, which may be reduced by any restitution paid to a customer up to $67,821, and barred from association with any NASD member in any capacity. The sanctions were based on findings that, as executor for a deceased individual's estate, Seymour deposited all monies derived from the estate into a bank account entitled "William J. Seymour, Trustee." Furthermore, Seymour proceeded to convert approximately $67,821 of the funds deposited for the benefit of the deceased individual's wife to his own use and benefit.

James Edward Shickora (Registered Representative, Raritan, New Jersey) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for three business days. Without admitting or denying the allegations, Shickora consented to the described sanction and to the entry of findings that he failed to pay a $6,600 NYSE arbitration award.

Gary R. Sigman (Registered Representative, Wynnewood, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sigman consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Charles Morton Southall (Registered Representative, Pebble Beach, California) submitted an Offer of Settlement pursuant to which he was fined $35,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Southall

consented to the described sanctions and to the entry of findings that he exercised effective control over the account of a public customer and recommended and effected in his account securities transactions that were unsuitable for the customer in view of the size and frequency of the securities.

Steven B. Theys (Registered Principal, Castle Rock, Colorado) was fined $50,000 and barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of a June 1992 NBCC decision. The sanctions were based on findings that Theys' former member firm underwrote an initial public offering for units in a blank-check offering, and placed over 90 percent of the underwriting with its own customers. In aftermarket trading, the firm, acting through Theys, dominated and controlled the market in the security such that there was no independent competitive market in the stock. Furthermore, they sold the units to the firm's retail customers at fraudulently excessive markups ranging from 10.33 to 30 percent over the prevailing inter-dealer price.

Moreover, Theys failed to establish, maintain, or enforce written supervisory procedures that would have enabled him to supervise properly the firm's associated persons concerning markups.

Dale C. Trask (Registered Representative, Swampscott, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $30,000, suspended from association with any NASD member in any capacity for five business days, and required to requalify by examination as a general securities representative. Without admitting or denying the allegations, Trask consented to the described sanctions and to the entry of findings that he engaged in a course of conduct involving the recommendation, purchase, and sale of various mutual funds that were excessive and unsuitable for the account of a public customer in relation to the customer's investment objectives, financial situation, and needs.

Robert L. Uiterwijk (Registered Representative, Soest, Holland) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $145,000 in restitution to his member firm. The sanctions were based on findings that Uiterwijk exercised discretionary authority over the account of a public customer without having first obtained written authorization from the customer. In addition, Uiterwijk misrepresented to the same customer and one other public customer that deposits had been made in their accounts and sent one of the customers a self-generated summary falsely reflecting such deposit. These misrepresentations were found to have been fraudulent in nature by the DBCC. Uiterwijk also failed to respond to NASD requests for information.

Jeffrey Jay Ward (Registered Representative, Roseville, California) was fined $70,000, barred from association with any NASD member in any capacity, and ordered to pay $9,409.85 in restitution to a member firm. The sanctions were based on findings that Ward received from nine insurance customers $9,409.85 and misappropriated the funds. In addition, Ward failed to respond to NASD requests for information.

Charles H. Wilson (Registered Representative, Leicester, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Wilson consented to the described sanctions and to the entry of findings that he created and submitted 12 fictitious insurance policy applications for public customers without their knowledge or consent.

Michael Randolph Wittels (Registered Representative, Newport Beach, California) was fined $23,072.48, which may be reduced by any restitution paid to his former member firm up to $3,072.48, and barred from association with any NASD member in any capacity.

The sanctions were based on findings that, to generate $3,072.48 in commissions for himself, Wittels submitted an insurance application for the purchase of insurance by a fictitious person and submitted an insurance application for an individual without the person's knowledge or consent. Furthermore, Wittels submitted an insurance application for an individual under false pretenses by explaining that the application was necessary for a sales contest. Moreover, Wittels submitted a "Notice Regarding Replacement" form which he forged or caused to be forged to facilitate and expedite the processing of an insurance application for another customer.

Individuals Fined

Harry A. Fredrick III (Registered Principal, Memphis, Tennessee) was fined $12,000 and required to requalify by examination as a general securities representative. The NBCC imposed the sanctions following appeal of a New Orleans DBCC decision. The sanctions were based on findings

that Fredrick executed certain U.S. Government agency securities transactions with public customers. However, Fredrick failed to disclose to the Board of Directors and senior officers that the prices were not reasonably related to the then current market price for the securities. This activity allowed one of the customers to avoid or postpone recognizing loss on its sale of the mortgage-backed securities, a practice commonly referred to as adjusted trading.

In addition, Frederick caused the falsification of the books and records of one customer in that realized losses on the sales were concealed, and the new securities purchased by the other customer were recorded at inflated prices. Furthermore, Fredrick failed to reflect on his firm's books and records that the aforementioned transactions were not effected at the prevailing market price and caused false and misleading confirmations to be mailed to the customers.

Robert Dennis Rickard (Registered Representative, Omaha, Nebraska) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $15,308.24 and required to pay $2,802.34 in restitution to the estate of a public customer. Without admitting or denying the allegations, Rickard 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 such recommendations were suitable for the customers in view of the frequency of the transactions and/or the customers' financial situations and needs.

Firms Expelled for Failure to Pay Fines, Costs, and/or Provide Proof of Restitution in Connection With Violations

Aimco Securities Company, Incorporated, San Diego, California

First American Biltmore Securities, Incorporated, Phoenix, Arizona

Firm Suspended

The following firm was suspended from NASD membership for failure to comply with formal written requests to submit financial information to the NASD. The action was based on the provisions of Article IV, Section 5 of the NASD Rules of Fair Practice and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after each entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

First Banqhouse Investment Group, Inc., New York, New York (August 10, 1993)

Suspension Lifted

The NASD has lifted suspensions from membership on the dates shown for the following firms because they have complied with formal written requests to submit financial information.

Exchange Services, Inc., Richmond, Virginia (July 7, 1993)

Holford Securities (U.S.), Inc., Irving, California (August 16, 1993)

R.J. Telese & Company, Sarasota, Florida (August 3, 1993)

Individual Barred for Failure to Comply With Sanctions Imposed

Gary Clifford Smith, Carthage, North Carolina

Individuals Whose Registrations Were Revoked for Failure to Pay Fines, Costs, and/or Provide Proof of Restitution in Connection With Violations

David M. Bittman, Arlington, Virginia

Alex L. Herman, Denver, Colorado

Jeffrey L. Karlitz, New York, New York

J. Gordon Nevers, Scottsdale, Arizona

For Your Information

"800 Portability" Means You Own Your 800 Telephone Number

As the result of a Federal Communications Commission ruling that took effect May 1, 1993, your firm can now transfer your 800 telephone number from one long-distance company to another. Previously, firms wanting to change their long-distance carriers were inhibited by two factors: the direct costs associated with reprinting stationary, business cards, and marketing materials and the threat of lost business from customers not aware of the firm's new number. With "800 Portability" your firm can now switch long-distance carriers and retain your existing 800 number.

The NASD/MCI Long Distance Program offers members MCI 800 Service at discounted rates of 21 to 27 percent off MCI's regular rates based on usage. In addition, the NASD rebates an additional amount to participating firms. The MCI 800 Service offers members both nationwide and international coverage, single-number dialing, choice of dedicated or switch lines, routing and coverage control, and Direct Termination Overflow (a feature designed to ensure that your customers never receive a busy signal by automatically switching your 800 line call overflow to your normal business lines).

To compare your firm's existing 800 number features and costs with those available through the NASD/MCI Long Distance Program, or to find out about the other services available through the program, call (800) 688-8220.

Rule Changes You Should Note

Effective June 23, 1993, the Securities and Exchange Commission (SEC) approved amendments to Article III, Section 34, Appendix F, Section 5(e) of the Rules of Fair Practice that increased the limit on non-cash compensation or sales incentives that the sponsor of a Direct Participation Program or rollup may pay to an associated person from $50 to $100.

Effective August 10, 1993, the SEC approved amendments to Article IX, Section 4 of the By-Laws that eliminated the special election provisions for filling vacancies on Nominating Committees. Under the new provisions, the Nominating Committee will fill any such vacancies by appointment with such appointment to be effective until the next regularly scheduled election.

NASD NOTICE TO MEMBERS 93-67

Board Eliminates Disclosure Safe Harbor For Members Trading Ahead of Their Own Customers' Limit Orders

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- ■ Trading
- □ Training

Executive Summary

In July, the NASD Board of Governors solicited member comment on eliminating a safe harbor for members trading ahead of customer limit orders. After reviewing comments received from members and others, the Board has taken action to eliminate the disclosure safe harbor and to replace it with a prohibition against members' trading ahead of their own customers' limit orders. The new requirement must be approved by the Securities and Exchange Commission (SEC) before it is implemented. The text of the proposed rule follows the discussion below.

Background and Description of Rule

In July 1993, the Board reviewed the background of the *Manning* disclosure safe harbor and voted to replace it with an Interpretation of Article III, Section 1 of the Rules of Fair Practice that would eliminate the safe-harbor approach and effectively prohibit a member from trading ahead of a customer's limit order.[1] Because of the significance of this change to The Nasdaq Stock Market℠, the Board authorized a *Notice to Members* soliciting comment on how elimination of the safe harbor and adoption of rules prohibiting trading ahead of customer limit orders would affect the operation of member firms and the treatment of investors' orders. The Board also solicited comment on any unintended effects or unacceptable consequences of any new requirements on member firms. Specifically, comment was requested on the impact of the requirements on integrated broker/dealers handling their own customer order flow, on customer limit orders received from other member firms (so-called member-to-member trades), and on market liquidity.

In response to *Notice to Members 93-49*, the NASD received approximately 30 comment letters from members and others. The vast majority of commenters supported elimination of the disclosure safe harbor for market makers trading ahead of their own retail clients. Commenters noted that elimination of the safe harbor would level the playing field for investors, enhance the image of The Nasdaq Stock Market, and instill greater confidence in investors that their limit orders in Nasdaq® would be handled fairly.

Many commenters, however, responded that the NASD should draw a distinction between orders from a member's own customers and orders from another broker/dealer. They pointed out that if the new rule effectively requires a market maker to give a limit order from another broker/dealer priority over its own quote, the potential for profit would be severely reduced and market-maker commitment would also suffer.

After full consideration of the concerns articulated in the comment process, the Board decided to eliminate the disclosure safe harbor and to prohibit member firms that hold their own customer limit orders from trading ahead of those orders. The language of the Interpretation establishes that a member holding its customer's limit order may not continue to trade its market-making position without executing that limit order under the specific terms and conditions that the customer understands and accepts. A member trading ahead of its customer would violate Article III, Section 1 of the

[1] See *Notice to Members 90-37* (June 1990) and *Notice to Members 93-49* (July 1993).

Rules of Fair Practice regarding just and equitable principles of trade.

In this regard, some commenters noted that the NASD should distinguish between retail and institutional customer limit orders, so that a market maker's ability to commit capital to large institutional orders would not be impaired by a narrow reading of "trading ahead." The NASD believes, however, that filling institutional-sized orders generally involves best-effort commitments and trading strategies other than a straight acceptance of a limit order. Firms accepting institutional orders on a best-efforts basis that may involve trading to cover a short position or buying stock along with the institution would not violate the rule as long as the firm maintains a clear understanding with its institutional clientele of the terms under which the order is being executed. Accordingly, the NASD does not distinguish between institutional and retail customers in the Interpretation because the proposed language that allows members to establish specific terms and conditions on each order clearly encompasses institutional orders.

Further, to avoid any unintended consequences from a broader application of the rule, the Board authorized a special task force to examine ramifications of extending limit-order protections to include member-to-member transactions. The task force will analyze the proposal's effect on market liquidity, volume of limit orders, market-maker commitment, spreads, and volatility.

The Board has taken this action as a part of a broader program to ensure investor protection and enhance the quality of the Nasdaq marketplace. The affirmative obligation for firms to protect their customer limit orders and to give them standing over their own market-making activity enhances opportunities for price improvement that directly benefits public investors.

The rule must be approved by the SEC before it becomes effective. Questions regarding this Notice may be directed to Beth E. Weimer, Associate General Counsel, at (202) 728-6998.

Text of Proposed Interpretation to Article III, Section 1 of the Rules of Fair Practice

(**Note:** Proposed language is underlined.)

<u>A member firm that accepts and holds an unexecuted limit order from its customer in a Nasdaq 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 under the specific terms and conditions by which the order was accepted by the firm, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Article III, Section 1 of the Rules of Fair Practice. Nothing in this section, however, requires members to accept limit orders from their customers.</u>

NASD NOTICE TO MEMBERS 93-68

Quotation and Trade-Reporting Rules for Members Dealing in High-Yield Bonds

Suggested Routing

- ■ Senior Management
- □ Advertising
- ■ Corporate Debt
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- ■ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- ■ Trading
- □ Training

Executive Summary

On March 18, 1993, the Securities and Exchange Commission (SEC) approved NASD rules regarding quotation- and transaction-reporting requirements for members trading high-yield, fixed-income securities. The following Notice answers some commonly asked questions about members' new obligations when they are participating in the high-yield market. The new rules can be found in the *NASD Manual* and the system is scheduled to begin roll-out in November 1993, with full implementation in early 1994.

Questions About the Fixed Income Pricing System℠

The Fixed Income Pricing System℠ (FIPS) requires dealers and brokers to display real-time quotes and to enter trade reports for certain high-yield corporate bonds. Participation in FIPS is mandatory for NASD® members holding themselves out as brokers or dealers in FIPS securities. FIPS has been designed to provide greater transparency and improved surveillance to the high-yield bond market. Under the rules of FIPS, NASD members that participate in the high-yield bond market must report all of their over-the-counter transactions in FIPS bonds within five minutes of execution. Trade reports in all other (non-FIPS) high-yield bonds are required by end-of-day. FIPS also gives buyers and sellers ready access to market information. The FIPS consolidated quotation and volume display reveals pricing and trading activity in the marketplace, helping prepare market participants for their own bond trading.

The following covers the most commonly asked questions regarding FIPS functions and the role of participants.

Question #1: What is FIPS?

Answer: The Fixed Income Pricing System, "FIPS," is a screen-based system operated by The Nasdaq Stock Market, Inc., that enables Nasdaq® to collect, process, and display quotes and summary transaction information in eligible high-yield corporate bonds to participants in the system and through information vendors. FIPS market hours for live quotations are 9:30 a.m. to 4 p.m., Eastern Time (ET). Trade reporting hours are from 9 a.m. to 5 p.m., ET.

Question #2: What securities are eligible for quoting in FIPS?

Answer: FIPS securities are fixed income corporate bonds rated BB+ or lower by Standard & Poor's Corporation. Nasdaq established an advisory committee to develop and monitor a list of the top-tier high-yield bonds based on volume, price, name recognition of the issue, research following, and representation from diverse industry groups. As a result, 35 bonds have been initially designated for mandatory quotation in FIPS and that number should rise to 50 within the first year of operation. FIPS participants may also voluntarily display quotes on any other high-yield bonds in which they wish to make markets.

High-yield securities quoted in FIPS that have matured, that have been called, that have been upgraded in rating to investment quality (higher than BB+), or that have been downgraded to an extent that the issue's trading characteristics do not warrant inclusion in the system, will be withdrawn from FIPS and replaced with another issue.

Question #3: What is a FIPS participant?

Answer: A FIPS participant is any

NASD member that is registered as a FIPS dealer or broker. A FIPS dealer buys and sells FIPS securities for its own account on a regular basis. A FIPS broker or broker's broker regularly buys and sells FIPS bonds for the accounts of others.

Question #4: How does a member participate in FIPS?

Answer: To participate as a FIPS dealer or broker, a member must apply for authorization as such with Nasdaq. The application will become effective upon receipt of Nasdaq approval by the member. Once authorized, a participant may begin quoting FIPS securities by first registering in each FIPS security through its FIPS terminal. If a FIPS dealer or broker no longer holds itself out as a dealer or broker in a FIPS security, the participant may voluntarily terminate its registration in that security while maintaining its registration in other FIPS securities.

Question #5: What are the obligations of a FIPS participant?

Answer: FIPS participants must continuously quote the FIPS securities in which they are acting as a dealer or broker. Quotations may be one- or two-sided and must be reasonably related to the prevailing market in each bond. Quotes must reflect a size of 100 bonds ($100,000 par value) and be in increments of 1/8 percentage points. Odd-lot quotations (less than 100 bonds) may also be displayed. FIPS dealers may enter quotations into FIPS under their own name or through a FIPS broker. Quotes entered under a dealer's own name will be identified as such; all others will bear the name of the broker with the dealer remaining anonymous.

A FIPS broker must transmit all quotes received from FIPS dealers to FIPS for dissemination to FIPS participants and information vendors.

Question #6: What happens if a member's ability to enter or update its quotes is impaired?

Answer: The member must contact Nasdaq Market Operations at (800) 243-4284 to request withdrawal of its quotations; however, should the member remain in FIPS, it must execute any orders received from another member at its quotations as disseminated through FIPS.

Question #7: Is a FIPS security subject to quotation halts?

Answer: Nasdaq may halt quotations in a FIPS security by withdrawing all broker and dealer quotations in the issue under the following circumstances:

• Nasdaq or an exchange halts trading in any equity security of a FIPS issuer.

• A FIPS issuer makes a public announcement, or information about the issuer becomes known, that affects trading in the FIPS bond.

Question #8: What is the procedure for reporting trades in FIPS securities and all other high-yield bonds?

Answer: Between 9 a.m and 5 p.m., ET, members must report all transactions in FIPS securities regardless of size or price within five minutes of the execution. Trade reports not filed within five minutes will be considered late and must include the execution time on the report.

Trades in all other high-yield securities (i.e., those not quoted in FIPS) may be reported anytime between 9 a.m. and 5 p.m., ET on trade date but, if not reported by 5 p.m. on trade date, the trade must be reported as late in a manner designated by Nasdaq.

Question #9: How are trade reports submitted?

Answer: Members with a FIPS terminal can submit their trade reports directly to Nasdaq via these terminals, through the dial-up capability provided by the service, or through a computer-to-computer interface with FIPS.

Members without FIPS terminals that averaged five or fewer trades a day in either FIPS securities or other high-yield bonds during the previous calendar quarter may use the FIPS service desk to report trades.

Question #10: Who is responsible for reporting a high-yield bond transaction?

Answer: The obligation to report a transaction in FIPS securities or other high-yield bonds depends on the role of each party in the trade. In transactions between:

• A FIPS dealer and a FIPS broker—the broker reports the trade.

• Two FIPS dealers—the sell-side dealer reports the trade.

• A FIPS participant and non-participant—the FIPS participant reports the trade.

• Two non-participants—the sell-side participant reports the trade.

• A member and non-member—the member reports the trade.

• A clearing firm and a correspondent firm—whichever firm executed the trade.

• A dealer in a riskless principal transaction—the dealer reports as a cross (riskless principal) transaction.

Question #11: When trade reporting, what details must be included in the report?

Answer: Each trade report must include the FIPS security symbol or CUSIP number (if the firm has a computer-to-computer interface with FIPS), number of bonds, unit price (net of commissions, commission equivalents, or accrued interest), time of execution (for late trades or for trades in securities not displayed in FIPS), capacity identifier (principal, agent, or riskless principal), and whether the trade is a buy, sell, or cross. In addition, the report must identify the contra-side broker or dealer or indicate that the contra-side was a customer. For multiple contra-sides, the member must break out the other parties separately in the report along with the number of bonds, unit price, and time of execution associated with each contra-side trade.

Question #12: How should members report odd-lot trades involving fractions of bonds, for example, 10 1/2 bonds @98.125?

Answer: When reporting such a trade, the member has to round up to the nearest whole dollar and bond, for example, report 11 bonds @ 99. Of course, the confirmation to the customer would have to reflect the actual transaction of 10 1/2 bonds @98.125.

Question #13: What transactions do not have to be reported?

Answer: The following transactions do not have to be reported:

• Transactions that are part of a primary distribution or a registered secondary distribution.

• Transactions made as part of a private offering under Section 4(2) of the Securities Act of 1933.

• Transactions where both sides agree to a price unrelated to the current market, for example, so the seller can make a gift of the securities.

• Transactions to acquire underlying securities at a previously established price unrelated to the current market.

• Transactions executed on an exchange.

Question #14: Must members report a trade involving an issue that they know has gone high-yield before Nasdaq becomes aware of it or will Nasdaq simply reject such trade reports?

Answer: A trade report in a high-yield bond is not due until after an issue becomes a part of the Nasdaq high-yield data base. A trade report for a bond not in the data base will be rejected.

Question #15: What will Nasdaq do with the quotation and volume information it collects through FIPS?

Answer: Nasdaq and information vendors will disseminate all quotations on a real-time basis during FIPS operating hours. The information disseminated will include bids and offers from brokers and dealers as well as a calculation of an inside market for each FIPS bond.

Each hour, Nasdaq and vendors will disseminate summary transaction information that will include the high execution price, low execution price, and volume for all transactions reported both in that hour and cumulatively in FIPS securities, aggregated from individual transaction reports made by members. In addition, an end-of-day summary will be disseminated with the day's overall high and low prices and cumulative volume. Transaction information in non-FIPS bonds will be monitored by Nasdaq for surveillance purposes only and not disseminated publicly.

* * * * *

The rules are effective and full implementation of the system is scheduled for early 1994. For general information on FIPS, call S. William Broka, Vice President, Trading and Market Services at (202) 728-8050; questions on the FIPS rules may be directed to Beth E. Weimer, Associate General Counsel at (202) 728-6998; and questions regarding equipment needs may be directed to Market Data Services at (301) 948-6162.

NASD NOTICE TO MEMBERS 93-69

Broker/Dealer and Agent Renewals for 1993-94

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- ■ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The 1993-94 NASD broker/dealer and agent registration renewal cycle begins in early November. This program simplifies the renewal process through the payment of one invoice amount that will include fees for NASD personnel assessments; NASD branch-office fees; and New York Stock Exchange (NYSE), American Stock Exchange (ASE), Chicago Board Options Exchange (CBOE), Pacific Stock Exchange (PSE) maintenance fees; in addition, it is planned that Philadelphia Stock Exchange (PHLX) maintenance fees will also be collected through this invoice. The invoice also includes state agent renewal fees and state broker/dealer renewal fees. Members should read this Notice and the instruction materials included in the invoice package to ensure continued eligibility to do business in the states effective January 1, 1994.

Initial Renewal Invoices

On or around November 11, 1993, initial renewal invoices will be mailed to all member firms. The invoices will include fees for NASD personnel assessments NASD branch office fees; NYSE, ASE, CBOE, PSE, and PHLX (proposed) maintenance fees; state agent renewal fees; and state broker/dealer renewal fees. The NASD must receive full payment of the November invoice **no later than December 17, 1993.**

NASD personnel assessments for 1994 will be based on the number of registered personnel with an approved NASD license as of December 31, 1993. That personnel assessment is $10 per person. NASD branch office assessments will be based on the number of active branches as of December 31, 1993. This branch office assessment is $50 per branch.

Agent renewal fees for NYSE, ASE, CBOE, PSE, PHLX (proposed), and state affiliations are listed in a table enclosed with each invoice. The table includes a list of broker/dealer renewal fees for states that are participating in this year's broker/dealer renewal program. NYSE, ASE, CBOE, PSE, and PHLX (proposed) maintenance fees—collected by the NASD for firms that are registered with NYSE/ASE/CBOE/PSE/PHLX as well as the NASD—are based on the number of NYSE-, ASE-, CBOE-, PSE-, and PHLX-registered personnel employed by the member.

If a state is not participating in this year's broker/dealer renewal program, members registered in that state must contact the state directly to ensure compliance with renewal requirements. In addition, some participating states may require steps beyond the payment of renewal fees to complete the broker/dealer renewal process. Members should contact states directly for further information on state renewal requirements.

Payment of the initial invoice should be in the form of a check made payable to the National Association of Securities Dealers, Inc. The check should be drawn on the member firm's account, with the firm's Central Registration Depository (CRD) number included on the check. Submit the check along with the top portion of the invoice and mail in the return envelope provided with the invoice. To ensure prompt processing, the renewal invoice payment should not be included with other forms or fee submissions. Members should be aware that failure to return payment to the NASD by the

December 17, 1993, deadline will mean a loss of eligibility to do business in the states effective January 1, 1994.

Filing Form U-5

Members may wish to avoid unwanted renewals by filing Form U-5 for agent terminations in one or more jurisdiction affiliations. Because of the increased convenience and flexibility reported by members that used post-dated Forms U-5 for renewals in previous years, the NASD will again process post-dated agent terminations this year. From November 1 to December 17, the NASD will accept and process Forms U-5 (both partial and full terminations) with **post-dated dates of termination**. Under this procedure, if the Form U-5 indicates a termination date of December 31, 1993, an agent may continue doing business in a jurisdiction until the end of the calendar year without being assessed renewal fees for that jurisdiction. Please ensure that Forms U-5 are filed by the renewal deadline date of December 17, 1993. Also, **post-dated Forms U-5 cannot be processed if the date of termination indicated is January 1, 1994, or thereafter**.

Members should exercise care when submitting post-dated Forms U-5. The NASD will process these forms as they are received but cannot withdraw a post-dated termination once processed. To withdraw a post-dated termination, a member would have to file a new Form U-4 **after** the termination date indicated on the Form U-5.

The NASD encourages members having access to the Firm Access Query System (FAQS) to utilize electronic filings for the submission of all Forms U-5 and Page 1s of Form U-4. FAQS offers several advantages to firms in this regard, including the ability to process terminations **immediately**, ensure in-house control over agent registrations, and reduce normal and express mailing costs as well as long-distance telephone charges. It also allows members to handle quickly and efficiently the large filing volumes that typically occur at this time every year. Because of that, the NASD will provide an additional service to FAQS users by expanding the on-line user hours for November and December 1993. The system will be operational from 7 a.m. to 11 p.m., Eastern Time (ET) Mondays through Fridays and will also be available on Saturdays from 9 a.m. to 5 p.m., ET during these months.

Filing Forms BDW

The CRD Phase II program, now in its fifth year, allows firms requesting terminations (either full or state only) to file their Forms BDW with the CRD to avoid the assessment of renewal fees in those jurisdictions that are designated on the Form BDW, **provided that the jurisdiction is a CRD Phase II participant**. Currently, there are seven jurisdictions that are not participating in Phase II. They are:

Alabama
Michigan
Puerto Rico
American Stock Exchange
Chicago Board Options Exchange
New York Stock Exchange
Pacific Stock Exchange.

Firms requesting termination in any of the above-listed jurisdictions must submit a Form BDW directly to the jurisdiction as well as to the CRD.

The deadline for receipt of Forms BDW by the CRD for firms desiring to terminate an affiliation before year-end 1993 is December 17, 1993. This same date applies to the filing of Forms BDW with the jurisdictions that are not participating in Phase II. Post-dated Forms BDW filed with the CRD **will** be accepted and processed in the same manner as post-dated Forms U-5.

Removing Open Registrations

For the seventh year, the NASD will include in the initial invoice package a roster of firm agents whose NASD registration is either terminated or purged due to a deficient condition older than 180 days, but who have approved registrations with states. This roster should aid in the reconciliation of personnel registrations prior to year's end. Firms may terminate obsolete state registrations through the submission of a Form U-5 or reinstate NASD licenses through the filing of a Page 1 of Form U-4. No roster will be included if a firm does not have agents within this category.

Final Adjusted Invoices

On or about January 17, 1994, the NASD will mail final adjusted invoices to members. These invoices will reflect the final status of firm and agent registrations as of December 31, 1993. Any adjustments in fees owed as a result of registration terminations or approvals subsequent to the initial invoice mailing will be made in this final reconciled invoice. If a member has more agents registered at year's end than it did on the November invoice date, additional fees will be assessed. If a member has fewer registered personnel at year's end than it did in November, a credit will be issued.

Included with this adjusted invoice will be the member renewal rosters, which will list all renewed personnel with the NASD, NYSE, ASE, CBOE, PSE, PHLX (proposed), and each state. Persons whose registrations are approved in any of these jurisdictions during November and December will automatically be included in this roster, while registrations that are pending approval or are deficient at year's end will **not** be included in the renewal process. Firms will also receive an NASD branch office roster that lists all branches for which they have been assessed.

Firms then will have a two-month period in which to reconcile any discrepancies on the rosters. All jurisdictions should be contacted directly in writing. Specific information and instructions concerning the final adjusted invoice package will appear in the January 1994 issue of *Notices to Members*, as well as on the inside cover of the renewal roster.

This year's final invoice package will also include a breakdown of fees assessed by billing code for firms that use billing codes in the registration process. This breakdown will aid firms in their internal research and allocation of fees.

Philadelphia Stock Exchange Slated to Join CRD

The PHLX is scheduled to become a participant in the CRD. Once the participation has been officially approved, the CRD will process requests for the PHLX General Securities Representative (GS) registration only and will collect renewal fees for any agent who is approved with the PHLX-GS registration. The PHLX agent renewal fee will be $8.

NASD Collects Florida Broker/Dealer Renewal Fees

For the first time this year, the NASD will be collecting Florida broker/dealer renewal fees on its initial and final adjusted renewal invoices. If a firm is registered in Florida on CRD by November 5, 1993, its invoice will reflect the $200 Florida broker/dealer renewal fee in addition to the $20 per agent renewal fee. In the past, all Florida broker/dealer renewal fees were paid by firms directly to the state.

Questions concerning this Notice may be directed to the NASD Member Services Phone Center at (301) 590-6500.

NASD NOTICE TO MEMBERS 93-70

SEC Amends Rule 17a-5 Giving Additional Responsibilities to Designated Examining Authorities

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) has approved changes to Rule 17a-5. This rule authorizes the designated examining authority (DEA) to grant or deny requests from broker/dealers for extensions of time to file their FOCUS and audited annual financial reports. Also, these amendments permit the DEA to approve a member's request for a change in a date as of which it files the audited annual financial report. Members must now submit these requests to their DEA, not the SEC.

Background

Rule 17a-5 requires broker/dealers to file with the SEC monthly and quarterly reports concerning their financial and operational status. However, the rule allows broker/dealers to file these reports with their DEA, instead of the SEC, if the DEA has a plan on file with the SEC that conforms to paragraph (a)(4) of the rule. Currently, all self-regulatory organizations that are DEAs have approved plans on file.

Under these plans, broker/dealers have filed FOCUS reports with their DEA, and the DEA has provided copies of applicable parts of the reports periodically to the SEC. Also, pursuant to the rule, broker/dealers have filed their annual audits with their DEA and the SEC.

Until now, authority to grant filing extensions for these reports, however, has rested with the SEC; likewise, the SEC approves changes in the "as of" date for filing annual audits. Last March, the SEC proposed delegating this responsibility to the DEA.

The proposal noted that, because the DEA is most familiar with the current financial and operational conditions of the member firms, it is in a better position to respond to their requests. The NASD agreed and supported the proposed rule changes in a comment letter.

Approved Amendments

On August 25, the SEC approved the following amendments to Rule 17a-5. The effective date of these changes is October 1, 1993.

• The authority to grant or deny requests for extensions of time for the filing of FOCUS reports is given primarily to a broker/dealer's DEA.

• The DEA has the primary responsibility to grant or deny broker/dealers' requests for extensions of time to file audited annual financial reports.

• The DEA has the authority to approve changes in the "as of" date of the audited annual financial reports.

Because the authority to approve these requests has been given to the DEA, the SEC also is amending the rule to delete references that give this authority to SEC regional administrators.

Submitting Requests to NASD

Members designated to the NASD must submit, in writing, their requests for extensions of time for filing FOCUS reports or annual audits to the appropriate NASD district office. Members also should contact the district office regarding changes in the firm's audit date.

Questions concerning this Notice should be directed to Samuel Luque, Associate Director, Compliance, at (202) 728-8472.

NASD NOTICE TO MEMBERS 93-71

SEC Provides Relief From Its Net Capital Rule's "Ready Market" Provisions for Foreign Equity Securities; Seeks Comments for Proposed Rulemaking

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On August 13, 1993, the Securities and Exchange Commission (SEC) issued a no-action letter that allows broker/dealers to treat foreign equity securities listed on the FT-Actuaries World Indexes (Indexes) as having a "ready market" under SEC Rule 15c3-1 (net capital rule). The SEC also published a concept release seeking public comment on whether its no-action letter approach is appropriate or if there are better alternative approaches.

Background

The net capital rule requires a broker/dealer to make certain deductions from its net worth to determine its net capital. Generally, these deductions include assets not readily convertible into cash, most unsecured receivables, and certain percentage deductions related to the securities positions the broker/dealer owns or treats as proprietary positions. A 100 percent deduction is taken for securities for which there is no "ready market" as defined in the net capital rule.

Under the rule, a ready market includes "a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sale price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom."

In 1975, the SEC's Division of Market Regulation issued an interpretive letter that addressed the application of the net capital rule's ready market provisions to foreign equity securities. That letter specified that foreign equity securities have ready markets if they are publicly issued in a principal securities market and listed on one of the principal exchanges in the major money markets outside the United States.

The 12 exchanges recognized as "principal exchanges" were Amsterdam, Brussels, Frankfurt, Johannesburg, London, Luxembourg, Montreal, Paris, Sydney, Tokyo, Toronto, and Zurich. Because the SEC said securities listed on these exchanges have a ready market, these securities were subject to haircuts similar to comparable United States securities traded on United States markets.

Current SEC Position

The Division of Market Regulation recently issued a no-action letter that supersedes all prior staff opinions and interpretations regarding the ready marketability of foreign equity securities. In a letter dated August 13, 1993, the SEC stated that broker/dealers may treat foreign equities listed on the Indexes as having a ready market for purposes of the net capital rule.

The Indexes are compiled jointly by the *Financial Times Limited*; Goldman, Sachs & Co.; and County NatWest/Wood Mackenzie (collectively, the Consortium) in conjunction with the Institute of Actuaries and The Faculty of Actuaries. The Indexes include securities listed on exchanges in 24 countries. The SEC's position makes these securities subject to the haircuts specified in paragraph (C)(2)(vi)(J) of the net capital rule, rather than the 100 percent deduction required for securities with no ready market. Broker/dealers now have an

increased number of foreign equity securities meeting the ready market criteria.

The SEC no-action letter that follows this Notice details the election process for securities on the Indexes. In its letter, the SEC notes that the components of the Indexes will be made available on a quarterly basis. Members may rely on the current quarterly Indexes until the publication of the next ones.

The SEC intends to review this position in the near future. To that end, the SEC published a concept release in the August 20, 1993, *Federal Register*, seeking comments on a number of questions regarding the treatment of foreign equity securities under the ready market provisions of the net capital rule.

Questions concerning the Notice may be directed to Brad Darfler, Compliance Department, at (202) 728-8946.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-32748; File No. S7-24-93]

Net Capital Rule

AGENCY: Securities and Exchange Commission.

ACTION: Concept release, request for comments.

SUMMARY: The Securities and Exchange Commission (the "Commission") solicits comment on a number of questions regarding the treatment of foreign equity securities under the "ready market" provisions of the net capital rule, Rule 15c3-1, under the Securities Exchange Act of 1934 ("Exchange Act"). Following receipt of public comments, the Commission will determine whether proposed rulemaking or other action is appropriate In the interim, the Commission is authorizing the Division of Market Regulation ("Division") to issue a no-action letter as to relief to be accorded foreign equity securities under the ready market provisions. The Commission seeks comment on whether this treatment should be revised.

DATES: Comments should be received on or before October 18, 1993

ADDRESSES: People wishing to submit written comments should file three copies thereof with Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW , Washington, DC 20549 All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, (202) 272-2904, Michael P. Jamroz, Branch Chief, (202) 272-2372, or Timothy H. Thompson, Staff Attorney, (202) 272-2398.

SUPPLEMENTARY INFORMATION:

I. Introduction

In determining a broker-dealer's net capital under Rule 15c3-1 of the Securities Exchange Act of 1934, the net capital rule ("Rule"), the broker-dealer deducts from net worth, as computed in accordance with generally accepted accounting principles, assets not readily convertible into cash, including most unsecured receivables, and certain percentage deductions related to the securities and commodity positions that it carries. Paragraph (c)(2)(vii) of the Rule requires a 100% deduction for securities held by the broker-dealer for which there is no "ready market" as defined in paragraph (c)(11) of the Rule.

Paragraph (c)(11) defines a ready market to "include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom." [1]

Generally, for domestic equity securities, the Rule has recognized as liquid those securities which are traded on the United States securities exchanges, NASDAQ securities, and certain other OTC securities where the broker-dealer can demonstrate that there are independent market makers for the security who quote the securities in an inter-dealer network.[2]

With respect to foreign securities, in December 1975, the Division of Market Regulation ("Division") issued an interpretive letter deeming a "ready market" to exist in certain circumstances.[3] Specifically, as described in that letter, only foreign equity securities that were publicly issued in a principal securities market and were listed on one of the principal exchanges in the major money markets outside the United States were deemed to have ready markets and receive haircuts similar to comparable United States securities traded on United States markets. The 12 exchanges in 11 countries which the Division recognized as being "principal exchanges in the major money markets" are: Amsterdam, Brussels, Frankfurt, Johannesburg, London, Luxembourg, Montreal, Paris, Sydney, Tokyo, Toronto, and Zurich.

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[1] The Rule also deems a ready market to exist where securities have been accepted as collateral by a bank where the broker-dealer can demonstrate that the excess of the market value of the securities over the amount of the loan is sufficient to make the loan acceptable as a fully secured loan to banks regularly making secured loans to brokers and dealers.

[2] If a broker-dealer holds a large position of a particular security measured in relation to the normal trading volume in that security (a blockage), the broker-dealer has the burden of proof of showing to its designated examining authority that the amount in excess of a certain trading volume has a ready market. Otherwise he must take a 100% haircut on the excess amount. The aggregate of the most recent four week inter-dealer trading volume in the security is treated as readily marketable by the broker-dealer· *See* letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, to Edward Kwalwasser, Esq., Senior Vice President, New York Stock Exchange Inc., and Thomas R. Cassella, Vice President, National Association of Securities Dealers, Inc., dated October 5, 1987.

[3] Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, to Anthony M. O'Connor, Co-Chairman, International Committee, SIA, dated December 29, 1975.

II. Concerns With the 1975 Approach

The Securities Industry Association ("SIA") has requested that the Commission adopt the FT–Actuaries World Indexes ("FT–A World Indexes") [4] as a ready market test for foreign equity securities.[5] The SIA believes this treatment will more accurately reflect the liquidity of foreign securities in today's markets. The SIA suggests that the Division's current ready market interpretation could hinder U.S. broker-dealers in the global marketplace for securities.

The FT-Actuaries World Indexes are indices on exchanges from 24 countries [6] and are jointly compiled by The Financial Times Limited, Goldman, Sachs & Co. and County NatWest/Wood Mackenzie (together, the "Consortium") in conjunction with The Institute of Actuaries and the Faculty of Actuaries.[7]

The Consortium generally attempts to include the largest, most liquid exchanges in its indexes so long as they meet certain standards for data dissemination and international interest. In determining which issues to include from a particular exchange, the Consortium subjects the issues listed on the exchange to five tests to screen out any small capitalization, illiquid, or restricted ownership stock. The Consortium also considers the economic sectoral make-up of a market before determining which individual stocks to include.

In an earlier letter, the Capital Committee of the SIA stated that "the interpretation of 'ready market' contained in the 1975 letter . . . no longer accurately assesses the liquidity of foreign securities and results, in some cases, in onerous haircuts on securities that trade in what are in fact demonstrably liquid markets." [8] The Capital Committee argued that since 1975 "new foreign securities markets have been established and the volume of trading in foreign securities by U.S. broker-dealers has increased significantly."

An objective approach that recognizes the most liquid individual securities from a large number of markets may be preferable to recognizing the stocks listed on particular exchanges in total for a number of reasons. First the process of recognizing ready markets can raise sensitive perception concerns for foreign markets. The use of an objective approach which recognizes some securities from virtually all developed markets would solve most of these concerns. It also would, in the case of the SIA proposal, shift responsibility to a credible group which compiles a widely-followed index. Moreover, it would avoid the difficulties inherent in a case-by-case determination by the Commission of ready market status; reliance would be placed on the objective determination of the index compilers. Second, the objective approach would eliminate the incongruity of giving capital value to illiquid securities listed on a recognized exchange while giving no value to world class securities which are traded on exchanges not now recognized.

III. Questions for Comment

The Commission seeks comment on whether it would be advisable for the Commission to recognize privately prepared indexes for ready market purposes. The Commission also seeks comment on whether the advantage of having a system where the most liquid securities generally are considered to be readily marketable outweighs problems that may arise from the Commission adopting this role. Finally, the Commission seeks recommendations on alternative approaches.

By the Commission

Dated: August 16, 1993

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 93–20140 Filed 8–19–93; 8:45 am]

BILLING CODE 8010-01-P

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[4] The markets represented in the FT–A World Indexes and the number of securities from each market (in parentheses) are: 1 Austria (18), 2. Belgium (42), 3. Denmark (33), 4. Finland (23), 5. France (98), 6. Germany (62), 7. Ireland (15), 8. Italy (73), 9. Netherlands (24), 10. Norway (22), 11 Spain (46), 12. Sweden (36), 13. Switzerland (55), 14. United Kingdom (219), 15. Canada (108), 16. United States (519), 17. Australia (68), 18. Hong Kong (55), 19. Japan (470), 20. Malaysia (69), 21. New Zealand (13). 22. Singapore (38), 23. Mexico (18), and 24. South Africa (60). As of Friday, June 4, 1993. Source: Financial Times.

[5] Letter from Dominic Carone, Chairman, Capital Committee, SIA, to Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, dated October 8, 1992. By letter dated August 13, 1993 the Division took a no-action position in which it stated that broker-dealers may treat foreign equity securities listed on the FT–A World Indexes as having a ready market for purposes of Rule 15c3–1 of the Exchange Act. That letter withdrew the applicability of all prior staff opinions relating to the ready marketability of foreign equity securities, including the 1975 letter referred to in footnote 3.

[6] All U S. securities would continue to be considered readily marketable if they are quoted on an established securities market. Of the 2,184 equities on the FT–A World Indexes as of June 4, 1993, 519 are U.S. securities.

[7] The Faculty of Actuaries and the Institute of Actuaries are two professional actuarial societies based in the United Kingdom. These societies have participated in the development and calculation of indexes on the UK market since 1929.

[8] *See supra,* note 5.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

August 13, 1993

Dominic A. Carone
Chairman
Capital Committee
Securities Industry Association
120 Broadway
New York, New York 10271

Re: Ready Marketability of Foreign Equity Securities

Dear Mr. Carone:

Your letter, dated October 8, 1992,1/ requests on behalf of the Capital Committee of the Securities Industry Association ("SIA"), that the Division of Market Regulation ("Division") advise the SIA, on behalf of its members and similarly situated broker-dealers, that the Division will not recommend that the Commission take enforcement action if broker-dealers treat the foreign equity issues that are listed on the FT-Actuaries World Indexes (the "Indexes") as having a ready market with respect to the ready market and haircut provisions of Rule 15c3-1 of the Securities Exchange Act of 1934 (17 C.F.R. § 240.15c3-1) ("Rule").

I.

In determining a broker-dealer's net capital under the Rule, a broker-dealer is required generally to deduct from net worth as computed in accordance with generally accepted accounting principles, assets not readily convertible into cash, most unsecured receivables, and certain percentage deductions related to the securities positions that it carries. Paragraph (c)(2)(vii) of the Rule includes a 100% deduction for securities held by a broker-dealer for which there is no ready market as defined in paragraph (c)(11) of the Rule. A lesser deduction is required for securities which are deemed to have a ready market.

With respect to foreign securities, in December 1975, the Division issued an interpretive letter deeming a "ready market" to

1/ Letter from Dominic A. Carone, Chairman, Capital Committee, Securities Industry Association, to Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, dated October 22, 1992.

exist in certain circumstances.2/ Specifically, as described in that letter, only foreign equity securities that were publicly issued in a principal securities market and are listed on one of the principal exchanges in the major money markets outside the United States are deemed to have ready markets and receive haircuts similar to comparable United States securities traded on United States markets. The 12 exchanges in 11 countries which the Division recognized as being "principal exchanges in the major money markets" are: Amsterdam, Brussels, Frankfurt, Johannesburg, London, Luxembourg, Montreal, Paris, Sydney, Tokyo, Toronto, and Zurich.3/

In your letter, you state that "since 1975, new foreign securities markets have been established and the volume of trading in foreign securities by U.S. broker-dealers has significantly increased," thus, causing U.S. broker-dealers to compete in a global marketplace. You argue that U.S. broker-dealers are adversely affected in this global marketplace because the interpretation of ready market contained in the 1975 letter no longer accurately assesses the liquidity of foreign equity securities. Thus, the SIA Capital Committee recommends that the Division recommend no action if broker-dealers treat the foreign equity securities listed on the FT-Actuaries World Indices as having a ready market.4/

II.

The FT-A World Indices are jointly compiled by The Financial Times Limited, Goldman, Sachs & Co., and County NatWest/Wood Mackenzie (together, the "Consortium") in conjunction with The Institute of Actuaries and The Faculty of Actuaries. The aim of the Consortium was to create and maintain a series of high-quality equity market indices for use by the global investment community.

The Consortium reviews annually the exchanges to be included in the indices. In determining which exchanges to include the

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2/ Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, to Anthony M. O'Connor, Co-Chairman, International Committee, SIA, dated December 29, 1975.

3/ Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, to Anthony M. O'Connor, Co-Chairman, International Committee, Securities Industry Association, dated December 29, 1975.

4/ The components of the Indices will be made available to the New York Stock Exchange and the National Association of Securities Dealers on a quarterly basis for distribution to their members. Reliance may be placed on the quarterly Indices until publication of the following quarterly Indices.

Consortium looks at the following criteria: direct equity investment by non-nationals must be available; accurate and timely data must be available; no significant exchange controls should exist which would prevent the timely repatriation of capital or dividends; significant international investor interest in the local equity market must have been demonstrated; and adequate liquidity must exist.

We understand that, in determining which issues to include on the Indices the Consortium subjects the issues listed in the different markets to five investibility screens to determine the investible universe. The first screen, the Size Screen, excludes the bottom 5% of any market's capitalization. The second screen, the Total Restriction Screen, excludes any foreign security which foreign investors are barred from owning. The third screen, the Partial Restriction Screen, excludes a portion of the capitalization of an issue where the security has restrictions on foreign ownership. A fourth screen, the "Free Float" Screen, generally excludes a security where one or more identifiable holders acting in concert holds more than 75% of the outstanding issue. The fifth screen, the Liquidity Screen, excludes any security that fails to trade for more than fifteen working days within each of two successive quarters.

Once the Consortium has determined the investible universe for a given market, it selects constituent stocks in order to capture about 85% of this investible universe. The Consortium also determines the economic sectoral make-up of each market before determining the individual stocks to include. The stocks are selected so that the index reflects the economic sector distribution of the investible universe.

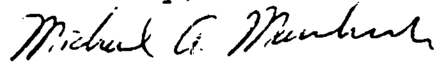
III.

Based on the above, the Division will not recommend to the Commission that enforcement action be taken as to section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3-1 thereunder if broker-dealers treat foreign equity securities listed on the FT-A World Indices as having a ready market for the purposes of the Rule. These securities will be subject to the haircuts specified under paragraph (c)(2)(vi)(J). All prior staff opinions relating to the ready marketability of foreign equity securities, including those contained in the letter to Anthony O'Connor of the SIA International Committee, dated December 29, 1975, are hereby withdrawn and should not be relied upon. You also should note that this letter is not intended to validate the use of the Indexes in any other context, but that the relief provided by this no-action letter is limited specifically to the terms herein.

You should be aware that this is a staff position with respect to enforcement action only and does not purport to express any legal conclusions. This position is based solely on the foregoing

description; any factual variations may warrant a different response. This position may be withdrawn or modified if the staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise, in furtherance of the purposes of the securities laws. In any event, the position stated herein will be reviewed by June 30, 1995. We expect to work with your Committee in determining the efficacy of this approach.

Sincerely,



Michael A. Macchiaroli
Associate Director

NASD NOTICE TO MEMBERS 93-72

SEC Approves Major Revisions to Rule 17a-11

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) recently approved changes to Rule 17a-11 that eliminate certain burdensome filing requirements. The requirements to give notice basically are unchanged. These amendments are the first major revisions to the rule in more than 20 years, which took effect August 12, 1993.

Background

Adopted in 1971, SEC Rule 17a-11 requires broker/dealers to report net capital and other operational problems and to file reports regarding those problems within certain time periods.

In October 1992, the SEC solicited comments on its proposal to relieve broker/dealers of the obligation to submit FOCUS reports when their net capital declines below certain levels. During the public comment period, the SEC Division of Market Regulation issued a no-action letter authorizing broker/dealers' designated examining authority (DEA) to waive the FOCUS filing requirements of paragraphs (a) and (b) of the rule when the notification was given by the broker/dealer within the specified time frames.

After reviewing the comments, the SEC decided these changes would not compromise the ability of the DEA or the SEC to monitor the condition of broker/dealers. The SEC adopted the proposed amendments substantially as proposed.

Summary of Amendments

In general, the amendments reduce certain reporting burdens on broker/dealers by eliminating the requirement that a broker/dealer submit supplemental reports to the SEC and other regulatory organizations when its net capital declines below certain specified levels, or in other instances that indicate the existence of financial or operational difficulties. The specific rule changes are discussed below.

Notice of Net Capital Deficiency

Broker/dealers still have to transmit notice of a net capital deficiency on the same day it occurs. That notice must now specify the broker/dealer's net capital requirement and its current amount of net capital. However, the amended rule eliminates the requirement that broker/dealers file a FOCUS report within 24 hours after notifying the SEC of a net capital deficiency.

The amended rule also requires a broker/dealer to give notice of a net capital deficiency when informed of such by its DEA or the SEC, even if the broker/dealer disagrees with the finding. The broker/dealer may specify in the notice its reasons for disagreeing.

Notification Regarding Subordination Agreements

The changes eliminate reference to the requirement that a broker/dealer notify the SEC telegraphically when its total outstanding principal amounts of satisfactory subordination agreements exceed the maximum allowable for more than 90 days. The SEC decided this reference was not needed since such a condition is a net capital violation that requires same-day notification to the DEA.

Early Warning Levels

Rule 17a-11 currently contains

three early warning levels. First, a broker/dealer that computes its net capital under the basic method must give notice if its aggregate indebtedness exceeds 1,200 percent of its net capital. Second, a broker/dealer that computes its net capital under the alternative standard has to give notice if its net capital falls below 5 percent of its aggregate debit items computed under the Reserve Formula. Third, a broker/dealer that computes its net capital under either standard is required to give notice if its total net capital declines below 120 percent of its minimum requirement.

Before, if any of these events occurred, a broker/dealer had to file a FOCUS report within 15 days after month end for three successive months. The amendments to the rule eliminate this filing requirement and replace it with a provision that requires a broker/dealer to give notice of any of these events within 24 hours of its occurrence. The SEC determined that the prompt notice requirement provides regulators with sufficient warning. Thereafter, any additional information necessary to monitor a broker/dealer's financial or operational condition may be requested by the DEA or the SEC.

Notification of Books and Records Deficiency

The amendments to the rule clarify the time within which a broker/dealer must give notice if it fails to make and keep current its required books and records. Instead of requiring a broker/dealer to give notice "immediately," the rule now specifies that notice must be given the same day of the event.

Transmittal of Required Notices and Reports

The amended rule lets a broker/dealer transmit any required notice by facsimile transmission or by telegraph. In addition, the reports regarding a books and records deficiency or a material inadequacy may be transmitted by overnight delivery.

References to Other Financial Responsibility Notice Requirements

The amended rule expands the list of references to the SEC's financial responsibility notice requirements to include all notice requirements contained in the net capital rule, the customer protection rule, and Rule 17a-5. This change does not add any additional reporting requirements; instead, it clarifies the references by including all pertinent ones rather than just some of them.

Other Amendments

The adopted amendments also include other changes. The structure of the rule has been reorganized and includes certain technical revisions.

In addition, because some paragraphs have been redesignated, the SEC had to make technical revisions to Rule 17a-5 that refer to paragraphs in Rule 17a-11.

One final amendment concerns Appendix D of the net capital rule. Currently Rule 15c3-1d prohibits a broker/dealer from entering into a temporary subordinated loan during any period in which the firm is subject to any of the reporting provisions of Rule 17a-11, including the period in which a broker/dealer had to file FOCUS reports, which requirement has now been eliminated.

Therefore, to prevent a broker/dealer from obtaining temporary subordinated loans during periods of financial or operational difficulties, the SEC is prohibiting a broker/dealer from obtaining a temporary subordinated loan if it has given notice under Rule 17a-11 within the preceding 30 calendar days.

* * * * *

A copy of the SEC's release concerning the change to Rule 17a-11, which was published in the *Federal Register*, Volume 58, Number 132, for July 13, 1993, is attached for your review. If you have any questions, please call Derick Black, Compliance Department, at (202) 728-8225.

FEDERAL REGISTER

EFFECTIVE DATE: The amendments shall become effective on August 12, 1993.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, (202) 272-2904, Roger G. Coffin, (202) 272-7375, or Elizabeth K. King, (202) 272-3738, Division of Market Regulation, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

A. Background

Section 17(a) of the Exchange Act provides the Commission with the authority to promulgate rules requiring registered broker-dealers to make and transmit reports that the Commission deems necessary in the public interest or for the protection of investors. Pursuant to this authority, the Commission adopted Rule 17a-11 (the "Rule") in 1971.[1] The Rule imposes a duty on broker-dealers to report net capital and other operational problems and to file reports regarding those problems within certain time periods. Although there have been minor revisions to the Rule since it was adopted, this is the first comprehensive examination of Rule 17a-11 in over 20 years. The Commission believes that the requirements to file FOCUS Reports may be eliminated without compromising the ability of the Commission or the Designated Examining Authorities ("DEAs") to monitor the condition of broker-dealers.

B. Proposal

On October 26, 1992, the Commission proposed for comment amendments to Rule 17a-11[2] that, in part, would relieve broker-dealers of the obligation to furnish the Commission with Part II or Part IIA of Form X-17A-5 ("FOCUS Report")[3] when their net capital declines below certain levels. During the public comment period, the Commission authorized the Division to issue a no-action letter permitting the DEAs to waive the requirement to file a FOCUS Report as currently required by paragraphs (a) and (b) of Rule 17a-11. In response to its proposal to amend Rule 17a-11, the Commission received two comment letters, one from the National Association of Securities Dealers, Inc. (the "NASD"), and one from the Chicago Mercantile Exchange (the "CME"), both of which supported the proposed amendments. The Commission is adopting the proposed amendments in substantially the form as proposed.

II. Rule Amendments

A. Paragraph (a)

Currently, paragraph (a) of Rule 17a-11 requires every broker-dealer whose net capital falls below its required minimum level, or whose total outstanding principal amounts of satisfactory subordination agreements exceed allowable levels for more than 90 days, to do two things. First, the broker-dealer must give notice of the event on that same day. Second, the broker-dealer must file a FOCUS Report within 24 hours of the notice.

The Commission is eliminating the requirement that broker-dealers file a FOCUS Report within 24 hours after notifying the Commission of a net capital deficiency. Broker-dealers will remain obligated to transmit notice of a net capital deficiency on the same day of the occurrence. Unlike the previous rule, however, the amendments require the notice to specify the broker-dealer's net capital requirement and its current amount of net capital.[4] The amendments also require a broker-dealer who has been notified by the Commission or its DEA of a net capital deficiency to give notice of the deficiency, even if the broker-dealer disagrees with the Commission's or the DEA's determination. In such a case, the amendments permit the broker-dealer to specify the reasons for its disagreement in the notice.

The same-day notice requirement gives the Commission and the DEAs adequate early warning of financial or operational problems. After receiving notice of a capital deficiency, the Commission or a DEA will be able to increase its surveillance of a broker-dealer experiencing difficulty and to obtain any additional information necessary to assess the broker-dealer's financial condition.

The amendments also eliminate the notification requirement for broker-dealers whose total outstanding principal amounts of satisfactory subordination agreements exceed the maximum allowable for a period in excess of 90 days. A broker-dealer is currently required, pursuant to paragraph (c)(2) of Rule 15c3-1d, to give notice to its DEA if, after giving effect to all subordinated loans that are mature or which are scheduled to mature within six months, its net capital declines below the identical levels contained in paragraph (a) of Rule 17a-11. The Commission believes that the notice provided for in Rule 15c3-1d is sufficient to give regulators an early warning of problems involving a broker-dealer's subordinated loan agreements.

B. Paragraph (b)

Paragraph (b) of Rule 17a-11 currently requires every broker-dealer whose net capital does not equal or exceed a certain level to file a monthly FOCUS Report for at least three months. The capital level contained in paragraph (b) is higher than the minimum level referred to in paragraph (a), and is referred to as an "early warning level."[5] When a broker-dealer's net capital level is declining, it would first trigger the filing requirements set forth in paragraph (b) of the Rule. If the broker-dealer's net capital continues to drop, and it falls below the broker-dealer's base minimum capital requirement, the broker-dealer would be required to comply with the additional FOCUS Report filing and notice requirements of paragraph (a) of the Rule.

The amendments to paragraph (b) of the Rule eliminate the requirement that a broker-dealer file a FOCUS Report within 15 days after the end of each month for three successive months. In lieu of this requirement, the amendments require brokers-dealers to give notice promptly (but within 24 hours) after the event triggering the filing requirement. The Commission expects that this notice requirement will be sufficient to alert the Commission and the broker-dealer's DEA that a broker-dealer may be experiencing financial or operational difficulty.

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[1] Securities Exchange Act Release No. 9268 (July 30, 1971), 36 FR 14725 (Aug. 11, 1971).

[2] Securities Exchange Act Release No. 31355 (Oct. 26, 1992), 57 FR 49156 (Oct. 30, 1992).

[3] FOCUS Reports contain schedules including the broker-dealer's: net capital; assets and liabilities; and income and expenses. Generally, Part IIA is filed by broker-dealers that do not clear or carry customer accounts, and those broker-dealers that are subject to the requirements of paragraphs (a)(2) and (a)(3) of Rule 15c3-1. Part II is filed by all other broker-dealers engaged in a general securities business and subject to paragraph (a)(1) of Rule 15c3-1.

[4] Many of the notices received by the Commission already contain this information. The Commission believes it would be appropriate, however, to specify the contents of the notice in the Rule to standardize the notices received.

[5] There are three early warning levels. First, a broker-dealer that has elected to compute its net capital under the basic method must give notice if its aggregate indebtedness, as defined in Rule 15c3-1, exceeds 1,200 percent of its net capital. Second, a broker-dealer that computes its net capital under the alternative standard is required to give notice if its net capital falls below 5 percent of its aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirement for Brokers and Dealers under Rule 15c3-3. Third, a broker-dealer that computes its net capital under either standard is required to give notice if its total net capital declines below 120 percent of its minimum requirement. If a broker-dealer falls out of net capital compliance, it must comply with both paragraphs (a) and (b) of Rule 17a-11.

Thereafter, the Commission or the DEA may require any additional information that it deems necessary to monitor the condition of the broker-dealer.

In their comment letters, both the NASD and the CME supported the proposed elimination of the reporting requirements. The NASD and the CME agreed that prompt notice by a broker-dealer experiencing financial or operational difficulties will provide its DEA with sufficient early warning to monitor the broker-dealer's condition.

C. Paragraph (b)(4)

The Commission is amending certain other paragraphs of Rule 17a–11. For example, there are references in paragraph (b)(4) of Rule 17a–11 to three existing notice provisions set forth in the net capital rule requiring broker-dealers subject to those provisions to give notice in accordance thereto. However, paragraph (b)(4) of Rule 17a–11 does not reference all of the applicable net capital[6] or customer protection rule[7] notice provisions (such as the requirement to give notice of large withdrawals of capital under paragraph (e) of Rule 15c3–1), and the Commission believes it would be appropriate for the Rule to do so. Accordingly, the Commission is amending Rule 17a–11 to refer to five previously existing notice provisions contained in the net capital rule, the customer protection rule, and Rule 17a–5.

These amendments do not add any additional reporting burdens because they simply reference certain notice sections for clarification purposes and do not, by themselves, create an obligation to report. Additionally, the net capital rule, the customer protection rule and Rule 17a–5 will remain unchanged (with the exception of minor technical revisions to Rule 17a–5 and Rule 15c3–1d discussed below). Rather, the Rule will be clarified to contain a complete, rather than a partial, listing of the Commission's financial responsibility notice requirements.

D. Paragraph (c)

Under current paragraph (c) of Rule 17a–11, every broker-dealer is required to give notice immediately if it fails to make and keep current its required books and records. In order to clarify the time within which notice must be transmitted under paragraph (c) of the Rule, the amendments require notice to be provided the same day of the event.

E. Paragraph (f)

Paragraph (f) of the Rule (which will be redesignated as paragraph (g)) requires broker-dealers to give notice by telegraph and to transmit reports to the principal office of the Commission in Washington, DC, the regional office of the Commission for the region in which the broker-dealer has its principal place of business, and the broker-dealer's DEA. The amendments specify that notice required by the Rule may be given or transmitted by means of either a facsimile transmission or telegraph. The amendments also state that the report required by paragraph (c) or paragraph (d) of Rule 17a–11 may be transmitted by overnight delivery.

F. Other Amendments

The Commission is adopting amendments that reorganize the Rule 17a–11's structure and make certain technical revisions. For example, references in the current Rule to "his" will be changed to "its" in order to eliminate any gender-specific language.

In addition, because the amendments will redesignate the notice requirement currently contained in paragraph (f) of Rule 17a–11 to paragraph (g), certain sections of Rule 17a–5 that refer to paragraph (f) require technical modification. Accordingly, the Commission is adopting revisions to certain sections of Rule 17a–5 that would change the references to paragraph (f) of Rule 17a–11 to paragraph (g).

Finally, paragraph (c)(5)(i) of Rule 15c3–1d permits a broker-dealer to obtain temporary subordinated loans in certain circumstances in order to participate in activities such as securities underwritings. Currently, Rule 15c3–1d prohibits a broker-dealer from entering into a temporary subordinated loan during any period in which the broker-dealer is subject to "any of the reporting provisions" of Rule 17a–11.[8] This provision was intended to cover the period in which a broker-dealer was required to file FOCUS reports under Rule 17a–11, which requirement is being eliminated by the Commission.

In order to retain the net capital rule's prohibition against a broker-dealer obtaining a temporary subordinated loan during a period of financial or operational difficulty, the Commission is making a technical amendment to paragraph (c)(5)(i) of Rule 15c3–1d. Based on a recommendation by the NASD, paragraph (c)(5)(i) is being amended to prohibit a broker-dealer from obtaining a temporary subordinated loan if it has given notice under Rule 17a–11 within the preceding thirty calendar days. This amendment will enable the DEAs to prevent a broker-dealer from obtaining temporary subordinated loans during periods in which the broker-dealer may be experiencing financial or operational difficulties.

III. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604 concerning the final rule amendments. The FRFA states that the Commission did not receive any comments concerning the Initial Regulatory Flexibility Analysis. A copy of the FRFA may be obtained by contacting Elizabeth K. King, Division of Market Regulation, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC, 20549, (202) 272–3881.

IV. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly section 15 thereof, 15 U.S.C. 78o, the Commission is amending §§ 240.17a–11, 240.17a–5, and 15c3–1d of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 240

Brokers, Confidential business information, Reporting and recordkeeping requirements, Securities.

Text of the Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78*l*, 78m, 78n, 78o, 78p, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, and 80b–11, unless otherwise noted.

* * * * *

2. § 240.15c3–1d is amended by revising the second sentence of the introductory text of paragraph (c)(5)(i) to read as follows:

§ 240.15c3–1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3–1).

* * * * *

(c) * * *

(5) * * *

[6] Rule 15c3–1 (17 CFR 240.15c3–1).

[7] 17 CFR 240.15c3–3.

[8] 17 CFR 240.15c3–1d(c)(5)(i).

(i) * * * This temporary relief shall not apply to a broker or dealer if, within the preceding thirty calendar days, it has given notice pursuant to § 240.17a-11, or if immediately prior to entering into such subordination agreement, either:

* * * * *

2. § 240.17a-5 is amended by revising paragraph (c)(2)(iii) and revising the first three sentences of paragraph (h)(2) to read as follows:

§ 240.17a-5 Reports to be made by certain brokers and dealers.

* * * * *

(c) * * *

(2) * * *

(iii) If in connection with the most recent annual audit report pursuant to § 240.17a-5, the independent accountant commented on any material inadequacies in accordance with paragraphs (g) and (h) of this section, and § 240.17a-11(e), there shall be a statement by the broker or dealer that a copy of such report and comments is currently available for the customer's inspection at the principal office of the Commission in Washington, DC, and the regional office of the Commission for the region in which the broker or dealer has its principal place of business; and

* * * * *

(h) * * *

(2) If, during the course of the audit or interim work, the independent public accountant determines that any material inadequacies exist in the accounting system, internal accounting control, procedures for safeguarding securities, or as otherwise defined in paragraph (g)(3) of this section, then the independent public accountant shall call it to the attention of the chief financial officer of the broker or dealer, who shall have a responsibility to inform the Commission and the designated examining authority by telegraphic or facsimile notice within 24 hours thereafter as set forth in § 240.17a-11 (e) and (g). The broker or dealer shall also furnish the accountant with a copy of said notice to the Commission by telegram or facsimile within said 24 hour period. If the accountant fails to receive such notice from the broker or dealer within said 24 hour period, or if the accountant disagrees with the statements contained in the notice of the broker or dealer, the accountant shall have a responsibility to inform the Commission and the designated examining authority by report of material inadequacy within 24 hours thereafter as set forth in § 240.17a-11(g). * * *

* * * * *

4. By revising § 240.17a-11 to read as follows:

§ 240.17a-11 Notification provisions for brokers and dealers.

(a) This section shall apply to every broker or dealer registered with the Commission pursuant to section 15 of the Act.

(b) Every broker or dealer whose net capital declines below the minimum amount required pursuant to § 240.15c3-1 shall give notice of such deficiency that same day in accordance with paragraph (g) of this section. The notice shall specify the broker or dealer's net capital requirement and its current amount of net capital. If a broker or dealer is informed by its designated examining authority or the Commission that it is, or has been, in violation of § 240.15c3-1 and the broker or dealer has not given notice of the capital deficiency under this § 240.17a-11, the broker or dealer, even if it does not agree that it is, or has been, in violation of § 240.15c3-1, shall give notice of the claimed deficiency, which notice may specify the broker's or dealer's reasons for its disagreement.

(c) Every broker or dealer shall send notice promptly (but within 24 hours) after the occurrence of the events specified in paragraphs (c)(1), (c)(2) or (c)(3) of this section in accordance with paragraph (g) of this section:

(1) If a computation made by a broker or dealer subject to the aggregate indebtedness standard of § 240.15c3-1 shows that its aggregate indebtedness is in excess of 1,200 percent of its net capital; or

(2) If a computation made by a broker or dealer, which has elected the alternative standard of § 240.15c3-1, shows that its net capital is less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a Exhibit A: Formula for Determination Reserve Requirement of Brokers and Dealers under § 240.15c3-3; or

(3) If a computation made by a broker or dealer pursuant to § 240.15c3-1 shows that its total net capital is less than 120 percent of the broker or dealer's required minimum net capital.

(d) Every broker or dealer who fails to make and keep current the books and records required by § 240.17a-3, shall give notice of this fact that same day in accordance with paragraph (g) of this section, specifying the books and records which have not been made or which are not current. The broker or dealer shall also transmit a report in accordance with paragraph (g) of this section within 48 hours of the notice stating what the broker or dealer has done or is doing to correct the situation.

(e) Whenever any broker or dealer discovers, or is notified by an independent public accountant, pursuant to § 240.17a-5(h)(2) of the existence of any material inadequacy as defined in § 240.17a-5(g), the broker or dealer shall:

(1) Give notice, in accordance with paragraph (g) of this section, of the material inadequacy within 24 hours of such discovery or notification; and

(2) Transmit a report in accordance with paragraph (g) of this section within 48 hours of the notice stating what the broker or dealer has done or is doing to correct the situation.

(f) Every national securities exchange or national securities association that learns that a member broker or dealer has failed to send notice or transmit a report as required by paragraphs (b), (c), (d), or (e) of this section, even after being advised by the securities exchange or the national securities association to send notice or transmit a report, shall immediately give notice of such failure in accordance with paragraph (g) of this section.

(g) Every notice or report required to be given or transmitted by this section shall be given or transmitted to the principal office of the Commission in Washington, D.C., the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the designated examining authority of which such broker or dealer is a member, and the Commodity Futures Trading Commission if the broker or dealer is registered as a futures commission merchant with such Commission. For the purposes of this section, "notice" shall be given or transmitted by telegraphic notice or facsimile transmission. The report required by paragraphs (d) or (e)(2) of this section may be transmitted by overnight delivery.

(h) Other notice provisions relating to the Commission's financial responsibility or reporting rules are contained in § 240.15c3-1(a)(6)(iv)(B), § 240.15c3-1(a)(6)(v), § 240.15c3-1(a)(7)(iv), § 240.15c3-1(c)(2)(x)(B)(*1*), § 240.15c3-1(c)(2)(x)(F)(*3*), § 240.15c3-1(e), § 240.15c3-1d(c)(2), § 240.15c3-3(i) and § 240.17a-5(h)(2).

Dated: July 7, 1993.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 93-16480 Filed 7-12-93; 8:45 am]

BILLING CODE 8010-01-M

NASD NOTICE TO MEMBERS 93-73

Members' Obligations to Customers When Selling Collateralized Mortgage Obligations (CMOs)

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- ■ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

As part of its comprehensive program to monitor and enhance member sales practices, the NASD is publishing this Notice to remind members of their obligations under the Rules of Fair Practice when recommending CMOs to their customers. In light of the complexity and the varying risk characteristics of CMOs, Article III, Sections 1 and 2 of the Rules of Fair Practice, require that members must be conversant in all of the characteristics of CMOs to assess adequately the suitability of CMOs for their customers. Moreover, members must ensure that their customers understand the characteristics and risks associated with CMOs.

Background

With the decline in interest rates over the last several years, investors have sought alternatives to the ever-lower yields of certificates of deposit (CDs), money market funds, and government securities. The desire to maximize returns while maintaining a high degree of credit safety has significantly enhanced interest in asset-backed securities, particularly collateralized mortgage obligations.

In recognition of the potential problems and in response to an increase in complaints related to CMO sales practices and advertising in the last few years, the NASD has taken a number of steps to address the issues relating to CMO sales practices. Among others, the initiatives taken by the NASD include the adoption of *Guidelines Regarding Communications with the Public About Collateralized Mortgage Obligations* (CMOs) that were published in *Notice to Members 93-18* and the enactment of a pre-use filing requirement for CMO advertising as published in *Notice to Members 92-59*. These advertising-related initiatives are having a positive effect in achieving the desired compliance results.

In continuing these efforts to oversee and enhance CMO sales practices, the NASD is reminding members of their obligations under the Rules of Fair Practice when recommending CMOs to their customers. In light of the complexity and the varying risk characteristics of CMOs, under Article III, Sections 1 and 2 of the Rules of Fair Practice, members and their associated persons must be conversant in all of the characteristics of CMOs to assess adequately the suitability of CMOs for their customers. Moreover, they must ensure that their customers understand the characteristics and risks of CMOs. Further, adequate supervisory procedures must be in place to monitor CMO activity within each NASD member firm.

Among the matters members and representatives selling CMOs should be acquainted with are:

General Characteristics

Although CMOs entitle investors to payments of principal and interest, they differ from CDs, corporate bonds, and Treasury securities in significant ways. CDs, corporate bonds, and Treasuries are issued with stated maturities and fixed interest rates. When a CD or bond matures or is called, the issuer returns the face value to the investor in a single principal payment. In contrast, while CMOs have stated final maturity dates at which all principal must be returned, they can make principal payments throughout the life of the security. In addition, the timing of these payments may vary signifi-

cantly depending on interest rate changes.

Principal payments on CMOs arise from both the regular amortization of the underlying mortgages and from prepayments of those mortgages due to sales or refinancings. As recent history shows, when interest rates decline substantially, many homeowners choose to refinance their mortgages. This activity can result in CMOs paying off principal more rapidly than had been anticipated. Thus, a CMO investor may be faced with reinvesting his or her principal at a current lower rate. In a rising interest rate environment, homeowners may not refinance or sell their houses as quickly; thus, CMO investors may face holding their investment for longer than anticipated. While principal payments may be quite predictable for certain tranches or classes of a given CMO, other tranches of the same issue may be significantly less predictable.

In addition, certain tranches may be structured in such a way that, depending on interest rates and prepayments, investors are at substantial risk and may lose all or a substantial portion of their principal. The risks associated with these less predictable tranches may make them unsuitable for many retail investors. Members must evaluate the suitability of such high-risk tranches for each individual investor based on the investor's sophistication and high-risk profile, and must ensure that the investor is aware of the risks and characteristics of the tranche.

Maturity/Return of Principal/ Prepayment Assumptions

As discussed above, investors have to know that CMOs are not the same as conventional debt securities or CDs and that time to maturity may vary as well as the amount of principal returned. Further, investors need to know that prepayment assumptions—estimates based on historic prepayment rates for each particular type of mortgage loan under various economic conditions from various geographic areas—are factored into the offering price, yield, and market value of a CMO. Explaining prepayment assumptions is important because the realization of the average-life and- yield estimates depends on their accuracy.

Condition of the Secondary Market/Liquidity

While there is a sizable secondary market for CMOs generally, there is less of a market for the more risky and complex tranches. CMOs are less uniform than traditional mortgage-backed securities and more expensive to trade. It is also harder to obtain current pricing information. Matching up buyers and sellers is often difficult, especially for the more esoteric tranches. Members should remind investors that, by selling their CMOs rather than waiting for the final principal payment, the securities may be worth more or less than their original face value. In addition, members should clearly inform investors of extra costs or commissions associated with CMO transactions.

Impact of Purchasing at a Premium or a Discount

While the principles of purchasing CMOs at a discount or a premium are similar to those of Treasuries, members should inform investors of the consequences of such purchases. Members need to advise investors of the factors and pricing assumptions of the discount or premium. In particular, for securities purchased at a premium, it should be clear that any guarantees on the securities only apply to the par value of the security and not to any premium paid.

Interest-Only, Principal-Only, and Floater Tranches, Including Inverse Floaters

Principal-Only (PO) Securities

Some tranches are structured so that investors receive only principal payments generated by the underlying collateral. POs usually sell at a deep discount from face value on the assumption that the purchaser will ultimately receive the entire face value through scheduled payments and prepayments; however, the market values of POs are extremely sensitive to prepayment rates, which, in turn, vary with interest rate changes. If interest rates are falling and prepayments accelerate, the value of the PO will increase. On the other hand, if rates rise and prepayments slow, the value of the PO will drop.

Interest-Only (IO) Securities

These securities result from the creation of POs; thus, CMOs with PO tranches also have IO tranches. IO securities sell at a deep discount to their "notional" principal amount, namely the principal balance used to calculate the amount of interest due. They have no face or par value and, as the notional principal amortizes and prepays, the IO cash-flow declines.

Unlike POs, IOs increase in value when interest rates rise and prepayment rates slow; consequently they are often used to "hedge" portfolios against interest rate risk. IO investors should be mindful that if

prepayment rates are high, they may actually receive less cash back than they initially invested. Because of these risks, a member may sell IOs only to a sophisticated investor maintaining a high-risk profile. The member should make sure the investor is aware of the risks and characteristics of IOs.

Floating-Rate Tranches

Floating-rate tranches or "floaters" carry interest rates tied to a variable interest rate index, such as the London Interbank Offered Rate (LIBOR), the Constant Maturity Treasury (CMT), or the Cost of Funds Index (COFI), subject to an upper limit or cap and sometimes to a lower limit or "floor." The performance of these investments also depends on the way interest rate movements affect prepayment rates and average lives.

Inverse Floaters (IFs)

Inverse floaters are structured to offset floating-rate tranches. Interest payments on IFs vary inversely with an index. Because IFs are more leveraged than other tranches, they have high price volatility as interest rates move. As the rate of the index drops, the interest rate on the IF rises at an accelerated pace. Conversely, rising rates cause an IF's interest payments to drop dramatically. At worst, rising rates will lower interest payments and extend return of principal beyond the anticipated average life. As with other high-risk tranches, IFs are only suitable for sophisticated investors with a high-risk profile and the investor must be made aware of the risks and characteristics of IF being purchased.

Accrual Bonds or Z-Tranches

The final tranche of a CMO is often structured as a Z-tranche or an accrual bond. Z-tranche holders receive no cash payments for an extended period of time. During the time that the earlier tranches are outstanding, a Z-tranche receives "accrued interest" which is credit for periodic interest payments that increase the face amount of the security at a compounded rate but are not actually paid out to investors. After all previous tranches are retired, the Z-tranche holders start receiving cash payments that include both principal and continuing interest.

While the presence of a Z-tranche can stabilize the cash flow in other tranches, the market value of Z-tranches can fluctuate widely, and their average life depends on other aspects of the offering. Because the interest on these securities is taxable when credited, even though the investor receives no actual payment, Z-tranches are often suggested as investments for tax-deferred retirement accounts. Thus, the wide variability of risk associated with Z-tranches requires member's suitability evaluations based on the combination of the Z-tranche with other investments as well as on the investor's sophistication and risk profile. The member must make the investor aware of the tranche's risks and characteristics.

* * * * *

The educational and regulatory initiatives discussed in this Notice will help members meet their obligations to investors under the Rules of Fair Practice and should prevent investor misunderstanding that could lead not only to dissatisfaction with CMOs as an investment, but also to potential violations of NASD rules and regulations. If you have any questions concerning this Notice, please contact Walter Robertson, Director, Compliance Department at (202) 728-8221.

NASD NOTICE TO MEMBERS 93-74

Veteran's Day and Thanksgiving Day: Trade Date-Settlement Date Schedule

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Veteran's Day, Thursday, November 11, 1993, and Thanksgiving Day, Thursday, November 25, 1993. On Thursday, November 11, The Nasdaq Stock Market[SM] and the securities exchanges will be open for trading. However, it will not be a settlement date since many of the nation's banking institutions will be closed in observance of Veteran's Day. All securities markets will be closed on Thursday, November 25, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Reg. T Date*
Nov. 2	Nov. 9	Nov. 11
3	10	12
4	12	15
5	15	16
8	16	17
9	17	18
10	18	19
11	18	22
12	19	23
17	24	29
18	26	30
19	29	Dec. 1
22	30	2
23	Dec. 1	3
24	2	6
25	Markets Closed	—
26	3	7

*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

Note: November 11, 1993, is considered a business day for receiving customer payments under Regulation T of the Federal Reserve Board.

Transactions made on November 11 will be combined with transactions made on the previous business day, November 10, for settlement on November 18. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

Brokers, dealers, and municipal securities dealers should use these settlement dates to clear and settle transactions pursuant to the NASD® Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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

NASD NOTICE TO MEMBERS 93-75

Nasdaq National Market® Additions, Changes, And Deletions as of September 24, 1993

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

As of September 24, 1993, the following 41 issues joined the Nasdaq National Market®, bringing the total number of issues to 3,264:

Symbol	Company	Entry Date	SOES Execution Level
ACOM	A+ Communications, Inc.	8/25/93	1000
GBIZ	Grow Biz International, Inc.	8/25/93	1000
GWALY	Great Wall Electronic International Limited (ADR)	8/25/93	1000
PFGC	Performance Food Group Company	8/25/93	1000
SKTV	Silver King Communications, Inc.	8/26/93	1000
SIMM	Simmons Outdoor Corporation	8/26/93	1000
OAKS	River Oaks Furniture, Inc.	8/27/93	1000
TAROF	Taro Vit Industries Ltd.	8/30/93	1000
GOTK	Geotek Industries, Inc.	9/1/93	1000
GOVTY	Govett & Company Limited (ADR)	9/1/93	200
FTCG	First Colonial Group, Inc.	9/3/93	1000
INBR	INBRAND Corporation	9/3/93	1000
BNTN	Benton Oil & Gas Company	9/9/93	1000
BSSI	BioSafety Systems, Inc.	9/9/93	500
CRNR	Cornerstone Imaging, Inc.	9/9/93	1000
CSNRW	Casino Resource Corporation (Cl A 9/15/96 Wts)	9/15/93	500
CSNR	Casino Resource Corporation	9/15/93	500
LDDS	LDDS Communications, Inc.	9/15/93	1000
PAIR	PairGain Technologies, Inc.	9/15/93	1000
ANTC	ANTEC Corporation	9/17/93	500
PHLY	Philadelphia Consolidated Holding Corp.	9/17/93	1000
RDMN	Redman Industries Inc.	9/17/93	1000
DIAUV	Diasonics Ultrasound, Inc. (WI)	9/20/93	1000
CASH	First Midwest Financial, Inc.	9/20/93	200
HLGRF	Hollinger, Inc.	9/20/93	1000
RPCLF	Revenue Properties Company Limited	9/20/93	1000
CBRA	Cobra Golf Incorporated	9/21/93	1000
NETM	NetManage, Inc.	9/21/93	1000
ASYT	Asyst Technologies Inc.	9/22/93	1000
KWND	KENETECH Corporation	9/22/93	1000
NXCO	Neurex Corporation	9/22/93	1000
WAMUM	Washington Mutual Savings Bank	9/22/93	500
APOD	A Pea in the Pod, Inc.	9/23/93	1000
HAVN	Haven Bancorp Inc.	9/23/93	1000
HTBB	HomeTown Buffet Inc.	9/23/93	1000
OROA	OroAmerica, Inc.	9/23/93	1000
GRIP	Royal Grip, Inc.	9/23/93	1000
SUMA	Summa Four Inc.	9/23/93	1000
APSI	APS Holding Corporation	9/24/93	1000
FCBF	FCB Financial Corp.	9/24/93	500
MCCO	Monaco Coach Corporation	9/24/93	1000

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since August 25, 1993:

New/Old Symbol	New/Old Security	Date of Change
RLLY/RLLY	Rally's Hamburgers, Inc./Rally's Inc.	8/30/93
OSFIF/BIIEF	O S F, Inc./B I I Enterprises, Inc.	8/31/93
CCAXW/CCAXW	Corrections Corporation of America (9/14/97 Wts)/Corrections Corporation of America (9/14/96 Wts)	9/2/93
NGCO/NGCOV	National Gypsum Company/National Gypsum Company (WI)	9/13/93
JEWLY/RATNY	Signet Group plc (ADR)/Ratners Group plc (ADR)	9/14/93
JEWLZ/RATNZ	Signet Group plc (ADR Conv Pfd)/Ratners Group plc (ADR Pref)	9/14/93
MMDI/MMDI	Momentum Corporation/Momentum Distribution Inc.	9/15/93
EXAM/FWCO	Express America Holdings Corp./First Western Corp.	9/21/93
SIGGZ/JEWLZ	Signet Group plc (ADR Conv Pfd)/Signet Group plc (ADR Conv Pfd)	9/22/93
SIGGY/JEWLY	Signet Group plc (ADR)/Signet Group plc (ADR)	9/22/93

Nasdaq National Market Deletions

Symbol	Security	Date
CKCP	Cybertek, Corporation	8/30/93
FFFC	Franklin First Financial Corp.	8/31/93
HDRP	H D R Power Systems Inc.	8/31/93
BTRIC	BTR Realty, Inc.	9/1/93
CBKS	Commonwealth Bancshares Corporation	9/1/93
CSTR	Costar Corporation	9/9/93
SHRE	Sahara Resorts	9/9/93
CMTKJ	Cimflex Tecknowledge Corporation	9/10/93
SEMIW	All American Semiconductor, Inc. (Cl A)	9/13/93
EQIC	Equitable of Iowa Companies	9/13/93
ICFI	ICF Kaiser International Inc.	9/14/93
BMED	Ballard Medical Products	9/15/93
LDDSA	LDDS Communications Inc. (Cl A)	9/15/93
NHDI	NHD Stores, Inc.	9/17/93
PSBN	Pioneer Bancorp Inc.	9/24/93
WCLBW	Warehouse Club (Wts)	9/24/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

BOARD BRIEFS

Actions Taken by the NASD® Board of Governors in September

• **President's Report**—The Nasdaq Stock Market℠ year-to-date numbers continue to support a record-setting pace. Average daily share volume is up 30 percent to 248 million, average daily dollar volume is running nearly 46 percent higher at $5.1 billion, market value of $735.9 billion is nearly 20 percent higher than year-end, and the average price per share has registered an 11 percent increase to $20.39. All the Nasdaq® indexes are performing above or near their all-time record levels.

Action may be forthcoming soon on a number of market quality issues that are pending before the Securities and Exchange Commission (SEC). The Nasdaq short-sale rule seems to be gaining support at the SEC, and we hope to see action on it perhaps as early as November. The concerns of option market makers appear to have been satisfactorily resolved. The SEC staff has indicated its willingness to move the issue along, and the general outlook for a short-sale rule is positive.

The pending Small Order Execution System (SOES℠) interim rule changes, with minor modifications, appear headed for positive consideration by the SEC. These proposals would permit market makers to update their quotations automatically after execution; prohibit short sales in SOES; reduce the maximum trade size from 1,000 shares to 500; reduce the required exposure limits for market makers from five to two times the tier level; and decrease SOES exposure limits by using unpreferenced order flow only. Longer term improvements to SOES would provide potential for price improvement, expand limit-order protection, and revise order-execution procedures.

A recent meeting with SEC Chairman Arthur Levitt covered a wide range of regulatory and market areas with specific focus on the timely issues of municipal securities and continuing education. In the area of municipal securities, the NASD has committed to work closely with the staffs of the Municipal Securities Rulemaking Board and the SEC during the months ahead to address solutions to the political contributions issue, to expand secondary market transaction information, to increase the availability of current issuer information in the municipal securities markets, and to address sales-practice abuses for the benefit of the investing public. The Chairman indicated his overall support for the concept of continuing education for brokers, an issue that was recently addressed by the Securities Industry Task Force on Continuing Education. That 12-person group, representing a broad cross section of member firms, independently concluded the industry would be well served by such a uniform continuing education program. A copy of their report and recommendations is available by calling (301) 590-6500.

• **Regulation**—Mutual fund rankings in member advertising and sales literature were the subject of Board action at its last meeting. As a result, the NASD will soon file with the SEC guidelines and filing requirements regarding the use of such rankings. The guidelines cover disclosures about the ranking and its sources, the time period covered, categories on which the ranking is based, and rankings of multiple-class/two-tiered funds. Under the filing requirements, members filing material that includes mutual fund rankings or comparisons would have to include a copy of the original ranking or comparison. Also, a prior-to-use filing requirement would apply to material that

includes rankings or comparisons based on categories not generally known or that were created by the filing investment company, its underwriter, or an affiliate.

To clarify the application of its policy on continuing commissions to the payment of service fees in connection with the sale of investment company shares, the Board approved a change for filing with the SEC, specifying that service fees as defined under the NASD's investment company sales-charge rules are not commissions.

Relying on a review of business practices regarding collateralized mortgage obligations (CMOs), the Board approved a number of actions in this area. These include:

—Adoption of a definition of CMO to be added to the Guidelines Regarding Communications with the Public About Collateralized Mortgage Obligations.

—Requiring members to offer customers an educational brochure describing CMOs in detail.

—Publishing a *Notice to Members* reminding members of their obligations to customers when selling CMOs.

—Adoption of an amendment to the Rules of Fair Practice to make the current CMO advertising pre-use filing requirement permanent.

• **Market Services**—The Board gave the go-ahead to an agreement that would allow the Chicago Board Options Exchange (CBOE) to list options on the Nasdaq 100®, a benchmark index for large growth stocks traded on The Nasdaq Stock Market. Such options will give investors a new tool for market timing and hedging in Nasdaq stocks, allowing more flexibility in managing their portfolios. In addition, the use of such products could have a beneficial impact on market liquidity and volatility because additional market-making capital would be present in the derivatives markets and large institutions. If this occurs, institutions would be able to hedge their positions better, and would be more likely to take larger positions in Nasdaq stocks and less inclined to liquidate these positions during periods of market turbulence.

Following consideration of comments received from members and other interested parties, the Board acted to approve for filing with the SEC a measure that would eliminate the "disclosure safe harbor," the so-called Manning Rule for those members that trade ahead of their customer limit orders. If approved by the SEC, the proposal would prohibit a member holding its own customer limit orders in Nasdaq securities from trading ahead of those orders at prices that would satisfy the terms of the orders.

• **Member Services**—A Board-approved change to the NASD Code of Arbitration Procedure makes it clear that employment and other industry class actions are, like customer-related class actions, excluded from arbitration. As a result, such matters are eligible for arbitration only if the class is decertified, class certification is denied, the party is excluded from the class by the court, or the party either withdraws from the class or elects not to take part in it.

NASD DISCIPLINARY ACTIONS

Disciplinary Actions Reported for October

The NASD® has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, October 18, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this edition.

Firms Suspended, Individuals Sanctioned

Century Capital Corp. of South Carolina (Greenville, South Carolina) and **John W. Brown, III (Registered Principal, Travelers Rest, South Carolina)** were fined $10,000, jointly and severally, and Brown was suspended from association with any NASD member in any capacity for 30 days. In addition, the firm was suspended from effecting principal transactions with retail customers except unsolicited liquidating transactions for 30 days and required to pay $23,514 in restitution to public customers. The Securities and Exchange Commission (SEC) affirmed the sanctions following appeal of a March 1992 National Business Conduct Committee (NBCC) decision. The sanctions were based on findings that, in contravention of the NASD's Mark-Up Policy, the firm, acting through Brown, effected principal transactions in six common stocks with public customers at unfair prices. The markups on these transactions ranged from 5.63 to 133.33 percent above the prevailing market price.

This action has been appealed to a United States Court of Appeals and the sanctions are not in effect pending consideration of the appeal.

Firms Fined, Individuals Sanctioned

John Dawson & Associates, Inc. (Chicago, Illinois) and **Douglas F. Samuels (Registered Principal, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined $15,000, jointly and severally. In addition, Samuels was suspended from acting as a financial and operations principal with any NASD member firm 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 Samuels, conducted a securities business while failing to maintain its minimum required net capital and failed to prepare and/or maintain an accurate net capital computation. The NASD also found that the firm, acting through Samuels, filed an inaccurate FOCUS Part I report.

Pendrick Reeves Associates, Inc. (New Canaan, Connecticut), Bruce R. Rubin (Registered Principal, New Haven, Connecticut) and **Elyas A. Seguin (Registered Principal, Stamford, Connecticut)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm and Seguin were fined $25,000, jointly and severally. In addition, Seguin is required to take and successfully pass the general securities principal examination. Rubin was fined $10,000 and required to requalify by examination as a financial and operations principal.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Rubin, engaged in a securities business

while failing to maintain its required minimum net capital and failed to prepare and maintain its books and records. In addition, the NASD found that Seguin was actively managing the firm without being properly qualified or registered with the NASD as a general securities principal.

Sacks Investment Company, Inc. (Novato, California) and **Richard Lawrence Sacks (Registered Principal, Novato, California)** were fined $159,956.42, jointly and severally, and Richard Sacks was barred from association with any NASD member in any capacity. The SEC modified the sanctions following appeal of a June 1991 NBCC decision. The sanctions were based on findings that the firm, acting through Sacks, engaged in securities transactions with public customers at unfair prices with markups ranging from 9 to 220 percent over the firm's contemporaneous cost. In addition, the firm, acting through Sacks, failed to report securities transactions to The Nasdaq Stock Market℠ and failed to employ a financial and operations principal and a municipal securities principal.

Furthermore, the firm, acting through Sacks, engaged in the sales of municipal securities without having first registered with the Municipal Securities Rulemaking Board and paying the required fees. The respondents also engaged in securities transactions on a principal basis without obtaining written approval from the NASD, in violation of its voluntary restriction agreement.

Individuals Barred or Suspended

Marvin L. Beckman (Registered Representative, Mesa, Arizona) submitted an Offer of Settlement pursuant to which he was fined $5,000, suspended from association with any NASD member in any capacity for 90 days, and required to requalify by examination as a registered representative. Without admitting or denying the allegations, Beckman consented to the described sanctions and to the entry of findings that he participated in private securities transactions while failing to provide prior written notice to his member firm.

Dirth Terone Campbell (Registered Representative, Kirkland, Washington) was fined $40,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Campbell filled out and signed a customer's name to a new account form using inaccurate, false, and misleading information and submitted the form to his member firm. Campbell opened this new account because the customer's other account was restricted for late payment of a purchase, and this new account would permit the customer to purchase a recommended stock despite the restriction. Campbell also violated Regulation T of the Federal Reserve Board by arranging for the extension or maintenance of credit to the customer on terms and conditions that Campbell's member firm could not set under the rule. Campbell also failed to respond to NASD requests for information.

George Benjamin Carpenter (Registered Representative, Berkeley, California) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $100,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Carpenter consented to the described sanctions and to the entry of findings that he misappropriated from the accounts of 10 public customers a total of $67,776.34 and converted the funds to his own use and benefit.

Todd Clark (Registered Representative, Arvada, Colorado) was fined $25,000, required to pay $25,000 plus interest in restitution to customers, and barred from association with any NASD member in any capacity. The sanctions were based on findings that Clark misused customer funds by recommending to them a stock investment that was to be guaranteed by a promissory note from a non-member and by receiving from the customers a $25,000 check payable to this firm based on the recommendation. However, the purchase of the stock was never reflected on Clark's member firm's books and records nor have the customers received shares of the stock or a refund of their investment. Clark also failed to respond to NASD requests for information.

Milan Leroy Dummer (Registered Representative, Minneapolis, Minnesota) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Dummer consented to the described sanctions and to the entry of findings that he borrowed $158,900 from 19 public customers by recommending and inducing the customers to make loans to him for his personal use.

The findings also stated that Dummer failed to disclose to the customers the amount of his total indebtedness and the fact he was borrowing from certain customers to repay other customers. In connection with this activity, the NASD found that Dummer induced the customers to make high-risk,

unsecured loans funded by monies withdrawn from savings accounts or borrowed against insurance policies by representing that the customers would receive a return of principal plus interest when he knew or should have known that it was unlikely the loans would be repaid.

Gary L. Engel (Registered Representative, Ardsley, New York) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Engel engaged in a series of fictitious transactions over a period of at least 10 months for the stated purpose of deceiving his member firm. Engel engaged in this fraudulent activity to conceal, among other things, trading losses. Furthermore, Engel caused fictitious trade and volume reports to be reported, published, and circulated.

James P. Foley (Registered Representative, Atlanta, Georgia) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000 and suspended from association with any NASD member in any capacity for two weeks. Without admitting or denying the allegations, Foley consented to the described sanctions and to the entry of findings that he completed and signed a public customer's name to an application for an annuity purchase of $125,000 without the customer's knowledge or consent.

Michael Jay Glover (Registered Representative, Chicago, Illinois) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Glover consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information concerning his termination from a member firm and a customer complaint.

Daniel Richard Hajduk (Registered Representative, Mt. Prospect, Illinois) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Hajduk consented to the described sanctions and to the entry of findings that he executed securities transactions for public customers without being registered as a representative and when he was under an NASD order to requalify by examination.

Arvis Harper, Jr. (Registered Representative, Edmond, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000, barred from association with any NASD member in any capacity, and must pay $5,184.16 in restitution to the appropriate party. Without admitting or denying the allegations, Harper consented to the described sanctions and to the entry of the findings that he received a $4,000 check from a public customer for investment purposes and failed to remit the funds to his member firm. In addition, the NASD found that Harper borrowed $5,184.16 from the same public customer and represented that he would repay the loan within one year at interest rates from 10 to 50 percent.

David G. Jackson (Registered Representative, Indianapolis, Indiana) submitted an Offer of Settlement pursuant to which he was fined $60,000, barred from association with any NASD member firm in any capacity, and required to pay $34,938.17 in restitution to the appropriate parties. The sanctions were based on the entry of findings that Jackson withdrew funds totaling $34,938.17 from the accounts of public customers without their knowledge or consent, and used the funds for purposes other than for the customers' benefit. Jackson also failed to respond to NASD requests for information.

Roger J. Lange (Registered Principal, Paris, Illinois) submitted an Offer of Settlement pursuant to which he was fined $5,000, jointly and severally with a former member firm. In addition, Lange was suspended from association with any NASD member in any capacity for three months, required to requalify by examination as a general securities principal, and must pay restitution to customers.

Without admitting or denying the allegations, Lange consented to the described sanctions and to the entry of findings that a former member firm, acting through Lange, conducted a securities business while failing to maintain its minimum required net capital and failed to maintain an accurate net capital computation. Moreover, the firm, acting through Lange, filed an inaccurate FOCUS Part I report and failed to comply with the terms of its restriction agreement with the NASD in that it effected principal transactions with customers without NASD approval.

Michael Ben Lavigne (Registered Principal, Spokane, Washington) was fined $10,000 and barred from association with any NASD member in any principal capacity. The NBCC imposed the sanctions following appeal of a Seattle District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that Lavigne

permitted a statutorily disqualified individual to remain associated with a member firm. In addition, Lavigne failed to implement written procedures to ensure that the aforementioned individual did not effect any transactions directly or indirectly in his customer accounts during his association with the firm. Moreover, Lavigne failed to supervise the transactions effected by the individual in customer accounts.

This action has been appealed to the SEC and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Michael Alan Leeds (Registered Principal, Guttenberg, New Jersey) was fined $238,354 and barred from association with any NASD member in any capacity. The SEC imposed the sanctions following appeal of a November 1990 NBCC decision. The sanctions were based on findings that on the first day of aftermarket trading, a former member firm acting through Leeds to dominate and control the market for an initial public offering. As a result, the market in the offering was noncompetitive. Under such circumstances and consistent with longstanding NASD and SEC precedent, the firm was required to use its contemporaneous cost of acquiring the offering to compute markups.

In addition, Leeds, acting for a former member firm, engaged in 1,159 fraudulently excessive markups and 590 fraudulently excessive markdowns with public customers. The excessive markups ranged from 12 to 112 percent above the prevailing market price with the excessive markdowns ranging from 5.6 to 57.3 percent below the prevailing market price of the offering.

Furthermore, Leeds failed to register with the NASD as a general securities principal during a period in which he acted as the firm's president.

Larry Wayne Lewis (Registered Representative, Wichita, Kansas) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $72,500 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lewis consented to the described sanctions and to the entry of findings that he received from a public customer checks totaling $14,500 for the purchase of shares of an income and bond fund and, instead, converted the funds to his own use and benefit without the customer's knowledge or consent.

James L. Mangone (Registered Representative, Miami, Florida) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $65,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Mangone consented to the described sanctions and to the entry of findings that he received checks totaling $13,000 from a public customer for the purchase of securities and, instead, deposited the funds into an account he controlled.

Michael Markowski (Registered Principal, Miami Beach, Florida) was fined $50,000, barred from association with any NASD member in a principal capacity, barred from maintaining a debt or equity interest in any member firm, and suspended from association with any NASD member in any capacity for two years. The SEC affirmed the sanctions following appeal of an NBCC decision.

The sanctions were based on findings that Markowski failed to respond to repeated written and oral requests for information made by the NASD concerning access to his member firm's books and records. Markowski also failed to update his registration to reflect his current address.

This action has been appealed to the United States Court of Appeals for the Second Circuit and a stay of the fine and suspension was granted. Further, during the pendancy of the stay, Markowski is not required to dispose of any debt or equity interest in a member firm. He may not, however, use such interest in any way to participate in or affect the management of any NASD member firm.

Linda L. Matsuyama (Registered Representative, Aurora, Colorado) submitted an Offer of Settlement pursuant to which she was fined $100,000, barred from association with any NASD member in any capacity, and required to pay $13,577.48 in restitution to a member firm. She must also provide additional restitution in an amount to be determined.

Without admitting or denying the allegations, Matsuyama consented to the described sanctions and to the entry of findings that she made improper use of approximately $13,500 in customer funds by inducing a public customer to invest in securities through the use of deceptive and fraudulent contrivances but failed to invest the funds as indicated. Moreover, the NASD found that Matsuyama sent false and misleading information to the aforementioned customer regarding the value of her accounts.

Allan Harry Mawhinney (Registered Representative, Buena Park, California) was fined $248,932.32 (which may be reduced by any amount paid to a

member firm up to $128,932.32), and barred from association with any NASD member in any capacity. The sanctions were based on findings that Mawhinney solicited purchases of stock from two public customers and received from such customers $128,932.32. Instead of purchasing stock for either customer, Mawhinney deposited the funds into his personal account and converted them to his own use and benefit. Mawhinney also failed to respond to an NASD request for information.

John P. McDonald (Registered Representative, Montgomery, Alabama) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $200,000, barred from association with any NASD member in any capacity, and required to pay $171,828.10 in restitution to a public customer. Without admitting or denying the allegations, McDonald consented to the described sanctions and to the entry of findings that on several occasions he executed unauthorized purchase and sale transactions in the accounts of public customers without their knowledge or consent.

Furthermore, the NASD determined that McDonald caused the withdrawal of $171,828.10 from the account of a public customer without the customer's knowledge or consent. In addition, the NASD found that McDonald opened an account in his wife's maiden name and executed transactions without her knowledge or consent.

William B. Michaels (Registered Representative, Tulsa, Oklahoma) submitted an Offer of Settlement pursuant to which he was fined $21,000 and suspended from association with any NASD member in any capacity for one week. Without admitting or denying the allegations, Michaels consented to the described sanctions and to the entry of findings that he recommended and engaged in transactions for public customers without having reasonable grounds for believing that the transactions were suitable based on the customers' financial situations, investment objectives, and needs.

The findings also stated that Michaels executed transactions for a public customer without having prior written authorization to do so.

Donna Pavlos (Registered Representative, Michigan City, Indiana) submitted an Offer of Settlement pursuant to which she was fined $1,500 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Pavlos consented to the described sanctions and to the entry of findings that she withdrew $328.80 from her member firm's checking account and used the funds for her personal benefit.

Anthony J. Puglisi (Registered Principal, Scottsdale, Arizona) and **Bessie LaVerne Puglisi (Associated Person, Scottsdale, Arizona)**. Anthony Puglisi was fined $150,000 and barred from association with any NASD member in any capacity and Bessie Puglisi was fined $100,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Anthony Puglisi received from nine public customers a total of $255,803.51 either directly or through unauthorized withdrawals from their securities accounts and failed to apply these funds for the intended use and benefit of the customers. In addition, Bessie Puglisi aided and abetted Anthony Puglisi in the aforementioned improper use of customer funds.

Moreover, Anthony and Bessie Puglisi provided customers with correspondence that contained false and misleading information and failed to respond to NASD requests for information. Furthermore, Bessie Puglisi acted as a principal of a member firm without proper qualification and registration as a principal.

Gene Lester Roach (Registered Principal, Riverside, California) was fined $5,000, jointly and severally with a former member firm, fined an additional $219,000, and barred from association with any NASD member in any capacity. The SEC modified the sanctions following appeal of a November 1991 NBCC decision. The sanctions were based on findings that Roach defrauded investors and made improper use of the proceeds of a private offering. Specifically, he deposited $169,000 of the investors' funds into a separate securities account maintained at another firm. Contrary to representations made in the offering memorandum concerning the use of funds, more than one third of the gross proceeds was used to purchase stock in two airlines, an unauthorized risk.

In addition, when acting for a member firm, Roach effected securities transactions while the firm failed to maintain its minimum required net capital.

Ricky W. Stockton (Associated Person, Oklahoma City, Oklahoma) was fined $100,000, barred from association with any NASD member in any capacity, and required to pay $227,392.05 in restitution to a public customer. The sanctions were based on findings that Stockton transferred a $285,000 face amount Government National Mortgage Association (GNMA) Pool from the account of

a public customer to the account of a company without the customer's knowledge or consent. In addition, Stockton issued shares of a preferred stock in the same customer's name in exchange for the aforementioned GNMA and misappropriated the $285,000 GNMA for use as capital for a former member firm without the customer's knowledge or consent.

Philip Samuel Wilder (Registered Representative, Lewiston, Idaho) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Wilder engaged in outside business activities while failing to provide prompt written notice to his member firm. Wilder also failed to respond to NASD requests for information.

Individual Fined

David Joseph Dambro (Registered Representative, Aurora, Colorado) was fined $2,500 and required to pay $10,060 in restitution to the estate of a customer. In addition, Dambro must requalify by examination before acting in any capacity requiring registration. The SEC affirmed the sanction following an appeal of a June 1992 NBCC decision. The sanctions were based on findings that Dambro recommended and purchased securities for a public customer without having reasonable grounds for believing such recommendation was suitable for the customer.

Firms Expelled for Failure to Pay Fines, Costs, and/or Provide Proof of Restitution in Connection With Violations

Bison Securities, Incorporated, Amherst, New York

Brook Investments, Incorporated, Chicago, Illinois

Cambridge-Newport Company, Incorporated, Springfield, Massachusetts

Firms Suspended

The following firms were suspended from NASD membership for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of Article IV, Section 5 of the NASD Rules of Fair Practice and Article VII, Section 2 of the NASD By-Laws. The date the suspensions commenced are listed after each entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

Drayer Group, Inc., Austin, Texas (September 3, 1993)

Energy Sale Services, Inc., Oklahoma City, Oklahoma (September 3, 1993)

Lamberson Knight Capital, Newport, Rhode Island (September 3, 1993)

Marc Thomaes Securities, Inc., Allendale, New Jersey (September 3, 1993-September 15, 1993)

Portfolio Asset Mgt./USA, El Paso, Texas (September 3, 1993)

Suspension Lifted

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

Cattle Securities, Inc., Rowlett, Texas (August 27, 1993)

Individuals Whose Registrations Were Revoked for Failure to Pay Fines, Costs, and/or Provide Proof Of Restitution in Connection With Violations

Michael D. Bedol, Santa Ana, California

Daniel V. Dispigno, Smithtown, New York

Gilbert M. Hair, Newbury, California

Thomas C. Henry, Oklahoma City, Oklahoma

Rondell E. Loftin, Sr., Oakland Park, Florida

Paul M. Michalovsky, New York, New York

Everett N. Oliver, North Mankato, Minnesota

Richard R. Perkins, Denver, Colorado

Michael D. Pittman, Aurora, Colorado

Terry L. Rogers, Oklahoma City, Oklahoma

Peter W. Schellenbach, Glencoe, Illinois

Herbert C. Stine, Atlanta, Georgia

Michael A. Tripi, Tonawanda, New York

Eric J. Youngquist, Windsor, Connecticut

For Your Information

Applying the Free-Riding and Withholding Interpretation to Investment Partnerships Managed By Entities or Persons Associated With NASD Members

In the June 1993 *Notices to Members*, the NASD solicited comments on proposed amendments to the Free-Riding and Withholding Interpretation under Article III, Section 1 of the Rules of Fair Practice. One of the proposed amendments involved using the "carve out" mechanism (August 1992 *Notices to Members*) at the management level for investment partnerships that are managed by NASD members, their associated persons, or related entities. Several commenters asked if the National Business Conduct Committee (NBCC) could grant interim relief so that such partnerships could use this "carve out" mechanism prior to the rule change being permanently adopted. The NBCC has determined to grant such interim relief on similar terms to its prior grant of such relief for partnerships that had restricted persons as investors. The NBCC wishes to point out that in granting this relief, performance based fees **cannot** be used for purchases in the new issue account.

To obtain such interim relief, the investment partnership must establish the following policing mechanisms:

1. The investment partnerships will establish a separate brokerage account, with a separate identification number, for its new-issue purchases. At the end of each fiscal year, the general partners will certify in writing to its independent certified public accountants that: (a) all hot issues purchased by the partnership were placed in this new-issue account; (b) the partners participating in the new-issue account are not restricted persons under the Interpretation; and (c) no management fees are based upon the performance of securities in the new issue account.

2. Prior to the execution of the initial hot-issue transaction, the partnership's outside legal counsel will render an opinion that complies paragraph B of the section of the Interpretation titled "Investment Partnerships and Corporations."

3. As part of its audit procedure for the partnership, the independent certified public accountant will confirm in writing to the partnership that all allocations for the new-issues account were made in accordance with the provisions of the applicable partnership agreement that restricts participation in hot-issue purchases.

4. The partnership will maintain in its files copies of the certifications, representations, and confirmations referred to in paragraphs (1) - (3) above for at least three years following the last purchase of a hot issue for the new-issue account.

5. The partnership will accept investment funds from other partnerships if such other partnerships provide the same documentation and assurances described in paragraphs (1) - (4) that restricted persons will not participate in the purchase of hot issues.

6. The certifications and documents required in paragraphs (1) - (3) shall be provided to the member holding such account at such time as these certifications and documents are filed with the partnership and its independent certified public accountant and the member shall make such documentation available to the NASD upon request.

To qualify for the interim relief described in this Notice, a member

executing a hot issue transaction for an investment partnership with restricted persons as general or limited partners must receive, prior to the initial transaction, the certification from the general partner described in paragraph 1 and the opinion of counsel letter described in paragraph 2. The certification from the independent certified public accountant described in paragraph 3 above shall be obtained at the partnership's next audit.

Questions concerning this Notice should be directed to T. Grant Callery, Vice President and General Counsel, at (202) 728-8285; Craig L. Landauer, Associate General Counsel, at (202) 728-8291; or Lewis E. Antone at (202) 728-8245.

NASD Fidelity Bond Program Enhanced

The NASD Fidelity Bond Program has been enhanced to increase its value to NASD member firms and reflect the SEC-mandated increase in net capital requirements for 1994 (*Notice to Members 92-72* for information on the new net capital requirements).

The NASD Fidelity Bond Program now offers members coverage up to $5 million (for firms that have not had any paid losses in the past three years) and with net capital requirements of less than $4,166,000. Previously, firms with net capital requirements over $416,000 had to use the Financial Institution Bond Form 14. NASD members can now use the Security Dealers Blanket Bond (SDBB) to apply for coverage in all states except Texas.

By using the SDBB, members receive additional benefits not available when using the standard Form 14. The SDBB provides the full limit of liability coverage for **each and every loss,** as opposed to the Form 14 coverage that ceases to exist once the firm's aggregate losses meet the policy limit (unless additional coverage is purchased by the firm for the balance of the year). It also provides firms with an automatic $25,000 audit expense coverage not available with the Form 14. Computer systems coverage, including voice-initiated transactions, is included in the SDBB. Additionally, firms have the opportunity to extend their coverage by purchasing an optional one-year discovery period to protect against losses later discovered that were sustained during the bond period.

In October, applications and information on the NASD-sponsored Fidelity Bond Program will be mailed to all NASD member firms. If you have additional questions on the program or would like to compare your existing coverage with the NASD program, please contact Seabury and Smith at (800) 922-9242.

Changes Enhance NASD/MCI Long Distance Program

Two recent changes have been made to the NASD/MCI Long Distance Program that further enhance the value and savings available through the program to NASD member firms.

Effective September 1, firms using MCI Data Services through the NASD/MCI Long Distance Program will receive monthly discounts on their MCI invoices of 4 to 20 percent off MCI's standard tariffed rates. Previously, participating members using this service only received a rebate from the NASD equal to 6 percent of their monthly data charges. Participating firms will now receive the appropriate MCI discount and the NASD rebate. MCI data services covered under the program include transmission speeds from 9600 bps up to TDS1.5.

In June, MCI introduced *Proof Positive* that will provide NASD members with several additional benefits. A quarterly report will be sent to each participating firm comparing its actual savings to AT&T. The report also compares your current service with other MCI services. If another MCI service would have reduced your long distance costs, the difference will automatically be credited to your firm's account by MCI. MCI also will recommend specific alternatives to assist you in reducing your monthly telephone charges.

Please call (800) 688-8220, for additional information on these program changes or to find out how to enroll in the NASD/MCI Long Distance Program.

SEC Extends Derivative Products Comment Period

The SEC is extending the comment period for Release No. 34-32256 (May 10, 1993 *Federal Register*) concerning derivative products. In its release, the SEC solicited comments on a broad range of questions regarding the impact of Net Capital Rule standards on broker/dealer participation in the derivative products market. The new deadline for comments is now December 17, 1993.

Persons interested in submitting written comments should file three copies with Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. All comments should refer to File No. S7-17-93.

NASD NOTICE TO MEMBERS 93-76

Mail Vote—NASD Solicits Member Vote On Filing Requirements For Use of Mutual Fund Rankings and Elimination Of Sunset Provisions in Prefiling Requirements For CMO Advertisements; **Last Voting Date: December 31, 1993**

Suggested Routing

- ■ Senior Management
- ■ Advertising
- ■ Corporate Finance
- ■ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- ■ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The NASD invites members to vote on an amendment to Article III, Section 35(c) of the Rules of Fair Practice that would require a member using mutual fund rankings in advertisements or sales literature to submit copies of the rankings and the data on which the rankings are based to the NASD Advertising Regulation Department for review. The amendment will also eliminate the sunset provisions in Article III, Subsection 35(c)(2) of the Rules of Fair Practice and in Subsection 8(c)(1)(B) of the Government Securities Rules, thereby making the prefiling requirement for advertisements relating to collateralized mortgage obligations (CMOs) permanent. The text of the proposed rule changes follow this Notice.

Background and Description Of the Proposal

The increasing number of mutual funds in recent years has been accompanied by an increasing number of mutual fund ranking entities (Ranking Entities). Ranking Entities, as well as mutual funds and fund affiliates, categorize and rank mutual funds by various criteria, including fund type; performance over a given period of years; total return; standardized yield calculated pursuant to Securities and Exchange Commission (SEC) rules; the variations in sales charges;and, risk/reward. References to such rankings in mutual fund advertisements and sales literature have also increased substantially in recent years as members try to sell mutual fund shares by promoting fund performance.

The NASD Board of Governors believes that it is important for the NASD to be able to review and regulate the use of ranking materials and the development of customized rankings to prevent the misleading use of such rankings. The NASD is, therefore, proposing to amend Article III, Section 35(c) of the NASD Rules of Fair Practice to require that copies of mutual fund rankings and the data on which the rankings are based be submitted to the NASD Advertising Regulation Department for review.

The NASD is also adopting mutual fund ranking guidelines (Guidelines) governing the NASD review. Although attached to this Notice, the Guidelines do not require member vote.

Subsection 35(c)(1) is proposed to be amended to require any member that files advertisements or sales literature pursuant to Subsection 35(c)(1) that include or incorporate rankings or comparisons of the investment company with other investment companies, to include a copy of the ranking or comparison used in the advertising or sales literature. The requirements of this provision will permit the NASD staff to determine immediately whether the use of the ranking complies with the Guidelines and to avoid the need to research the ranking or obtain a copy of the source information to verify the accuracy of the material.

Subsection 35(c)(2) currently requires that certain advertisements be filed 10 days before use. The NASD is proposing to amend the section to apply the preuse requirement to all investment company advertisements or sales literature that incorporate rankings or comparisons either generally published or created directly or indirectly by the investment company, its underwriter, or an

affiliate.[1] While the NASD is concerned about permitting investment companies or their affiliates to create ranking categories, rather than a Ranking Entity, it recognizes that a customized ranking may provide meaningful information to the investor. Such filings must also include a copy of the data, ranking, or comparison on which the ranking or comparison is based.

The NASD is also proposing to amend Article III, Subsection 35(c)(2) of the Rules of Fair Practice and Subsection 8(c)(1)(B) of the Government Securities Rules to eliminate sunset provisions that cause the prefiling requirements relating to CMOs to expire on November 16, 1993. This change will make the prefiling requirement for CMO advertisements permanent.[2]

Request for Vote

The Board of Governors believes that requiring members to include rankings, comparisons, and data used when submitting for review advertisements and sales literature that incorporate mutual fund rankings or comparisons will enhance member compliance. The information provided to the NASD Advertising Regulation Department will assist it in assuring that the use of such information is accurate and presents investors with fair and meaningful data on which to make an informed investment decision. The NASD considers the proposed rule change necessary and appropriate and recommends that members vote their approval.

As to the proposed elimination of the sunset provisions for the prefiling of collateralized mortgage obligation advertisements, the Board believes that the positive regulatory benefits seen since implementation of the provision (i.e., the reduction in misleading advertising) justifies a permanent prefiling requirement.

The text of the proposed rule change that requires member vote is below. Please mark the attached ballot according to your convictions and mail it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be postmarked by **no later than December 31, 1993**. The amendment will not be effective until it is filed with and approved by the SEC.

Also included below is the text of the Guidelines For the Use of Rankings in Mutual Fund Advertisements and Sales Literature being filed separately with the SEC. The Guidelines are included for members' information and do not require member vote before submission to the SEC.

Questions regarding this Notice should be directed to Thomas A. Pappas, Assistant Director, Advertising/Investment Companies Regulation Department, at (202) 728-8330; Elliott R. Curzon, Senior Attorney, Office of General Counsel, at (202) 728-8451; and Robert J. Smith, Attorney, Office of General Counsel, at (202) 728-8176.

Text of Proposed Amendment to Section 35(c) of the Rules of Fair Practice

Communications With the Public

(**Note:** New language is underlined; deletions are in brackets.)

Sec. 35.

* * * * *

(c) Filing Requirements and Review Procedures

(1) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) not included within the requirements of Subsection (c)(2) of this Section, and public direct participation programs (as defined in Article III, Section 34 of the Rules of Fair Practice) shall be filed with the Association's Advertising Department within 10 days of first use or publication by any member. Filing in advance of use is recommended. Members are not required to file advertising and sales literature which have previously been filed and which are used without change. Any investment company filing any advertisement or sales literature pursuant to this Subsection that includes or incorporates rankings or comparisons of the investment company with other investment companies shall include a copy of the ranking or comparison used in the advertisement or sales literature.

(2) Advertisements concerning collateralized mortgage obligations registered under the Securities Act of 1933, and advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment

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[1]The proposed Guidelines permit the use of a ranking based on a category or subcategory created by a fund affiliate rather than by a Ranking Entity, so long as the ranking is based on the performance measurements of a Ranking Entity.

[2]To provide sufficient time for membership vote and SEC approval of the elimination of the sunset provisions, the NASD has submitted a rule change to the SEC to extend the sunset provisions temporarily.

trusts) that include or incorporate rankings or comparisons of the investment company with other investment companies where the ranking or comparison category is not generally published or is the creation, either directly or indirectly, of the investment company, its underwriter or an affiliate, shall be filed with the Association's Advertising Department for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed or expressly disapproved by the Association, shall be withheld from publication or circulation until any changes specified by the Association have been made or, in the event of disapproval, until the advertisement has been refiled for, and has received, Association approval. Any investment company filing any advertisement or sales literature pursuant to this Subsection shall include a copy of the data, ranking or comparison on which the ranking or comparison is based. [This subsection (c)(2) shall remain in effect for one year from November 16, 1992 unless modified or extended prior thereto by the Board of Governors.]

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Text of Proposed Amendment To Section 8(c)(1)(B) of the Government Securities Rules

Communications With the Public

Sec. 8.

(c) Filing Requirements and Review Procedures

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(B) advertisements concerning collateralized mortgage obligations shall be filed with the Association's Advertising Regulation Department for review at least 10 days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed or expressly disapproved by the Association, shall be withheld from publication or circulation until any changes specified by the Association have been made or, in the event of disapproval, until the advertisement has been refiled for, and has received, Association approval. [This subsection (c)(1)(B) shall remain in effect for one year from November 16, 1992 unless modified or extended prior thereto by the Board of Governors.]

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Guidelines for the Use of Rankings in Mutual Fund Advertisements and Sales Literature

I. Definition of "Ranking Entity"

For purposes of these guidelines, the term "Ranking Entity" refers to any entity that provides general information about mutual funds to the public, that is independent of the mutual fund and its affiliates, and whose services are not procured by the mutual fund or any of its affiliates to assign the fund a ranking. Examples of "Ranking Entities" include services such as Morningstar and Lipper and financial publications such as *Money* and *Barron's*.

II. Required Disclosures

A. Headlines/Prominent Statements

1. A headline or other prominent statement must not state or imply that a mutual fund is the best performer in a category unless it is actually ranked first in the category.

2. Prominent disclosure of the mutual fund's ranking, the total number of mutual funds in the category, the name of the category, and the period on which the ranking is based (i.e., the length of the period and the ending date; or, the first day of the period and the ending date), must appear in close proximity to any headline or other prominent statement that refers to a ranking.

B. All advertisements and sales literature containing a mutual fund ranking must disclose, with respect to the ranking:

1. the name of the category (e.g., growth funds);

2. the number of funds in the category;

3. the name of the Ranking Entity;

4. the length of the period and the ending date, or, the first day of the period and the ending date;

5. criteria on which the ranking is based;

6. for load funds, whether the ranking takes into account sales charges;

7. if fees have been waived or expenses advanced during the period on which the ranking is based, and the waiver or advancement had a material effect on the ranking, a statement to that effect; and

8. the publisher of the ranking data (e.g., *ABC Magazine*, June 1993).

The disclosure required by B1, B2, and B3 must be set forth prominently in the body of the advertisement or sales literature.

C. If the mutual fund ranking consists of a symbol (e.g., a star system) rather than a number, the

advertisement or sales literature also must disclose the meaning of the symbol (e.g., a four-star ranking indicates that the fund is in the top 30 percent of all mutual funds).

D. All advertisements and sales literature containing a mutual fund ranking must disclose that past performance is no guarantee of future results.

III. Time Periods

A. Any mutual fund ranking set forth in an advertisement or sales literature must be, at a minimum, current to the most recent calendar quarter ended prior to the submission for publication.

B. Except for money market mutual funds:

1. advertisements and sales literature must not use any ranking based on a period of less than one year;

2. a mutual fund ranking based on total return must be accompanied by rankings based on total return for the one-, five-, and ten-year periods (or life of the fund) supplied by the same Ranking Entity in the category and based on the same time period; and,

3. a mutual fund ranking based on the current SEC standardized yield must be accompanied by rankings based on total return for the one-, five-, and ten-year periods (or life of the fund) supplied by the same Ranking Entity in the category and based on the same time period.

IV. Categories

A. The choice of category (including a subcategory of a broader category) on which the mutual fund ranking is based must be one that provides a sound basis for evaluating the performance of the fund.

B. Subject to the standards below, a mutual fund ranking must be based only on (1) a published category or subcategory created by a Ranking Entity or (2) a category or subcategory created by a fund or a fund affiliate, but based on the performance measurements of a Ranking Entity.

C. When the mutual fund ranking is based on a subcategory, the advertisement or sales literature must disclose the name of the full category and the fund's ranking and the number of funds in the full category. This requirement does not apply if the subcategory is (1) based solely on the investment objectives of the funds included and (2) created by a Ranking Entity. This disclosure could be included in a footnote.

D. The advertisement or sales literature must not use any category or subcategory that is based upon the mutual funds' asset size (whether or not it has been created by a Ranking Entity).

E. If an advertisement uses a category created by the mutual fund or a fund affiliate, including a "subcategory" of a category established by a Ranking Entity, the advertisement must prominently disclose:

1. the fact that the fund or its affiliate has created the ranking category;

2. the number of funds in the category;

3. the basis for selecting the category; and

4. the Ranking Entity that developed the research on which the ranking is based.

F. An advertisement or sales literature containing a headline or other prominent statement that proclaims a mutual fund ranking created by a fund or its affiliate must indicate, in close proximity to the headline or statement, that the mutual fund ranking is based upon a category created by the fund or its affiliate.

V. Multiple Class/Two-Tier Funds

Mutual Fund rankings for more than one class or fund with the same portfolio must be accompanied by prominent disclosure of the fact that the funds or classes have a common portfolio.

NASD NOTICE TO MEMBERS 93-77

SEC Adopts Rule 15c6-1; Establishes Three-Business-Day Settlement for Securities Transactions

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) recently adopted Rule 15c6-1 under the Securities Exchange Act of 1934 to establish three business days, instead of five, as the standard settlement timeframe for most securities transactions. The new rule is effective June 1, 1995.

Background

Earlier this year, the SEC solicited comments on its proposal to adopt Rule 15c6-1 as one means of reducing the risks associated with unsettled securities transactions.

The proposed rulemaking followed several studies by government and industry groups after the October 1987 market break. These groups closely scrutinized the clearance and settlement system as they sought to identify causes for the market decline and develop initiatives to protect market participants from the impact of such declines in the future.

The Group of Thirty conducted one of these studies. The Group is an independent, non-partisan, nonprofit organization composed of international financial leaders that focuses on international economic and financial issues. In March 1989, the Group of Thirty issued a report with a number of proposals to improve clearance and settlement practices and standards. Among these proposals was the recommendation that settlement take place on the third day after trade date (T+3).

Following release of this report, two subcommittees, the U.S. Steering Committee and a U.S. Working Committee of the Group of Thirty, were formed to evaluate these recommendations. The subcommittees concluded that shortening the settlement cycle would be beneficial.

Next, the SEC convened a round table to discuss the subcommittees' recommendations. Round table participants generally agreed that these recommendations should be adopted but expressed concern about the impact on broker/dealers conducting a predominantly retail business.

Subsequently, an industry task force, headed by John W. Bachmann, the Managing Principal of Edward D. Jones & Co. of St. Louis, Missouri, undertook an independent evaluation of these issues. In May 1992, the Bachmann Task Force presented its findings supporting T+3 settlement to the SEC.

In its proposal, the SEC set forth three reasons for supporting adoption of Rule 15c6-1. "First, at any given point in time, fewer unsettled trades would be subject to credit and market risk, and there would be less time between trade execution and settlement for the value of those trades to deteriorate. Second, the rule would reduce the liquidity risk among the derivative and cash markets and reduce financing costs by allowing investors that participate in both markets to obtain the proceeds of securities transactions sooner. Finally, the SEC noted that a shorter settlement timeframe could encourage greater efficiency in clearing agency and broker/dealer operations."

According to its records, the SEC received more than 1,900 comment letters. After reviewing the comments, the SEC revised proposed Rule 15c6-1 and determined to adopt it effective June 1, 1995.

Description of Rule 15c6-1

Rule 15c6-1 provides that, unless otherwise expressly agreed to by the parties at the time of the transaction, a broker or dealer cannot enter into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract. The Rule does *not* apply to a contract for an exempted security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills.

The rule allows a broker or dealer to agree that settlement will occur in more or less than three business days, provided the agreement is explicit and reached at the time of the transaction. However, this does not require broker/dealers to specify all contract terms before a trade is executed.

The rule provides three exemptions to its three-day-settlement provision:

• Transactions in limited partnership interests that are unlisted or not quoted in The Nasdaq Stock Market[SM].

• The sale for cash of securities by an issuer to an underwriter pursuant to a firm commitment offering registered under the Securities Act of 1933, or the sale to an initial purchaser by a broker/dealer participating in such offering.

• Securities transactions that the SEC may from time to time exempt by order if the SEC determines that such exemption is consistent with the public interest and the protection of investors.

Finally, it should be noted that the rule does not preclude individual investors from obtaining physical securities certificates.

In adopting the rule, the SEC expressed its confidence that broker/dealers can make the necessary systems and operational changes to comply with three-day settlement by June 1, 1995, the rule's effective date.

A copy of the SEC's release adopting Rule 15c6-1, which was published in the October 13, 1993, *Federal Register*, is attached.

Questions concerning this Notice may be directed to Samuel Luque, Associate Director, Compliance, at (202) 728-8472, or Brad Darfler, Compliance, at (202) 728-8946.

their securities on issuer records in a three-day settlement environment. Fifty-six of the commentators that oppose the Rule expressed concern about the costs of complying with the three-day settlement. A complete list of commentators is attached as Appendix 1. Staff of the Commission has prepared a summary of the comments, a copy of which has been placed in the official file.

As discussed below, the Commission agrees with many of the commentators' suggestions, and the Commission has modified Rule 15c6–1 accordingly. For example, the Commission is modifying the Rule to exempt at this time transactions in limited partnership interests that are not listed on a national securities exchange or traded in the over-the-counter market ("unlisted limited partnership interests") and certain new issues involving firm-commitment underwritings. Although the Commission is not expanding the scope of the Rule to encompass municipal securities, the Commission is calling upon the Municipal Securities Rulemaking Board ("MSRB") to take all steps necessary to shorten the routine settlement cycle for municipal securities transactions by the effective date of Rule 15c6–1. In addition, the Commission has determined not to exempt other securities issued by mutual funds and private label mortgage-backed securities, or listed limited partnership interests. Finally, the Commission is modifying the Rule to authorize the Commission, by order, to exempt additional securities from the scope of Rule 15c6–1. For the reasons discussed in the Proposing Release and below, the Commission is adopting Rule 15c6–1, as revised, effective June 1, 1995.

I. Background

In recognition of the importance of broker-dealer settlement practices to the clearance and settlement process,[3] the Securities Acts Amendments of 1975 ("1975 Amendments")[4] authorized federal regulation of the time and method by which broker-dealers settle securities transactions. In adopting the 1975 Amendments, Congress directed the Commission to act in the national interest to achieve safety and efficiency in clearance and settlement. Section 17A of the 1934 Act directs the Commission "to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempted securities)."[5] That directive was revised by the Market Reform Act of 1990[6] to reflect the interdependence of options, futures, and equity markets that trade products involving securities or stock indexes.

Currently, the settlement cycle in the U.S. varies among markets.[7] Settlement of securities transactions on the fifth business day after the trade date ("T+5") is largely a function of market custom and industry practice. There is no federal rule that mandates a specific settlement cycle for securities transactions. Indeed, at one time, other settlement periods were considered "regular-way."[8] Prior to 1953, settlement at the American Stock Exchange ("Amex") occurred on the second day after the trade date ("T+2"), and gradually moved to the third day after the trade date ("T+3") in 1953, T+4 in 1962, and to the present T+5 in 1968.[9] The New York Stock Exchange ("NYSE") originally settled trades on T+1 in the 1920s, but settlement has gradually moved to T+5.[10] Currently, self-regulatory organization ("SRO") rules define "regular way" settlement as settlement on T+5.[11] At this time, however, and for the reasons set out below, the Commission believes T+3 settlement should be mandated.

II. Basis and Purpose of the Rule

A. Regulatory Basis

The market break of 1987 highlighted the need for improvements in the nation's clearance and settlement system.[12] The performance of the clearance and settlement system was viewed by many as a threat to the stability of the market during this time. During and after the week of October 19, 1987, over 50 introducing brokers failed, many as a result of the inability of customers to meet margin calls and pay settlement obligations.[13] The failure to meet margin calls and/or transaction settlement obligations exposed some clearing firms to financial loss, thus threatening the entire financial system.[14]

Shortly after the 1987 market break, then Treasury Secretary Nicholas F. Brady referred to the clearance and settlement system as the weakest link in the nation's financial system and noted that improving clearance and settlement would "help ensure that a securities market failure does not become a credit

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[3] The term "clearance" includes the comparison of data regarding the terms of settlement of securities transactions and the allocation of securities settlement responsibilities. After trade comparison, most trades clear through a continuous net settlement system ("CNS") operated by a clearing corporation registered with the Commission under Section 17A of the 1934 Act. Under CNS, the clearing corporation nets each clearing member's purchases and sales to arrive at a daily net receive or deliver obligation for each security and a daily net settlement payment obligation. The term "settlement" includes the delivery of securities in exchange for funds, pursuant to the terms of the original transaction, and the custody of securities. See section 3(a)(23)(A) of the 1934 Act, 15 U.S.C. 78c(a)(23)(A).

[4] Public Law 94–29 section 16, 89 Stat. 146.

[5] See 15 U.S.C. § 78o, 78q-1, and 78w.

[6] Public Law 101–432, 104 Stat. 963.

[7] Settlement in the futures, options, and government securities markets occurs on the day after trade date ("T+1") using same-day funds. Settlement of most trades in corporate and municipal securities, on the other hand, takes place on the fifth business day after the trade date ("T+5") with money payments among financial intermediaries made in next-day funds (*i.e.*, payment by means of certified checks passing between the clearing corporation and its members). Thus, financial intermediaries have good funds on "T+6."

[8] See e.g., Remarks of Commissioner Mary L. Schapiro before the Securities Industry Association ("SIA") Regional Conference (March 20, 1991), stating that "[p]rior to 1968, equity transactions in the U.S. were settled on the fourth day after the trade date ("T+4"), without causing undue harm to retail customers."

[9] Letter from Mary Ann Callahan, Vice President/Director of International Development, National Securities Clearing Corporation ("NSCC"), to Toshitsugu Shimizu, Assistant Manager, Tokyo Stock Exchange (June 30, 1987).

[10] Frank W. Curran, Address to Executives and Officers of Korea Securities Industry (March 28, 1974).

[11] See e.g., National Association of Securities Dealers, Inc. Uniform Practice Code ¶ 3512, section 12 and New York Stock Exchange Rule 64.

[12] Commentators opposed to Rule 15c6–1 predominantly expressed concern about the cost implications of the rule, which are addressed in section II.B of this release. Fewer than ten commentators indicated that the rule was unnecessary or that Commission goals could be achieved by other means. See discussion, *infra*, at pp. 19–21.

[13] Division of Market Regulation, The October 1987 Market Break ("Market Break Report") 10–20 (February 1988).

[14] *Id.* at 10–16. Clearing firms stand between the clearing corporation, on the one side, and market professionals, introducing firms, and public investors on the other. Many customers, institutional and otherwise, open their accounts with an introducing broker. Introducing brokers use executing brokers (which are usually members of a clearing agency) to execute and clear customer trades. If the customer fails to meet margin calls made by the executing firm or fails to pay on T+5 the settlement amount for securities it has purchased, the introducing or executing broker must pay that debt. If the amount exceeds the introducing broker's ability to pay and it fails, the clearing member executing firm will be responsible for the customer's debt. If the clearing member fails to meet its obligation to the clearing agency, the clearing agency will suspend and cease to act for that member. Clearing agencies ceased to act for three clearing members during the week of October 19, 1987. The Depository Trust Company ("DTC") and NSCC ceased to act for Metropolitan Securities ("Metropolitan"), American Investors Group, and H.B. Shaine and Co. ("Shaine"). The Options Clearing Corporation ("OCC") ceased to act for Shaine, and MBS Clearing Corporation ceased to act for Metropolitan. *Id.*

market failure."[15] Gerald Corrigan, President of the Federal Reserve Bank of New York ("FRBNY"), noted: "[T]he greatest threat to the stability of the financial system as a whole [during the 1987 market break] was the danger of a major default in one of these clearing and settlement systems."[16]

The connection between a crisis in the clearance and settlement system and the financial industry was highlighted by the bankruptcy in 1990 of Drexel Burnham Lambert Group, the holding company parent of Drexel Burnham Lambert, Inc. ("Drexel"), a large broker-dealer. As described more fully in the Commission's testimony before the Senate Banking Committee,[17] near gridlock developed in the mortgaged-backed securities market and in the corporate debt and equity markets where Drexel was an active participant. Drexel had significant positions in mortgage-backed securities that required physical delivery of certificates to settle and also in corporate equity and debt that could be liquidated by book-entry transfer. Lenders and counterparties, however, were reluctant to release both physical certificates and book-entry securities to Drexel. Those counterparties were concerned that the delivery of securities to Drexel against the promise of payment at the end of the day might result in the deliverer's inability to retrieve the securities if the deliverer did not receive payment because of an intervening event, such as the filing of a petition for bankruptcy by or against Drexel, or the assertion of a lien or set-off by one or more financial institutions handling those funds or securities.[18]

The events that surrounded the subsequent liquidation of Drexel's positions in mortgage-backed and corporate securities highlighted two concerns—first, the risk that counterparty credit concerns could lead to gridlock in securities markets, even where regulators assured markets that a major participant is solvent; second, that these risks are not limited to markets where transactions are subject to netting by clearing corporations. These events forced the conclusion that the clearance and settlement system deserved immediate attention.[19]

As noted by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System ("Federal Reserve Board" or "Board"), "The importance of strong clearing and settlement systems cannot be overemphasized. This area was identified by the Brady Commission and others after the market break last year as a potential point of vulnerability in the U.S. financial system. The overloading of the * * * clearing systems last October induced breakdowns that dramatically increased uncertainty among investors and likely contributed to additional downward pressures on prices."[20]

In the Proposing Release, the Commission set forth three reasons why adoption of Rule 15c6–1 would be necessary or appropriate. First, at any given point in time, fewer unsettled trades would be subject to credit and market risk, and there would be less time between trade execution and settlement for the value of those trades to deteriorate. Second, the proposed Rule would reduce the liquidity risk among the derivative and cash markets and reduce financing costs by allowing investors that participate in both markets to obtain the proceeds of securities transactions sooner. Finally, the Commission noted that a shorter settlement timeframe could encourage greater efficiency in clearing agency and broker-dealer operations.

Commentators that support T+3 settlement believe that the new Rule would facilitate these goals. Commentators stated specifically that the Rule would significantly reduce settlement risk. The Federal Reserve Board stated that settlement systems for securities and other financial instruments are a potential source of systemic disturbance to financial markets and to the economy.[21] In the Board's view, the key features of an ideal settlement system are the settlement of trades immediately after execution and payment in same-day funds, and compressing the settlement timeframe for corporate securities to three days from five days is an important and achievable step toward this ideal. Similarly, the FRBNY noted that shortening the settlement cycle decreases the opportunity for adverse developments to occur between the execution and settlement of each trade, thus lowering the credit and market risks that can arise when settling individual transactions. A move to T+3 reduces the total volume and value of outstanding obligations in the settlement pipeline at any point in time; the FRBNY believes this will better insulate the financial sector from the potential systemic consequences of serious market disruptions.[22]

Commentators stated also that the Rule will facilitate risk reduction by achieving closer conformity between the corporate securities markets and the markets for other securities that currently settle in fewer than five days (*i.e.*, government securities and derivative securities), and will encourage market participants to achieve greater efficiencies in clearing agency and broker-dealer operations. For example, the Government Securities Clearing Corporation ("GSCC") stated that settlement risk can arise from dissimilarities in settlement cycles among markets as well as the length of a specific market's settlement cycles, which can lead to artificial delays in moving securities and make it more difficult to establish risk reduction

[15] The Market Reform Act of 1989: Joint Hearings on S. 648 before the Subcomm. on Securities and the Senate Comm. on Banking, Housing and Urban Affairs, 101st Cong., 1st Sess. 225 (Oct. 26, 1989) (statement of Nicholas F. Brady, Secretary of the Treasury).

[16] Luncheon Address: Perspectives on Payment System Risk Reduction by E. Gerald Corrigan, President, FRBNY, reprinted in The U.S. Payment System: Efficiency, Risk and the Role of the Federal Reserve 129–30 (1990).

[17] The Issues Surrounding the Collapse of Drexel Burnham Lambert, Hearings before the United States Congress, Senate Committee on Banking, Housing, and Urban Affairs, 101st Cong., 2d Sess. 5 (1990) (testimony of Richard C. Breeden, Chairman, Commission) ("Drexel testimony").

[18] Ordinarily, lenders who accept securities in DTC's pledge program release those securities to the debtor's control without requiring full payment of outstanding loans, provided payment (including refunding through new pledge loans) occurs before the end of the day. This permits the debtor (typically, a broker-dealer) to deliver the pledged securities against payment to another participant or to NSCC during both of DTC's delivery processing cycles. Because settlement of transactions typically starts with delivery of securities, with the deliverer assuming the risk that payment will be made at or before the end of the day, release of pledged collateral can help maximize the number of trades that settle while shifting some credit risk to the deliverer's bank.

When Drexel experienced financial difficulties, however, its lenders and counterparties took steps to reduce their credit risk exposure to Drexel. In particular, because of concern about what might happen during the day or the quality of collateral that might be posted at the end of the day, lenders insisted upon repayment before release of securities, which meant Drexel could not settle open transactions even as it was winding down its portfolio. See Drexel testimony at 47.

[19] Initiatives in clearance and settlement reform undertaken since 1987 are outlined in Appendix 2.

[20] See Remarks by Alan Greenspan before the Annual Convention of the SIA (November 30, 1988).

[21] Letter from William W. Wiles, Secretary to the Board, to Jonathan G. Katz, Secretary, Commission (September 1, 1993). See also Bank for International Settlements, Delivery Versus Payment in Securities Settlement Systems (September 1992).

[22] Letter from William J. McDonough, President, FRBNY, to Jonathan G. Katz, Secretary, Commission (August 27, 1993).

mechanisms such as common netting and cross margining arrangements.[23] The American Bankers Association echoed these views, noting that by reducing the lag between the settlement of derivatives and government securities and the settlement of corporate securities, investors that participate in both markets will be able to reduce their financing costs and obtain the proceeds of their securities transactions on a more timely basis.[24]

The Commission believes that the benefits of three-day settlement will inure to all market participants. As noted in the Proposing Release, the value of securities positions can change suddenly causing a market participant to default on unsettled positions. Because the markets are interwoven through common members, default at one clearing corporation or by a major market participant or end-user[25] could trigger additional failures, resulting in risk to the national clearance and settlement system ("system").[26] This risk is even more acute given the growth of the over-the-counter derivative product markets where dealers shift risk exposure among major market participants in international centers and end-users.[27] Finally, in a T+3 settlement environment, because the settlement date will be accelerated by two business days, a broker-dealer who executes a trade based on a customer's verbal agreement will be able to take action as much as two business days sooner than in a T+5 environment to mitigate losses in the event of the customer's cancellation.

B. Cost of Systems and Operational Changes

The Commission believes that the potential benefits from shortening the settlement cycle by two business days outweigh the costs associated with such a change. The benefits of a shorter settlement cycle include reduced credit, market, and systemic risk. Perhaps no single conclusion from the Bachmann Task Force ("Task Force") Report[28] is more significant than the equation "Time = Risk." A shorter settlement cycle not only reduces the number of outstanding trades, but significantly changes how market participants calculate credit and market risk.

Activity in the national clearance and settlement system measures in the tens of billions of dollars, with continuous-net-settlement ("CNS") processing at the National Securities Clearing Corporation ("NSCC") averaging over $22.5 billion in corporate equity and debt transactions a day. This activity creates considerable risk to clearing corporations, including credit risk, market risk on open contractual commitments, and systemic risk because clearing corporations interpose themselves between purchasers and sellers of securities. The Task Force found that the risk reduction to one clearing corporation, NSCC, from reducing the standard settlement cycle to T+3 in the event of the failure of an average large member could range from $6.5 million (or 58%) to $208 million (or 55%) in a worst case scenario.[29] Equally significant, if the temporary insolvency of eleven average large firms were to occur on a typical trading day, T+3 would reduce the risk to NSCC by $72 million (or 59%) to $2.3 billion (or 55%) in a worst-case situation.[30]

Notwithstanding these benefits, some commentators, generally small retail broker-dealers, thought that the costs involved in shortening the settlement cycle would outweigh the benefits. Although they were unable to quantify their estimated expenses with precision, these commentators noted problems with receipt of confirmation, payment by check, and possible financing costs resulting from the rule.[31] Commentators supporting the Rule, including exchanges, the ABA, the Securities Industry Association ("SIA"), and a significant number of broker-dealers representing a large majority of the retail customer base indicated that the risk reduction benefits of Rule 15c6–1 were important to the national clearance and settlement system, and they therefore supported the Rule.

The Commission is sensitive to the costs necessary for transition to a shorter settlement timeframe but on balance believes that the benefits to the financial system outweigh those costs. Moreover, the Commission believes Rule 15c6–1 creates an incentive for broker-dealers, particularly retail firms, to encourage timely customer payment and improve management of cash flows. With more than 19 months before the effective date of Rule 15c6–1, the Commission expects broker-dealers will have adequate notice to educate customers about the need for prompt payment and will have adequate time and incentive to implement changes to reduce the need for financing.

As discussed in more detail in the Final Regulatory Flexibility Analysis ("FRFA"), a potentially large expense for retail firms likely will be interest expenses, while a few firms projected a cost increase from hiring additional personnel.[32] Many of the cost estimates are based on assumptions of static

[23] Letter from Jeffrey F. Ingber, General Counsel and Secretary, GSCC, to Jonathan G. Katz, Secretary, Commission (June 30, 1993).

[24] Letter from Sarah A. Miller, Senior Government Relations Counsel, American Bankers Association, to Jonathan G. Katz (June 30, 1993).

[25] See Securities Exchange Act Release No. 32256 (May 14, 1993), 58 FR 27486 (concept release regarding changes to Commission's net capital treatment of derivative products); and the Group of Thirty, Derivatives: Practices and Principles (July 1993).

[26] Clearing corporations function as, among other things, post-trade processing facilities and guarantors of post-trade settlements. Upon reporting matched trade information to its members, the clearing corporation becomes the counterparty to every trade and guarantees payment and delivery. See Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 ("Full Registration Order"). To protect against the credit risk presented by unsettled positions, clearing corporations obtain contributions from their members to a pool of funds designed to provide a ready source of liquidity in case of a member default. See Securities Exchange Act Release Nos. 16900 (June 17, 1980), 45 FR 4192 (announcing the Division of Market Regulation's standards for the registration of clearing agencies); 20221 supra; and 30679 (July 1, 1992), 57 FR 30279 (order approving modifications to the CNS portions of NSCC, Midwest Clearing Corporation, and Securities Clearing Corporation of Philadelphia clearing fund formulas). Any sizable loss in liquidating the open commitments of a defaulting member, however, would be assessed pro rata against all clearing members. See e.g., NSCC Rule 4. See also, Market Break Report, Chapter 10.

[27] Task Force on Securities Settlement Report to the Governor of The Bank of England (June 1993).

[28] Bachmann Task Force, Report of the Bachmann Task Force on Clearance and Settlement in the U.S. Securities Markets ("Task Force Report") (May 1992).

[29] Task Force Report at 35.

[30] *Id.* at 36.

[31] Based on the information received from commentators upon staff requests for further data, the firms' estimated costs ranged from $0 to $5 million. Three firms stated that they expected to incur little or no cost. Other firms cited annual cost figures as follows: $12,000, $20,000, $55,000, $75–100,000, $87,000, $99,300, $1 million, $3.8 million, and $5 million.

Two clearing firms provided specific cost data. One clearing firm stated that it would have initial start-up costs of approximately one million dollars to make changes to its cash management and trade processing systems and procedures. Letter from George Minnig, Managing Director, Pershing Division of Donaldson, Lufkin and Jenrette Securities Corporation ("Pershing"), to Jonathan G. Katz, Secretary, Commission (June 21, 1993). The other responding clearing firm stated that its informal analysis indicated that it would have annual costs, mainly based on financing late payments, of approximately five million dollars. Letter from Jeffrey R. Larsen, Senior Legal Counsel, Fidelity Investments Institutional Services Company, Inc. ("Fidelity"), to Jonathan G. Katz, Secretary, Commission (June 24, 1993).

[32] The Commission notes that the cost data received in general were very rough estimates, not based on detailed studies, and the Commission expects that actual costs will vary among firms depending on many factors, including the nature and location of the firm's clientele and the level of technology employed by the firm.

circumstances. Firms generally projected costs, or claimed the move to T+3 settlement would be impossible for them, by assuming continued reliance upon the U.S. mail for delivery of confirmations and checks and no change in the behavior of customers who do not provide payment until receipt of confirmations; all without considering use of new practices and technologies.

The Commission believes that alternatives exist to speed processing funds payments. For example, broker-dealers could encourage clients to deposit funds or securities with the broker-dealer upon placing an order, or to send funds and securities that day. Existing technology allows firms to advise customers immediately after trade execution what the net cost is. Sixteen commentators indicated that many customers will not pay by check until they see the written confirmation which means that funds won't arrive at the firm until after a "round-trip" mailing.[33]

Alternatively, firms could establish facilities with local banks that would permit customers to authorize payments to firms using electronic funds transfer systems. One type of electronic funds transfer system is the Automated Clearing House ("ACH") system operated under the guidelines established by the National Automated Clearing House Association ("NACHA"),[34] which is now used by several retail service industries for periodic and occasional funds payments. A study done in 1990 by the U.S. Working Committee of the Group of Thirty indicated that the costs of ACH may be offset by a reduction of internal costs arising from the processing of checks and elimination of financing costs currently incurred for checks received after T+5 and could be absorbed by the initiating firm.[35] Several commentators noted that firms and customers may be uncomfortable using these systems for security, administrative, and other reasons.

Several broker-dealers have expressed reluctance to use ACH because of liability that may result from a customer exercising his sixty-day right of rescission in the current ACH system. In response to this concern, NACHA recently passed a rule that will, effective April 1994, require a receiving depository financial institution to obtain a signed affidavit from a consumer when the consumer claims that a transaction to his or her account is unauthorized or that an authorization had been revoked. NACHA is confident that this rule amendment will make the ACH network more attractive for retail security transactions.

Seven retail broker-dealers, including the three retail broker-dealers that believe the Rule is not necessary, suggested that the Commission adopt a daily mark-to-market instead of shortening the settlement cycle to three days. These commentators believe that a daily mark-to-market is the best way to reduce "real" systemic risk, *i.e.*, market risk, as opposed to time risk. The commentators suggested that the Commission propose a pass-through mark-to-market similar to the one NSCC imposes on open trades in its CNS system.[36]

The Commission believes the mark-to-market mechanism raises more concerns than it does solutions, inasmuch as it reduces, but does not eliminate, the potential risk of unsettled trades. Indeed, the Bachmann Task Force concluded that shortening the settlement cycle significantly reduced market risk to clearing agencies when a major participant defaults compared to a system that only required pass-through of daily marks-to-the-market. Moreover, it would appear to require firms to have the capacity to collect funds from customers to meet some or all mark-to-market obligations, particularly in volatile markets where the firm might not have enough working capital to meet the mark-to-market payment obligation. In addition, because the firm would not have any collateral to post, financing could be difficult to obtain except on an unsecured basis. In this regard, shortening the settlement cycle should be more manageable for firms because the firm can post the customer's securities as collateral for financing pending settlement with the customer.

As stated above, the Commission believes that greater risk reduction can be achieved through reducing the settlement timeframe. While a risk reduction measure such as a mark-to-market may be more readily acceptable to the retail segment of the industry, the Commission believes that retail broker-dealers and their customers can achieve T+3 settlement given the extended transition period for implementation.

C. Building Blocks

Several commentators expressed concern that certain "building blocks" must be in place before the Commission mandated T+3 settlement. The building blocks most frequently cited were an interactive institutional delivery system at securities depositories (to allow institutional broker-dealers, money managers, and custodians to confirm trades, correct errors, and instruct release of funds and securities on an intraday basis), making as many securities as possible eligible for processing in those depositories, and improving retail customer payment systems to broker-dealers. Commentators also identified several regulatory initiatives they believe are predicates to T+3 settlement, including changes in the Commission's confirmation rule (Rule 10b-10), broker-dealer financial responsibility rules (Rules 15c3-1 and 15c3-3), and the Federal Reserve Board broker-dealer credit rules (Regulation T). These concerns are described briefly below and in greater detail in appendix 3.

The Commission believes that none of these building blocks justify delaying the Commission's adoption of Rule 15c6-1. Efforts to implement several of the building blocks commentators identified are underway, and the Commission reasonably anticipates implementation will be completed before June 1, 1995, the effective date of Rule 15c6-1. Indeed, if the Commission were to defer action on this Rule, those efforts might well languish. Moreover, certain changes, particularly those that involve regulation, are best considered after a date for shortening the settlement cycle has been established, as the Commission is doing today. Of course, the Commission will monitor efforts to address these and other concerns.

[33] In addition, three commentators indicated that the customer needed to review the confirmation to eliminate unauthorized transactions. Commentators raise valid concerns about unauthorized transactions and the utility of the written confirmation in detecting unauthorized transactions. Nevertheless, unauthorized transactions generally represent a small percentage of all trades executed each day, and the key to avoiding those transactions is prompt communication of key trade terms to the customer, which could be accomplished orally as well as in writing. Even more to the point, firms should take corrective action whenever they discover unauthorized transactions in customer accounts without regard to when the customer receives a confirmation.

[34] ACH is a domestic electronic payment system operated under the direction of NACHA and is utilized by over 22,000 banks, thrifts, and other depository financial institutions on behalf of corporations and individuals.

[35] U.S. Working Committee, Implementing the Group of Thirty Recommendations in the United States (November 1990).

[36] See *e.g.*, letter from Robert C. Disset, Director, Operations Division, A.G. Edwards & Sons, Inc. ("A.G. Edwards"), to Jonathan G. Katz, Secretary, Commission (June 1, 1993).

1. SRO and Industry Initiatives

To facilitate three-day settlement, The Depository Trust Company ("DTC") is developing an interactive Institutional Delivery ("ID") system[37] that would permit real-time confirmation/affirmation of institutional trades. In March 1993, DTC distributed to its participants and other ID system users a design paper containing detailed descriptions of the various features of the interactive ID system as well as a tentative implementation schedule for each. DTC proposes to introduce certain features in late 1993, with the interactive receipt of trade input and affirmations, and the interactive distribution of confirmations and Eligible/Ineligible Trade Reports, scheduled for the first half of 1994.

Institutional trades comprise a large part of the U.S. securities market. As of the third quarter of 1992, institutions held 29% of the total outstanding corporate equity securities in the U.S., totaling over $1.4 trillion.[38] During 1992, institutions accounted for two-thirds, and perhaps more, of daily share volume on the NYSE.[39]

DTC's ID system is the workhorse for processing institutional trades in the national ID system, which links broker-dealers, investment managers, and custodian banks through a network of electronic communications systems to speed confirmations, settlement instructions, and corrections among the agents for institutional investors. Currently, 81% of institutional transactions are affirmed by T+1, and 94% are affirmed by T+2. An interactive ID system will allow the processes of trade data input, confirmation output, affirmation, and issuance of settlement instructions to be completed in a matter of minutes. Consequently, with an interactive ID system in place, the number of institutional trades that are affirmed by T+2 could approach 100%. DTC has filed with the Commission a proposed rule change under section 19(b)(1) of the 1934 Act outlining its proposed enhancements to the ID system.[40] Commission staff will review the proposal in light of the requirement under section 17A of the 1934 Act that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and the safeguarding of funds and securities.

Some commentators believe that T+3 settlement would be difficult to achieve without making all securities depository eligible. Currently, only a small fraction of securities listed on an exchange, the National Association of Securities Dealers Automated Quotation System ("NASDAQ"), or the over-the-counter ("OTC") Bulletin Board are not eligible for deposit at a registered clearing agency. Accordingly, the Commission does not believe this is a serious impediment to T+3 settlement, although the percentage of ineligible securities must remain minuscule. The Legal and Regulatory Subgroup of the U.S. Working Committee of the Group of Thirty ("Legal and Regulatory Subgroup") is drafting a uniform rule intended to incorporate a depository eligibility requirement into a listing standard for each registered national securities exchange and into the eligibility requirements of NASDAQ. The Commission expects the exchanges and the National Association of Securities Dealers ("NASD") to submit proposed rule changes to the Commission under section 19(b)(1) of the 1934 Act in the near future. Although the rules, if approved, would not reach settlement of transactions in securities that are not listed on a national exchange or NASDAQ, the Commission believes preliminarily that this effort could be an important step towards improving the efficiency of the national clearance and settlement system, and indeed towards facilitating T+3 settlement.

The Commission did not solicit comment on the desirability of settling securities transactions in same-day funds. However, six commentators stated that additional risk reduction could be gained by converting to a same-day funds payment system. DTC and NSCC recently distributed a memorandum outlining their plans and timetable for converting to same-day funds settlement and detailing how DTC and NSCC believe many aspects of the same-day funds settlement system will function. DTC and NSCC expect to implement the proposal by late 1994 or early 1995. The Commission supports the efforts of the SROs and will continue to work with the SROs towards early implementation of the initiatives.

2. Regulatory Initiatives

Some commentators suggested that implementation of a T+3 settlement period will require amendments to the Commission's confirmation rule, Rule 10b-10 adopted under the 1934 Act.[41] That rule, however, does not require the confirmation to be received prior to settlement, and therefore the current practice of sending the confirmation the day after trade date will satisfy Rule 10b-10 in a T+3 settlement cycle. Implementation of T+3, however, may alter the confirmation's utility as a customer invoice because confirmation delivery and transfer of customer funds and securities may not be possible within the three-day settlement period. The Commission therefore encourages broker-dealers to consider changes to their procedures for delivery of confirmations, as necessary, to accommodate three-day settlement. Such changes might include dispatch on trade date from offices within one-day delivery range of the customer or transmission of confirmations by facsimile or other electronic means.

Commentators also asked the Commission to review Rules 15c3-1 and 15c3-3 to determine whether amendments will be required to conform those rules to a shorter settlement timeframe. Rule 15c3-1[42] establishes the net capital requirements for brokers and dealers. To determine net capital, Rule 15c3-1 requires a broker or a dealer to deduct from net worth, as computed in accordance with generally accepted accounting principles, assets not readily convertible into cash, including most unsecured receivables. A broker or a dealer also must deduct certain specific percentages from the securities and commodity positions that it carries in its proprietary account. The rule also requires that a failed to deliver contract that has been outstanding for a certain specified period of time be treated as a proprietary position of the broker-dealer and subject to a percentage deduction.

[37] In the ID system, brokers notify the depository of trades made by an investment manager on behalf of an institutional client. The investment manager and the client's custodian banks are notified of the trade and asked to affirm that the information is correct. Trades affirmed by T+3 settle automatically by book-entry at the depository on T+5.

The majority of settlements between broker-dealers and their institutional customers are processed through the National Institutional Delivery System ("national ID system" or "NIDS") which includes links with three securities depositories (Midwest Securities Trust Company, Philadelphia Depository Trust Company, and DTC) and their member broker-dealers. See, e.g., Securities Exchange Act Release No. 25120 (November 13, 1987), 52 FR 44506.

[38] NYSE, Fact Book for the Year 1992 (April 1993) at 26.

[39] For the first six months of 1993, an average of 264 million shares were traded daily on the NYSE.

[40] See File No. SR-DTC-93-07.

[41] 17 CFR 240.10b-10.

[42] 17 CFR 240.15c3-1.

This time period is dependent upon the time from the settlement date.[43]

Rule 15c3–3[44] requires brokers and dealers to maintain possession or control of all customer fully paid and excess margin securities. As with Rule 15c3–1, some of the requirements imposed on brokers and dealers by Rule 15c3–3 are dependent upon the time from settlement. One commentator referred specifically to Rule 15c3–3(m).[45] Rule 15c3–3(m) requires that a broker or dealer that has executed a sell order for a customer, and has not obtained possession of such securities from the customer within ten business days after the settlement date, must immediately close the transaction with the customer by purchasing securities of like kind and quantity. The Commission notes that Rule 15c6–1 merely changes the number of days following the trade date that settlement will occur. Therefore, being keyed to settlement date, Rules 15c3–1 and 15c3–3, including Rule 15c3–3(m), are consistent with Rule 15c6–1.

Commentators urged the Commission, in conjunction with other regulators, to review Regulation T ("Reg T")[46] to determine how, if at all, Reg T should be modified. Currently, Reg T does not require that any action be taken unless a customer fails to pay for securities within seven business days of the trade date. The commentators were concerned that Reg T as currently drafted could leave customers and broker-dealers with the impression that payment from the customer is not due in a three-day settlement environment until the expiration of the seven-day period specified by Reg T. The Commission understands that the Federal Reserve Board staff has undertaken a general review of Reg T, and the Commission has already asked the Federal Reserve Board staff informally to consider whether conforming amendments to Reg T would be necessary in a three-day settlement environment.

In the Proposing Release, the Commission solicited comment on whether the Commission should require disclosure of whether the securities being offered in an initial public offering ("IPO") are depository eligible, and if not, why not. Five commentators supported the adoption of a disclosure requirement for IPOs as described above. Three commentators stated that a disclosure requirement was not necessary. None of the commentators, however, articulated the basis for their support. Nevertheless, the Commission believes that disclosure regarding whether or not an IPO will be eligible for deposit at a securities depository may be appropriate. Accordingly, the Commission is directing the staff to pursue requiring disclosure in those instances when neither the issuer nor the underwriter intends to make the securities depository eligible.

D. Implementation Date

The Commission believes that the benefits of a shorter settlement cycle exceed the costs associated with implementing that change, including the cost to firms to finance purchases by retail customers that traditionally rely on the U.S. mail service to deliver checks. The potential reduction in systemic risk coupled with the opportunity to provide smoother transmission of value from markets using a five-day settlement convention to markets using earlier settlement timeframes (such as the next-day settling government securities and derivative product markets) are essential to maintaining investor confidence and the premier competitive position of U.S. securities markets. As one commentator stated, "The speed with which market conditions can change today and the risk inherent in the five day settlement timeframe, warrant consideration of an earlier implementation date. We believe that the move to a three business day timeframe for settlements could and should occur earlier than 1996."[47] Although the transition to T+3 will entail costs and changes, the Commission believes the U.S. securities industry is more than equal to the challenge given current technology and financing sources.

The Commission is adopting Rule 15c6–1 with an effective date of June 1, 1995. The Commission believes that changes in industry practice and custom such as an earlier settlement timeframe must involve marketplaces, marketplace regulators, and participants in those markets acting cooperatively. In connection with this, the Commission recognizes that some broker-dealers need to make operational and procedural changes to comply with a three-day settlement period and that certain building blocks must be in place prior to compressing the settlement cycle. In view of the Commission's desire to minimize the potential cost of complying with the Rule and the need for more work at the SRO and regulatory levels, the Commission is adopting an extended transition period to allow affected parties to implement necessary changes gradually.

Forty of the commentators that support adoption of proposed Rule 15c6–1 suggested that the proposal be implemented on January 1, 1996, or earlier. The Cashiers' Association of Wall Street, Inc. ("Cashiers' Association"), the Public Securities Association ("PSA"), and Data Management Division of Wall Street ("Data Management Division") agreed that the proposal should be implemented in 1996 but believed implementing the proposal in January 1996 would place an excessive strain on broker-dealers' production systems.[48] These commentators suggested implementing the proposed Rule late in the first quarter or second quarter of 1996 to allow broker-dealers more time to complete year-end processing.

Eight commentators suggested specifically that the proposed Rule be deferred until the necessary building blocks are in place or for an indefinite period, three retail broker-dealers stated that the Rule was not necessary, and one broker-dealer specifically opposed implementation earlier than January 1, 1996.

The Commission is adopting Rule 15c6–1 with an effective date of June 1, 1995, rather than January 1, 1996, for two principal reasons. First, the Commission believes it is better not to change the settlement cycle timeframe at the same time market participants, custodians, and investors might be distracted by other matters, such as year-end tax and trading concerns. Second, June 1, 1995, is reasonably close so as to draw the immediate attention of those who must take steps to initiate compliance, and is reasonably far-off to permit completion of those preparatory steps. An effective date of January 1, 1996 or June 1, 1996, would continue to expose securities markets to risks that can and should be reduced. Accordingly, the Commission believes a 19 month delay in the effective date of Rule 15c6–1 is appropriate.

[43] See Rule 15c3–1(c)(2)(ix).

[44] 17 CFR 240.15c3–3.

[45] 17 CFR 240.15c3–3(m).

[46] Reg T, 12 CFR part 220, *et. seq.*, imposes, among other things, initial margin requirements and payment rules on securities transactions. See 15 U.S.C. § 78a *et seq.*, part 220.

[47] Letter from Albert Peterson, Executive Vice President, State Street Bank and Trust Company, to Jonathan G. Katz, Secretary, Commission (June 2, 1993).

[48] See letters from Paul Farace, President, Cashiers Association, to Jonathan G. Katz, Secretary, Commission (June 14, 1993); and letter from Salvatore N. Cucco, President, Data Management Division, to Jonathan G. Katz, Secretary, Commission (June 16, 1993).

Nevertheless, the Commission will monitor industry efforts toward implementation and will take all appropriate steps in that regard.

As stated above, the Commission encourages broker-dealers who wish to limit financing costs or the use of overnight mail to explore the available alternatives to payment by check through the U.S. mail. In addition, the Commission believes that customer education regarding those alternatives is paramount to successful implementation of T+3 settlement. For example, broker-dealers can require clients to deposit funds or securities upon placing an order, educate customers on the necessity of providing funds earlier, and emphasize the usefulness of in-house brokerage accounts. Alternatively, broker-dealers could encourage customers to use an electronic payment system, such as the ACH system, to pay for transactions.

The Commission recognizes that it must play its part in facilitating a smooth transition to shorter securities settlements. Adoption of Rule 15c6–1 may entail expense and may be unpopular among those who would prefer to see no change in current practice or would prefer to see next-day and even same-day settlement prevail. Reducing systemic risk is important to the safety and vitality of securities markets, and the Commission's efforts and resources remain committed to those goals. The Commission invites a continuing dialogue and partnership with all interested parties.

III. Scope of Rule 15c6–1

A. Application of Rule 15c6–1 to Municipal Securities, Limited Partnership Interests, New Issues, Mutual Funds, and Mortgage-Backed Securities

The Commission received approximately 66 comment letters addressing the scope of Rule 15c6–1. Generally, those commentators were supportive of the Commission's efforts to include a broad range of products within a shortened settlement cycle. The Commission has considered these comments, and for the reasons discussed below, the Commission believes that Rule 15c6–1 appropriately applies to securities issued by mutual funds, private-label mortgage-backed securities, and limited partnership interests that are listed on an exchange. The Rule does not apply to municipal securities, and the Commission has determined that, in addition, unlisted limited partnership interests and new issues should be exempt from the Rule for the reasons discussed below. Finally, the Rule has been revised to provide that the Commission may, by order, exempt additional securities from the scope of the Rule.

1. New Issues

Several commentators voiced concerns that new issues of securities[49] could not be settled by T+3 due to the need to deliver a prospectus prior to settlement.[50] Specifically, commentators have indicated that because the prospectus cannot be printed prior to the trade date (the date on which the securities are priced), the prospectus printing and delivery process cannot be completed within a T+3 timeframe. The problems described by commentators would seem to be specific to firm commitment offerings where the underwriter must make payment with its own funds to the issuer on a specified date, whether or not its customers have purchased and paid for the securities.[51]

To address this problem, the Commission is modifying the Rule to provide a limited exemption from T+3 for the sale of securities for cash pursuant to firm commitment offerings.[52] The exemption is limited to sales to an underwriter by the issuer and initial sales by members of the underwriting syndicate and selling group. Any secondary resale of such securities must be settled within T+3.

The Commission recognizes that the comment process may not have identified all situations or types of trades where settlement on T+3 would be problematic. Accordingly, the Rule has been revised to authorize the Commission to exempt, by order, additional types of trades from the scope of Rule 15c6–1.[53] This revision and the exemption for firm commitment offerings should assure that the Rule will not interfere unduly with the settlement of securities whose characteristics make it difficult to operate within the framework of Rule 15c6–1.

2. Municipal Securities

In proposing Rule 15c6–1, the Commission invited commentators to address the merits of including municipal securities within the scope of the Rule. Due to differences between the corporate and municipal securities markets and the unique role the MSRB has in overseeing the municipal securities market, and based in part on comments received, the Commission has determined not to include municipal securities within the scope of Rule 15c6–1. The Commission makes this determination, however, with the expectation that the MSRB will take the lead in implementing three-day settlement of municipal securities by June 1, 1995, the implementation date of the new Rule.

Over fifty commentators favored including municipal securities within the scope of the Rule. Those commentators believe that maintaining separate settlement cycles for corporate and municipal securities is unnecessary and would impose significant cost and operational difficulties on industry participants.

Several other commentators favor excluding municipal securities from the scope of Rule 15c6–1, citing the many special features of the municipal securities markets. Those features include a lower confirmation/affirmation percentage of transactions in municipal securities than corporate securities, lack of CUSIP numbers in many municipal securities,[54] non-depository eligibility of many municipal issues, and the greater reliance on confirmations by purchasing investors.

The Commission believes that the benefits of reduced systemic, market, and credit risk justify reducing the settlement timeframe for municipal securities from five to three business days consistent with Rule 15c6–1. The Commission recognizes, however, that the differences between the corporate and municipal securities markets may justify a different approach to implementing T+3 settlement for

[49] A new issue of securities includes both IPOs and offerings of additional debt or equity issues by reporting companies.

[50] See section 5 of the Securities Act of 1933 ("1933 Act") (15 U.S.C. § 77e).

[51] In a firm commitment offering, the underwriter purchases the securities from the issuer, generally for a fixed price, and then re-sells the securities to the public, thereby assuming the risk of market fluctuations in the price of securities.

[52] The exemption will apply only to offerings when cash is the sole form of consideration given in exchange for the securities. This requirement is intended to limit the exemption to the conventional firm commitment public offerings which are associated with the problems raised by the commentators rather than including transactions such as issuer exchange offers or business combinations.

[53] Concurrent with the adoption of the Rule, the Commission is delegating to the Director of the Division of Market Regulation authority to exempt such additional types of trades.

[54] CUSIP is an acronym for the Committee on Uniform Securities Identification Procedures. Although most outstanding municipal securities have CUSIP numbers, there probably are several thousand maturities that do not.

municipal securities than corporate securities. For example, while publicly-traded corporate debt issuances number in the thousands, there are over one million municipal securities "maturities," each of which is a separate security for purposes of trade clearance and settlement and not all of which are depository eligible. In addition, approximately 80,000 entities issue municipal securities, which are not subject to the provisions of the Securities Act of 1933 ("1933 Act") and are exempted from many provisions of the 1934 Act.

Despite these differences, significant progress has been made towards more efficient, automated clearance and settlement of municipal securities.[55] First, the Commission understands that the system changes at clearing agencies necessary for T+3 settlement of municipal securities should be functional by July 1, 1994. Second, as a result of recent changes to MSRB rules, most, if not all municipal securities dealers and institutional investors have access (directly or through correspondents) to clearing agencies for automated clearance, confirmation, and settlement of their municipal securities trades. Third, only a fraction of newly-issued municipal securities are not routinely made eligible for deposit at securities depositories, and efforts are underway to address the remaining newly-issued securities. This progress has been the result of cooperative efforts by the Commission, the MSRB, clearing agencies, and their members.

Although commentators have raised concerns about the differences between municipal and other debt securities, the Commission believes that these differences can be overcome. For example, it may be appropriate to consider exempting certain types of municipal securities trades for a certain amount of time. Similarly, it might be appropriate to explore alternatives to the confirmation as the means of identifying securities that have been sold and as a risk disclosure document. It might also be appropriate to consider exemptions for trades in connection with firm commitment underwritings and for trades in securities for which CUSIP numbers are not required.

The Commission also understands commentator concern about potential costs to municipal securities dealers, such as financing retail customer purchase transactions pending receipt of payment from customers. With sufficient notice, the Commission believes that the municipal securities industry can identify and address these costs in ways similar to other broker-dealers.

In summary, the Commission is confident that municipal securities dealers and market participants, under the guidance of the MSRB, can accomplish the goal of shortening the settlement timeframe by two business days and that regular-way settlement for municipal securities can be subject to the same timetable as other securities. Accordingly, the Commission is requesting a report from the MSRB within six months outlining a time schedule in which the MSRB intends to implement T+3 in the municipal securities market.

3. Limited Partnership Interests

The Commission invited comment as to whether limited partnership interests should be included in the scope of Rule 15c6–1. Eleven commentators supported inclusion of limited partnership interests, citing the difficulty caused by different settlement dates for different types of securities. Eight commentators opposed the inclusion of limited partnership interests.

Many commentators distinguished between limited partnership interests that are listed on an exchange or on NASDAQ ("listed limited partnerships") and those that are not listed ("unlisted limited partnerships"). Six commentators stated that listed limited partnerships should be included in the scope of the Rule, while no commentator specifically stated that listed limited partnerships should be excluded from the scope of the Rule. Six commentators stated that unlisted limited partnerships should be excluded from the scope of the Rule, while no commentator specifically stated that unlisted limited partnerships should be included in the scope of the Rule.

Accordingly, the Commission is modifying the Rule to distinguish between trades involving listed versus unlisted limited partnership interests, including listed limited partnership interests and excluding unlisted limited partnership interests. First, the majority of commentators appear to support the inclusion of listed limited partnerships. Second, as exchange or NASDAQ traded securities, these interests currently settle in a five-day timeframe and exclusion of listed limited partnerships from Rule 15c6–1 would unnecessarily contribute to the bifurcation of the settlement cycle in these markets. Under Rule 15c6–1, therefore, listed limited partnerships will be required to settle by T+3.

Many commentators expressed concern, however, about the ability to settle unlisted limited partnerships by T+3, indicating that extended time periods are required to settle trades in these instruments. In order to settle, transfer documentation must be obtained in order to determine whether the transfer of ownership is permitted on the books and records of the issuer.[56] In addition, several commentators noted that there is not an active secondary market in unlisted limited partnership interests. Therefore, the Commission has determined to exempt unlisted limited partnership interests from the Rule.

4. Securities Issued by Mutual Funds

As proposed, Rule 15c6–1 would include securities issued by investment companies.[57] The Commission noted that mutual funds often permit customers to purchase shares by telephone and requested comment on

[55] For example, the Commission recently approved a rule proposed by the MSRB requiring the use of automated clearance and settlement systems on most Delivery Versus Payment and Receipt Versus Payment customer transactions. Securities Exchange Act Release No. 32460 (July 22, 1993), 58 FR 39260. In addition, the MSRB has filed with the Commission a proposed rule change that will require use of automated clearance and settlement systems on most interdealer transactions. Securities Exchange Act Release No. 32262 (May 4, 1993), 58 FR 27757. That proposed rule change was filed in concert with NSCC's recently implemented comparison system which accelerates the comparison cycle for municipal securities. Securities Exchange Act Release No. 32747 (August 13, 1993), 58 FR 44530. The Commission also approved an MSRB proposal requiring most interdealer transactions in municipal securities that are eligible for book-entry settlement in a registered securities depository to be settled by book-entry through the facilities of that depository or in an interface with another registered securities depository.

[56] Required paperwork varies among different issuers, and the processing requirements may take weeks. According to the comment letter from the Chicago Partnership Board, some issuers require that blank paperwork be ordered after a trade is agreed to, and these same issuers often take weeks to deliver the paperwork once ordered. Letter from James Frith, Jr., President, Chicago Partnership Board, to Jonathan G. Katz, Secretary, Commission (June 4, 1993).

[57] The Investment Company Act of 1940 ("1940 Act"), 15 U.S.C. 80a–1, describes several forms of investment companies. Among these are "open-end" and "closed-end" management companies and unit investment trusts. Sections 4, 5, 1940 Act; 15 U.S.C. 80a–4, 80a–5. Open-end companies, commonly known as mutual funds, offer redeemable securities. Unit investment trusts also issue redeemable securities, although their sponsors generally create a secondary market for their shares. Closed-end companies resemble corporations in that at any time they have a fixed number of shares outstanding that are traded on an exchange or in the over-the-counter market at prices which reflect supply and demand.

whether a T+3 settlement timeframe would make it necessary for mutual funds and broker-dealers to implement operational changes to confirm the sale to the investor, to receive the proceeds, and to settle the transaction.[58] Twenty-five commentators believed the proposed three-day settlement should be applied to securities issued by mutual funds. These commentators stated that the exclusion or delayed implementation of a shortened settlement cycle for mutual funds would complicate rather than simplify the transition to T+3. Seven commentators believed the Rule should provide an exemption for securities issued by mutual funds.

The Commission has determined that Rule 15c6–1 should apply to broker-dealer contracts for the purchase and sale of securities issued by investment companies, including mutual funds shares. A broker-dealer selling securities issued by a closed-end fund or unit investment trust could avail itself of the exemption for new issues in a firm commitment underwriting under Rule 15c6–1(b). Thus, the new issue exemption would cover underwritings of closed-end funds and unit investment trusts but not open-end funds.

The Commission believes it is appropriate to include mutual fund transactions because mutual fund shares represent a significant and growing percentage of a broker-dealer's transactions. Even though some mutual fund shares may represent diversified portfolios, contracts for the purchase and sale of these securities pose many of the same systemic, market, and credit risk concerns as other securities subject to Rule 15c6–1, and in the event of a broker-dealer insolvency, these contracts will also need to be resolved. In addition, many, if not most, mutual fund purchases and redemptions are now processed through the centralized "FUND SERV" system operated by NSCC.[59] Although NSCC does not formally guarantee performance on contracts cleared in the "FUND SERV" service, its central role, coupled with potential changes to payment settlement timeframes, suggests that reducing the "FUND SERV" settlement timeframe to three business days would significantly reduce risk to the national clearance and settlement system.

Several commentators expressed concern that shortening the timeframe for redemptions by two business days would create liquidity concerns in the event of unexpectedly high volumes of redemptions. The commentators noted that although mutual funds generally meet redemption requests from cash on hand, a particularly large volume of redemption requests would require mutual funds to sell securities from their portfolios. The commentators maintain that application of the T+3 settlement requirement under these circumstances could be problematic, particularly for mutual funds with portfolios heavily invested in securities not subject to T+3 settlement.

The Commission shares commentator concern about the potential for redemptions to create a liquidity crisis, but believes several factors mitigate these concerns. First, the Commission expects that mutual fund managers will account for the risk of a liquidity crisis in planning their portfolio investments. Second, the Commission is delaying the effective date of Rule 15c6–1 by more than nineteen months, which should permit fund managers sufficient time to identify potential exposures and take appropriate remedial steps. Third, the primary components of mutual fund portfolio assets should, by June 1, 1995, settle within three business days of the date of the trade (including U.S. government, corporate equity and debt, and municipal securities). Indeed, as discussed above, the Commission expects the MSRB will act to implement T+3 settlement for municipal securities by June 1, 1995, consistent with Rule 15c6–1. Finally, the Commission will retain authority to exempt, by order, specific trades or classes of trades from the requirement of Rule 15c6–1.

Several commentators raised concerns about whether application of Rule 15c6–1 would be consistent with obligations and requirements under section 22(e)[60] of the Investment Company Act of 1940 ("1940 Act") and section 11(d)(1) of the 1934 Act.[61] Section 22(e) generally provides that investment companies may not suspend the right of redemption, or postpone payment or satisfaction upon redemption of any redeemable security for more than seven days after tender of the security being redeemed, except under certain circumstances.

The Commission believes that the primary purpose of the seven day period prescribed in section 22(e) is to set forth an outside limit on the amount of time that an investment company may take to satisfy a redeeming shareholder's request for payment. Further, the Commission believes that the underlying rationale of section 22(e) is to ensure that "redeemable" securities are, in fact, redeemable, and that that rationale does not conflict with the purposes of Rule 15c6–1.[62] Moreover, industry practice regarding the settlement timeframe for securities transactions, including transactions in mutual funds, has fluctuated since the enactment of the 1940 Act. Accordingly, while the commentators may contend that the seven-day period provided by section 22(e) is analogous to the current industry convention of effecting settlement on the fifth business day following trade date, the fact that those periods are the same today is merely fortuitous.

Section 11(d)(1) generally prohibits a person that acts as both a broker and a dealer from extending credit to a customer to allow that customer to purchase securities issued by a mutual fund. The Commission preliminarily believes these requirements should not be an obstacle to reducing the settlement timeframe for trades in mutual fund shares. At the time these requirements were enacted, the settlement timeframe was T+2. Commentators have discussed with the Commission staff the potential application of these provisions and the staff expect to address these concerns before June 1, 1995.

5. Mortgage-Backed Securities

As proposed in February 1993, private-label mortgage backed securities

[58] See Proposing Release, at note 33.

[59] The Mutual Fund Settlement, Entry, and Registration Service ("Fund/Serv") was implemented in 1986 to enable NSCC members to submit mutual fund purchase and redemption orders to NSCC, and to enable NSCC in turn to transmit the orders to its members acting on behalf of eligible mutual funds.

[60] 15 U.S.C. 80a–22(e).

[61] 15 U.S.C. 78k(d)(1).

[62] The legislative history of section 22(e), although sparse, indicates the significant importance placed on an open-end investment company shareholder's right to redeem shares, "and receive at once, or within a very short time, the approximate cash asset value of such shares as of the time of the tender." See Hearings Before a Subcomm. of the Comm. on Banking and Currency on S. 3580, 76th Cong., 3d Sess. (1940), at 985. The Commission believes that the wording of section 22(e)—"No registered investment company * * * shall * * * postpone the date of payment or satisfaction upon redemption of any redeemable security * * * for more than seven days after the tender of such security"—clearly suggests that the section is intended to be a "limit" rather than a "grant."

("MBS")[63] would fall within the ambit of Rule 15c6–1. The Rule would not, however, apply to those MBSs issued by government agencies and government sponsored enterprises ("GSE").[64] In the Proposing Release, the Commission invited commentators to consider whether adopting a T+3 settlement timeframe would cause difficulties for issuers and investors in the MBS market and to consider generally whether additional safeguards relating to clearance and settlement of MBSs would be appropriate.

The commentators generally were supportive of applying the proposed Rule to MBSs. Some of the commentators stated that the Rule should apply to MBSs issued by government agencies and GSEs as well as to private-label collateralized mortgage obligations ("CMO"). The PSA stated that although it would prefer that all MBSs settle on the same basis, the bifurcation between private-label MBSs on the one hand, and government agency and GSE MBSs on the other, did not present an insurmountable barrier. The PSA stated that the larger firms probably would adopt a T+3 settlement standard for all MBSs, whether or not subject to the Rule.

Commentators identified several areas of concern with respect to MBSs. The first relates to the availability of factors,[65] and whether that could create a barrier for private-label MBSs to move to T+3. Transactions that are effected before the current month's factor is available must go through a cancel and correct procedure to ensure that the correct amount of principal and interest is attributed to the investor for that month. Shortening the settlement cycle could make it less likely that the current month's factor will be available for a given transaction, which would be reflected by more cancel and correct transactions.

The Commission notes, along with The PSA, that for private-label MBSs settling through DTC, DTC's CMO Trade Adjustment System[66] keeps track of trades settling with the previous month's factor and automatically adjusts those trades after the current factor is available. Over three-quarters of outstanding private-label CMOs are on deposit at DTC, and the CMO Trade Adjustment System is used regularly among participants.[67]

The Commission believes that trades in private-label CMOs should be included within the scope of Rule 15c6–1. First, although CMO trades could require some adjustments to reflect changing principal payments in underlying collateral, existing trade adjustment and reconciliation systems and practices appear adequate. Second, the potential for gridlock in the event of a major participant default[68] warrants the exchange of as much value as soon as possible in these markets, even if that means that some post-trade adjustment is necessary. This is even more important given the increasing complexity of CMO products, the absence of transparent markets for establishing fair value, and concern about the liquidity of CMO markets in the event of a major market event.

Commentators also expressed concern about how contracts for purchase or sale of mortgage pass-throughs in the to-be-announced ("TBA") market would be treated under Rule 15c6–1. Trading in this market occurs without providing specific mortgage pool information. Among other things, TBA trading allows an underwriter of a private-label mortgage pass-through security to acquire the financing necessary to assemble the pool of mortgages that will comprise a given mortgage pass-through security.[69] In response to those concerns, the Commission will interpret Rule 15c6–1 to require that settlement of mortgage pass-through securities occur within three days after a specific pool is identified for delivery under the contract. Under current TBA market conventions, as specified in PSA Guidelines,[70] firms must designate specific pools allocated to a TBA transaction at least 48 hours before settlement.[71] Firms following this convention will be deemed to comply with Rule 15c6–1.

In summary, all private-label MBSs shall be subject to the T+3 settlement requirement. TBA trades will not be subject to the Rule; instead, once a pool is designated, settlement must occur within three days. New issuances of CMOs that are the subject of a firm commitment underwriting will be subject to the settlement timeframe applicable to other initial issuances as provided in Rule 15c6–1(b).

B. Ability of Broker-Dealers to Override T+3 Settlement

As proposed, Rule 15c6–1 provides that, unless otherwise expressly agreed by the parties at the time of the transaction, a broker or dealer is prohibited from entering into a contract for the purchase or sale of a security (other than an exempted security, government security, municipal security, commercial paper, bankers' acceptance, or commercial bill) that provides for payment of funds and delivery of securities later than T+3. As described above, the proposed Rule allows a broker or dealer to agree that settlement will take place in more than three business days, when the agreement is express and reached at the time of the transaction.

Several letters from individual commentators and approximately 1,550 substantially similar letters expressed concern that the ability to override the three day settlement requirement could create a market inefficiency that could be exploited by some broker-dealers. Those commentators suggested that the ability of broker-dealers to override the three day settlement requirement for specific transactions will permit broker-dealers to establish two classes of investors, providing advantages to investors holding with the broker-dealer

[63] MBSs include mortgage pass through securities, collateralized mortgage obligations ("CMO"), and Real Estate Mortgage Investment Conduits ("REMIC"). Private-label MBSs include privately issued MBSs collateralized by agency or government sponsored enterprise mortgages or mortgage pass through securities.

[64] Government agencies include, for example, the Government National Mortgage Association ("Ginnie Mae"). GSEs include, without limitation, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac").

[65] A factor is the proportion of outstanding principal to the original principal balance, expressed as a decimal. In the case of CMOs and REMICs, factors are made available once a month, and in the case of private-label MBSs, this occurs at the end of the month.

[66] See Securities Exchange Act Release No. 30277 (January 22, 1992), 57 FR 3657 (order approving DTC's CMO Trade Adjustment System).

[67] Telephone conversation with James Riley, Planning Department, DTC, and Patricia Trainor, Associate Counsel, DTC (August 23, 1993).

[68] See *e.g.*, testimony concerning the bankruptcy of Drexel.

[69] Mortgage pass-through securities have been traded for many years and frequently are the collateral from which CMOs and REMICs are created. For a description of this market, *see e.g.*, Securities Exchange Act Release No. 26671 (March 28, 1989), 54 FR 13266 (granting the Participants Trust Company temporary registration as a clearing agency).

[70] PSA, Uniform Practices for the Clearance and Settlement of Mortgage-Backed Securities and Other Related Securities 8.B.1 (1992).

[71] Forward trades are done typically on a TBA basis because certain specifics, such as the pool numbers, are not available at the time of the trade and are typically provided 48 hours before settlement to allow for the smooth settlement of the pass-through security. Letter from Dominick F. Antonelli, Chairman, PSA Municipal Securities Division Operations and Compliance Committee, and Stephen W. Hopkins, Chairman, PSA Mortgage Securities Division Operations Committee, to Jonathan G. Katz, Secretary, Commission (July 8, 1993).

in indirect or beneficial ownership form over those investors choosing to own shares of stock in direct ownership form.

Several commentators suggested eliminating from the Rule the ability to override the three day settlement requirement. The large majority of the letters, however, did not suggest eliminating the override provision, but rather encouraged the Commission to ensure that broker-dealers do not use the override provision to discourage direct forms of securities ownership.

The override provision was intended to apply only to unusual transactions, such as seller's option trades, that typically settle as many as sixty days after execution as specified by the parties to the trade at execution. It was not intended to permit broker-dealers to specify before execution of specific trades that a group of trades will settle in a timeframe other than T+3. In general, broker-dealers will not be able to contract out of the three day settlement timeframe.

The Commission supports industry efforts to develop products which will enhance the ability of retail investors to choose among suitable forms of ownership. The Commission, moreover, intends for the choice of securities ownership to be driven by market forces, and not for the override provision of Rule 15c6–1 to be used by market participants to prefer one form of ownership over another. The Commission will continue to monitor the use of the override provision of Rule 15c6–1, and, if such abuses are detected, will consider additional rulemaking.

IV. Competition Findings

Section 23(a)(2) of the 1934 Act[72] requires the Commission, in adopting rules under the 1934 Act, to consider the anti-competitive effects of such rules, if any, and to balance any impact against the regulatory benefits gained in terms of furthering the purposes of the 1934 Act. Several commentators, primarily small retail broker-dealers, raised concerns that Rule 15c6–1 would increase their costs, thereby making it more difficult to compete with larger broker-dealers. The Commission notes that Rule 15c6–1 does not distinguish between categories of broker-dealers, and believes that the costs created would be imposed evenly upon larger and smaller broker-dealer firms. The costs may be higher for certain firms, regardless of their size, that have not invested in necessary infrastructure and technology.[73] These costs would be necessary in assuring that the purpose of the Rule, risk reduction, is met. The Commission has considered Rule 15c6–1 in light of the standard cited in section 23(a)(2) and believes that adoption of the Rule will not impose any burden on competition not necessary or appropriate in furtherance of the 1934 Act.

[72] 15 U.S.C. 78w(a)(2).

[73] These broker-dealers, however, are not subject to a unique cost. Instead, they are incurring a cost previously paid by their competitors.

V. Conclusion

The Commission believes that Rule 15c6–1 will reduce credit and liquidity risks, reduce the settlement gap between the corporate securities market and the government securities and derivatives markets, and increase efficiency in broker-dealer and clearing agency operations. Some broker-dealers currently have the operational capability to comply with three-day settlement. However, where a broker-dealer's procedures currently are not designed to accommodate three-day settlement, the facilities to expedite the settlement process do exist (*e.g.*, bank wire systems or overnight postal courier services). The Commission believes that broker-dealers and their customers can make the necessary systems and operational changes to comply with three-day settlement given the extended transition period for implementation of the Rule. The Commission recognizes, however, that the extent and nature of modifications depends on the specific needs of each firm. Nevertheless, the Commission recommends that, as necessary, industry participants that need to make significant systems or operational changes evaluate their progress periodically as the implementation date for T+3 approaches and make adjustments as appropriate to ensure a smooth transition to T+3 settlement.

VI. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") regarding Rule 15c6–1, in accordance with 5 U.S.C. 604. The FRFA notes the potential costs of operational and procedural changes that may be necessary to comply with the Rule. In addition, the FRFA notes the importance of the risk reduction that will result from a shorter settlement cycle. The Commission believes that the benefits of Rule 15c6–1 outweigh the costs that will be incurred by industry participants in complying with the Rule.

A copy of the FRFA may be obtained by contacting Christine Sibille, Attorney, Branch of Debt and International Clearing Agency Regulation, Office of Securities Processing Regulation, Division of Market Regulation, Commission, 450 Fifth Street, NW., Mail Stop 5–1, Washington, DC 20549.

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organizations and functions (Government organizations).

17 CFR Part 240

Brokers and dealers, Registration and regulation, Securities.

Text of the Amendments

In accordance with the foregoing, title 17 chapter II of the Code of Federal Regulations is amended as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for part 200, subpart A continues to read in part as follows:

Authority: 15 U.S.C. 77s, 78d–1, 78d–2, 78w, 78*ll*(d), 79t, 77sss, 80a–37, 80b–11, unless otherwise noted.

* * * * *

2. Section 200.30–3 is amended by adding paragraph (a)(55) to read as follows:

§ 200.30–3 Delegation of authority to Director of Division of Market Regulation.

* * * * *

(a) * * *

(55) Pursuant to § 240.15c6–1 of this chapter, taking into account then existing market practices, to exempt contracts for the purchase or sale of any securities from the requirements of § 240.15c6–1(a) of this chapter.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78*l*, 78m, 78n, 78o, 78p, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.15c6–1 is added to read as follows:

§ 240.15c6–1 Settlement cycle.

(a) Except as provided in paragraph (b) of this section, a broker or dealer shall not effect or enter into a contract for the purchase or sale of a security (other than an exempted security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills) that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.

(b) Paragraph (a) of this section shall not apply to contracts:

(1) For the purchase or sale of limited partnership interests that are not listed on an exchange or for which quotations are not disseminated through an automated quotation system of a registered securities association;

(2) For the sale for cash of securities by an issuer to an underwriter pursuant to a firm commitment offering registered under the Securities Act of 1933, or the sale to an initial purchaser by a broker-dealer participating in such offering; or

(3) For the purchase or sale of securities that the Commission may from time to time, taking into account then existing market practices, exempt by order from the requirements of paragraph (a) of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is consistent with the public interest and the protection of investors.

Dated: October 6, 1993.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

Note: Appendices 1 through 3 to the preamble will not appear in the Code of Federal Regulations.

Appendix 1—List of Commentators

The following commentators submitted comments relating to proposed Rule 15c6–1.

Government Agency

Board of Governors of the Federal Reserve System ("Federal Reserve Board" or "Board")

Self-Regulatory Organizations

Boston Stock Exchange ("BSE")
Chicago Mercantile Exchange ("CME")
The Depository Trust Company ("DTC")
Government Securities Clearing Corporation ("GSCC")
International Securities Clearing Corporation ("ISCC")
Midwest Clearing Corporation/Midwest Securities Trust Company ("CHX")
Municipal Securities Rulemaking Board ("MSRB")
National Securities Clearing Corporation ("NSCC") New York Stock Exchange ("NYSE")
The Options Clearing Corporation ("OCC")

Trade Associations

American Bankers Association ("American Bankers")
American Bar Association Section of Business Law, Subcommittee on Market Regulation and Subcommittee on Registration
Statements, 1933 Act of the Committee on Federal Regulation of Securities ("American Bar Association")
American Council of Life Insurance ("American Council")
American Society of Corporate Secretaries, Inc. ("Corporate Secretaries")
Association of Reserve City Bankers ("Reserve City Bankers")
The Cashiers' Association of Wall Street, Inc. ("Cashiers' Association")
Corporate Transfer Agents Association, Inc. ("CTAA")
Data Management Division of Wall Street (Securities Industry Association) ("Data Management Division")
Investment Company Institute ("ICI")
National Association of Securities Dealers, Inc. ("NASD")
National Automated Clearing House Association ("NACHA")
New York Clearing House ("NYCH")
Public Securities Association ("PSA")
Regional Municipal Operations Association ("RMOA")
Securities Industry Association ("SIA")
Securities Operations Division of the SIA ("SOD")
Security Traders Association ("Traders Association")
The Securities Transfer Association, Inc. ("STA")
Syndicate Operations Association Incorporated ("SOA")

Broker-Dealers

A.G. Edwards & Sons, Inc. ("A.G. Edwards")
Alex. Brown & Sons Incorporated ("Alex Brown")
Arthurs Lestrange & Company Incorporated ("Arthurs Lestrange")
Asiel & Co. ("Asiel")
Robert W. Baird & Co. Incorporated ("Baird")
Baker & Co., Incorporated ("Baker")
Bear Stearns & Co., Inc. ("Bear Stearns")
Bodell Overcash Anderson & Co., Inc. ("Bodell Overcash")
Jack V. Butterfield Investment Company ("Butterfield")
J.W. Charles Securities, Inc. (4 letters) ("J.W. Charles")
Chatfield Dean & Co., Inc. ("Chatfield")
Cheevers, Hand & Angeline, Inc. ("Cheevers")
The Chicago Corporation ("Chicago Corporation")
Collopy & Company Inc. ("Collopy")
Consolidated Financial Investments, Inc. ("Consolidated")
CUSO Equities, Inc. ("CUSO")
Cygnet Resources, Inc. ("Cygnet")
D.A. Davidson & Co. ("Davidson")
Davenport & Co. of Virginia, Inc. ("Davenport")
Dean Witter Reynolds, Inc. ("Dean Witter")
J.V. Delaney & Associates ("Delaney")
Dempsey & Company ("Dempsey")
H.C. Denison Co. ("Denison")
Dorsey & Company, Incorporated ("Dorsey")
East/West Securities Co. ("East/West")
Ferris, Baker Watts, Incorporated ("Ferris Baker")
Fidelity Investments Institutional Services Company, Inc. ("Fidelity")
Financial Network Investment Corporation ("Financial Network")
John Finn & Company, Inc. ("John Finn")
The First Boston Corporation ("First Boston")
First Dallas Securities Incorporated ("First Dallas")
First Manhattan Co. ("First Manhattan")
First Northeast Securities, Inc. ("First Northeast")
Gilbert Marshall & Company ("Gilbert")
Goldman, Sachs & Co. ("Goldman Sachs")
Grove Securities, Inc. ("Grove")
Gruntal & Co. Incorporated ("Gruntal")
G–W Brokerage Group, Inc. ("G–W")
Hamilton & Company Incorporated ("Hamilton")
The Heitner Corporation ("Heitner")
Hopper Securities-Vermont ("Hopper")
Wayne Hummer & Co. ("Hummer")
Interstate/Johnson Lane Corporation ("Interstate/Johnson Lane")
Raymond James & Associates, Inc. (2 letters) ("Raymond James")
Kenneth Jerome & Company ("Jerome")
JJC Specialist Corp. ("JJC")
Edward D. Jones & Co. ("E.D. Jones")
Juran & Moody, Inc. ("Juran & Moody")
Kidder, Peabody & Co., Incorporated (2 letters) ("Kidder")
Kirk Securities Corporation ("Kirk")
La Branche & Co. ("LaBranche")
Legg Mason Wood Walker, Incorporated ("Legg Mason")
Lewco Securities Corp. ("Lewco")
Locust Street Securities, Inc. ("Locust")
McCourtney-Breckenridge & Company ("McCourtney")
M.E. Metzler Organization, Incorporated ("M.E. Metzler")
Merchant Capital Corporation ("Merchant Capital")
Mericka & Co., Inc. ("Mericka")
Meridian Associates, Inc. ("Meridian")
Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch")
Miller & Schroeder Financial, Inc. ("Miller")
Montgomery Securities ("Montgomery")
Morton Seidel & Co., Inc. ("Morton Seidel")
Mutual Service Corporation ("Mutual")
Nicodemus & Sherwood, Inc. ("Nicodemus")
Northern Trust Securities, Inc. ("Northern Trust")
Paine Webber Incorporated ("Paine Webber")
Paulson Investment Company Inc. ("Paulson")
Pershing Division of Donaldson, Lufkin and Jenrette Securities Corporation ("Pershing")
Peterson Financial Corp. ("Peterson")
Pflueger & Baerwald Inc. ("Pflueger")
Piper Jaffray Companies Inc. ("Piper Jaffray")
Pirrone & Co., Inc. ("Pirrone")
Robert A. Podesta & Co. ("Podesta")
The Principal/Eppler, Guerin & Turner, Inc. ("Principal Financial")
Protective Group Securities Corporation ("Protective")

Prudential Securities Incorporated ("Prudential")
Quick & Reilly, Inc. ("Quick & Reilly")
Quincy Cass Associates Incorporated ("Quincy")
Richards, Merrill & Peterson, Inc. ("Richards Merrill")
Robinson & Lukens, Inc. ("Robinson Lukens")
Rodgers Capital Corporation ("Rodgers")
Roland Francis & Co., Inc. ("Roland Francis")
Sands Brothers & Co., Ltd. ("Sands Bros.")
Saperston Financial Inc. ("Saperston")
Charles Schwab & Co., Inc. ("Schwab")
S.C. Parker & Co., Inc. (3 letters) ("S.C. Parker")
Janney Montgomery Scott Inc. ("Montgomery Scott")
Scott & Stringfellow Investment Corp. ("Scott Stringfellow")
Selected Securities Company ("Selected")
Sierra Trading ("Sierra Trading")
Smith, Moore & Co. ("Smith Moore")
Southwest Securities Incorporated ("Southwest")
Summitt Investment Corporation ("Summitt")
Robert Thomas Securities, Inc. ("Robert Thomas")
Robertson, Stephens & Company ("Robertson Stephens")
The Warner Group Inc. ("Warner")
U.S. Clearing Corp. ("U.S. Clearing")
Wheat, First Securities, Inc. ("Wheat First")
William J. Conway & Co., Inc. ("Conway")
Wulff, Hansen & Co. ("Wulff Hansen")
Wyoming Financial Securities, Inc. ("Wyoming")
B.C. Ziegler and Company ("B.C. Ziegler")
Ziegler Thrift Trading, Inc. ("Ziegler Thrift")

Investment Advisors

Jobel Financial, Inc. ("Jobel")
Massachusetts Financial Services Company ("Massachusetts Financial")
Neuberger & Berman ("Neuberger")
Oppenheimer Management Corporation ("Oppenheimer Management")
Seger-Elvekrog, Inc. ("Seger-Elvekrog")
Society National Bank ("Society")
St. Denis J. Villere & Company ("St. Denis")
Stephenson and Company ("Stephenson")

Bank Custodians

Bank of America National Trust and Savings Association ("Bank of America")
The Chase Manhattan Bank, N.A. ("Chase")
Citibank, N.A. ("Citibank")
Morgan Guaranty Trust Company of New York ("Morgan Guaranty")
United States Trust Company of New York ("U.S. Trust")
Wachovia Trust Services, Inc. ("Wachovia")

Insurance Company-Affiliated Broker-Dealers

Green Hill Financial Service Corp. ("Green Hill")
MML Investors Services, Inc. ("MML")
Sun Investment Services Company ("Sun")

Limited Partnerships Broker-Dealer

Chicago Partnership Board, Inc. ("Chicago Partnership Board")

Mutual Fund Broker-Dealers

Chubb Securities Corporation ("Chubb")
Penn Square Management Corporation ("Penn Square")
H.D. Vest Investment Securities, Inc. ("H.D. Vest")

Municipal Bond Broker-Dealers

Clayton Brown & Associates, Inc. ("Clayton Brown")
Halpert and Company, Inc. ("Halpert")
Hanifen, Imhoff Inc. ("Hanifen")
The Leedy Corporation ("Leedy")

Transfer Agents

Burnham Pacific Properties, Inc. ("Burnham")
Chemical Banking Corporation ("Chemical")
Fidelity Accounting & Custody Services Company ("FACS")
Morgan Stanley & Co. Incorporated ("Morgan")
Oppenheimer Shareholder Services Division of Oppenheimer Management Corporation (2 letters) ("Oppenheimer Shareholder")
State Street Bank and Trust Company ("State Street")
Southern Company Services, Inc. ("Southern")
Texaco Inc. ("Texaco")
Valero Energy Corporation ("Valero")
Wisconsin Energy Corporation ("Wisconsin")

Individuals

Scott G. Abbey
John W. Bachmann
Dr. & Mrs. L.O. Banks
Rodney E. Bate
Chris Bennett
Nelda Bergsten
Russell M. Bimber
Helen A. Bird
Allan R. Black
Weston A. Boyd
Carl R. Brasee
D.N. Bulla
Mark C. Bublak
Thomas A. Byrne
D.H. Carlson
John Cirrito
Daniel B. Coleman
Richard Conway
Douglas Czarnecki
Martin H. Drayer
Karen Frye
Gordon G. Garney
Elaine Graham
Rae T. Gaida
Professor Steven Hill
Donald R. Hollis
Frank Hutcheon
Mark Jackson
Rex and Susan Jacobsen
Kenneth S. Janke
Marilyn D. Jennings
James A. Jephcote
William P. Kilroy
David M. Klausmeyer
Donald R. Kryzan
Robert T. Levine
Lowell H. Listrom
Pearl Lurie
Ina Mandel
Joseph J.F. March
George J. Minnig
Stephen A. Molasky
H.J. Porter
Mani K. Pulimood
Richard R. Romane
Donald Rhyne
Michael A. Rogawski
Ramona B. Schafehen
Charles F. Schlein, Jr.
D. Schroeder
Kenneth Shazel
Hank Simon
Richard B. Smith
George Sneed
Murray L. Solomon
Walter Stelma
Frank C. Vogel
Robert C. Waldo, Jr.
Warren D. Weber
Martin J. Webler
Barbara Wilkinson
Theo L. Wealinsh
Daniel P. Worth

Insurance Company

Aetna

Other

Armstrong World Industries, Inc.
William Batdorf & Company, Certified Public Accountants
BellSouth Corporation ("BellSouth")
Bryan Cave
The College Retirement Equities Fund ("CREF")
DQE
E.F. Miller & Company ("E.F. Miller")
Federal Reserve Bank of New York ("FRBNY")
The Group of Thirty ("Group of Thirty")
Minnesota Utility Investors ("MUI")
Sixty Niner Investment Club ("Sixty Niner")
Texas Industries, Inc. ("Texas Industries")
Thomson Financial Services ("Thomson")

In addition, the Commission received substantially similar letters from three separate groups, as set out below.

Individual Investors

1,550 identical letters supporting direct registration

Regional Investment Brokers, Inc. ("RIBS") Letters ("RIBS Letters")

[101 letters opposing T+3 settlement]

Century Capital Corp. of South Carolina ("Century")
Corporate Securities Group, Inc. (16 letters) ("Corporate Securities")
Culverwell & Co., Inc. (5 letters) ("Culverwell")
Girard Securities, Inc. ("Girard")
Greenway Capital Corporation ("Greenway")
Investors Associates, Incorporated ("Investors Associates")
La Jolla Capital Corporation ("LaJolla")
M.H. Meyerson & Co., Inc. ("Meyerson")
Royce Investment Group, Inc. ("Royce")
RIBS
Royce Employees (69 letters)
Sentra Securities Corporation ("Sentra")
Spellman & Company, Inc. ("Spellman")
Wilson-Davis & Company Incorporated ("Wilson Davis")

Transfer Agent Letters

17 letters supporting T+3 settlement

The Bank of New York ("BONY")
Barnett Banks, Inc. ("Barnett")
CBI Industries Inc. ("CBI")
CEL-SCI Corporation ("CEL-SCI")

Central and South West Corporation ("Central")
E.I. du Pont de Nemours and Company ("DuPont")
Nevada Power Company ("Nevada Power")
First Chicago Trust Company of New York ("First Chicago")
Florida Progress Corporation ("Florida Progress")
GenCorp
Mellon Financial Services Corporation No. 17 ("Mellon")
Northern States Power Company ("Northern States")
Northwest Natural Gas Company ("Northwest")
Ottertail Power Company ("Ottertail")
Society National Bank ("Society National")
WPL Holdings, Inc.
Union Data Service Center, Inc. ("Union Data")

Appendix 2—Recent Initiatives in Clearance and Settlement Reform

Although the U.S. clearance and settlement system is among the safest in the world, recent events have demonstrated that vulnerabilities exist. Record volume and volatility during October 1987 proved detrimental to broker-dealers who were unable to resolve processing errors before settlement with their customers on T+5. Moreover, the steep decline in stock prices during that period, as well as the decline on October 16, 1989, left some broker-dealers vulnerable to loss from the positions of customers who were unable or unwilling to meet either margin calls or transaction settlement obligations. This in turn called into question the ability of those broker-dealers to meet their obligations to the clearing corporations.[1]

After the October 1987 market break, several groups sought to identify causes of the market decline and changes that could be made to shield market participants from the impact of sudden steep declines in the market.[2] All these studies identified clearance and settlement as an area which needed further attention.[3]

At the same time, in March 1988, the Group of Thirty[4] organized a symposium in London to discuss the state of clearance and settlement in the world's principal securities markets. The symposium participants concluded that there was a need for international agreement on a uniform set of practices and standards for the clearance and settlement of securities transactions in order to improve the process. In light of this conclusion, the Group of Thirty organized a Steering Committee to work with a professional and broad-based Working Committee in order to produce a set of operational proposals for practices and standards in the area of clearance and settlement.

In March 1989, the Group of Thirty issued a report by the Steering Committee setting forth nine recommendations ("Group of Thirty recommendations"),[5] including implementation of settlement on T+3, to modernize and improve clearance and settlement systems at a local level and to make them compatible with each other internationally.[6] Following the release of the Group of Thirty Report, several countries initiated separate efforts to study how their clearance and settlement systems compared with the Group of Thirty recommendations. In the U.S., a Working Group was created for this purpose. The U.S. Working Group concluded that, while the U.S. was in compliance with seven of the Group of Thirty recommendations, continued consideration should be given to the implementation of the two remaining recommendations, T+3 settlement and settlement in same-day funds.[7]

Two subcommittees, a U.S. Steering Committee and a U.S. Working Committee of the Group of Thirty ("the U.S. committees") were formed to evaluate the benefits of shortening the settlement cycle and converting to the use of same-day funds. The U.S. committees urged adoption of the two recommendations and, in order to support a move to T+3 settlement, also recommended that: (1) Book-entry settlement be mandatory for transactions between financial intermediaries and between financial intermediaries and their institutional customers;[8] and (2) all new securities issues should be made eligible for depository services.

In November 1990, the Commission held a Roundtable to discuss the recommendations of the U.S. committees. Roundtable participants generally agreed that the two recommendations should be adopted, but urged that the timetables for implementation be sufficiently flexible so that obstacles to implementation could be fully explored and practical solutions found and implemented. Roundtable participants expressed concern that broker-dealers conducting a predominantly retail business might have difficulty operating in a three business day settlement timeframe in the national clearance and settlement system because of the need, among other things, to obtain payment from retail clients for purchase transactions.

Following the Commission's Roundtable, former SEC Chairman Richard Breeden asked Howard Shallcross, Director of Operations, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), to form a committee to examine how retail firms and their customers could best be accommodated in a T+3 settlement environment and to report the committee's findings to the Commission. The committee was asked specifically to determine how to solve the problem of timely payments for retail purchase transactions as well as any other retail issues that it considered appropriate. The Shallcross Committee prepared a draft report that recommended alternative risk reduction proposals, such as marking unsettled securities transactions to the market beginning on T+1.[9] Subsequently, former Chairman Breeden asked the U.S. Steering Committee of the Group of Thirty to form a task force, chaired by John W. Bachmann, Managing Principal, Edward D. Jones & Co., to review what changes to the clearance and settlement system were

[1] See Division of Market Regulation, Commission, The October 1987 Market Break Chapter 10 at 20–21 ("Market Break Report").

[2] *Id.* See also Working Group on Financial Markets, Interim Report to the President of the United States (May 1988) (Appendix D) (the Working Group is chaired by the Secretary of the Treasury and its members include the Chairmen of the SEC, the Commodity Futures Trading Commission, and the Board of Governors of the Federal Reserve System); Presidential Task Force on Market Mechanisms, Report to the President of the United States (January 1988) (the so-called "Brady Report"); and General Accounting Office, Preliminary Observations on the October 1987 Crash (January 1988).

[3] Since 1987, considerable progress has been made toward increasing clearing corporations' capabilities to handle large volumes of trades and manage financial risk. Examples include increases in the number of cross margining facilities sponsored by The Options Clearing Corporation ("OCC") and commodity clearing organizations, expansion of the depository system to include new financial products such as commercial paper, and development of extensive lines of communication between banking, securities, and commodities organizations.

[4] The Group of Thirty, established in 1978, is an independent, non-partisan, non-profit organization composed of international financial leaders whose focus is on international economic and financial issues.

[5] See Group of Thirty, Clearance and Settlement Systems in the World's Securities Markets (March 1989) ("Group of Thirty Report").

[6] These recommendations were: (1) By 1990, trade comparison between direct market participants should occur by the day following the date of trade execution; (2) by 1992, indirect market participants should be members of a trade comparison system which achieves positive affirmation of trade details; (3) by 1992, each country should have an effective and fully developed central securities depository; (4) by 1992, if appropriate, each country should implement a netting system; (5) by 1992, a delivery versus payment system should be employed as the method for settling all securities transactions; (6) countries should adopt a same-day funds payment method for settlement of securities transactions; (7) a rolling settlement system should be adopted by all markets as follows: (a) by 1990, final settlement should occur on the fifth day after the date of trade execution, (b) by 1992, final settlement should occur on the third day after the date of execution; (8) securities lending and borrowing should be encouraged as a method of expediting the settlement of securities transactions; and (9) by 1992, each country should adopt the standards for securities numbering and messages developed by the International Standards Organization.

[7] "Same-day funds" refers to payment in funds that are available on payment date and generally are transferred by electronic means.

[8] On June 11, 1993, the Commission approved a proposed rule change filed by the securities exchanges and the National Association of Securities Dealers ("NASD") that requires members, member organizations, or affiliated members of the securities exchanges and the NASD to use the facilities of a securities depository for the book-entry settlement of all transactions in depository eligible securities with another financial intermediary (broker, dealer, or bank). In addition, the rule prohibits members, member organizations, or affiliated members of the SROs from effecting a delivery-versus-payment ("DVP") or receipt-versus-payment ("RVP") transaction in a depository eligible security with an institutional customer unless the transaction is settled by book-entry using the facilities of a securities depository. Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33679.

[9] Shallcross Committee, Impact of T+3 Migration on the Retail Sector A Preface to the Interim Report to the SEC (March 20, 1991).

necessary, to identify practical solutions, and to propose a reasonable timeframe for implementation of each of those solutions.[10] The Bachmann Task Force [11] ("Task Force") undertook that challenge, identifying many of the issues that would confront retail broker-dealers in a T+3 settlement environment and proposing solutions and timetables for resolving those issues.

In May 1992, the Task Force presented its findings and recommendations to the Commission.[12] Among other things, the Task Force concluded that "time equals risk" and that the settlement cycle for corporate and municipal securities should be compressed to T+3.[13] The Task Force also evaluated the principal suggestion of the Shallcross Committee, *i.e.*, that unsettled trades should be marked-to-the-market. The Task Force produced a quantitative analysis that showed that shortening the settlement cycle to T+3 would result in greater risk reduction than a daily mark-to-market without a shortened settlement cycle.[14] The Task Force concluded that compared with T+5 settlement, T+3 settlement would result in a 58% reduction in risk to National Securities Clearing Corporation ("NSCC") [15] in the event of the failure of an average large clearing member. The Task Force's data further showed that NSCC's average expected exposure in a T+5 settlement period with a daily mark-to-market would be 30% higher than its exposure in a T+3 settlement period without a daily mark-to-market.

On June 22, 1992, the Commission published the Task Force Report in the **Federal Register** for public comment.[16] The Commission received over 1,000 comment letters from banks, broker-dealers, investment advisors, trade associations, clearing agencies, exchanges, transfer agents, and individual investors. Although many of these commentators expressed concern about the potential loss of access to physical certificates,[17] in large part they were supportive.

The Commission agrees with the Task Force conclusion that "time equals risk." Based on that analysis and recent events demonstrating that vulnerabilities still exist in the U.S. clearance and settlement system, the Commission believes that it is prudent to shorten the time that unsettled trades remain outstanding.

Appendix 3—Building Blocks

A. Industry and SRO Initiatives

1. Interactive Institutional Delivery ("ID") Process

Moving settlement to T+3 requires that the affirmation [1] process be completed on T+1. Early affirmation of institutional trades can be accomplished by enhancing DTC's existing batch processing ID system to permit DTC to process information on receipt and distribute reports on request.

Commentators consider DTC's interactive ID system a critical building block to successful implementation of Rule 15c6–1. Twenty-one of the 101 commentators that support the proposed Rule express the need for early affirmation of institutional trades. These commentators believe that DTC's proposed interactive system will allow participants to be highly interactive, allowing completion of the confirmation/affirmation process on T+1, rather than on T+2 or T+3 as is the case in DTC's current batch processing ID system. One trade association, one clearing broker-dealer, and two retail broker-dealers conditioned their support of the proposal on DTC's interactive ID system being fully operational prior to adoption of the proposed Rule. Those commentators believed that T+3 settlement was not possible if affirmation/confirmation was not completed by T+1. Finally, five opposing commentators stated that their opposition to the Rule was based in part on the need to implement first DTC's interactive ID system.

DTC is developing an enhanced ID system that would provide users with an interactive option and would unify the existing ID and International ID systems. DTC expects to offer the interactive system to ID users in early 1994.[2] System users will be able to use the system either in the present batch environment or interactively, with the capability to accomplish all ID processing within a single business day. DTC plans to implement the enhanced system in stages. The proposed system includes a Standing Instructions Database ("SID"), to be implemented in late 1993;[3] an Electronic Mail feature, to be implemented in late 1993 or early 1994;[4] a "matching" system, to be implemented in mid-1994;[5] and an Authorization/Exception Processing and Reporting feature to be implemented in mid-1994.[6]

DTC has filed a proposed rule change under Section 19 of the 1934 Act regarding the interactive ID system. Although the Commission generally supports DTC's efforts towards an interactive ID system, Commission staff will review the proposal for consistency with the purposes of the 1934 Act.

2. Revisions to the Automated Clearing House ("ACH") System

To address the problem of timely payments between a retail broker and its customer, broker-dealers should consider ACH [7] as one

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[10] Letter from Richard C. Breeden, Chairman, Commission, to Lewis W. Bernard, Chairman, U.S. Steering Committee, Group of Thirty (July 11, 1991).

[11] In addition to Mr. Bachmann, the members of the Task Force included: David M. Kelly, President and Chief Executive Officer, National Securities Clearing Corporation ("NSCC"); Richard C. Ketchum, Executive Vice President and Chief Operating Officer, NASD; John F. Lee, President, New York Clearing House; Gerard P. Lynch, Managing Director, Morgan Guaranty Trust Company of New York; James J. Mitchell, Senior Executive Vice President, Northern Trust Securities, Inc.; Richard J. Stream, Managing Director, Piper Jaffray Companies Inc.; and Arthur L. Thomas, Senior Vice President, Merrill Lynch.

[12] Bachmann Task Force, Report of the Bachmann Task Force on Clearance and Settlement in the U.S. Securities Markets (May 1992).

[13] The Task Force recommended that this be accomplished by July 1994. The Task Force made eight other recommendations that would facilitate settling securities transactions on T+3: Revising the Automated Clearing House ("ACH") system; requiring an interactive institutional delivery process; settling all transactions among financial intermediaries and their institutional customers in book-entry form only and in same-day funds; depository eligibility for new issues; monitoring flipping (*i.e.*, the sale of stock back to the underwriting syndicate during the new issue stabilization period); expanding cross-margining; streamlining the handling of physical certificates; and monitoring all market activity.

[14] Task Force Report at 34–39.

[15] NSCC is the largest U.S. clearing corporation and is registered as a clearing agency under Section 17A of the 1934 Act. NSCC, among other things, functions as a post-trade processing facility and as a guarantor of post-trade settlements. In the latter capacity, NSCC assumes the credit risk of fails to deliver and fails to receive by substituting itself as the contra party on the day after trade date. Trades that are not settled on settlement date are carried forward to the next settlement day as open obligations. NSCC seeks to protect against the financial risk of these open positions by obtaining contributions from its members to a pool of funds. Any sizable loss in liquidating the open commitments of a defaulting member essentially would be absorbed by all members.

[16] See Securities Exchange Act Release No. 30802 (June 15, 1992), 57 FR 27812.

[17] Over 800 of the comment letters were from individual investors responding to the recommendation to streamline the handling of physical certificates. The letters indicate a belief that the Task Force recommendation to streamline the handling of physical certificates would result in the elimination of physical certificates and force investors to hold securities in street name. The Task Force did not propose eliminating physical certificates for those retail investors who choose to maintain their record of ownership in that form.

[1] Under standard practice, an affirmation serves as the institution's authorization to the custodian to deliver securities against payment by (or accept securities and release payment to) the broker-dealer. A confirmation differs from an affirmation in that confirmation reports must contain all the information required by Rule 10b–10. If the broker-dealer includes all the necessary data about the trade in the ID transmission, he can comply with the trade confirmation requirements of Securities Exchange Act Rule 10b–10, 17 CFR 240.10b–10 (1992).

[2] DTC, An Interactive Option for the Institutional Delivery System, Memorandum to Participants and Other ID Users (March 31, 1993).

[3] The SID feature will be a repository for customer account and settlement information such as customer name, agent and interested parties furnished by institutions, agents and broker-dealers. This SID will eliminate the need for the broker-dealer to maintain all such information in its internal records and to provide all such information each time that it enters trade data into the ID system. *See* File No. SR–DTC–93–07, at 3–5, describing the features of the interactive ID system.

[4] The Electronic Mail feature will eliminate the need to make telephone calls or send facsimile transmissions by enabling broker-dealers and institutions to send and receive details of an order execution, allocations of block trades, or requests for cancellation (if the institution disagrees with a confirmation that the institution has received through the ID system). *Id.*

[5] The enhanced ID system will match trade data received from the broker-dealer with the instructions received from the institution automatically with the results of the matching being reported through the distribution of various output reports to the broker-dealer, the agent, and the institution. *Id.*

[6] This feature will allow delivering parties to authorize settlement of unaffirmed trades of DTC-eligible securities on the settlement date and later. *Id.*

[7] ACH is a domestic electronic payment system operated under the direction of the National

alternative to physical checks for payment and collection of funds to and from customers.

Ten of the 100 commentators that supported the proposed Rule suggested that an electronic payment system that results in finality of payment would make T+3 settlement more practicable, particularly for retail transactions. Most of the commentators addressing this issue stated that ACH would be the desired method of payment if the securities and banking industries could reach a consensus on the necessary revisions to Regulation E and NACHA operating rules so that transactions executed through registered broker-dealers would not be subject to rescission. Four commentators conditioned their support of Rule 15c6–1 on the implementation of a payment system that achieves finality of payment. NACHA, although it was officially neutral on the general merits of proposed Rule 15c6–1, stated that in a three-day settlement environment, the industry would need a payment system such as ACH for retail transactions.[8] Five opposing commentators stated that one reason for their opposition was the lack of an electronic payments system that results in finality of payment, which was considered by those commentators as an essential building block for T+3 settlement.

Following publication of the Bachmann Task Force Report, NACHA proposed a rule amendment that would remove the sixty-day right of rescission for payments in connection with securities transactions. That proposal was defeated. On August 30, 1993, NACHA approved a rule amendment that requires a receiving depository financial institution to obtain a signed affidavit from a consumer when the consumer claims that a transaction to his or her account is unauthorized or that an authorization has been revoked.[9] With the affidavit process in place, a retail securities transaction can be processed through the ACH network as follows: (1) A consumer will purchase securities from his or her broker; (2) the broker will initiate a debit to the consumer's account through its bank; and (3) the debit will be effected against the consumer's account at his or her bank. The consumer claiming that a retail securities transaction was unauthorized or that the authorization for that entry had been revoked would go to his or her bank and sign an affidavit to that effect prior to the bank returning the transaction. Under NACHA rules, the consumer has fifteen days after the receiving depository financial institution sends or makes available to the consumer information pertaining to that debit entry to claim that a transaction was unauthorized or that the authorization was revoked. The receiving depository financial institution must return the rescinded transaction within sixty days of the original settlement date. This change modifies the current process for handling unauthorized transactions over the ACH network, making it consistent with the procedures in the check processing system.

The Commission understands that further changes may be imminent. For example, NACHA is considering modifying the rule change to establish a dollar limit on the mandatory affidavit request and to establish a definition of what constitutes a reasonable timeframe for the receiving depository financial institution to respond to a request from the originating depository financial institution for a copy of the affidavit.[10]

The Commission encourages banks, broker-dealers, clearing agencies, and securities industry representatives to continue to improve the ACH process. The Commission recognizes, however, that ACH represents one of several methods of effecting payments and, accordingly, encourages broker-dealers to pursue other ways to secure good funds on T+3, including wider use of asset management accounts.

3. Mandatory Depository Eligibility

Some commentators believe that T+3 settlement would be difficult to achieve without mandating depository eligibility for all securities. In connection with this, one commentator indicated that the cost of doing business in new issues would increase significantly unless mandatory depository eligibility is developed along with an automated means of tracking flipping.[11]

Nine commentators believed that depository eligibility should be mandatory for all new issues. Two retail broker-dealers indicated that they would not support adoption of the proposed Rule without mandatory depository eligibility. Data Management Division, while neutral on the overall merits of proposed Rule 15c6–1, stated that depository eligibility for all securities should be mandatory.[12] Three opposing commentators believed that all new issues should be depository eligible.

As a practical matter, according to DTC, 94% of all issues listed on the New York Stock Exchange and 99% of issues traded in the over-the-counter market on the National Association of Securities Dealers Automated Quotation System ("NASDAQ") are depository eligible.[13]

Representatives of SROs and the Legal and Regulatory Subgroup of the U.S. Working Committee of the Group of Thirty ("Legal and Regulatory Subgroup") are drafting a uniform SRO rule for depository eligibility for new issues. The uniform rule is intended to incorporate a depository eligibility requirement into a listing standard for each registered national securities exchange and into the eligibility requirements for NASDAQ. Because listing standards for each SRO differ and the manner in which those standards are set forth in their respective rules is not uniform, however, individual SROs will consider the appropriate means to adopt such a uniform depository eligibility requirement to their current listing standards when all SROs have agreed upon and developed a uniform rule. Although the rules, if approved, would not reach settlement of transactions in securities that are not listed on a national exchange or NASDAQ, the Commission preliminarily believes this effort represents an important step towards improving the efficiency of the national clearance and settlement system, and indeed towards making T+3 settlement more practicable.

As discussed above, an issue closely related to mandatory depository eligibility is how to prevent the practice of selling back to syndicate members during the new issue stabilization period, *i.e.*, flipping. The current practice by lead managers in the settlement of IPOs is to issue and deliver certificates in physical form in order to track the sale of securities during the stabilization period. Most of the commentators addressing the depository eligibility issue suggested that an alternative method of monitoring flipping be developed. The U.S. Working Committee of the Group of Thirty Focus Group on Flipping ("Focus Group") has developed a conceptual framework as an alternative to the current practice for monitoring flipping. The Focus Group intends to provide the controls for underwriters to monitor flipping while allowing book-entry settlement to occur.

Although a number of issues remain to be resolved, the Commission recognizes the potential benefits that can be achieved from mandatory depository eligibility and the development of an automated means of monitoring flipping, such as increasing the efficient operation of the clearance and settlement system. The Commission therefore encourages efforts to address concerns and advance these initiatives.

4. Same-Day Funds Settlement

Six commentators suggested that the industry should implement same-day funds settlement prior to shortening the settlement cycle. The Commission believes that significant risk reduction can be gained by converting to a same-day funds payment system. DTC and NSCC are preparing to convert to same-day funds settlement by late 1994 or early 1995. DTC and NSCC recently distributed a Memorandum that details how DTC and NSCC believe many aspects of the new same-day funds settlement system will function, and solicited comments on the proposal.

DTC now processes securities deliveries through two different settlement systems, one that settles in same-day funds ("SDFS") and

Automated Clearing House Association ("NACHA") and is utilized by over 22,000 banks, thrifts, and other depository financial institutions on behalf of corporations and individuals.

[8] Letter from Elliott McEntee, President & Chief Executive Officer, NACHA, to Jonathan G. Katz, Secretary, Commission (June 30, 1993).

[9] Letter from Elliott McEntee, President & Chief Executive Officer, NACHA, to Jeff Marquardt, Assistant Director, Payment Systems Studies & Payment System Risk Division of Reserve Bank Operations & Payment Systems, Board of Governors (August 31, 1993).

[10] *Id.*

[11] Letter from Stanley J. Kraska, President, SOA, to Jonathan G. Katz, Secretary, Commission (June 22, 1993). Flipping occurs when, during the new issue stabilization period, an investor sells the stock back to the syndicate or to another investor who in turn sells it back to the syndicate. Under current practice, the securities certificate number is used to identify which member of the syndicate sold the issue to the investor who "flipped" it back to the syndicate. Identifying that syndicate member allows the syndicate to recoup from the syndicate member a portion of the seller's concession.

[12] Letter from Salvatore N. Cucco, President, Data Management Division, to Jonathan G. Katz, Secretary, Commission (June 16, 1993).

[13] Telephone conversation with Richard Nesson, General Counsel, DTC (September 21, 1993).

the other in next-day funds ("NDFS"). The NDFS system primarily services corporate equities and corporate and municipal debt issues; the SDFS system primarily services commercial paper and other money market-like instruments. The vast majority of transactions that settle at DTC settle in its NDFS system, although the total value of the transactions that settle in the SDFS system is much larger than that in the NDFS system. NSCC currently operates a single NDFS system in which the money settlement obligations of NSCC's participants are the net results of all NSCC activity.

DTC's and NSCC's NDFS systems and operations are intertwined. DTC is the nation's largest depository for corporate and municipal securities, while NSCC, in addition to its other services, operates the securities industry's largest trade clearance and settlement system for corporate securities. Under the proposed SDFS system, DTC will combine its NDFS and SDFS systems into a single SDFS system, using its current SDFS system as the base design. DTC and NSCC will employ a mandatory netting procedure (expected to be implemented prior to SDFS conversion) whereby a participant's net debit at one organization will be netted against the amount of its net credit, if any, at the other organization. Participants will continue to settle separately with DTC and NSCC.

The same-day funds conversion project is intended to provide two major benefits: Standardization of the form in which funds are settled and risk reduction. It should simplify the cash management practices of firms that currently deal in both same-day and next-day funds settling securities, as well as reducing existing overnight exposure.

The Commission encourages DTC's and NSCC's efforts to finalize the details of the same-day funds proposal. The Commission urges DTC and NSCC to start an educational campaign targeting retail participants, and have the flow of information begin well ahead of the implementation date for Rule 15c6-1.

B. Regulatory Initiatives

As discussed below, the Commission will recommend to other appropriate regulatory authorities that they amend their rules as necessary and appropriate to permit three business day settlement.

1. Rule 10b-10

Some commentators suggested that implementation of a T+3 settlement period will require amendments to the Commission's confirmation rule, Rule 10b-10 adopted under the 1934 Act.[14] Rule 10b-10 requires that broker-dealers send customers written confirmation disclosing information relevant to the transaction "at or before completion" of the transaction.[15] Generally, Rule 15c1-1 under the 1934 Act defines "completion of the transaction" to mean the time when: (i) A customer is required to deliver the security being sold; (ii) a customer is required to pay for the security being purchased; or (iii) a broker-dealer makes a bookkeeping entry showing a transfer of the security from the customer's account or payment by the customer of the purchase price.[16]

Currently, broker-dealers typically send customer confirmations the day after trade date. While the confirmation must be sent by settlement, because the confirmation does not need to be received prior to settlement, the current practice of sending the confirmation the day after trade date will satisfy Rule 10b-10 even under T+3.

Implementation of T+3, however, may alter the confirmation's utility as a customer invoice because confirmation delivery and transfer of customer funds and securities may not be possible within the three day settlement period. Under the current five day settlement period, confirmations generally reach customers in time for the customer to review them prior to transferring funds or securities to the transacting broker-dealer. Under T+3, the customer frequently will not receive the confirmation through the mails by day three; thus, shortening the settlement period to three days may require broker-dealers either to cover the cost of the transaction for a longer period of time or demand funds or securities from the customer earlier than under current practice.[17] Accordingly, the Commission encourages broker-dealers to consider changes to their systems to dispatch confirmations as early as possible following execution of a trade. The Commission also encourages broker-dealers to develop and implement the systems necessary to provide customers, at the time of execution, the net purchase price.

In addition to serving currently as an invoice, the confirmation serves other significant investor protection functions. In particular, the confirmation serves as a written record of the customer's transaction, thus satisfying the Statute of Frauds,[18] provides customers a means of checking the accuracy of their trades, and informs the customer of the broker-dealer's status and often its compensation in connection with the trade. Although the Commission believes that implementation of T+3 will not create compliance problems with regard to Rule 10b-10, it is continuing to consider the effect of T+3 on the confirmation's investor protection functions.

2. Rules 15c3-1 and 15c3-3

Rule 15c3-1 [19] establishes the net capital requirements for brokers and dealers. Rule 15c3-3 [20] requires brokers and dealers to maintain possession or control of all customer fully paid and excess margin securities. Commentators asked the Commission to review these rules to determine whether amendments will be required to conform them to a shorter settlement timeframe.

In determining a broker-dealer's net capital under Rule 15c3-1, the broker-dealer deducts from net worth, as computed in accordance with generally accepted accounting principles, assets not readily convertible into cash, including most unsecured receivables. A broker-dealer also must deduct certain category specific percentages from the securities and commodity futures positions that it carries in its proprietary account. The rule also requires that a failed to deliver contract that has been outstanding for a certain specified period of time be treated as a proprietary position of the broker-dealer and subject to a percentage deduction. This time period is dependent upon the time from settlement date. A contract becomes a fail when it has not settled by the prescribed settlement date. By establishing a shorter settlement timeframe, Rule 15c6-1 will affect the 15c3-1 requirements correspondingly, thus a contract will become a fail in three business days rather than the current five business days.

As with Rule 15c3-1, some of the requirements imposed on broker-dealers by Rule 15c3-3 are dependent upon the time from settlement. One commentator, Goldman Sachs,[21] referred specifically to Rule 15c3-3(m).[22] Rule 15c3-3(m) requires that a broker or dealer that has executed a sell order for a customer, and has not obtained possession of such securities from the customer within ten business days after the settlement date, must immediately close the transaction with the customer by purchasing securities of like kind and quantity.

The Commission notes that Rule 15c6-1 merely changes the number of days following the trade date that settlement will occur. For example, under the new rule, the ten day time period referred to in Rule 15c3-3(m) would generally begin three business days following the trade date, instead of the five business day convention currently in effect. Therefore, Rules 15c3-1 and 15c3-3 are consistent with Rule 15c6-1.[23]

3. Regulation T ("Reg T")

Commentators urged the Commission, in conjunction with the Federal Reserve Board, to review Reg T [24] to determine how, if at all, Reg T should be modified. Currently, Reg T does not require that any action be taken unless a customer fails to pay for securities within seven business days of the trade date. The concern is that Reg T as currently drafted could leave customers and brokers and

[14] 17 CFR 240.10b-10.

[15] 17 CFR 240.10b-10(a).

[16] 17 CFR 240.15c1-1(b).

[17] Rule 10b-10 does not specify mail delivery as the sole means of sending customer confirmations. Facsimile transmissions would be acceptable under the Rule as well.

[18] Uniform Commercial Code section 8-319 states that a "contract for the sale of securities is not enforceable by way of action or defense unless * * * there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker, sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price." U.C.C. 8-319 (1990).

[19] 17 CFR 240.15c3-1.

[20] 17 CFR 240.15c3-3.

[21] Letter from Anthony J. Leitner, Vice President-Associate General Counsel, Goldman Sachs, to Jonathan G. Katz, Secretary, Commission (June 30, 1993).

[22] 17 CFR 240.15c3-3(m).

[23] Similarly, the Commission notes that the time periods indicated in the formula for determining reserve requirements for brokers and dealers, Rule 15c3-3a, also are consistent with Rule 15c6-1.

[24] Reg T, 12 CFR part 220, *et. seq.*, imposes, among other things, initial margin requirements and payment rules on securities transactions. See 15 U.S.C. 78a *et seq.*, part 220.

dealers with the impression that payment from the customer is not due in a three day settlement environment until the expiration of the seven-day period specified by Reg T.

Consistent failures of customers to make payment until seven days would diminish greatly the benefits to be achieved from Rule 15c6–1. Recently, the Federal Reserve Board published notice of its intent to review Reg T generally, including perhaps tying the deadline for payment to settlement date.[25] Accordingly, the Commission has authorized the Division to request the Federal Reserve Board staff to consider whether conforming amendments to Reg T requiring payment from customers within two business days following the settlement date would be appropriate.

[25] See Securities Credit Transactions, Review of Regulation T, "Credit by Brokers and Dealers" (August 18, 1992), 57 FR 37109.

4. Disclosure of Depository Eligibility

In the Proposing Release, the Commission solicited comment on whether the Commission should adopt a disclosure requirement under the 1933 Act concerning depository eligibility of an IPO. The disclosure requirement, as discussed in the Proposing Release, would require disclosure of whether the securities being offered in an IPO are depository eligible, and if not, why not.

Five commentators supported the adoption of a disclosure requirement for IPOs as described above. The Cashiers' Association, DTC, and CHX agreed that the Commission should adopt a disclosure requirement concerning depository eligibility of IPOs, but these commentators believed that it was not necessary to include as an exhibit to the registration statement a letter from a securities depository confirming that the securities are eligible for deposit with that depository. Three commentators opposed the proposal, stating that it was unnecessary.

The Commission believes that depository eligibility is important to perfecting the national clearance and settlement system. Moreover, the Commission believes that disclosure regarding whether or not an IPO is, or will be, eligible for deposit at a securities depository is appropriate. SRO rules require broker-dealers to use depositories to confirm and settle trades in depository eligible securities. Disclosure that the securities are not depository eligible will facilitate compliance and efficient clearance and settlement in the secondary market immediately after the offering. Accordingly, the Commission is directing the staff to pursue requiring disclosure when neither the issuer nor the underwriter are intending to make the securities being offered depository eligible.

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BILLING CODE 8010-01-P

NASD NOTICE TO MEMBERS 93-78

SEC Approves Extension Of MSRB Continuing Disclosure Information Pilot System

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- □ Legal & Compliance
- ■ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- ■ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) approved an extension, through April 6, 1995, of the Municipal Securities Rulemaking Board's (MSRB) Continuing Disclosure Information Pilot System for accepting and disseminating disclosure notices relating to outstanding issues of municipal securities.

Background

The Continuing Disclosure Information Pilot System (System) is part of the MSRB's Municipal Securities Information Library System (Library System). With its Library System, the MSRB seeks to increase the integrity and efficiency of the municipal securities market by ensuring that the price charged for an issue in the secondary market reflects all available official information about that issue. Operating on a pilot basis since January of this year, the System accepts time-sensitive continuing disclosure information that affects municipal securities in the secondary market for dissemination to interested parties.

To evaluate and address technical, policy, and cost issues, the MSRB chose to implement the System in phases. During the first six months, the System only accepted information from trustees. The MSRB accelerated the second phase and began accepting disclosure notices from issuers as of May 17, 1993.

Currently, the System accepts only short submissions (one to three pages in length) that trustees and issuers submit by mail, facsimile transmission, or electronic transmission. The System then makes these documents available in two ways. A subscription service transmits each document to subscribers as soon as possible after the document is accepted. Information submitted by mail or facsimile goes out by facsimile transmission; information submitted electronically by computer modem is disseminated electronically. Interested persons may also review and copy these documents at the MSRB's Public Access Facility in Alexandria, Virginia.

Extension of Pilot

In August, the MSRB requested an 18-month extension of the program to allow more time for issuers and trustees to recognize the overall benefit to the market in voluntarily providing continuing disclosure information via the System. The SEC granted the extension through April 6, 1995.

During the extended pilot period, the MSRB will explore the feasibility of accepting and disseminating longer documents through the System. Although the SEC approved the extension on an accelerated basis to permit the System to continue to operate without interruption, interested parties are encouraged to submit comments. NASD members that wish to comment on the System should refer to File No. SR-MSRB-93-9 and send six copies of the comment letter to:

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549.

The SEC will make all comments available for public inspection and copying at its Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies also will be available for inspection and copying at the MSRB's principal offices.

NASD NOTICE TO MEMBERS 93-79

Christmas Day: Trade Date-Settlement Date Schedule

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

The Nasdaq Stock Market[SM] and the securities exchanges will be closed on Friday, December 24, 1993, in observance of Christmas Day. "Regular way" transactions made on the preceding business days will be subject to the settlement date schedule listed below.

Trade Date		Settlement Date		Reg. T Date*	
Dec.	16	Dec.	23	Dec.	28
	17		27		29
	20		28		30
	21		29		31
	22		30	Jan 3,	1994
	23		31		4
	24	Markets Closed			—
	27	Jan. 3,	1994		5

Note: Securities markets will be open on Friday, December 31, 1993, and Monday, January 3, 1994. There will be no observance of New Year's Day.

Brokers, dealers, and municipal securities dealers should use these settlement dates to clear and settle transactions pursuant to the NASD® Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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

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*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

NASD NOTICE TO MEMBERS 93-80

Nasdaq National Market® Additions, Changes, And Deletions as of October 25, 1993

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

As of October 25, 1993, the following 77 issues joined the Nasdaq National Market®, bringing the total number of issues to 3,325:

Symbol	Company	Entry Date	SOES Execution Level
TBAY	Gotham Apparel Corp.	9/27/93	1000
BPIX	Broadcasting Partners, Inc. (Cl A)	9/28/93	1000
COSB	CSB Financial Corporation	9/28/93	500
SUDS	Sudbury, Inc.	9/28/93	1000
HAUL	Allied Holdings, Inc.	9/29/93	500
CMEL	Checkmate Electronics, Inc.	9/29/93	1000
FFPB	First Palm Beach Bancorp, Inc.	9/29/93	1000
KESI	Kentucky Electric Steel, Inc.	9/29/93	1000
LUCK	Lady Luck Gaming Corporation	9/29/93	1000
LOEW	Loewenstein Furniture Group, Inc.	9/29/93	1000
MPRO	MicroProbe Corporation	9/29/93	1000
MPROW	MicroProbe Corporation (9/28/98 Wts)	9/29/93	1000
UTEK	Ultratech Stepper, Inc.	9/29/93	1000
FHCI	Future Healthcare, Inc.	9/30/93	1000
LDAKA	LIDAK Pharmaceuticals (Cl A)	9/30/93	1000
LDAKM	LIDAK Pharmaceuticals (Cl B 5/8/95 Wts)	9/30/93	500
LDAKZ	LIDAK Pharmaceuticals (Cl C 5/26/95 Wts)	9/30/93	500
LFCT	Leader Financial Corporation	9/30/93	1000
NRVH	National R.V. Holdings, Inc.	9/30/93	1000
NAWC	North American Watch Corporation	9/30/93	1000
SFXBA	SFX Broadcasting, Inc. (Cl A)	9/30/93	500
SBCN	Suburban Bancorporation, Inc.	9/30/93	500
ARAM	Aramed, Inc.	10/1/93	1000
GNSAW	Gensia, Inc. (12/31/96 Wts)	10/1/93	200
MAXM	The Maxim Group, Inc.	10/1/93	500
MAXMW	The Maxim Group, Inc. (9/30/98 Wts)	10/1/93	500
ACCX	Atchison Casting Corporation	10/4/93	1000
GART	Gartner Group, Inc. (Cl A)	10/5/93	1000
TAPE	Magnetech Corporation	10/5/93	1000
NPAF	National Picture & Frame Company	10/5/93	1000
CLBK	Commercial Bankshares, Inc.	10/6/93	500
IVIP	IVI Publishing, Inc.	10/6/93	500
SPZN	Speizman Industries, Inc.	10/6/93	500
UBSH	Union Bankshares Corporation	10/6/93	1000
ZONEL	Discovery Zone, Inc. (Liquid Yield Option Notes)	10/7/93	N/A
FSFC	First Southeast Financial Corporation	10/8/93	1000
MCTI	Micro Component Technology, Inc.	10/8/93	1000
RHNB	RHNB Corporation	10/11/93	1000
ALDNF	Aladdin Knowledge Systems Ltd.	10/12/93	500
BEERF	Big Rock Brewery Ltd.	10/12/93	500
CIVCR	Civic BanCorp (11/2/93 Rts)	10/12/93	500

Symbol	Company	Entry Date	SOES Execution Level
EFIL	Envirofil, Inc.	10/12/93	1000
KARE	Koala Corporation	10/12/93	1000
MBIA	Merchants Bancorp, Inc.	10/12/93	500
NVIC	N-Viro International Corporation	10/12/93	1000
STCH	Shared Technologies Inc.	10/12/93	1000
BMCCP	Bando McGlocklin Capital Corporation (Pfd)	10/13/93	500
BZHKF	Belize Holdings Inc.	10/13/93	1000
FBAYF	Frisco Bay Industries Ltd.	10/13/93	1000
IFGI	Insignia Financial Group, Inc. (Cl A)	10/13/93	1000
OMGI	OM Group, Inc.	10/13/93	1000
LNET	LodgeNet Entertainment Corporation	10/14/93	1000
TENXF	Tee-Comm Electronics Inc.	10/14/93	500
DECK	Deckers Outdoor Corporation	10/15/93	500
EPUR	Enviropur Waste Refining & Technology, Inc.	10/15/93	1000
EPURW	Enviropur Waste Refining & Technology, Inc. (12/31/93 Cl B Wts)	10/15/93	1000
ULTE	Ultimate Electronics, Inc.	10/15/93	1000
WIKS	Wickes Lumber Company	10/15/93	500
AXAS	Abraxas Petroleum Corporation	10/19/93	500
CLBC	Club Car, Inc.	10/19/93	500
CROS	Crossmann Communities, Inc.	10/19/93	1000
INSV	InSite Vision Incorporated	10/19/93	1000
IWRK	Iwerks Entertainment, Inc.	10/19/93	1000
NRIM	Northrim Bank	10/19/93	500
POYO	Pollo Tropical, Inc.	10/19/93	1000
DAVL	Davel Communications Group, Inc.	10/20/93	1000
ENSY	EnSys Environmental Products, Inc.	10/20/93	500
PARSD	Pharmos Corporation	10/20/93	1000
WRTEP	WRT Energy Corporation (Pfd)	10/20/93	500
EVGMP	Evergreen Media Corporation (Pfd)	10/21/93	500
WRTE	WRT Energy Corporation	10/21/93	500
CBSAP	Coastal Banc Savings Association (Pfd)	10/22/93	500
ENVGW	Envirogen, Inc. (10/12/98 Wts)	10/22/93	500
SBLT	The Sunbelt Companies, Inc.	10/22/93	1000
TGIC	Triad Guaranty Inc.	10/22/93	1000
RENO	Reno Air, Inc.	10/25/93	1000

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since September 27, 1993:

New/Old Symbol	New/Old Security	Date of Change
DOSEW/DOSEW	Choice Drug Systems, Inc. (9/30/94 Wts)/Choice Drug Systems, Inc. (9/30/93 Wts)	10/4/93
COHO/COHO	Coho Energy, Inc./Coho Resources, Inc.	10/4/93
SMTSZ/SMTSZ	Somanetics Corporation (12/29/93 Wts)/Somanetics Corporation (9/28/93 Wts)	10/4/93
DIAU/DIAUV	Diasonics Ultrasound, Inc./Diasonics Ultrasound, Inc. (WI)	10/5/93
GRNT/GRNT	Grant Geophysical Inc./Grant Tensor Geophysical Corp.	10/5/93
GRNTP/GRNTP	Grant Geophysical Inc. (Pfd)/Grant Tensor Geophysical Corp. (Pfd)	10/5/93

New/Old Symbol	New/Old Security	Date of Change
KREGP/BLSAP	Koll Real Estate Group Inc. (Pfd)/Bolsa Chica Co. (Ser A Pfd)	10/8/93
KREG/BLSA	Koll Real Estate Group Inc. (Cl A)/The Bolsa Chica Co.	10/8/93
IMPX/IMPX	IMP, Inc./International Microelectronics	10/12/93
ICTL/OHCO	International CableTel, Inc./OCOM CP	10/14/93
FRDM/FRDMA	Friedman's Inc. (Cl A)/Friedman's Inc. (Cl A)	10/15/93
DIDI/DIDIF	Destron/IDI, Inc./Destron/IDI, Inc.	10/18/93
ZALE/ZALEV	Zale Corporation/Zale Corporation (WI)	10/21/93
GOLD/FGBC	Goldenbanks of Colorado, Inc./First Golden Bancorp	10/22/93
PCCW/PCLB	Price/Costco Inc./The Price Company	10/22/93

Nasdaq National Market Deletions

Symbol	Security	Date
ATKM	ATKM Metals Center, Inc.	9/27/93
CBWV	Commerce Banc Corporation	9/28/93
ASIXE	Assix International	10/1/93
VCRE	Vari-Care Inc.	10/1/93
PROT	Protective Life Corporation	10/4/93
CNSB	Centennial Savings Bank, FSB	10/5/93
OHBC	Ohio Bancorp	10/13/93
BFCS	Boston Five Bancorp, Inc.	10/14/93
FRDMA	Friedman's Inc. (Cl A)	10/14/93
FCMI	Future Communications Inc.	10/14/93
SIMU	Simula, Inc.	10/14/93
SODA	A & W Brands Inc.	10/15/93
NDTA	National Data Corporation	10/15/93
AUTR	Autotrol Corporation	10/19/93
MORR	Morrison Restaurants Inc.	10/21/93
COST	Costco Wholesale Corporation	10/22/93
ENGH	Engraph Inc.	10/22/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

NASD Notice to Members 93-81

NASD Reminds Members of the Requirement for Fairness Of Agency Commissions And Applicability of the 5% Policy

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- ■ Trading
- ■ Training

Executive Summary

Members are reminded that commission charges to customers in agency transactions are fully subject to all provisions of Article III, Section 4 of the NASD Rules of Fair Practice. As such, the NASD 5% Policy applies as equally to commissions on agency trades as it does to markups or markdowns on principal transactions. Members are urged to review the level of their agency commissions to ensure that they are fair and reasonable and fully comply with all aspects of Section 4.

Background

The fairness of members' charges to customers both in regard to markups or markdowns on principal transactions and commissions in agency transactions has been the subject of close examination by the NASD across the country. As is evident by the number of disciplinary actions taken in recent years by the NASD involving egregious markup practices that have resulted in the imposition of serious sanctions on members and their associated persons, the NASD has been an aggressive enforcer in ensuring fair dealing with customers. Concerns are now being raised with the level of commissions being charged to customers that in some instances are not fair and reasonable in light of the requirements of Article III, Section 4 of the NASD's Rules of Fair Practice. In addition, members have raised questions about the applicability of various aspects of Section 4 to agency commissions. This Notice is being issued to assist members in adopting policies and procedures designed to achieve compliance with Section 4, and in resolving questions of fairness in agency commission transactions.

Application of Article III, Section 4 and 5% Policy to Agency Commissions

Article III, Section 4 of the Rules of Fair Practice states in part that, if a member acts as agent for a customer in any transaction, the customer shall not be charged more than a fair commission or service charge, taking into consideration all relevant circumstances.

To provide direction in this area, the NASD Board of Governors adopted its 5% Policy as an Interpretation of the Board under Section 4. It indicates that it may be conduct inconsistent with just and equitable principles of trade for a member to charge a commission that is not reasonable. The policy further states that it applies to all transactions in which the member acts as agent and charges its customer a commission. Therefore, the NASD 5% Policy and Article III, Section 4 of the Rules clearly apply to commissions charged in agency transactions and are not limited to markups in principal transactions.[1]

Regardless of product or type of transaction, members should ensure that customers are receiving fair prices and not being charged unfair or unreasonable commissions. The issue of fairness relative to agency commission charges as well as markups is determined by considering all relevant factors to the transactions. Article III, Section 4 requires any NASD member that acts as an agent for its customer to charge only a "fair commission or service charge, taking into consideration all relevant circumstances including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered

[1] *NASD Manual*, paragraph 2154.

by reason of his experience in and knowledge of such security and the market therefore."[2] Disclosure does not justify a commission or markup that is unfair or excessive in light of all other relevant circumstances.

In addition, other relevant factors include the price of the security and the amount of money involved in the transaction. In this regard, members should pay particular attention to commissions charged on agency transactions involving low-priced securities, including consideration of minimum commission charges.

The NASD 5% Policy, which has been revalidated on various occasions since it was originally adopted in 1943, provides guidance to members in determining the fairness of markups, markdowns, and commissions. Consistent regulatory policy requires that agency transactions come under the same guidelines as principal transactions. Indeed, that approach was affirmed in 1943 in a letter from the NASD Board of Governors to the membership that discussed the NASD 5% Policy.

> Where consummated on an agency basis, the commission charged the customer must not be unfair and should not exceed the amount which, were the member to act as a principal, would be in accord with the standards of practices discussed above.[3]

It expressly states that the 5% Policy is a guide, not a rule, and is applicable to commissions as well as markups and markdowns.[4] Thus, if a member undertakes an agency transaction, a commission should generally not exceed 5 percent of the total transaction amount unless the member can show or document factors under the policy that justify a higher amount. The NASD has, since 1943, deemed it inconsistent with Article III, Sections 1 and 4 and just and equitable principles of trade for a member to charge a customer a commission or a markup/markdown that is not reasonable or fair in light of the 5% Policy.[5]

The 5% Policy does not define specifically what constitutes a fair or reasonable commission, since "what might be considered fair in one transaction could be unfair in another transaction because of different circumstances."[6] Instead, the 5% Policy requires that a determination of the fairness of a commission is based on "a consideration of all the relevant factors," of which the percentage of commission on the transaction is only one.[7] Indeed, as with a markup/markdown, the 5% Policy says that commissions at 5 percent, or even less, may be deter-mined to be unfair or unreasonable when the other relevant factors have been carefully considered.

Market Conditions

When the market conditions for a security reflect active and competitive trading, the security typically will be readily available for the member to buy or sell on behalf of its customer. Thus, active, competitive market conditions would not usually justify a higher commission. However, in the case of an inactive security, the member's effort and cost of buying or selling the security for the customer may have a bearing on the amount of commission. Any special or unusual effort or cost should be documented if a higher commission is to be justified. The member bears the burden of adequately documenting any such claim.

Expense of Execution

The cost of actual execution of the customer's transaction may be taken into account. Normal overhead expenses, including commissions or other compensation to be paid to registered representatives, should not be taken into consideration in determining whether commissions to be charged customers are reasonable.[8]

As the SEC has stated:

> The fact that a member is entitled to a profit is merely one of the circumstances to be considered in determining whether a price is fair, and excessive expenses cannot justify an excessive markup.[9]

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[2] Ibid.

[3] In re: National Association of Securities Dealers, Inc., 17 S.E.C. 459 at Appendix A (1944).

[4] In a recent case, Kevin B. Waide, Securities Exchange Act Release No. 30561, footnote 12 (April 7, 1992), the SEC agreed that the NASD's 5% Policy applied to commissions in agency transactions. See *Notice to Members 92-16* (April 1, 1992) for details concerning the application of the 5% Policy to markups and markdowns.

[5] *NASD Manual*, paragraph 2154.

[6] Ibid.

[7] Ibid.

[8] See *Osborne, Stern and Co., Inc.*, Sec. Exch. Act Rel. No. 31211 (1992), at footnote 13, and *Boren & Co.*, 40 S.E.C. 217 (1960).

[9] *Boren & Co.*, 40 S.E.C. 217 (1960). See also Kenneth B. Stucker, 42 S.E.C. 910 (1966) (Excessive expenses in effecting sales—such as studies of the companies

Value of Services Rendered

In most instances, a member's service to its customer in executing a buy or sell transaction as agent for that customer is not extraordinary and therefore not sufficient to justify a commission greater than 5 percent. For example, a member's efforts to promote the stock and stimulate its sales cannot be viewed as a service for which customers can be charged by raising the commissions.[10]

Many of these factors were considered in a recent NASD disciplinary proceeding that involved a member, the sole market maker in the particular security at issue, who regularly charged its customers commissions ranging from 7 percent to 9 percent when acting as its customers' agent in the purchase or sale of securities. In its decision, the National Business Conduct Committee found that the member failed to demonstrate any "extraordinary" expense, service, or market condition that would justify a commission in excess of 5 percent.[11]

Members are also reminded of their obligation under Section 27 of the NASD Rules of Fair Practice to have in place adequate written supervisory procedures to monitor employee conduct in customer transactions, including the fairness of commissions.

* * * * *

The NASD hopes that this Notice, which embodies longstanding NASD policies and principles, will aid members in their compliance efforts, and thereby enhance customer protection and help preserve the integrity of the marketplace.

Questions concerning this Notice may be directed to your local NASD District Office, or to William R. Schief (Vice President) or Daniel M. Sibears (Director), NASD Regulation, 1735 K Street, NW, Washington, DC 20006-1500.

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involved, attendance at the companies' stockholder meetings, political activity to further the companies' interests, and compliance with recordkeeping requirements—didn't justify excessive charges to customers.).

[10] See Kenneth B. Stucker, 42 S.E.C. 910 (1966).

[11] See Van Clemens & Company, Inc., CO4920012 (April 22, 1993).

NASD Disciplinary Actions

Disciplinary Actions Reported for November

The NASD® has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, November 15, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this edition.

Firms Expelled, Individuals Sanctioned

Roger J. Lange & Co., Inc. (Paris, Illinois), Roger J. Lange (Registered Principal, Brocton, Illinois), John H. Mathues (Registered Principal, Lake Zurich, Illinois), and **Richard F. Duell (Registered Representative, Buffalo Grove, Illinois)** submitted an Offer of Settlement pursuant to which the firm and Lange were fined $250,000, jointly and severally. The firm was expelled from NASD membership and Lange was barred from association with any NASD member in any capacity. Mathues and Duell were each fined $15,000 and suspended from association with any NASD member in any capacity for 10 consecutive business days. In addition, Mathues was required to pay $10,537.16 in restitution to customers and Duell was required to pay $16,060.01 in restitution to customers.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm and Lange willfully violated Section 5 of the Securities Act of 1933 by offering and selling unregistered shares of a common stock to public customers. In addition, the findings stated that the firm and Lange charged their customers fraudulently excessive markups and markdowns in 205 principal transactions involving the aforementioned common stock. The firm's markups and markdowns, ranging from 10 to 63 percent, were calculated from the inside quotes on the OTC Bulletin Board®.

According to the findings, Lange, Duell, and Mathues also charged their retail customers unfair prices in the same stock, in that the gross credits compared to the dollar amounts of the transactions were patently excessive with the charges ranging from 10 to 50 percent of the total cost to customers. The NASD also determined that the firm, Lange, Duell, and Mathues effected retail sales of the same stock, a designated security, without completing certain forms before the sales as required by Securities and Exchange Commission (SEC) Rule 15c2-6, (the cold call rule). Moreover, the NASD found that the firm and Lange failed to report certain price and volume information for the firm's daily trading in this common stock and allowed the solicitation of customers for purposes of effecting principal trades in the common stock.

Finally, the NASD determined that the firm, Lange, and Mathues failed to establish, implement, and enforce reasonable supervisory measures to detect these violations.

Firms Suspended, Individuals Sanctioned

A.C. Masingill & Associates, Inc. (Knoxville, Tennessee), Arthur C. Masingill, Jr. (Registered Principal, Knoxville, Tennessee), Jeffrey R. Sharp (Registered Representative, Knoxville,

Tennessee), and **Gaines C. Walker (Registered Representative, Knoxville, Tennessee)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was fined $30,000 and suspended from NASD membership for six months. Masingill and Sharp were each fined $7,500 and Masingill was suspended from association with any NASD member in any capacity for six months. In addition, Sharp was suspended from association with any NASD member in any capacity for 90 days and Walker was fined $5,000 and suspended from association with any NASD member in any capacity for 30 days.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that in violation of Sections 5(a) and 5(b) of the Securities Act of 1933, the firm, acting through Sharp and Walker, sold or caused to be sold to eight public customers certificates of deposit that were debt instruments of a foreign bank that were neither registered pursuant to Section 6 of the Act nor exempt from registration under Sections 3 and 4 of the Act. They also failed to provide the purchasers with any prospectus, offering, or disclosure documents. In this activity, the NASD found that the firm, acting through Sharp and Walker, neglected to exercise or perform adequate due diligence by failing to conduct a reasonable review and investigation into the operations of the offering bank, the nature of its business, and the manner in which the proceeds of the offering would be invested. Furthermore, the findings stated that the firm, acting through Sharp and Walker, failed to obtain full and complete financial statements of the bank in question and to conduct effective due diligence as to whether the aforementioned certificates of deposit were securities, and if so, whether they were subject to registration under federal or state securities laws.

In addition, the NASD determined that the firm, acting through Sharp and Walker, sold certificates of deposit to public customers when they should have known that such securities were unsuitable for these customers in light of the customers' investment objectives. Also, the NASD found that Sharp and Walker communicated to customers and made untrue statements of material fact regarding the securities sold without a sufficient basis for formulating a belief. According to the findings, the firm, acting through Masingill and Sharp, failed to give or send to customers written confirmation of transactions, including a disclosure of the capacity in which they were acting, and the amount of remuneration received. The findings also stated that the firm, acting through Masingill and Sharp, failed to prepare, maintain, and preserve accurate books and records and computations of net capital, and engaged in a securities business while failing to maintain its required minimum net capital. Furthermore, the findings stated that the firm, acting through Masingill and Sharp, submitted inaccurate FOCUS Part II Reports and failed to comply with its restriction agreement with the NASD.

The NASD found that the firm, acting through Masingill, submitted an audited financial statement which inaccurately presented the firm's net capital and they failed to give immediate telegraphic notice to the proper regulatory authorities that the firm's books and records were not current, its net capital was less than the minimum required by SEC Rule 15c3-1, and that the firm had failed to comply with the other requirements of SEC Rule 17a-11. Furthermore, the firm, acting through Masingill, failed to amend its broker/dealer application for membership to reflect a change in its clearing agreement and failed to establish, maintain and enforce an adequate system of supervision outlining the types of business conducted by the firm and the activities of its registered representatives. In addition, the firm and Masingill allowed Sharp to act in a principal capacity without proper registration.

Investment Planning, Inc. (Dubuque, Iowa), Erwin J. Hafeman (Registered Principal, Dubuque, Iowa), John L. Finn (Registered Principal, Dubuque, Iowa), and **John K. Finn (Registered Principal, Dubuque, Iowa)**. The firm was fined $10,000, suspended from membership in the NASD for 10 business days, prohibited from engaging in principal transactions with customers for 30 days, and required to participate in a staff interview. Also, the District Committee must approve the firm's business plan before it engages in principal transactions with customers. Hafeman was fined $30,000, suspended from association with any NASD member in any capacity for 90 days, barred from association with any NASD member in a principal capacity, and required to requalify by examination as a representative. J.K. Finn and J.L. Finn were each fined $10,000, suspended from association with any NASD member in any capacity for 10 business days, and required to requalify by examination as general securities representatives.

The SEC affirmed the sanctions following appeal of an August 1990 National Business Conduct Committee (NBCC) decision. The sanctions were based on findings

that the firm, acting through Hafeman, J. K. Finn, and J. L. Finn, sold corporate and municipal bonds as principal to customers at unfair and unreasonable prices with markups over the wholesale market price on the corporate bonds ranging from 4 to 7.26 percent and from 4 to 5.99 percent on the municipal bond transactions.

Firms Fined, Individuals Sanctioned

Wasatch Stock Trading, Inc. (Salt Lake City, Utah), Roger Hill Neslen (Registered Principal, Sandy, Utah), and **Michael W. Klekas (Registered Principal, Salt Lake City, Utah)**. The firm was fined $20,000, and suspended from conducting a securities business for 15 days. Neslen was fined $10,000, barred from association any NASD member as a financial and operations principal, or in any proprietary or ownership position of any NASD member firm. Neslen also was suspended from association with any NASD member in any capacity for 15 days. Klekas was fined $10,000, suspended from association with any NASD member in any capacity for 15 days, and required to requalify by examination in any capacity.

The NBCC imposed the sanctions following appeal of a Denver District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that the firm, acting through Neslen and Klekas, engaged in a fraudulent and deceptive course of conduct that involved "parking" securities in customers' accounts to provide the appearance that the firm was in compliance with the net capital requirement of SEC Rule 15c3-1. In addition, the firm, acting through Neslen, conducted a securities business while failing to maintain minimum required net capital and failed to make required deposits into its *Special Reserve Account for the Exclusive Benefit of Customers* in accordance with the SEC Customer Protection Rule 15c3-3. Moreover, the firm, acting though Neslen, filed inaccurate FOCUS Part I and II reports and engaged in a fraudulent and deceptive course of conduct of "kiting" checks between its bank accounts to create the appearance of good funds in those accounts. Furthermore, the firm, acting through Neslen, failed to establish adequate written supervisory procedures required to supervise the types of business in which it engaged and failed to enforce its written supervisory procedures.

Firms and Individuals Fined

S.D. Cohn & Co., Inc. (New York, New York) and **Sidney D. Cohn (Registered Principal, East Williston, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were 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 the firm, acting through Cohn, conducted a securities business while failing to maintain its required minimum net capital. In addition, the NASD found that the firm, acting through Cohn, failed to comply with the provisions of the NASD's rule concerning written supervisory procedures and failed to comply with its restriction agreement with the NASD.

The Nikko Securities Co. International, Inc. (New York, New York), Ryosuke Suzuki (Associated Person, New York, New York), Stephen A. Axilrod (Registered Principal, New York, New York), Masumi Yamaguchi (Registered Principal, New York, New York), and **Tominari Miyuki (Associated Person, Tenafly, New Jersey)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined $15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that in contravention of Schedule C of the NASD By-Laws, Suzuki, Axilrod, Yamaguchi, and Miyuki acted in the capacity of general securities principals without being properly registered and approved. In addition, the NASD found that the firm, acting through Suzuki and Yamaguchi, failed to comply with NASD rules concerning certain supervisory procedures.

T. L. Smith Securities, Inc. (Fort Worth, Texas) and **Thad Lasley Smith (Registered Principal, Fort Worth, Texas)** were fined $10,000, jointly and severally. The sanction was based on findings that the firm, acting through Smith, permitted seven individuals associated with the firm to sell securities without proper qualification or registration with the NASD. The firm, acting through Smith, also purchased and sold municipal securities without having a qualified municipal securities principal registered with the NASD.

In addition, the firm, acting through Smith, failed to establish and maintain adequate written supervisory procedures. Also, the firm, acting through Smith, deposited the check of a public customer into the firm's operating account rather than a *Special Reserve Account for the Exclusive Benefit of Customers*, in violation of the SEC's Customer Protection Rule 15c3-3.

Firms Fined

Kemper Securities Group, Inc. (Chicago, Illinois) submitted an Offer of Settlement pursuant to which the firm was fined $10,000. Without admitting or denying the allegations, Kemper consented to the described sanction and to the entry of findings that the firm failed to properly and adequately supervise a registered representative to assure compliance with the NASD Rules of Fair Practice.

Individuals Barred or Suspended

Douglas Drake Alcala (Registered Representative, Seattle, Washington) was fined $5,000, suspended from association with any NASD member in any capacity for 60 days, and required to pass an appropriate qualifying examination before becoming associated with any NASD member. The sanctions were based on findings that Alcala recommended securities transactions for the account of public customers without having reasonable grounds for believing that such recommendations were suitable for the customers in light of their financial situations, needs, and investment objectives.

Elizabeth Bidwell (Registered Representative, Miller Place, New York) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $5,807.72 in restitution to her member firm. The sanctions were based on findings that Bidwell caused disbursement request forms purportedly signed by public customers to be presented to her member firm requesting the full cash surrender value of the customers' insurance policies. This activity caused her member firm to issue checks totaling $5,807.72 that Bidwell negotiated for her own account and benefit. In addition, Bidwell failed to respond to NASD requests for information.

Carole Muller Borowski (f/k/a Carole Muller) (Registered Representative, Washington, D.C.) submitted an Offer of Settlement wherein she was suspended from association with any NASD member in any capacity for two months. Without admitting or denying the allegations, Borowski consented to the described sanction and to the entry of findings that, to generate commissions, she effected mutual fund investments in a customer's account. According to the findings, she then margined mutual fund shares in the same customer's account to purchase more mutual fund shares, which practice was unsuitable for the customer.

Reginald E. Brown (Registered Representative, Monroeville, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information concerning customers' insurance policies.

Jeanne M. Casebolt (Registered Representative, La Junta, Colorado) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $2,937 plus interest in restitution to customers. The sanctions were based on findings that Casebolt obtained from six insurance customers $2,937 intended for the purchase of insurance policies. However, Casebolt failed to forward these funds to her member firm, failed to cause the intended policies to be purchased, and failed to use the funds for the benefit of the customers. Casebolt also failed to respond to NASD requests for information.

Yosik Chu (Registered Representative, Teaneck, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $29,250, barred from association with any NASD member in any capacity, and required to pay $4,500 in restitution to his member firm. Without admitting or denying the allegations, Chu consented to the described sanctions and to the entry of findings that he secured an $850 policy loan from a public customer's life insurance policy and retained the funds for his own use and benefit. In addition, the NASD found that Chu received $5,000 in cash from public customers which he retained for his own use and benefit.

Ernest A. Cipriani, Jr. (Registered Representative, Ellsworth, Pennsylvania) was fined $3,000 and barred from association with any NASD member in any capacity. The NBCC affirmed the sanctions following appeal of a Philadelphia DBCC decision. The sanctions were based on findings that Cipriani received from a public customer $647.20 in cash intended for payment of insurance premiums. Cipriani retained the monies and failed to remit the funds to his member firm.

Cipriani has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Jamie Gail Clingman (Registered Principal, Decatur, Texas) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $44,095 in restitution to a member

firm or customers. The sanctions were based on findings that Clingman voided 12 checks issued to public customers for payment of interest and principal on investment notes owned and redeemed by the customers. Clingman then reissued replacement checks totaling $44,095 listing herself as payee and converted the proceeds to her own use and benefit without the customers' knowledge or consent.

Richard P. Durant (Registered Representative, Jacksonville, Florida) was fined $120,000, barred from association with any NASD member in any capacity, and required to pay $47,000 in restitution to his member firm. The sanctions were based on findings that Durant withdrew $47,000 from an annuity owned by a public customer and converted the funds to his own use and benefit without the customer's knowledge or consent. In addition, Durant failed to respond to an NASD request for information.

Charles N. Edmonds (Registered Representative, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,500 and suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, Edmonds consented to the described sanctions and to the entry of findings that he participated in a private securities transaction while failing to notify his member firm of his intention to engage in such activities.

Larry Alan Eggers (Registered Principal, Gilroy California) was barred from association with any NASD member in any capacity. The NBCC affirmed the sanctions following appeal of a San Francisco DBCC decision. The sanctions were based on findings that Eggers participated in private securities transactions without giving prior written notification to his member firm. In connection with these transactions, Eggers made material false statements and omissions to investors by representing that an investment was guaranteed a specific rate of return, while failing to disclose any financial information that would support these representations, in violation of Section 17(a)(2) of the Securities Act of 1933.

Kirk L. Ferguson (Registered Principal, Centerville, Utah) was fined $5,000, jointly and severally with a member firm, and jointly and severally, has to provide restitution of $56,335 plus interest to customers. The NASD has to approve an explanation to the customers of the reason for the restitution and the firm and Ferguson have to provide proof to the NASD that they have made such restitution. Ferguson was fined an additional $5,000, suspended from association with any NASD member in any capacity for five business days, and required to requalify by examination as a financial and operations principal and general securities principal before acting in those capacities with any NASD member firm.

The NBCC affirmed the sanctions following appeal of a Denver DBCC decision. The sanctions were based on findings that the firm, acting through Ferguson, conducted a securities business while failing to maintain its minimum required net capital and effected securities transactions with retail customers in a common stock that included markups ranging from 5 to 10 percent above the prevailing market price. Moreover, the firm, acting through Ferguson, engaged in, and induced others to engage in, deceptive and fraudulent devices and contrivances in connection with the aforementioned stock by dominating and controlling the market in the stock such that there was no independent, competitive market in the shares.

Ferguson has appealed the action to the SEC, and the sanctions are not in effect pending consideration of the appeal.

Paul F. Fomby (Registered Principal, Chicago, Illinois) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Fomby failed to respond to NASD requests for information concerning the alleged use of $295 from members of the public.

Michael T. Fornal (Registered Representative, Alexandria, Virginia) was fined $120,000, barred from association with any NASD member in any capacity, and ordered to pay restitution to customers for the funds he converted. The sanctions were based on findings that Fornal converted $531,990 received from public customers to his own use and benefit through forged documents, unauthorized wire transfers, and misrepresentations. Fornal also failed to respond to NASD requests for information.

Michael K. Fultz (Registered Representative, Boulder, Colorado) was barred from association with any NASD member in any capacity. The sanction was based on findings that Fultz had in his possession unauthorized material while taking the Series 7 examination.

John L. Gravitt (Registered Representative, Denver, Colorado) was fined $15,000, suspended from association with any

NASD member in any capacity for 30 days, and must requalify by examination in any capacity in which he seeks to act in the securities industry. The sanctions were based on findings that Gravitt effected five unauthorized transactions in a customer's account.

Steven Michael Hartwell (Registered Representative, Fort Bragg, North Carolina) was fined $10,000, suspended from association with any NASD member firm in any capacity for seven business days, and ordered to requalify by examination in any capacity he seeks to become associated. The sanctions were based on findings that Hartwell engaged in outside business activities while failing to provide prompt written notification to his member firm.

Nazmi C. Hassanieh (Registered Representative, Memphis, Tennessee) was barred from association with any NASD member in any capacity. The NBCC imposed the sanction following appeal of a New Orleans DBCC decision. The sanctions were based on findings that Hassanieh recommended that public customers invest in a limited partnership without having reasonable grounds for believing that such recommendation was suitable based on their investment objectives, financial situations, and needs. In addition, Hassanieh failed to respond to NASD requests for information.

Hassanieh has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Edwin H. Haw, Jr. (Registered Representative, Chicago, Illinois) was fined $57,500 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Chicago DBCC decision. The sanctions were based on findings that Haw received six checks totaling $7,910 from his member firm, made payable to a public customer. Haw failed to deliver the checks to the customer, forged the customer's signature to the checks, and used the funds for his personal use and benefit. In addition, Haw failed to respond to NASD requests for information.

Barbara Robinson Hoganson (Registered Representative, Aurora, Illinois) was fined $900 and suspended from association with any NASD member in any capacity for six months with the proviso that she be credited for the period during which she did not function in any registered capacity (as such, her suspension has been served). The NBCC imposed the sanctions following appeal of a Chicago DBCC decision. The sanctions were based on findings that Hoganson obtained $300 in cash from a public customer's bank by generating an account withdrawal form without the customer's knowledge or consent. Hoganson then signed a bank officer's initials to complete the withdrawal, deposited $250 of the funds in an account in which she had an interest or controlled, and retained the $300 for her own use and benefit until a later date.

Mark A. Hollis (Registered Representative, Headland, Alabama) was fined $25,000, barred from association with any NASD member in any capacity, and required to pay restitution to the appropriate party. The sanctions were based on findings that Hollis received $538 from public customers as payment toward various insurance policies and failed to submit the funds to his member firm, thereby converting the funds to his own use without the customers' knowledge or consent. In addition, Hollis failed to respond to NASD requests for information.

Jean J. Hunter (Registered Representative, Chicago, Illinois) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Hunter received from a public customer $180 in cash with instructions to purchase an insurance policy. Hunter failed to follow said instructions and used the funds for some purpose other than to benefit the customer. In addition, Hunter failed to respond to NASD requests for information.

John R. Johnston (Registered Principal, Ada, Oklahoma) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for three months and suspended in any principal capacity for one year. Without admitting or denying the allegations, Johnston consented to the described sanctions and to the entry of findings that he allowed an associated person to manage and participate in the affairs of a former member firm when he knew, or should have known, that the individual was not qualified as a principal in accordance with Schedule C of the NASD By-Laws.

Michael Joseph Kearns (Registered Representative, Houston, Texas) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Kearns failed to respond to NASD requests for information concerning a customer complaint.

Michael J. Keen (Registered Representative, Hackensack, New Jersey) was fined $30,000 and

barred from association with any NASD member in any capacity. The sanctions were based on findings that Keen executed unauthorized transactions in the accounts of public customers without their knowledge or consent. In addition, Keen failed to respond to NASD requests for information.

Jeffrey H. Krisman (Registered Representative, Tulsa, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $120,000, barred from association with any NASD member in any capacity, and required to pay $22,255.44 in restitution to his former member firm. Without admitting or denying the allegations, Krisman consented to the described sanctions and to the entry of findings that he caused seven checks totaling $21,868 to be issued from the account of a public customer and converted the funds to his own use and benefit without the customer's knowledge or consent. In addition, the NASD found that Krisman failed to respond to NASD requests for information.

Thomas Edward Krotkowski (Registered Representative, Tacoma, Washington) was fined $100,000 and barred from association with any NASD member in any capacity. In addition, Krotkowski is required to provide proof that he has paid restitution to his former member firm before applying for relief from the disqualification arising from the bar.

The NBCC imposed the sanctions following appeal of a Seattle DBCC decision. The sanctions were based on findings that Krotkowski completed disbursement request forms for 41 insurance customers requesting that their policies be surrendered without their consent. Krotkowski then signed the customers' names to the forms and submitted the forms to his member firm for the customers, obtained the surrender checks totaling $19,780.37, and endorsed the checks with the name of each customer.

Jill Kyle (Associated Person, Fremont, California) was fined $100,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Kyle misappropriated from her member firm $35,367.74 and converted the proceeds to her own use and benefit. Kyle also failed to respond to NASD requests for information.

Derek J. Leigh (Registered Representative, New York, New York) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that during the course of a Series 7 examination it was determined that Leigh impersonated an individual scheduled for the exam who paid him $1,000 to take the exam on his behalf. In addition, Leigh failed to respond to an NASD request for information.

Timothy P. Looney (Registered Principal, Shreveport, Louisiana) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $120,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Looney consented to the described sanctions and to the entry of findings that he received five checks totaling $74,508.94 from a public customer for the purpose of purchasing a fixed annuity and, instead, converted the funds to his own use and benefit without the customer's knowledge or consent. In addition, the NASD found that Looney failed to respond to NASD requests for information.

Garland W. H. McDonald (Registered Representative, Mesa, Arizona) submitted an Offer of Settlement pursuant to which he was fined $100,000, barred from association with any NASD member in any capacity, and required to provide proof of restitution in the amount of $67,010.45 to customers plus per annum interest at the rate of 10 percent.

Without admitting or denying the allegations, McDonald consented to the described sanctions and to the entry of findings that he misrepresented to public customers that they could purchase certain interest bearing notes at a discount from him. According to the findings and based on these representations, the customers gave McDonald $67,010.45 for investment in these notes. Moreover, the findings stated that McDonald failed to invest these funds for the benefit of the customers and, instead, deposited the monies into his business bank account for his own benefit, and provided fabricated order tickets, confirmations, or receipts that implied the notes were being sold through his member firm.

Joseph R. Mulally (Registered Representative, Sinking Spring, Pennsylvania) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Mulally forged the endorsement of an insurance customer on a $2,563.28 check and deposited the check to his own bank account without the customer's authorization or consent. Mulally also failed to respond to NASD requests for information.

Robert J. Niichel (Registered Representative, Littleton, Colorado) was fined $25,000 and

barred from association with any NASD member in any capacity. The sanctions were based on findings that Niichel instructed his member firm to change the addresses on the accounts of public customers to reflect addresses at which these customers did not reside in an attempt to circumvent state registration requirements. Niichel also failed to respond to NASD requests for information.

William Felbert Nowlin, III (Registered Representative, Los Angeles, California) was fined $100,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Nowlin solicited a public customer to purchase stock and received from the customer a $10,200 check for payment of the stock. However, Nowlin failed to purchase any stock for the customer or return any funds to the customer. Instead, he converted the funds by depositing the check into the personal securities account of another registered representative and led the representative to believe that the money being deposited was to be used to purchase securities on Nowlin's behalf.

In addition, regarding an NASD investigation into the above activities, Nowlin willfully made or caused to be made an untrue statement of a material fact or omitted to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.

Joseph H. O'Brien, II (Registered Principal, New York, New York) was fined $5,000, barred from association with any NASD member in any capacity, and required to pay $7,500 in restitution to a public customer. The NBCC imposed the sanctions following appeal of a New York DBCC decision. The sanctions were based on findings that O'Brien withdrew $15,000 from the account of a public customer and converted the funds to his own use and benefit without the customer's authorization, knowledge, or consent.

O'Brien has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Robyn Lynn Ruppert O'Leary (Registered Representative, St. Louis, Missouri) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, O'Leary consented to the described sanction and to the entry of findings that on several occasions, she sent written communications to public customers that contained material misstatements or omissions of facts, unwarranted claims and opinions, and failed to make certain disclosures including the risks involved. In addition, the NASD found that O'Leary recommended and executed sales of shares of a growth fund and purchases of a common stock for the securities accounts of public customers without having reasonable grounds for believing that the recommendations were suitable in view of the nature and size of the recommended transactions and the customers' investment objectives, financial situations, and needs.

Lloyd Dwight Pankey (Registered Principal, Spokane, Washington) submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Pankey consented to the described sanction and to the entry of findings that he engaged in outside business activities without giving his member firm prompt written notice. The findings also stated that Pankey engaged in private securities transactions while failing to provide prior written notice to his member firm and engaged in the solicitation, sales, and supervision of securities sales through an unregistered broker/dealer.

Douglas Lee Parker (Registered Representative, Iron River, Michigan) was fined $70,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Parker, on three occasions, received from public customers funds totaling $37,000 intended for investment purposes. Instead of purchasing the securities as instructed by the customers and without their knowledge or consent, Parker deposited the funds in a bank account he controlled, retained the monies, and used the proceeds for his own benefit until a later date. In addition, Parker failed to respond to NASD requests for information.

Douglas G. Powell (Registered Representative, West Palm Beach, Florida) was fined $45,000, barred from association with any NASD member in any capacity, and required to pay $4,683 in restitution to public customers. The sanctions were based on findings that Powell effected the purchase of shares of a common stock for the joint securities account of public customers without their knowledge or consent. In addition, Powell failed to respond to an NASD request for information.

Douglas J. Quick, Jr. (Registered Representative, Lindenhurst, New York) was fined $50,000 and barred from association with any

NASD member in any capacity. The sanctions were based on findings that Quick forged the signature of a public customer on a letter of authorization causing the transfer of $9,400 from the customer's securities account to Quick's personal account. To conceal this activity, Quick forged a change of address request form for the same customer and presented it to his member firm to assure that the customer did not receive a monthly statement of account.

Douglas B. Reeves (Registered Principal, Cheyenne, Wyoming) was fined $100,000 and barred from association with any NASD member in any capacity. However, the fine is waived if restitution of $80,000 plus interest is paid to certain customers within 180 days.

Without admitting or denying the allegations, Reeves consented to the described sanctions and to the entry of findings that he misappropriated funds from various customers through the use of fraudulent misrepresentations. Specifically, the NASD found that Reeves requested the disbursement of a $200,000 check from the account of two customers without their consent. Reeves used the funds to pay shareholders of a former member firm he founded.

The NASD also determined that Reeves caused checks totaling $80,000 from a customer account to be endorsed and made payable to a corporation of which he was a majority shareholder, and deposited the funds in the corporation's account without the customer's knowledge. Thereafter, the findings stated that Reeves instructed a bookkeeper of the corporation to pay $65,000 of the funds to Reeves and to record the purchase of a debenture by the customer on the corporation's books and records. All of the above activity was also found by the NASD to violate Section 40 of the Rules of Fair Practice concerning private securities transactions.

The NASD also determined that Reeves instructed a customer to withdraw $25,000 from a mutual fund account and $50,000 from her securities account at the member firm he founded. Reeves then deposited the $25,000 check in his business account and provided the customer with a statement indicating that the funds had been invested in the firm he founded. However, she was not listed as a shareholder on the firm's books and records. Also, the NASD found that initially Reeves did not tell the customer what he intended to do with the $50,000, but later told her the funds were used for a specific investment purpose. However, the investment was never recorded by the company in which the customer's funds were allegedly placed.

The NASD also determined that Reeves sent correspondence to two public customers on a member firm's letterhead representing that the firm was providing a mortgage on real property to them. This letter included payment coupons that instructed the customers to remit their payments to the member firm's branch office for deposit into another customer's securities account. However, the firm did not lend money to the customers and neither the branch manager nor an acting principal of the member firm approved the correspondence. Finally, the NASD found that Reeves failed to respond to NASD requests for information.

This investigation was conducted by the Denver District Staff with the assistance of the Wyoming Securities Division.

Dale M. Russell (Registered Principal, LaVerne, California) was fined $53,287.45 and suspended from association with any NASD member in any capacity for seven days. The SEC affirmed the sanctions following appeal of a May 1992 NBCC decision. The sanctions were based on findings that Russell engaged in private securities transactions without giving prior written notification of such activity to his member firm.

Larry Samples (Registered Representative, Ypsilanti, Michigan) was fined $170,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Samples received from a public customer a $50,000 check with instructions to use the funds to purchase shares of stock. Samples failed to follow the customer's instructions, deposited the funds in an account in which he had a beneficial interest, and used the funds for some purpose other than for the benefit of the customer. Samples also failed to respond to NASD requests for information.

LeAnn Bobleter Sargent (Registered Representative, Minneapolis, Minnesota) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined $31,250 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sargent consented to the described sanctions and to the entry of findings that she misused the funds of a public customer by depositing a $6,250 check intended for a securities transaction into her personal bank account without the customer's knowledge or consent. In addition, the findings stated that Sargent failed to respond to an NASD request for information.

Michael Schklar (Registered Representative, Carmel, Indiana) was fined $50,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Schklar purchased and sold options for the accounts of public customers without their knowledge or consent and in the absence of written or oral authorization to exercise discretion in the customer accounts. Schklar also failed to respond to NASD requests for information.

Jeffrey R. Schultz (Registered Representative, Toledo, Ohio) was fined $100,000, barred from association with any NASD member in any capacity, and required to pay $15,438 in restitution to a public customer. The sanctions were based on findings that Schultz misappropriated $10,438 from three public customers and received $5,000 from another public customer for the purchase of shares of a mutual fund which were never purchased. In addition, Schultz failed to respond to NASD requests for information.

Stephen L. Shinham (Registered Representative, Frederick, Maryland) submitted an Offer of Settlement pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Shinham consented to the described sanctions and to the entry of findings that he prepared and submitted to his member firm a false statement disclosing that an individual witnessed a customer's signature on two insurance policy applications, when, in fact, Shinham knew that the individual had not witnessed these signings. In addition, the findings stated that Shinham induced the same individual to sign and submit to his member firm a statement falsely attesting that she witnessed the customer's signature on the two insurance policy applications.

Larry L. Simmons (Registered Representative, Oklahoma City, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was suspended from association with any NASD member in any capacity for six months and required to requalify by examination as a general securities representative. Without admitting or denying the allegations, Simmons 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.

The NASD also found that Simmons recommended and engaged in purchase transactions for shares of a limited partnership for the custodial accounts of a public customer without having reasonable grounds for believing that these recommendations and resultant transactions were suitable for the customer on the basis of her financial situation, investment objectives, and needs.

Kelly Suzanne Simpson (Associated Person, Monterey, California) was fined $5,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Simpson forged signatures to six checks totaling $551.76 and failed to respond to NASD requests for information.

Alfred J. Small (Registered Representative, Glen Cove, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $11,000, suspended from association with any NASD member in any capacity for 30 days, and required to pay $5,500 in restitution to a public customer within 30 days or be barred in any capacity until restitution is completed. Without admitting or denying the allegations, Small consented to the described sanctions and to the entry of findings that he executed three unauthorized transactions in the joint account of public customers without their knowledge or consent.

Small's registration was revoked for failure to pay restitution. The revokation is in effect until he has completed restitution.

David Ritchie Smith (Registered Principal, Sausalito, California) was fined $35,000, jointly and severally with other respondents, and barred from association with any NASD member in any principal or supervisory capacity. In addition, Smith was suspended for 90 days from association with any NASD member in any capacity.

The NBCC imposed the sanctions following appeal of a San Francisco DBCC decision. The sanctions were based on findings that a member firm, acting through Smith, failed to comply with the SEC's Customer Protection Rule 15c3-3 in that it received and accepted customer funds in contravention of its claimed exemption from the rule and did not otherwise comply with the full provisions of the rule. In addition, the firm, acting through Smith, failed to file its FOCUS Part II reports on a timely basis, to establish adequate written supervisory procedures, or to implement a supervisory system to prevent violations and achieve compliance with securities rules and regulations.

Smith has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Gloria Mae Smith (Registered Representative, Ocala, Florida) was fined $100,000, barred from association with any NASD member in any capacity, and required to pay $34,318.47 in restitution to her member firm. The sanctions were based on findings that Smith directed her member firm to issue 40 checks totaling $34,318 from the life insurance policies of public customers and directed that the checks be sent to a post office box that she maintained and controlled. Smith then negotiated said checks by forging the customers' signatures and applied the proceeds to her own use and benefit.

Joseph Herschel Stafford (Registered Representative, Houston, Texas) was fined $25,000, barred from association with any NASD member in any capacity, and required to pay $8,000 in restitution to a public customer. The sanctions were based on findings that Stafford recommended to a public customer the purchase and sale of securities without having reasonable grounds for believing that such recommendations were suitable for the customer based upon her financial situation and needs. In addition, Stafford failed to respond to NASD requests for information.

Allen Dewitt Suggs, Jr. (Registered Representative, Middleburg, Florida) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Suggs failed to respond to an NASD request for information concerning the discrepancies between a written statement that he previously provided to the NASD staff and his sworn testimony given during a related proceeding in state court.

Kelly Sutton (Registered Principal, Flower Mound, Texas), John Y. Cole (Registered Representative, Dallas, Texas), Robert R. Romero (Registered Principal, Pflugerville, Texas), and **Robyn L. Reagan (Registered Representative, Dallas, Texas)** submitted Offers of Settlement pursuant to which Sutton was fined $10,000. Cole was fined $15,000, suspended from association with any NASD member in any capacity for 10 business days, and required to requalify by examination as a general securities representative. Romero was fined $15,000, suspended from association with any NASD member in any capacity for 10 days, and required to requalify by examination as a general securities principal. In addition, Reagan was fined $20,000, suspended from association with any NASD member in any capacity for 20 days, and required to requalify by examination as a general securities representative.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Sutton, Cole, Romero, and Reagan executed or caused to be executed unauthorized transactions in the accounts of public customers without their knowledge or consent. The findings also stated that Cole, Romero, and Reagan engaged in high-pressure sales tactics with respect to sales solicitations made to public customers. In addition, the NASD found that Reagan failed and refused to execute promptly the instructions of a public customer to sell securities.

Peter Theodorellis (Registered Representative, Brooklyn, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $55,000, barred from association with any NASD member in any capacity, and required to pay $32,233 in restitution to public customers. Without admitting or denying the allegations, Theodorellis consented to the described sanctions and to the entry of findings that he executed 104 unauthorized transactions in the joint account of public customers without their knowledge or consent. In addition, the NASD found Theodorellis forged the signatures of the same customers to an option agreement and approval form and a margin agreement.

Jon J. Vargo (Associated Person, Edison, New Jersey) submitted an Offer of Settlement pursuant to which he was fined $10,000, barred from association with any NASD member in any capacity, and required to pay $20,537.50 in restitution to public customers. Without admitting or denying the allegations, Vargo consented to the described sanctions and to the entry of findings that he solicited and received checks totaling $20,537.50 from public customers for the purchase of shares of a common stock, deposited the checks into the bank account of a company other than his member firm, and failed to issue written notification of the purchase or to return the funds to the customers. In addition, Vargo failed to register or qualify as a general securities principal while being actively involved in the management of a member firm.

James G. Wagner (Registered Representative, Elkton, Maryland) was fined $35,000 and barred from association with any NASD member in any capacity. The fine will be reduced by any amount which Wagner can demonstrate, to the satisfaction of the NASD, that he has paid in restitution to a customer. The sanctions were based on findings that Wagner exercised discretion in the account

of a public customer without obtaining prior written authorization from the customer and without having the discretionary account accepted in writing by his member firm. In addition, these transactions were excessive in size and frequency in view of the nature and financial resources of the account. Moreover, Wagner guaranteed the customer against past and future losses in his securities account and failed to respond to NASD requests for information.

Henry Clarence White (Registered Representative, Cleveland, Ohio) was fined $50,000, barred from association with any NASD member in any capacity, and required to pay $5,000 in restitution to a public customer. The sanctions were based on findings that White misappropriated and converted to his own use customer funds totaling $5,000. In addition, White failed to respond to NASD requests for information.

Jody L. Williams (Registered Representative, Virginia Beach, Virginia) was fined $25,000, barred from association with any NASD member in any capacity, and ordered to pay restitution to the parties whose funds he converted. The sanctions were based on findings that Williams withdrew $450 from a public customer's account and converted the funds to his own use and benefit. Williams also failed to respond to NASD requests for information.

Robert T. Williams (Registered Representative, Holbrook, New York) was fined $30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Williams executed unauthorized transactions in the accounts of public customers without their knowledge or consent. In addition, Williams failed to respond to NASD requests for information.

Samuel L. Williams (Registered Principal, Pompano Beach, Florida) was fined $125,000, barred from association with any NASD member in any capacity, and required to pay $195,625.22 in restitution to a public customer. The sanctions were based on findings that Williams prepared, maintained, and provided to 32 public customers false securities position and activity statements. In addition, Williams received from a public customer $195,625.22 intended for investment purposes and, instead, converted the funds to his own use and benefit without the customer's knowledge or consent. Williams also failed to respond to NASD requests for information.

Garry R. Winsett (Associated Person, Fairhope, Alabama) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was barred from association with any NASD member in any capacity and required to pay $68,000 in restitution to the appropriate parties. Without admitting or denying the allegations, Winsett consented to the described sanctions and to the entry of findings that he failed to amend his *Uniform Application for Securities Industry Registration and Transfer* (Form U-4) to reflect an investigation by the State of Georgia. In addition, the NASD found that Winsett failed to notify his member firm in writing that he maintained a personal securities account with another member firm, and failed to notify the other firm that he was employed by his member firm.

Jerry N. Wood (Registered Representative, Tulsa, Oklahoma) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $120,000, barred from association with any NASD member in any capacity, and required to pay $890,000 in restitution to the appropriate parties. Without admitting or denying the allegations, Wood consented to the described sanctions and to the entry of findings that he caused checks totaling $1,275,263 to be issued from the accounts of 22 public customers. Thereafter, the findings stated that Wood endorsed and deposited the checks into his personal checking account, thereby converting the funds to his own use and benefit without the customers' knowledge or consent.

The findings also stated that Wood forged the signatures of two public customers to letters of authorization in order to direct funds into two other customer accounts, and altered the account statement of a public customer in an effort to conceal an apparent conversion of funds. In addition, the NASD found that Wood failed to respond to NASD requests for information.

Karen A. Yoos (Associated Person, Baltimore, Maryland) was fined $7,500 and barred from association with any NASD member in any capacity. The NBCC affirmed the sanctions following appeal of a Washington, D.C., DBCC decision. The sanctions were based on findings that Yoos submitted to a public customer four falsified mutual fund statements for the customer's custodian accounts reflecting transactions that had not yet occurred.

Individuals Fined

Wendell D. Belden (Registered Principal, Tulsa, Oklahoma) submitted an Offer of Settlement pursuant to which he was fined $25,000. Without admitting or denying the allegations, Belden

consented to the described sanction and to the entry of findings that he provided the general public with misleading sales literature that omitted and misstated material facts, and failed to meet applicable standards. Furthermore, the NASD found that this sales literature was used prior to obtaining written supervisory approval and was not submitted to the NASD Advertising Department within 10 days of its first use. The findings also stated that Belden distributed to the general public sales literature that did not clearly set forth the name of a registered broker/dealer. In addition, the NASD determined that, in violation of the provisions of Article I of Schedule C of the NASD By-Laws, Belden advertised, operated, and effected securities transactions through an unregistered broker/dealer.

Anthony J. Parisi (Registered Representative, Scottsdale, Arizona) was fined $20,000 and required to provide proof of restitution to a customer in the amount of $6,830.38 plus interest. The sanctions were based on findings that, in violation of the Policy of the Board of Governors entitled "Fair Dealing With Customers," Parisi made misrepresentations to a public customer to induce the improper trading of mutual fund shares in the customer's account.

Firms Expelled for Failure to Pay Fines, Costs, and/or Provide Proof Of Restitution in Connection With Violations

Gliksman Securities Corporation, Marina Del Rey, California

Wilshire Discount Securities, Incorporated, Riverside, California

Firms Suspended

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of Article IV, Section 5 of the NASD Rules of Fair Practice and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after each entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

A.C. Masingill & Associates, Inc., Knoxville, Tennessee (September 30, 1993)

APAI Corporation, New York, New York (September 30, 1993)

Bowers, Thompson & Co., Inc., Indianapolis, Indiana (September 30, 1993)

Enterprise Development, Inc., Columbia, South Carolina (October 12, 1993)

Lucas & Rogers, Inc., Chicago, Illinois (September 30, 1993 to October 4, 1993)

Individuals Whose Registrations Were Revoked for Failure to Pay Fines, Costs, and/or Provide Proof Of Restitution in Connection With Violations

Jeffrey R. Boak, Chapel Hill, North Carolina

Hector C. Carreno, Dallas, Texas

Kenneth R. Clark, Laramie, Wyoming

David J. Dambro, Aurora, Colorado

Robert A. Eilenberger, Denver, Colorado

Anthony G. Galante, Las Vegas, Nevada

Michael J. Janik, Cherry Hill, New Jersey

Ellen L. Margaretten, North Miami, Florida

David E. Mauk, Seattle, Washington

Calvin T. McKibben, Richardson, Texas

Raymond E. Moore, Santa Rosa, California

Stephen E. Parker, Little Rock, Arkansas

Frank P. Ravenna, Jr., Pomona, New York

Robert R. Ruppert, Newport Beach, California

Dale M. Russell, La Verne, California

Tracy L. Sams, Huntsville, Alabama

Jim D. Swink, Jr., Little Rock, Arkansas

Gregory A. Winn, Plano, Texas

NASD Assesses More Than $400,000 in Fines Against Hermitage Capital Corporation, 30 Individuals

The NASD took disciplinary action against Hermitage Capital Corporation of Nashville, Tennessee, Beverly W. Landstreet, IV, its president, and 29 other individuals, in connection with the underwriting and sale of shares of

Radiation Care, Inc. (RCI).

Pursuant to a Letter of Acceptance, Waiver, and Consent, in which the firm neither admitted nor denied the allegations, Hermitage was censured, fined $100,000, and suspended from participation in any underwriting activity for six months, with the exception of selling group participation that does not involve primary record-keeping responsibilities. Hermitage also agreed to install new management within 180 days and to submit to a reapplication proceeding subject to the approval of the New Orleans DBCC. In addition, Landstreet was censured, fined $25,000, and suspended from association with any NASD member in any principal capacity for six months.

The NASD found that Hermitage, acting through Landstreet, in a new issue public offering of the stock of RCI in 1992, failed to prepare and maintain accurate books and records; to ensure that the escrow agent was properly investing the escrowed funds received from the offering; and to prepare and maintain customer confirmations for RCI purchases that contained required disclosure. In addition, the firm, acting through Landstreet, violated the NASD Free-Riding and Withholding Interpretation by selling shares of RCI, a "hot issue," to restricted persons. The Interpretation, designed to ensure that a bona fide offering is made to the investing public, prohibits sales of hot issues to various categories of restricted persons.

The NASD also took action against 29 registered individuals, associated with other NASD member firms who purchased shares of the RCI offering, in violation of the NASD Free-Riding and Withholding Interpretation, which specifically prohibits the sale of hot issues to securities industry officials and employees. The NASD has censured each of these individuals and assessed monetary penalties totaling $317,717.50. In addition, three of the individuals have consented to bars from association with any NASD member in any capacity.

These disciplinary actions were taken by the NASD's New Orleans DBCC that exercises jurisdiction over members with main and branch offices in Louisiana, Mississippi, Alabama, Arkansas, Tennessee, Oklahoma, and Kentucky.

NASD Announces Disciplinary Action Against Prudential Securities Incorporated

The NASD has taken disciplinary action against Prudential Securities Incorporated (PSI) in connection with sales of limited partnership offerings during the 1980s.

Pursuant to a Letter of Acceptance, Waiver and Consent (AWC), in which PSI neither admitted nor denied the allegations, PSI was censured, fined $5 million, and agreed to adopt several meaningful remedial procedures designed to prevent the recurrence of the misconduct that is the subject of this action. The NASD's disciplinary action was taken in conjunction with settlements reached with the SEC and state regulatory agencies.

The SEC settlement embraces an SEC Order Instituting Public Proceedings, Making Findings and Imposing Sanctions (including ordering PSI to adopt, implement, and maintain certain remedial measures) and a Final Order entered by a Federal District Court pursuant to Section 21(e) of the Securities Exchange Act of 1934. The Order, among other things, provides for PSI to pay $330 million into a Claims Fund established for investors having eligible claims for compensatory damages and establishes an expedited Claims Resolution Process supervised by a court approved Claims Administrator. This settlement was reached in coordination with the NASD, the SEC, and a Special Task Force of the North American Securities Administrators Association (NASAA).

"The $5 million fine levied in this action, in addition to other significant remedial measures, sends a clear message to securities firms: when dealing with the investing public, they must be diligent in assuring that recommendations to customers are suitable, and that investors are properly provided with adequate disclosure of all risks," said John E. Pinto, NASD Executive Vice President, Regulation. "Importantly, the establishment of a Claims Fund of at least $330 million is a significant step toward safeguarding customer interests."

From 1980 through 1990, PSI sold approximately $8 billion of interests in more than 700 different limited partnership offerings to investors nationwide. The vast majority of the limited partnership interests PSI sold carried significant risks of loss, in that their financial success was largely dependent on the value of the assets in which the limited partnerships invested.

In numerous instances, PSI misrepresented speculative, illiquid limited partnerships as safe, income-producing investments, suitable for safety-conscious and conservative investors. As a result of these practices, PSI sold limited partnerships to a significant number of investors for whom the investments were not suitable in light of

the individuals' financial condition or investment objectives, and caused many other investors to purchase securities they would not otherwise have purchased if they had been adequately informed of the inherent risks of these types of partnership investments.

PSI's origination and marketing of limited partnerships was handled by the firm's Direct Investment Group (DIG). DIG was responsible for PSI's development of limited partnership offerings in conjunction with PSI's co-sponsors, the distribution of promotional materials, and the administration of PSI's subsequent participation in the business operation of many limited partnerships. In virtually every aspect of its operations, but particularly for its marketing and promotional efforts, DIG operated outside of PSI's existing supervisory and compliance structure.

PSI did not adequately supervise DIG personnel or monitor their marketing activities. DIG's promotional materials directed to its sales force contained materially false and misleading statements concerning limited partnerships that, in many instances, were contrary to prospectus disclosures and misrepresented the safety, potential returns, and liquidity of the relevant limited partnership investments.

The approximately $8 billion PSI raised in limited partnerships was invested principally in real estate, oil and gas producing properties, and aircraft leasing ventures. Limited partnership investors generally have suffered significant losses in recent years due to, among other factors, declining prices for these assets. Moreover, in many instances, the partnerships have substantially reduced or altogether ceased making cash distributions to their limited partners.

"This enforcement action reflects a greater overall scrutiny that the NASD has placed on sales practices in its periodic reviews of member firms," Pinto said. "Investors should know the NASD is taking an even harder look to ensure that they are treated fairly."

Pinto also praised the cooperative efforts of the SEC and NASAA indicating "this was an extensive and comprehensive investigation that demonstrates the effectiveness of the combined efforts of the NASD and federal and state agencies."

This disciplinary action was taken by the NASD's New York DBCC.

NASD Expels R.B. Webster Investments, Inc., Bars its President

The United States Court of Appeals for the Eleventh Circuit denied a motion by R.B. Webster Investments, Inc., of Lauderhill, Florida, and its president Robert Bruce Orkin of Coconut Creek, Florida, for a stay of NASD-imposed sanctions, pending the outcome of an appeal to the SEC. Therefore, the sanctions are effective immediately.

In the NASD disciplinary action, R.B. Webster and Orkin were censured and fined $200,000, jointly and severally, and ordered to pay $53,784 in restitution to customers. R.B. Webster was also expelled from NASD membership and Orkin was barred from association with any NASD member in any capacity. The disciplinary action was initiated by the NASD's Atlanta DBCC and the NASD's final decision was issued by its NBCC following an appeal.

The NASD found that R.B. Webster, acting through Orkin, effected principal transactions with public customers at unfair prices in units of Applied Geometrics, Inc. (Applied) and LMA Technical, Inc. (LMA) securities. Both issues were securities of "blind pool" companies traded over-the-counter and quoted in the pink sheets. The NASD found that R.B. Webster and Orkin had charged markups ranging from 10 to 138 percent for Applied units and from 10 to 84 percent for LMA units, in violation of the NASD Mark-Up Policy. In addition, the respondents used their domination and control of the market for Applied and LMA securities to manipulate the prices of such securities from the $10 initial public offering price to $27.50 in each case. Furthermore, the NASD found that the firm abused its dominant position in the market to set arbitrary prices and executed sales to the public at arbitrarily high prices.

The respondents then appealed the NASD decision to the SEC, and requested a stay of the sanctions pending SEC review of the disciplinary action against them. The SEC denied this request for a stay, citing among other reasons, the seriousness of the violations found by the NASD. The SEC stated, "While determination relating to applicants' conduct must await consideration of the merits of their appeal, excessive markup and market manipulation are serious violations . . . the denial of their [R.B. Webster and Orkin] stay request is outweighed by the need to protect the public interest." Respondents then appealed the SEC denial of a stay to the U.S. Court of Appeals for the Eleventh Circuit. The SEC filed a motion to dismiss the appeal and voluntarily consented to an interim stay while the Court considered the respondents' emergency motion for an interim stay. The

Court then denied the emergency motion of R.B. Webster and Orkin and granted the SEC motion to dismiss. Therefore, the sanctions of expulsion and bar are in effect.

The NASD investigation is part of a continuing nationwide effort by the NASD to eliminate trading and sales-practice abuses. "Obviously, the NASD is very pleased with the determination of the SEC and the U.S. Court of Appeals to permit the NASD's expulsion of R.B. Webster and bar of Orkin to take effect," said John E. Pinto, NASD Executive Vice President, Regulation. "We believe the interests of the investing public have been well served by closing R.B. Webster down and removing Orkin from the securities business."

For Your Information

Examination Revisions Announced

Effective January 1, 1994, some NASD examinations will reflect recent SEC rule changes. Please note these changes only affect those examinations that cover these rules.

• The Net Capital Rule (SEC Rule 15c3-1)—the changes to the minimum net capital requirements by class of broker/dealer, effective January 1 to June 30, 1994 (refer to *Notice to Members 92-60* and *Notice to Members 93-30*).

• Reports to Be Made by Certain Brokers and Dealers (SEC Rule 17a-5)—amendments to the rule give additional responsibilities to "designated examining authorities" (refer to *Notice to Members 93-70*).

• Notification Provisions for Brokers and Dealers (SEC Rule 17a-11)—amendments to the rule eliminate certain filing requirements. However, the requirements to give notice remain basically unchanged (refer to *Notice to Members 93-72*).

For further explanation, contact Carole Hartzog at (301) 590-6696.

NASD Member Firm Insurance Program Eligibility Enhancements

The NASD Member Firm Insurance Program provides member firms employing 2 to 50 persons with group insurance coverage. The program previously excluded contracted branch offices and contracted employees from eligibility. Such branch offices and employees are now eligible to apply to the program if they meet the definition of a small group. The NASD Member Firm Insurance Program, underwritten through The Travelers, offers qualified participants Major Medical, Dental, Term Life, and Accidental Death and Dismemberment insurance. Available in all states and the District of Columbia, the program is tailored to conform to each state's laws and regulations. For additional information on the program or assistance in determining your group's eligibility, please contact Seabury and Smith at (800) 321-1998; in the Washington, DC area call (202) 296-8030, extension 353 or 354.

NASD Member Voting Results

As a member service, the NASD publishes the result of member votes on issues presented to them for approval in the monthly *Notices to Members*. Most recently, members voted on the following issues:

• ***Notice to Members 93-50***—Proposed New Section to the Rules of Fair Practice Relating to the Respective Obligations and Supervisory Responsibilities of Introducing and Clearing Firms. Ballots For: 1,429; Against: 397; and Unsigned: 211.

• ***Notice to Members 93-51***—Proposed Amendment to the Corporate Financing Rule Relating to Fairness and Reasonableness of Anti-Dilution Provisions in Underwriters' Warrants, Options, and Convertible Securities. Ballots For: 1,600; Against: 280; and Unsigned: 154.

• ***Notice to Members 93-52***—Proposed Amendment Exempting Money Market Mutual Funds From Disclosure Requirements. Ballots For: 1,645; Against: 250; and Unsigned: 140.

Questions regarding these items should be directed to Stephen Hickman, President's Office, at (202) 728-8381.

NASD NOTICE TO MEMBERS 93-82

Mail Vote—NASD Solicits Member Vote on Proposed Amendment Exempting Money Market Mutual Funds From Disclosure Requirements; **Last Voting Date: January 31, 1994**

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [x] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [ ] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [x] Mutual Fund
- [ ] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [ ] Systems
- [ ] Trading
- [ ] Training

Executive Summary

The NASD invites members to vote on a revised proposed amendment to Article III, Section 26(d)(4) of the Rules of Fair Practice to exempt money market mutual funds with asset-based sales charges equal to or less than .25 of 1% of net assets (or 25 basis points) from the required disclosure under that subsection that "long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charge permitted by this section." The last voting date is January 31, 1994. The text of the proposed amendment follows this Notice.

Background

On July 7, 1993, new rules governing investment company sales charges took effect under Article III, Section 26(d) of the Rules of Fair Practice. The NASD has received several applications for exemption from Subsection 26(d)(4), which requires that the prospectus for an investment company with an asset-based sales charge must disclose that "long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by this section." The applications noted that the rule language is specific and requires the disclosure, even if the statement may not be true for a particular mutual fund.

The applicants pointed out that in the case of a money market mutual fund, there is a high probability that the statement will be inaccurate because such funds generally have very low asset-based sales charges and an investor would have to be a shareholder for an extremely long time before the disclosure would be true. According to one applicant, a shareholder of its fund would have to remain in the fund for more than 55 years before exceeding the maximum front-end charge. The applicants suggest that since money market mutual funds are traditionally short-term investments or cash management vehicles, it is unlikely that investors will stay in such funds for lengthy periods. As a result, they believe that the disclosure may be misleading, or at least confusing, to investors in money market mutual funds.

The NASD published the proposed rule change for member vote in *Notice to Members 93-52* (September 1993). After publication of the proposal for vote, the Securities and Exchange Commission (SEC) notified the NASD that it objected to the rule change as proposed because for certain money market funds with high asset-based sales charges (50 basis points or more) the disclosure statement would be accurate. For example, a fund with an asset-based sales charge of 50 basis points and a 3 percent return on investment would reach the economic equivalent of the maximum front-end sales charge permitted by Subsection 26(d) in approximately 14 years. Accordingly, the NASD is proposing to amend the proposed rule change to limit the exemption to money market mutual funds with asset-based sales charges of 25 basis points or less. Because this amendment to the proposed rule change represents a material change to the original proposal, the NASD is asking that members vote on the amended proposed rule change.

Request for Vote

The Board of Governors agrees with the arguments of the applicants and the comments of the SEC. Accordingly, it has determined to

recommend amending Subsection 26(d)(4) to exempt money market mutual funds with asset-based sales charges of 25 basis points or less from the disclosure requirement. The Board does not believe that requiring funds to include disclosure statements in such circumstances serves any identifiable purpose nor does it advance any recognizable regulatory interest.

The Board considers the proposed amendment necessary and appropriate and recommends that members vote their approval. The text of the proposed new rule that requires member vote is below. Please mark the attached ballot according to your convictions and mail it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be postmarked **no later than January 31, 1994**. The amendment would not take effect until it is filed with and approved by the SEC.

Questions regarding this Notice may be directed to R. Clark Hooper, Vice President, Investment Companies Regulation Department, (202) 728-8329, or Elliott R. Curzon, Senior Attorney, Office of General Counsel, (202) 728-8451.

Text of Proposed Amendment to Article III, Section 26 of the Rules Of Fair Practice

(**Note:** New language is underlined.)

Investment Companies

Sec. 26

* * * * *

(d) (4) No member or person associated with a member shall offer or sell the securities of an investment company with an asset-based sales charge unless its prospectus discloses that long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by this section. Such disclosure shall be adjacent to the fee table in the front section of a prospectus. <u>This subsection shall not apply to money market mutual funds which have asset-based sales charges equal to or less than .25 of 1% of average net assets per annum.</u>

NASD Notice to Members 93-83

SEC Approves New Trade Reporting Requirements for Pre-Opening Transactions And Convertible Debt Transactions

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- ■ Trading
- □ Training

Executive Summary

Beginning December 20, 1993, members will be required to submit to the NASD trade reports of transactions in convertible debt securities listed on Nasdaq within 90 seconds after execution. Also on December 20, 1993, members executing trades between 9 and 9:30 a.m., Eastern Time (ET) in Nasdaq and over-the-counter (OTC) securities not listed on Nasdaq will be required to report those transactions within 90 seconds after execution to the NASD through the Automated Confirmation Transaction (ACT℠) service, utilizing the after-hours or ".T" symbol. The Securities and Exchange Commis-sion (SEC) has approved both of these rule changes, which appear in Schedule D to the By-Laws. The text of the rules follows the discussion below.

Background and Description of Amendments

The SEC has approved a new Part XIII to Schedule D to the By-Laws to require real-time trade reporting for convertible bonds listed on Nasdaq. Specifically, the requirements call for members to report all transactions in convertible debt securities for surveillance purposes within 90 seconds after execution, using the same reporting protocols as those for Nasdaq equity securities. The new rules also provide that only those transactions for 99 bonds or less will be disseminated real-time to the public starting in April 1994. The NASD is simultaneously eliminating the requirement for end-of-day volume reporting currently required for market makers in convertible debt securities.

Market makers trading convertible bonds now report end-of-day volume and last-sale information into the ACT service, which will be designated as the vehicle for trade-by-trade transaction reporting for convertible debt. The time frames for reporting will be identical to those for equity securities, within 90 seconds after execution. The rules also specify which party to a transaction is required to report (in most transactions, the market maker registered in the bond in Nasdaq is the reporting party) and provide reporting policies, such as reporting transactions at the selling or purchasing price, irrespective of markups, markdowns, or commissions. These requirements parallel those currently in place for Nasdaq equity securities.

For members that trade infrequently, the NASD will make the ACT service desk available for trade reporting purposes. The NASD operates the ACT service desk to facilitate members that average fewer than five trades a day and that do not have Nasdaq Workstation® equipment. Therefore, the ACT service desk will also be made available to members that average five or fewer bond trades a day.

In implementing real-time reporting for Nasdaq convertible debt securities, the NASD carefully evaluated its effect on the membership. The NASD recognizes that increased transparency in the relatively illiquid convertible bond market could have significant costs in terms of liquidity and dealer participation in such a market. Accordingly, the NASD will disseminate on a real-time basis beginning in April 1994 only the retail or "odd lot" transactions, defined in the rules as transactions of 99 bonds or less. With this limited dissemination of information, the NASD believes that the potential negative impact on liquidity caused by real-time dissemination of all transaction prices and volumes will be mitigated, and the public will be better served by see-

ing intra-day transactional data. Accordingly, the NASD believes that the extension of trade reporting to convertible debt securities listed on Nasdaq and the dissemination of the retail-type trade reports will not result in an adverse impact on the liquidity of those securities because of the limited amount of market-sensitive information that will be made available to the public on a real-time basis.

The SEC has also approved amendments to Schedule D of the NASD By-Laws and the Rules of Practice and Procedure for the Automated Confirmation Transaction service to require trade reporting for transactions in Nasdaq securities and OTC securities not listed on Nasdaq between the hours of 9 and 9:30 a.m., ET. Under the new rule, members must append ".T" to trade reports submitted between 9 and 9:30 a.m., ET, because these trades occur outside normal market hours.

The new rules require members to input the details of reportable transactions from 9 to 9:30 a.m., ET, into ACT to facilitate trade reporting, comparison, and vendor dissemination. Pre-opening transactions in SelectNet℠ during the 9 to 9:30 a.m., ET, session are already being processed and disseminated, and ACT will now be used to capture reports of trades executed outside of SelectNet during that time period. The changes mandate reporting of such trades through ACT within 90 seconds of execution. This requirement also reduces the use of Form T for reporting transactional data to the NASD and ensures that all trades in Nasdaq and OTC securities occurring between 9 and 9:30 a.m., ET, are fully integrated into the NASD's audit trail file.

The reporting requirements are effective December 20, 1993.

Questions regarding this Notice may be directed to Market Surveillance at (301) 590-6080 or to Beth E. Weimer, Associate General Counsel, at (202) 728-6998.

Text of New Rules

(**Note:** New language is underlined; deletions are in brackets.)

SCHEDULE D

PART V

REQUIREMENTS APPLICABLE TO NASDAQ MARKET MAKERS

Sec. 5 Reports

[(a) Daily. A market maker shall report to the Automated Confirmation Transaction service each business day between 4:10 p.m. and 5:00 p.m. Eastern Time its daily volume, which shall be determined by the larger of total aggregated purchases or sales relating to convertible debt securities in which it is registered as a Nasdaq market maker. If a market maker has not executed transactions in a convertible debt security in which it is registered as a market maker on that business day, no report on that security need be submitted.

Daily volume reports shall be entered via the Automated Confirmation Transaction service. In cases of equipment malfunction or failure, volume reports shall be telephoned to Nasdaq Operations-Members.

A market maker shall also report to the Automated Confirmation Transaction service each business day all other data relating to convertible debt securities quoted in the Nasdaq system as the Association shall require.

(b) Monthly. A market maker shall report monthly to the Automated Confirmation Transaction service such data on securities quoted in the Nasdaq system as the Association shall require.]

[(c) Other.] A market maker shall make such [other] reports to the Association as may be prescribed from time to time by the Association.

PART X

REPORTING TRANSACTIONS IN NASDAQ NATIONAL MARKET SYSTEM DESIGNATED SECURITIES

Sec. 2 Transaction Reporting

(a) When and How Transactions are Reported

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(4) Last sale reports of transactions in designated securities executed between 9:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(5) All members shall report weekly to the Market

Operations Department in New York City, on a form designated by the Board of Governors, last sale reports of transactions in designated securities executed outside the hours of [9:30] 9:00 a.m. and 5:15 p.m. Eastern Time.

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PART XI

REPORTING TRANSACTIONS IN NASDAQ SMALLCAP℠ SECURITIES

Sec. 2 Transaction Reporting

(a) When and How Transactions are Reported

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(4) Last sale reports of transactions in designated securities executed between 9:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(5) All members shall report weekly to the Market Operations Department in New York City, on a form designated by the Board of Governors, last sale reports of transactions in designated securities executed outside the hours of [9:30] 9:00 a.m. and 5:15 p.m. Eastern Time.

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PART XII

REPORTING TRANSACTIONS IN OVER-THE-COUNTER EQUITY SECURITIES

Sec. 2 Transaction Reporting

(a) When and How Transactions are Reported

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(3) Last sale reports of transactions in OTC Equity Securities executed between 9:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Last sale reports of transactions in OTC Equity Securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall also be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours.

(4) All members shall report weekly to the Market Operations Department in New York City, on a form designated by the Board of Governors, last sale reports of transactions in OTC Equity Securities executed outside the hours of [9:30] 9:00 a.m. and 5:15 p.m. Eastern Time.

PART XIII

REPORTING TRANSACTIONS IN NASDAQ CONVERTIBLE DEBT SECURITIES

This Part has been adopted pursuant to Article VII of the Corporation's By-Laws and sets forth the applicable reporting requirements for transactions in convertible bonds that are listed on Nasdaq ("designated securities"). Members shall utilize the Automated Confirmation Transaction Service ("ACT") for transaction reporting.

Sec. 1 Definitions

(a) Terms used in this Part shall have the same meaning as those defined in the Association's By-Laws and Rules of Fair Practice, unless otherwise specified herein.

(b) "Automated Confirmation Transaction Service" is the service that, among other things, accommodates reporting and dissemination of last sale reports in designated securities.

(c) "Registered Reporting Market Maker" means a member of the Association that is registered as a Nasdaq market maker in a particular designated security. A member is a Registered Reporting Market Maker in only those designated securities for which it is registered as a Nasdaq market maker. A member shall cease being a Registered Reporting Market Maker in a designated security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of the Corporation.

(d) "Non-Registered Reporting Member" means a member of the Association that is not a Registered Reporting Market Maker.

Sec. 2 Transaction Reporting

(a) When and How Transactions are Reported

(1) Registered Reporting

Market Makers shall, within 90 seconds after execution, transmit through ACT last sale reports of transactions in designated securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution.

(2) Non-Registered Reporting Members shall, within 90 seconds after execution, transmit through ACT or the ACT service desk (if qualified pursuant to Part VIII of Schedule D to the By-Laws), or if ACT is unavailable due to system or transmission failure, by telephone to the Market Operations Department in New York City, last sale reports of transactions in designated securities executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution.

(3) Non-Registered Reporting Members shall report weekly to the Nasdaq Operations Department in New York City, on a form designated by the Board of Governors, last sale reports of transactions in designated securities which are not required by paragraph (2) to be reported within 90 seconds after execution.

(4) Last sale reports of transactions in designated securities executed between 9:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted though ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall be transmitted through the ACT system within 90 seconds after execution; trades reported after 4:00 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(5) All members shall report weekly to the Market Operations Department in New York City, on a form designated by the Board of Governors, last sale reports of transactions in designated securities executed outside the hours of 9:00 a.m. and 5:15 p.m. Eastern Time.

(6) All trade tickets for transactions in eligible securities shall be time-stamped at the time of execution.

(7) A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principals of trade, in violation of Article III, Section 1 of the Rules of Fair Practice.

(b) Which Party Reports Transaction

(1) In transactions between two Registered Reporting Market Makers, only the member representing the sell side shall report.

(2) In transactions between a Registered Reporting Market Maker and a Non-Registered Reporting Member, only the Registered Reporting Market Maker shall report.

(3) In transactions between two Non-Registered Reporting Members, only the Member representing the sell side shall report.

(4) In transactions between a member and a customer, the member shall report.

(c) Information To Be Reported

Each last sale report shall contain the following information:

(1) Nasdaq symbol of the designated security;

(2) Number of bonds;

(3) Price of the transaction as required by paragraph (d) below;

(4) A symbol indicating whether the transaction is a buy, sell, or cross;

(5) The time of execution if the trade is reported more than 90 seconds after execution.

(d) Procedures for Reporting Price and Volume*

Members that are required to report pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) For agency transactions, report the number of bonds and the price excluding the commission charged.

(2) For dual agency transactions, report the number of bonds only once, and report the price excluding the commission charged.

(3) For principal transactions, except as provided below, report each purchase and sale transaction separately and report the

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* For examples of reporting procedures, refer to Part XII of this Schedule, "Reporting Transactions in Nasdaq National Market System Securities."

number of bonds and the price. For principal transactions that are executed at a price which includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, markdown or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the bond, the number of bonds involved in the transaction, the published bids and offers with size at the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction. Exception: A "riskless" principal transaction in which a member that is not a market maker in the security after having received from a customer an order to buy, purchases the bond as principal from another member or customer to satisfy the order to buy or, after having received from a customer an order to sell, sells the bond as principal to another member or customer to satisfy the order to sell, shall be reported as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down.

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) transactions which are part of a primary distribution by an issuer;

(2) transactions made in reliance on Section 4(2) of the Securities Act of 1933;

(3) transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the bond, e.g., to enable the seller to make a gift;

(4) purchases or sales of bonds effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire bonds at a preestablished consideration unrelated to the current market.

(f) Dissemination of Transaction Reports

The Association will collect and process trade reports on all transactions in convertible bonds listed on Nasdaq for surveillance purposes. On a real-time basis, the Association will disseminate to members and the public through the Nasdaq system and through securities information processors transactions in convertible debt listed on Nasdaq equalling 99 bonds or less.

• • • Interpretation of the Board of Governors

The Association seeks to emphasize the obligations of members to report transactions in designated securities within 90 seconds after execution. All transactions in designated securities not reported within 90 seconds after execution shall be reported as late, and the Association routinely monitors members' compliance with the 90 second requirement. If the Association finds a pattern or practice of unexcused late reporting, that is, repeated reports of executions in designated securities after 90 seconds without reasonable justification or exceptional circumstances, the member may be found to be in violation of Article III, Section 1 of the Association's Rules of Fair Practice. Exceptional circumstances will be determined on a case by case basis and may include conditions such as extreme volatility in a designated security, or in the market as a whole. Timely reporting of all transactions in designated securities is necessary and appropriate for the fair and orderly operation of the Association's marketplace, and the Association will view noncompliance as a rule violation.

NASD NOTICE TO MEMBERS 93-84

SEC Approves Amendments Prohibiting Certain Anti-Dilution Terms in the Warrant Agreements of Underwriters and Related Persons; **Effective Date: December 15, 1993**

Suggested Routing

- ■ Senior Management
- □ Advertising
- ■ Corporate Finance
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- ■ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On October 29, 1993, the Securities and Exchange Commission (SEC) approved amendments to the Corporate Financing Rule (Rule) under Article III, Section 44 of the Rules of Fair Practice to prohibit underwriters and related persons from accepting as underwriting compensation options, warrants, or convertible securities that (i) contain anti-dilution terms designed to provide the underwriter and related persons with disproportionate rights, privileges, and economic benefits that are not provided to the purchasers of the securities offered to the public, or (ii) contain terms that provide for the receipt or accrual of cash dividends before the exercise or conversion of the security.

The text of the amendment, which takes effect December 15, 1993, follows this Notice.

Background

The NASD recognizes that contracts between the company and investors that cover the issuance of options, warrants, and convertible securities may contain certain anti-dilution terms designed to protect the security holders from events that dilute their economic interest in the company. The NASD reviewed the anti-dilution terms contained in the contracts of underwriters and related persons for warrants received as underwriting compensation and found that underwriters and related persons sometimes negotiate to receive protection from dilution in their warrant contracts through certain "disproportionate" rights. These rights provide them with a larger number of shares upon exercise or lower exercise price than rights available to shareholders of the offering when events occur that do not affect all shareholders, such as additional issuances by the company, including issuances under stock option plans, or the conversion of existing convertible securities. The NASD found different variations of how adjustments to the exercise price and number of shares occur in response to such issuances of securities. Such variations included formulas that "weight" the effect of changes in the company's capitalization and that "rachet" the adjustment without regard to the actual dilutive effect of the new issuance of securities.

The NASD has determined that all variations of such disproportionate anti-dilution rights are unfair and unreasonable when not also provided to investors in the public offering. The receipt of such disproportionate benefits by underwriters and related persons, when such benefits are not received by other purchasers of the public securities, could result in the underwriter and related persons receiving securities as underwriting compensation in excess of 10 percent of the securities sold to the public in the offering, in violation of the Stock Numerical Limitation Rule contained in Subsection (c)(6)(B)(ix) of the Rule.

Description of Amendments

The NASD has adopted new Subsection (c)(6)(B)(vi)(7) of the Rule that defines as unfair and unreasonable the receipt by the underwriter and related persons of underwriting compensation consisting of any option, warrant, or convertible security that contains anti-dilution terms designed to provide the underwriter and related persons with disproportionate rights, privileges, and economic benefits that are not provided to the

purchasers of the securities offered to the public. To address circumstances where the security received by the underwriter and related persons is different from the security to be offered to the public, new Subsection (c)(6)(B)(vi)(7) also provides that the rights, privileges, and economic benefits received by underwriters and related persons may be compared to the rights, privileges, and economic benefits of the public shareholders of the issuer whose shares have a bona fide independent market, in compliance with Subsection (c)(5)(A) of the Rule.

New Subsection (c)(6)(B)(vi)(8) defines as unfair and unreasonable the receipt by the underwriter and related persons of underwriting compensation consisting of any option, warrant, or convertible security that contains anti-dilution terms that provide for the receipt or accrual of cash dividends before the exercise or conversion of the security. The NASD has determined that the receipt or accrual arrangement is unfair and unreasonable under the Rule because it provides the underwriter and related person with economic rights, privileges, and benefits that are more favorable than the benefits received by investors in the public offering.

Questions concerning this Notice may be directed to Paul Mathews or Eugene Buchanan, Supervisors, Corporate Financing Department, at (202) 728-8258.

Text of Amendments to the Corporate Financing Rule Under Article III, Section 44 of the Rules Of Fair Practice

(**Note:** New language is underlined; deleted language is bracketed.)

(c) Underwriting Compensation and Arrangements

(6)(B)(vi)(6) has a piggyback registration right with a duration of more than seven (7) years from the effective date of the offering;[or]

(7) has anti-dilution terms designed to provide the underwriter and related persons with disproportionate rights, privileges and economic benefits which are not provided to the purchasers of the securities offered to the public (or the public shareholders, if in compliance with subsection (c)(5)(A) above);

(8) has anti-dilution terms designed to provide for the receipt or accrual of cash dividends prior to the exercise or conversion of the security; or

Subsection (c)(6)(B)(vi)(7) of the Rule is renumbered Subsection (c)(6)(B)(vi)(9).

NASD NOTICE TO MEMBERS 93-85

SEC Approves Amendments to CMO Advertising Guidelines: **Effective Immediately**

Suggested Routing

- ■ Senior Management
- ■ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

The Securities and Exchange Commission (SEC) recently approved amendments to the Guidelines Regarding Communications With the Public About Collateralized Mortgage Obligations (CMO Guidelines) at Article III, Section 35 of the Rules of Fair Practice. The amendments add a definition of the term collateralized mortgage obligation (CMO) to the CMO Guidelines and require members to offer to customers educational material on CMOs which conveys certain important information. The text of the amendments, which are effective immediately, follows this Notice.

Background

The SEC recently approved amendments to the CMO Guidelines, adding a definition of the term collateralized mortgage obligation (CMO) and requiring members to offer to customers educational material on CMOs that conveys certain important information. The amendments result from the NASD's continuing program to enhance the regulation of sales practices in marketing CMOs to retail customers.

Definition of CMO

The CMO Guidelines adopted in early 1993 did not define the term "collateralized mortgage obligation." The NASD believes that defining the term collateralized mortgage obligation aids in understanding and interpreting the Guidelines. Accordingly, the amendments define the term. The definition is substantially identical to the one that is used by the Public Securities Association (PSA) in its educational materials. Under the definition, a CMO is a "multiclass bond backed by a pool of pass-through securities or mortgage loans." The relationship between a CMO and a real estate mortgage investment conduit (REMIC) is also described. For purposes of the NASD's rules, the terms CMO and REMIC are used interchangeably.

Educating Customers

The NASD believes the complexity of CMOs mandates that members take steps to ensure their customers are fully educated about CMOs. Accordingly, the amendments require members to offer investors an educational document or other material about CMOs. The amendment specifies that the document: (1) explain CMOs, including the various types of tranches; (2) discuss mortgage loans and mortgage securities; (3) explain the features of CMOs, including credit quality, prepayment rates and average lives, interest rates (including effect on values and prepayment rates), tax considerations, minimum investments, transaction costs, and liquidity; (4) discuss the questions an investor should ask before investing; and (5) contain a glossary of terms that may be helpful to an investor considering an investment.

The educational document may be similar to the PSA brochure, *An Investor's Guide to Real Estate Mortgage Investment Conduits REMICs*. In adopting the educational material provision, the NASD notes that the PSA brochure meets all of the requirements for an acceptable customer education document. The foregoing, however, does not constitute a recommendation or endorsement of the PSA brochure.

Questions regarding this Notice may be directed to R. Clark

Hooper, Vice President, Advertising/Investment Companies Regulation Department, (202) 728-8329, or Elliott R. Curzon, Senior Attorney, Office of General Counsel, (202) 728-8451.

Text of Amendment to the Guidelines Regarding Communications With the Public About Collateralized Mortgage Obligations at Article III, Section 35 of the Rules of Fair Practice

(**Note:** New text is underlined.)

Guidelines Regarding Communications With the Public About Collateralized Mortgage Obligations

1. General Considerations

For purposes of these Guidelines and the NASD's Rules, the term "collateralized mortgage obligation" (CMO) refers to a multiclass bond backed by a pool of mortgage pass-through securities or mortgage loans. CMOs are also known as "real estate mortgage investment conduits" (REMICs). As a result of the 1986 Tax Reform Act, most CMOs are issued in REMIC form to create certain tax advantages for the issuer. The terms CMO and REMIC are now used interchangeably.

In order to prevent a communication about CMOs from being false or misleading, there are certain factors to be considered, including, but not limited to, the following.

Product Identification

In order to assure that investors understand exactly what security is being discussed, all communications concerning CMOs should clearly describe the product as a "collateralized mortgage obligation." Member firms should not use proprietary names for CMOs as they do not adequately identify the product.

To prevent confusion and the possibility of misleading the reader, communications should not contain comparisons between CMOs and any other investment vehicle, including Certificates of Deposit.

Educational Material

In order to ensure that customers are adequately informed about CMOs, members are required to offer to customers educational material which covers the following matters:

- A discussion of CMO characteristics as investments and their attendant risks
- An explanation of the structure of a CMO, including the various types of tranches
- A discussion of mortgage loans and mortgage securities
- Features of CMOs, including: credit quality, prepayment rates and average lives, interest rates (including effect on values and prepayment rates), tax considerations, minimum investments, transactions costs and liquidity
- Questions an investor should ask before investing, and a glossary of terms that may be helpful to an investor considering an investment.

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NASD NOTICE TO MEMBERS 93-86

SEC Approves Amendment to Section 65(f)(1) of the Uniform Practice Code Relating to Resolution of Fails Resulting From Account Transfers; **Effective February 1, 1994**

Suggested Routing

- ■ Senior Management
- □ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- ■ Operations
- □ Options
- □ Registration
- □ Research
- □ Syndicate
- ■ Systems
- □ Trading
- □ Training

Executive Summary

On October 26, 1993, the Securities and Exchange Commission (SEC) approved an amendment to Section 65(f)(1) of the Uniform Practice Code (UPC) that clarifies the time frame within which members are required to initiate the resolution of fails resulting from account transfers. The text of the amendment, which takes effect February 1, 1994, follows the discussion below.

Background and Description of the Amendment

On October 26, 1993, the SEC approved an amendment to Section 65(f)(1) of the Uniform Practice Code (UPC) to clarify that the appropriate time frame for initiating the resolution of fails resulting from account transfers is 10 days after the date delivery is due. The measure applies to exceptions to certain types of securities for which a 30-days-after the date delivery is due is more appropriate.

The language of subsection 65(f)(1) of the UPC requires members to "promptly" resolve fails resulting from account transfers, as compared with NYSE Rule 412(c), which requires resolution of such fails within 10 days. The NASD determined that members should initiate a close-out within 10 days from the date delivery was due. However, to accommodate the wide variety of securities as well as associated delivery and transfer issues, typical of many over-the-counter securities, the amendment includes an exception to permit more time for certain types of securities, typical of the non-exchange market, for which a 10-day close-out period is not practicable.

For fail contracts resulting from customer account transfers, Section 65(f)(1) now requires the inclusion of such fails in the member's fail file, and requires the member to take steps to obtain physical possession or control of the failed securities, by initiating a buy-in procedure or otherwise, not more than 10 business days following the delivery date. The time frame within which a member is required to obtain taking possession or control of the failed securities is extended to 30 days for certain securities, including banker's acceptances, bond anticipation notes, certificates of deposit, commercial paper, FMAC certificates, FNMA certificates, foreign securities, GNMA certificates, limited partnership interests, municipal bonds, mutual fund shares (transferable), revenue anticipation notes, SBA certificates, and tax anticipation notes.

The amendment **takes effect February 1, 1994**. Questions regarding this Notice may be directed to Dorothy L. Kennedy, Assistant Director, Market Operations, at (203) 375-9609, and Robert J. Smith, Attorney, Office of General Counsel, at (202) 728-8176.

Text of Amendment to Section 65 of the Uniform Practice Code

(**Note:** New language is underlined; deleted language is bracketed.)

* * * * *

Uniform Practice Code

* * * * *

Customer Account Transfers

Sec. 65

* * * * *

(f)(1) Any fail contracts resulting from this account transfer proce-

dure shall be included in a member's fail file and [shall be promptly resolved according to applicable close-out and liability procedures], not later than 10 business days following the date delivery was due, the member shall take steps to obtain physical possession or control of securities so failed to receive by initiating a buy-in procedure or otherwise; provided, that with respect to the following types of securities or instruments, not later than 30 business days following the date delivery was due, the member shall take steps to obtain physical possession or control of securities so failed to receive by initiating a buy-in procedure or otherwise:

(A) banker's acceptances;

(B) bond anticipation notes;

(C) certificates of deposit;

(D) commercial paper;

(E) FMAC certificates;

(F) FNMA certificates;

(G) foreign securities;

(H) GNMA certificates;

(I) limited partnership interests;

(J) municipal bonds;

(K) mutual fund shares (transferable);

(L) revenue anticipation notes;

(M) SBA certificates; and

(N) tax anticipation notes.

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NASD NOTICE TO MEMBERS 93-87

NASD Provides Guidance for Reinvestment of Maturing Certificates of Deposit in Mutual Funds

Suggested Routing

- ■ Senior Management
- ■ Advertising
- □ Corporate Finance
- □ Government Securities
- □ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- ■ Mutual Fund
- □ Operations
- □ Options
- ■ Registration
- □ Research
- □ Syndicate
- □ Systems
- □ Trading
- ■ Training

Executive Summary

The NASD is publishing this Notice to remind members, particularly members affiliated with banks or participating in bank networking arrangements, of their obligations under the Rules of Fair Practice to disclose to customers the varying risks of investing the proceeds of deposits, such as a maturing Certificate of Deposit (CD), in a security, such as a mutual fund, collateralized mortgage obligation (CMO), or variable insurance product. Members and their sales persons should emphasize to customers that these securities products, while potentially providing attractive investment returns, are not the same as CDs, are not government insured, and have varying risks associated with them.

Background

In November 1991, the NASD published *Notice to Members 91-74* reminding members of their obligations to customers when marketing bond mutual funds as replacements for maturing CDs. With interest rates then at their lowest levels in 20 years, members were engaging in intensive marketing efforts offering customers with maturing CDs the opportunity to purchase bond mutual funds because of the funds' higher yields. This trend has persisted as interest rates have continued to fall.

With interest rates currently at or near 30-year lows, rolling over bank deposits or maturing CDs into new CDs or other depository instruments is unattractive to many investors. The NASD is reminding all members, and especially members with bank affiliations, members that participate in bank networking arrangements, and members that have marketed brokered CDs to their customers in the past, that they have a significant obligation in their oral as well as their written communications to provide customers, seeking non-depository alternatives to depository accounts, with full and fair disclosure of the material differences between the products, especially the greater degree of risk to capital that the customer may experience. Failure to provide adequate disclosure to customers, or engaging in certain marketing efforts with respect to replacements for depository instruments, may violate the NASD Rules of Fair Practice and subject members and their associated persons to disciplinary action.

While the advice contained in this Notice is primarily directed at mutual fund sales because the NASD believes many investors seeking alternatives to CDs or other depository instruments look first to mutual funds, members are advised that the general advice of this Notice—disclosure of risks to any customer moving from a guaranteed or insured investment such as a CD to another uninsured investment—is applicable to most other categories of investment alternatives.

Disclosure

The NASD believes that the appropriate disclosures for certain mutual fund investment alternatives should, at a minimum, include the following:

• For money market funds, investors should be advised that, although fund managers strive to maintain a stable net-asset value, the funds are not federally insured and there is no guarantee that a stable net-asset value will be maintained.

• For fixed-income or bond funds, investors should receive clear disclosures that, although such funds may pay higher rates than CDs, their net-asset values are sensitive to interest-rate movement and a rise in interest rates can result in a decline in the value of the customer's investment.

• For equity funds, while there may be less possibility that investors will confuse such funds with an insured product such as a CD, they should be clearly advised of the higher degree of risk to capital associated with equity mutual funds.

Bank Affiliated Members

Many first-time investors may use the services and products provided by a bank affiliated broker/dealer. This creates a higher level of responsibility on these members to ensure that investors understand the distinctions between the bank products and those offered by the broker/dealer, and that suitability and supervision standards are strictly followed. Members must develop procedures that require registered persons to reiterate to customers, in all oral and written communications, the material differences between their past dealings in insured depository instruments and investments in securities that carry risk to principal.

Further, bank affiliated members and members participating in bank networking arrangements have to be particularly sensitive to the potential for customer confusion about mutual fund purchases made at bank branch locations. To guard against customer confusion or misinformation, bank affiliated members and members participating in bank networking arrangements should consider taking certain precautions, including, but not limited to the following:

• Advertising and sales presentations should disclose that mutual fund shares purchased through banks are not deposits or obligations of, or guaranteed by, the bank and are not federally insured or otherwise guaranteed by the federal government. Members may wish to obtain signed, written acknowledgements from their customers that they have received and have understood these disclosures. Members should readvise their customers of these and other pertinent disclosures annually.

• Bank customers may enter the location with certain preconceived assumptions and expectations of the types of products and services available within the bank. Members are under a significant burden to ensure that the customer understands the differences in the products and services offered by the bank and those offered by the broker/dealer, and that the customer is not confused or misled by any misunderstanding or previous assumption, albeit inaccurate.

• Where banks permit their unregistered employees to discuss with customers the reinvestment of maturing CDs in mutual funds sold by the bank, members should advise their affiliates that unregistered employees should provide disclosures similar to those provided by members. Members should carefully review the activities of these unregistered employees to ensure that they do not require NASD registration. In addition, such members should advise their affiliates to use appropriate signs or labels near the investment area to distinguish the operation from the bank's traditional deposit-taking functions.

Finally, all members, including bank affiliated members and members participating in bank networking arrangements, are reminded that they are subject to the full scope of NASD regulations and are thus obligated to comply with various customer protection provisions in the NASD Rules of Fair Practice and other NASD Rules. Among these are the following:

• Article III, Section 1 of the Rules of Fair Practice, which requires members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

• Article III, Section 2 of the Rules of Fair Practice, which requires members to have reasonable grounds for believing that their recommendations to a customer are suitable for that customer.

• Article III, Section 15(d)(2) of the Rules of Fair Practice, which permits members to use negative-response letters in connection with certain bulk exchanges of money market mutual funds under certain conditions.

• Article III, Section 18 of the Rules of Fair Practice, the NASD's general antifraud provision, which prohibits members from employing fraud, deception, or other manipulative practices in the sale of securities.

• Article III, Section 21(c) of the Rules of Fair Practice, which requires members to obtain and to maintain certain information about their customers.

• Article III, Section 26 of the Rules of Fair Practice, which governs the distribution of mutual fund shares with respect to sales charges, concessions, discounts, selling dividends, and disclosure, among

other matters.

• Article III, Section 27 of the Rules of Fair Practice, which imposes significant supervision obligations on member firms and also requires members to register branch locations with the NASD.

• Article III, Section 29 of the Rules of Fair Practice, which governs the distribution of insurance company variable contract products with respect to sales charges, selling agreements, and redemption.

• Article III, Section 35 of the Rules of Fair Practice, and the guidelines associated with the section, which sets forth advertising and sales literature filing requirements and general and specific rules governing member communications with the public.

• Paragraph 5266 of the *NASD Manual*, which prohibits breakpoint sales of mutual funds.

• Paragraph 5269 of the *NASD Manual*, which prohibits members from selling mutual fund shares at other than the public offering price.

The educational and regulatory initiatives discussed in this Notice are designed to help members meet their obligations to investors under the NASD Rules of Fair Practice and to prevent investor misunderstanding that could lead not only to dissatisfaction with mutual funds and other securities sold, but also to potential violations of NASD rules and regulations. NASD regulatory staff will be examining all members, including those who are bank affiliates and who are providing networking arrangements for banks, for compliance with such regulations.

If you have any questions concerning this Notice, please contact R. Clark Hooper, Vice President, Advertising/Investment Companies Regulation at (202) 728-8329 or your local NASD district office.

NASD NOTICE TO MEMBERS 93-88

SEC Approves Amendment Clarifying The Application of the NASD's Corporate Financing Rule to Rule 415 Shelf Offerings and Certain Canadian Securities; **Effective Date: February 1, 1994**

Suggested Routing

- ■ Senior Management
- □ Advertising
- ■ Corporate Finance
- □ Government Securities
- ■ Institutional
- □ Internal Audit
- ■ Legal & Compliance
- □ Municipal
- □ Mutual Fund
- □ Operations
- □ Options
- □ Registration
- □ Research
- ■ Syndicate
- □ Systems
- □ Trading
- □ Training

Executive Summary

On November 10, 1993, the Securities and Exchange Commission (SEC) approved an amendment to Subsection (b)(7)(C) to Article III, Section 44 of the Rules of Fair Practice clarifying that the exemptions from the filing requirements of the NASD's Corporate Financing Rule for securities registered on Forms S-3 or F-3 offered pursuant to Rule 415 under the Securities Act of 1933 (Securities Act) are limited to offerings that meet the eligibility criteria as set forth in these forms prior to October 21, 1992. In addition, the exemption for securities registered on Form F-10 under the Securities Act is amended to limit the exemption to Canadian issuers that meet the standards set forth in the SEC release approving that form and are offered pursuant to Canadian shelf-offering procedures. The text of the amendment, effective on February 1, 1994, follows the discussion below. In addition, attached is a copy of SEC registration statement Forms S-3 and F-3, prior to October 21, 1992, and Form F-10 as originally approved by the SEC.

Background

The Interpretation of the Board of Governors, Review of Corporate Financing (Corporate Financing Interpretation) was adopted in the early 1970s as an interpretation of the NASD basic ethical rule contained in Article III, Section 1 of the Rules of Fair Practice, which requires that "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." The purpose of the Corporate Financing Interpretation was to determine whether the offering terms and arrangements of public offerings filed with the NASD for review were fair and reasonable in accordance with Article III, Section 1 of the Rules of Fair Practice. To that end, it required that the NASD issue an opinion as to the fairness and reasonableness of underwriting terms and arrangements.

Although not defined in the Corporate Financing Interpretation, the term "public offering" is defined in Schedule E to the NASD By-Laws[1] to include any primary or secondary distribution of securities made pursuant to a registration statement or offering circular, except for offerings pursuant to Section 4(2) of the Exchange Act. Pursuant to the terms of the Corporate Financing Interpretation as of 1981, exemptions from the filing requirements of the Corporate Financing Interpretation were provided for certain specified classes of offerings that were regulated by other rules of the NASD, were under a specific scheme of regulation by other entities such as the SEC or the Treasury Department, or were subject to market forces that would assure the fairness and reasonableness of underwriting terms and arrangements of such offerings.

In 1982, the SEC adopted the Integrated Disclosure System, including new Form S-3[2]. Form S-3, the SEC's short-form registration statement, permits the issuer to

[1] The Corporate Financing Interpretation provided that definitions in the By-Laws or the Rules of Fair Practice have the meaning defined therein for purposes of the Interpretation unless the context requires otherwise. The discussion herein is based on the definition as of 1981.

[2] The financial criteria for Form S-3 was modified from that in Form S-16, with the other requirements for reporting history and default on debt remaining the same.

incorporate many of the required disclosure items by reference to the disclosure of the same items in filings under the Securities Exchange Act of 1934. On March 8, 1983, the NASD simultaneously issued *Notice to Members 83-12* (March 8, 1983) (1983 *Notice to Members*) and filed with the SEC Rule Filing SR-NASD-83-3[3] (1983 rule filing) for immediate effectiveness to clarify the availability of an exemption from the filing requirements of the Corporate Financing Interpretation for shelf offerings pursuant to new Rule 415.

The NASD stated in the 1983 *Notice to Members* and 1983 rule filing that exemptions to the Corporate Financing Interpretation filing requirements had previously been available where market forces or other constraints were present to assure the fairness and reasonableness of underwriting terms and arrangements, including specifically the amount of underwriting compensation. The 1983 *Notice to Members* and 1983 rule filing further stated that market pressures in Rule 415 transactions registered on Form S-3 often result in the amount of underwriting compensation being determined through a competitive bidding process that helps to achieve its reasonableness. Finally, the NASD stated it had concluded that even in transactions that eventually include a traditional underwriting agreement, competitive pressures come into play in the negotiations preceding the execution of the agreement that can be relied on to achieve the overall fairness of the agreements. An important clarification was provided in the 1983 *Notice to Members* and 1983 rule filing that offerings subject to the exemption were only exempt from the filing requirements of the Corporate Financing Interpretation and remained subject to the substantive requirements of the Interpretation.[4]

Subsequently, in 1988, the NASD issued *Notice to Members 88-101* (December 1988) in response to inquiries of members and their counsel for clarification regarding the Corporate Financing Department's review procedures for Rule 415 offerings. That Notice includes the following statement regarding the view of the Corporate Financing Committee as to the continuing rationale for the availability of the exemption for offerings registered on Form S-3 and offered pursuant to Rule 415:

> In connection with Rule 415 offerings, the Committee determined to exempt from the filing requirements securities registered on Form S-3 because an issue able to satisfy Form S-3's "registrant requirements" would be followed closely by investors and market professionals. The Committee also felt that the securities markets would efficiently determine a fair price for the securities being offered and that any underwriting compensation received by members ordinarily would be determined under very competitive circumstances (generally limited to normal brokerage transactions). The Committee did not believe that the same facts were present in Rule 415 offerings where the securities are registered on any form other than S-3.

In 1991, the NASD filed rule filing SR-NASD-91-19 with the SEC, which included a proposed codification of the Corporate Financing Interpretation as the new Corporate Financing Rule.[5] The Rule 415/S-3 exemption was included in the new Rule at Subsection (b)(7)(C) and specified that the exemption was also available for shelf offerings on Form F-3 consistent with the Corporate Financing Committee's earlier interpretation.

Subsequently, the SEC adopted the Multi-Jurisdiction Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers (MJDS) which adopted new forms for offerings in the U.S. by Canadian issuers[6], and the NASD adopted an exemption for offerings filed on new Form

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To use Form S-3, the issuer was required to have at least $150 million aggregate market value of voting stock held by non-affiliates or, alternatively, $100 million aggregate market value of voting stock held by non-affiliates and an annual trading volume of at least three million shares, except in the case of an offering of investment grade debt (i.e., debt rated in one of the four highest generic rating categories by a nationally recognized statistical rating organization).

[3] Securities Exchange Act Rel. No. 19648 (April 4, 1983); 48 F.R. 15358 (April 8, 1983).

[4] In 1984, in response to a request by the staff of the SEC for an interpretation of the filing requirements under the Corporate Financing Interpretation for foreign private issuers, the NASD determined to treat offerings on Form F-3 the same as offerings on Form S-3 by providing an exemption to the filing requirements if the offering is made pursuant to Rule 415 on the basis that the scheme of regulation on Form F-3 paralleled that for a company registering on Form S-3.

[5] The Corporate Financing Rule was adopted as Article III, Section 44 to the NASD Rules of Fair Practice on April 15, 1992, at which time the Corporate Financing Interpretation was rescinded. Securities Exchange Act Rel. No. 30587 (April 15, 1992); 57 FR 14597 (April 21, 1992).

[6] Securities Act Release No. 6902 (June 21, 1991).

F-10 by Canadian private and crown corporations and offered pursuant to Canadian shelf-offering rules.[7]

On October 21, 1992, the SEC approved an amendment to expand the availability of Form S-3 and to make Rule 415 registrations available to additional issuers as part of an effort to reduce the cost of financing through the securities markets.[8] The SEC's amendment to Form S-3 has reduced the reporting history requirement of Form S-3 from 36 to 12 months for most issuers, reduced the public float test from $150 million to $75 million, and eliminated the three-million-share volume requirement. Finally, no reporting history is required to rely on Form S-3 to register investment grade asset-backed securities. At the same time, the SEC amendments permitted the registration of a single shelf-registration statement covering debt, equity, and other classes of securities without a specific allocation of offering amounts among the classes of securities being registered.

Description of the Amendment

The NASD reviewed the SEC's amendments to Form S-3 in keeping with its prior history of considering amendments to the NASD's Corporate Financing Filing Requirements to coordinate with the SEC's amendments to its registration forms and rules. The NASD is obligated to ensure the fairness of underwriting terms and arrangements as a self-regulatory organization registered under Section 15A of the Securities Exchange Act of 1934. The NASD determined that investment grade non-convertible debt and investment grade non-convertible securities registered on amended Form S-3 should continue to be exempt from the Corporate Financing Rule Filing Requirements, regardless of the registration form relied on, under a separate exemption set forth in Section (b)(7)(B) of the Corporate Financing Rule.

The NASD, however, concluded it did not have sufficient information for the issuers that became eligible to file on Form S-3 to reach a determination that the Rule 415/S-3 exemption should be extended to the newly qualified issuers. Therefore, the NASD determined not to change its Filing Requirements at this time to provide an exemption for offerings by companies that meet the new requirements of Form S-3. The NASD will, however, undertake a one-year review of offerings filed with the NASD on registration statement Form S-3 and are offered pursuant to Rule 415 by companies that would not meet the prior criteria for Form S-3 to determine whether the market forces related to such offerings result in the presence of fair and reasonable underwriting terms and arrangements.

Accordingly, to clarify the Filing Requirements of the Corporate Financing Rule for issuers that now qualify to register on amended Form S-3, Section (b)(7)(C) of the Corporate Financing Rule is amended to provide that the exemption is only available for offerings that comply with Form S-3 pursuant to the requirements for that Form prior to October 21, 1992, which is the date of SEC approval of the amendments to Form S-3 expanding the availability of Form S-3 and making Rule 415 registrations available to additional issuers. The NASD believes the proposed rule change continues to ensure that compliance with the NASD's Corporate Financing Rule is effectively monitored.

Section (b)(7)(C) of the Corporate Financing Rule is also amended so that the exemption provided for shelf offerings on Form F-3 has been modified to reference the requirements for that Form prior to October 21, 1992, and the exemption for Form F-10 has been modified to reference the SEC release approving the MJDS. Although the SEC did not adopt amendments to these forms at the time it amended Form S-3, the NASD believes it should clarify all of these exemptions in the event amendments are adopted by the SEC in the future.

Policy for the Review of Shelf-Registration Statements

In determining not to expand the exemption from the Corporate Financing Rule at this time, the NASD recognizes its responsibility to ensure that application of the Rule does not impose a substantial burden on issuers. In this connection, it is important to note that the Corporate Financing Department has procedures to facilitate the expeditious review of shelf offerings. The NASD believes that publication of these procedures, as set forth below, will assist issuers, members, and their counsel to avail themselves of procedures that will expedite review of an offering pursuant to Rule 415 that is registered on SEC Form S-3 and avoid additional reviews of arrangements entered into in connection with

[7] Form F-10 may be used by Canadian issuers with outstanding equity with an aggregate market value of at least (CN) $360 million and a public float of at least (CN) $75 million, where the issuer has a reporting history with Canadian authorities of at least 36 months.

[8] Securities Act Rel. No. 6964 (October 22, 1992), 57 FR 48970 (October 29, 1992).

separate offerings off the shelf.

The procedures approved by the Corporate Financing Committee are as follows:

1. Where the participating NASD member(s) have not been determined, the issuer may file the offering with the NASD for potential NASD member participants.

2. All necessary documents should be filed as set forth in Section (b)(5) of the Corporate Financing Rule.

3. The cover letter to the filing should include all information in response to the items set forth under "Information Required to Be Filed" contained in Subsection (b)(6) of the Corporate Financing Rule requiring, among other things, estimates of the maximum underwriting compensation, maximum price per share, and maximum amounts of any other underwriting compensation, as well as a statement of any affiliations between the issuer and any NASD member, and any purchases of securities of the issuer made by any NASD member in the prior 12 months.

4. The Corporate Financing Department staff will render an opinion of no objections to the underwriting terms and arrangements if undertakings are received for the compensation and disclosure of the compensation in the offering document and that the Corporate Financing Department would be notified of any changes of issuer-member affiliation or purchases of the issuer's securities by a member.

5. In recognition of the market-timing issues associated with shelf offerings, the staff of the Corporate Financing Department are authorized to grant priority to the review of shelf offerings. To determine the timetable for a proposed shelf offering, NASD staff routinely contact counsel on the date the offering is filed.

Interpretation

In the SEC release[9] publishing the amendment for comment, the NASD stated in footnote 5 to the release that the Form S-3 and Form F-3 exemptions from the Corporate Financing Rule filing requirements cannot be used for offerings if the Rule 415 box is checked on the cover page of the registration statement but the securities are distributed in a single traditional underwriting arrangement shortly after effectiveness. The NASD position set forth in footnote 5 reflects the NASD's original intent to limit the Corporate Financing Rule filing exemption to "delayed basis" shelf offerings. The NASD recognizes that the circumstances under which registrants may claim reliance on Rule 415 was changed by the SEC's adoption of Rule 430A in 1987[10] —well after the NASD's 1983 adoption of the S-3/Rule 415 exemption. Rule 430A provided a registrant the flexibility to offer its securities during a five-day post-effective period without filing an amendment to the registration statement. If the registrant was uncertain at the time of filing whether or not the securities would be offered promptly after effectiveness or on a delayed basis under Rule 415, the SEC permitted the registrant to follow an administrative procedure to retain the option to proceed under either Rule 430A or Rule 415 for all or a portion of the registered securities.[11]

Registrants also may claim reliance on Rule 415 in the case where the registrant includes on a single registration statement securities to be offered shortly after effectiveness in a conventional underwritten offering and other securities (such as common stock underlying warrants and securities of selling shareholders) to be offered on a delayed basis in the future. In this case, the registrant would include undertakings in compliance with Rule 415 for the delayed offerings, but not for the conventional underwriting.

As a result of the ability of registrants to rely on Rule 430A and Rule 415 simultaneously and to register a conventional and delayed offering on the same registration statement, it has been argued that the act of "checking the Rule 415 box" on the cover page of the registration statement is sufficient for a member to rely on the S-3/Rule 415 exemption to the Filing Requirements of the Corporate Financing Rule. The Filing Requirements of

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[9] Securities Exchange Act Release No. 32316 (May 17, 1993); 58 F.R. 29672.

[10] Rule 430A permits the filing of a final prospectus that omits certain pricing and underwriting compensation information and interest payments and maturity dates so long as a prospectus with the final information is filed with the SEC within five days following the effective date of the offering.

[11] Securities Act Release No. 6964 (October 22, 1992), footnote 30 citing Securities Act Release No. 6714 (May 27, 1987). The SEC further expanded the ability of a registrant to rely on Rule 430A when it amended Form S-3 in 1992, by amending Form 430A to permit price changes and volume decreases that do not materially change the disclosure in the registration statement to be reflected in the final prospectus without the need to file a post-effective amendment. Previously, even immaterial decreases in the volume of securities offered and a pricing change outside of a bona fide range would have required the filing of a post-effective amendment. Securities Act Release No. 6964 (October 22, 1992).

the Corporate Financing Rule requires that all public offerings of securities be filed with the NASD for review if a member participates in the offering, unless an exemption from filing is available. The NASD believes that a claimed exemption from the Filing Requirements of the Corporate Financing Rule cannot be “potentially” or “possibly” available, or available under some circumstances and not others, or—in the case of a shelf registration—only available for a portion of the securities registered. It is, therefore, inappropriate for a member to rely on any of the available exemptions from the Filing Requirements of the Corporate Financing Rule if, at the time between the date when filing with the Corporate Financing Department would be required and the effective date of the offering, the member does not reasonably believe that the offering, including each tranche of securities off of a shelf registration, qualifies for an exemption. The member is required to review the facts and circumstances of the offering and must reasonably believe that the proposed manner of distribution satisfies an exemption from the Filing Requirements of the Corporate Financing Rule to rely on that exemption.

In particular, the NASD believes that “checking the Rule 415 box” on the cover page of a Form S-3 registration statement is not dispositive of the availability of the S-3/Rule 415 exemption under the Corporate Financing Rule as the Rule 415 election may relate solely to the future issuance of common stock underlying warrants or of common stock registered for selling shareholders and not to the registration on the same registration statement of securities of the issuer that are to be sold in a conventional underwriting shortly after effectiveness of the registration statement. Moreover, if a registrant relies on both Rule 430A and Rule 415 for an offering registered on Form S-3, the NASD believes that the offering is required to be filed for review under the Filing Requirements of the Corporate Financing Rule, as the simultaneous reliance on Rule 430A indicates that it is possible the securities may be sold in the form of a traditional underwriting syndicate within a few days following the effective date of the offering.[12]

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To assist members in determining whether an exemption from the Filing Requirements is available under Subsections (b)(7)(C)(i) and (ii) to Article III, Section 44 of the NASD Rules of Fair Practice, the NASD is attaching to this Notice a copy of Forms S-3 and F-3 as those forms existed before October 21, 1992, and a copy of Form F-10 as approved by the SEC on June 21, 1991.

The amendments take effect February 1, 1994. Questions regarding this Notice may be directed to the Corporate Financing Department of the NASD at (202) 728-8258.

Text of Amendment to Article III, Section 44 of the Rules of Fair Practice

(**Note:** New language is underlined; deleted language is bracketed.)

THE CORPORATE FINANCING RULE

Underwriting Terms and Arrangements

Sec. 44. (b) Filing Requirements

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(7) Offerings Exempt From Filing

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(C) offerings of securities:

(i) registered with the Securities and Exchange Commission on registration statement Forms S-3 or F-3 pursuant to the standards for those Forms prior to October 21, 1992 and offered pursuant to Rule 415 adopted under the Securities Act of 1933, as amended; [,] or

(ii) a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory, and is registered with the Securities and Exchange Commission on Form F-10 [(only with respect to Canadian issuers)] pursuant to the standards for that Form approved in Securities Act Release No. 6902 (June 21, 1991) and offered pursuant to [the home jurisdiction’s] Canadian shelf prospectus offering procedures;

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[12] In its release adopting the amendments to Form S-3, the SEC was asked regarding a practice that had developed in response to concerns about immediate underwritten sales of a large (or the entire) amount of securities offered pursuant to a registration statement that disclosed that the securities would be offered from time to time in the market, and did not disclose the terms of the distribution immediately after effectiveness. The SEC reminded registrants that disclosure in the registration statement at the time of effectiveness should accurately reflect the registrant’s current plans and arrangements for the distribution of securities and stated that compliance with the 48-hour waiting period is not an appropriate basis for relying on Rule 415. Securities Act Release No. 6964 (October 22, 1992).

FORM S-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

I. **Eligibility Requirements For Use of Form S-3.**

This instruction sets forth registrant requirements and transaction requirements for the use of Form S-3. Any registrant which meets the requirements of paragraph A. below ("Registrant Requirements") may use this form for the registration of securities under the Securities Act of 1933 which are offered in any transaction specified in paragraph B. below ("Transaction Requirements"), provided that the requirements applicable to the specified transaction are met. With respect to majority-owned subsidiaries, *see* paragraph C. below.

A. *Registrant Requirements.* All registrants must meet the following conditions in order to use this Form S-3 for registration under the Securities Act of securities offered in the transactions specified in paragraph B. below:

1. The registrant is organized under the laws of the United States or any State or Territory or the District of Columbia and has its principal business operations in the United States or its territories.

2. The registrant has a class of securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 or a class of equity securities registered pursuant to Section 12(g) of the Exchange Act or is required to file reports pursuant to Section 15(d) of the Exchange Act.

3. The registrant: (a) has been subject to the requirements of Section 12 or 15(d) of the Exchange Act and has filed all the material required to be filed pursuant to Section 13, 14 or 15(d) for a period of at least 36 calendar months immediately preceding the filing of the registration statement on this form; and (b) has filed in a timely manner all reports required to be filed during the 12 calendar months and any portion of a month immediately preceding the filing of the registration statement and, if the registrant has used (during the 12 calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25 (b) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by the rule.

4. Neither the registrant nor any of its consolidated or unconsolidated subsidiaries have, since the end of the last fiscal year for which certified financial statements of the registrant and its consolidated subsidiaries were included in a report filed pursuant to Section 13 (a) or 15 (d) of the Exchange Act: (a) failed to pay any dividend or sinking fund installment on preferred stock; or (b) defaulted: (i) on any installment or installments on indebtedness for borrowed money, or (ii) on any rental on one or more long term leases, which defaults in the aggregate are material to the financial position of the registrant and its consolidated and unconsolidated subsidiaries, taken as a whole.

5. A foreign issuer, other than a foreign government, which satisfies all of the above provisions of these registrant eligibility requirements except the provisions in paragraph A.I. above, relating to organization and principal business shall be deemed to have met these registrant eligibility requirements provided that such foreign issuer files the same reports with the Commission under Section 13(a) or 15(d) of the Exchange Act as a domestic registrant pursuant to paragraph 3 above.

6. If the registrant is a successor registrant, it shall be deemed to have met conditions 1, 2, 3, and 4 above if: (a) its predecessor and it, taken together, do so, provided that the succession was primarily for the purpose of changing the state of incorporation of the predecessor or forming a holding company and that the assets and liabilities of the successor at the time of succession were substantially the same as those of the predecessor, or (b) if all predecessors met the conditions at the time of succession and the registrant has continued to do so since the succession.

B. *Transaction Requirements.* Security offerings meeting any of the following conditions and made by registrants meeting the Registrant Requirements above may be registered on this form:

1. Primary Offerings by Certain Registrants.

Securities to be offered for cash by or on behalf of a registrant, or outstanding securities to be offered for cash for the account of any person other than the registrant, including securities acquired by standby underwriters in connection with the call or redemption by the registrant of warrants or a class of convertible securities;
provided that the aggregate market value of the voting stock held by non-affiliates of the registrant is $150 million or more, or alternatively, the aggregate market value of the voting stock held by non-affiliates of the registrant is $100 million or more and the registrant has had an annual trading volume of such stock of three million shares or more.

Instruction. The aggregate market value of the registrant's outstanding voting stock shall be computed by use of the price at which the stock was last sold, or the average of the bid and asked prices of such stock as of a date within 60 days prior to the date of filing. Annual trading volume shall be the volume of shares traded in any continuous 12 month period ended within 60 days prior to the date of filing. *See* the definition of "affiliate" in Securities Act Rule 405.

2. Primary Offerings of Certain Debt and Non-Convertible Preferred Securities.

Non-convertible debt and preferred securities to be offered for cash by or on behalf of a registrant, provided such securities are "investment grade securities," as defined below. A non-convertible debt or preferred security is an "investment grade security" if, at the time of effectiveness of the registration statement, at least one nationally recognized statistical rating organization (as that term is used in Rule 15c3-1 (c) (2) (vi) (F) under the Exchange Act) has rated the security in one of its generic rating categories which signifies investment grade; typically, the four highest rating categories (within which there may be sub-categories or gradations indicating relative standing) signify investment grade.

3. Transactions Involving Secondary Offerings.

Outstanding securities to be offered for the account of any person other than the issuer, including securities acquired by standby underwriters in connection with the call or redemption by the issuer of warrants or a class of convertible securities, if securities of the same class are listed and registered on a national securities exchange or are quoted on the automated quotation system of a national securities association. In addition, attention is directed to General Instruction C to Form S-8 for the registration of employee benefit plan securities for resale.

4. Rights Offerings, Dividend or Interest Reinvestment Plans, and Conversions or Warrants.

Securities to be offered: (a) upon the exercise of outstanding rights granted by the issuer of the securities to be offered, if such rights are granted on a *pro rata* basis to all existing security holders of the class of securities to which the rights attach; or (b) pursuant to a dividend or interest reinvestment plan; or (c) upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer of the securities to be offered, or by an affiliate of such issuer; *provided* the issuer has sent to all record holders of such rights, or to all participants in such plans, or to all record holders of such convertible securities or transferable warrants, respectively, material containing the information required by Rule 14a-3(b) under the Exchange Act and Items 401, 402 and 403 of Regulation S-K within the 12 calendar months immediately preceding the filing of the registration statement, except that the information required by Items 401, 402 and 403 of Regulation S-K need only be provided to holders of rights exercisable for common stock, holders of securities convertible into common stock, participants in plans which may invest

in common stock, or in securities convertible into common stock or warrants exercisable for common stock, respectively.

C. *Majority-Owned Subsidiaries.* If a registrant is a majority-owned subsidiary, security offerings may be registered on this form if:

1. The registrant-subsidiary itself meets the Registrant Requirements and the applicable Transaction Requirement;

2. The parent of the registrant-subsidiary meets the Registrant Requirements and the conditions of Transaction Requirement B.2. (Primary Offerings of Certain Debt and Non-Convertible Preferred Securities) are met; or

3. The parent of the registrant-subsidiary meets the Registrant Requirements and the applicable Transaction Requirement and fully guarantees the securities being registered as to principal and interest.

Note. In such an instance, the parent-guarantor is the issuer of a separate security consisting of the guarantee which must be concurrently registered but may be registered on the same registration statement as are the guaranteed securities.

FORM F-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

I. Eligibility Requirements for Use of Form F-3

This instruction sets forth registrant requirements and transaction requirements for the use of Form F-3. Any foreign private issuer, as defined in Rule 405 which meets the requirements of I.A. below ("Registrant Require-ments") may use this Form for the registration of securities under the Securities Act of 1933 (the "Securities Act") which are offered in any transaction specified in I.B. below ("Transaction Requirements"), provided that the requirements applicable to the specified transaction are met. With respect to majority-owned subsidiaries, see Instruction I.A.6 below.

A. *Registrant Requirements.* All registrants must meet the following conditions in order to use this Form F-3 for registration under the Securities Act of securities offered in the transactions specified in I.B. below:

1. The registrant has a class of securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") or a class of equity securities registered pursuant to Section 12(g) of the Exchange Act or is required to file reports pursuant to Section 15(d) of the Exchange Act and is eligible to file and has filed annual reports on Form 20-F under the Exchange Act.

2. The registrant: (a) has been subject to the requirements of Section 12 or 15(d) of the Exchange Act and has filed all the material required to be filed pursuant to Sections 13, 14, or 15(d) for a period of at least 36 calendar months immediately preceding the filing of the registration statement on this Form; and (b) has filed in a timely manner all reports required to be filed during the 12 calendar months and any portion of a month immediately preceding the filing of the registration statement and, if the registrant has used (during the 12 calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25(b) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by the Rule.

3. Neither the registrant nor any of its consolidated or unconsolidated subsidiaries have, since the end of their last fiscal year for which certified financial statements of the registrant and its consolidated subsidiaries were included in a report filed pursuant to Section 13(a) or 15(d) of the Exchange Act: (a) failed to pay any dividend or sinking fund installment on preferred stock; or (b) defaulted (i) on any installment or installments on indebtedness for borrowed money, or (ii) on any rental on one or more long-term leases, which defaults in the aggregate are material to the financial position of the registrant and its consolidated and unconsolidated subsidiaries, taken as a whole.

4. The aggregate market value worldwide of the voting stock held by non-affiliates of the registrant is the equivalent of $300 million or more, except that the provisions of this paragraph do not apply if the only securities being registered are to be offered in a transaction of the type described in B.2. of the Transaction Requirements.

Instruction. The aggregate market value of the registrant's outstanding voting stock shall be computed by use of the price at which the stock was last sold, or the average of the bid and asked prices of such stock, in the principal market for such stock as of a date within 60 days prior to the date of filing. [See the definition of "affiliate" in Securities Act, Rule 405.]

5. If the registrant is a successor registrant, it shall be deemed to have met conditions 1, 2, 3, and 4 above if: (a) its predecessor and it, taken together, do so, provided that the succession was primarily for the purpose of changing the state or other jurisdiction of incorporation of the predecessor or forming a holding company and that the assets and liabilities of the successor at the time of succession were substantially the same as those of the predecessor; or (b) all predecessors met the conditions at the time of succession and the

registrant has continued to do so since the succession.

6. *Majority-owned Subsidiaries.* If a registrant is a majority-owned subsidiary, security offerings may be registered on this Form if:

(i) the registrant-subsidiary itself meets the Registrant Requirements and the applicable Transaction Requirement;

(ii) the parent of the registrant-subsidiary meets the Registrant Requirements and the condition of Transaction Requirement B.2. (Primary Offerings of Certain Debt Securities) are met; or

(iii) the parent of the registrant-subsidiary meets the Registrant Requirements and the applicable Transaction Requirements and fully guarantees the securities being registered as to principal and interest.

Note: In the situations described in (i), (ii), and (iii) above, the parent-guarantor is the issuer of a separate security consisting of the guarantee which must be concurrently registered but may be registered on the same registration statement as are the guaranteed securities. Both the parent-guarantor and the subsidiary shall each disclose the information required by this Form as if each were the only registrant except that if the subsidiary will not be eligible to file annual reports on Form 20-F after the effective date of the registration statement, then it shall disclose the information specified in Form S-3. Rule 3-10 of Regulation S-X specifies the financial statements required.

B. *Transaction Requirements.* Security offerings meeting any of the following conditions and made by registrants meeting the Registrant Requirements above may be registered on this Form:

1. *Primary Offerings by Certain Registrants*

Securities to be offered for cash by or on behalf of a registrant; if the financial statements in the registrant's latest filing on Form 20-F comply with Item 18 thereof.

2. *Offerings of Certain Debt Securities*

Non-convertible debt securities to be offered for cash if such debt securities are "investment grade debt securities," as defined below. A non-convertible debt security is an "investment grade debt security" if, at the time of effectiveness of the registration statement, at least one nationally recognized statistical rating, organization (as that term is used in Rule 15c3-1 (c) (2) (vi) (F) under the Exchange Act has rated the security in one of its generic rating categories that signifies investment grade; typically, the four highest rating categories (within which there may be subcategories or graduations indicating relative standing) signify investment grade.

3. *Transactions Involving Secondary Offerings*

Outstanding securities to be offered for the account of any person other than the issuer, including securities acquired by standby underwriters in connection with the call or redemption by the issuer of warrants or a class of convertible securities. In addition, Form F-3 may be used by affiliates to register securities for resale pursuant to the conditions specified in General Instruction C to Form S-8 if the financial statements in the registrant's latest filing on Form 20-F comply with Item 18 thereof.

4. *Rights Offerings, Dividend or Interest Reinvestment Plans, and Conversions or Warrants*

Securities to be offered: (a) upon the exercise of outstanding rights granted by the issuer of the securities to be offered, if such rights are granted *pro rata* to all existing security holders of the class of securities

to which the rights attach; or (b) pursuant to a dividend or interest reinvestment plan; or (c) upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer of the securities to be offered, or by an affiliate of such issuer. The registration of securities to be offered or sold in a standby underwriting in the United States or similar arrangement is not permitted pursuant to this paragraph. See paragraphs (1), (2), and (3) above.

FORM F-10

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

I. Eligibility Requirements For Use of Form F-10.

A. Form F-10 may be used for the registration of securities under the Securities Act of 1933 (the "Securities Act"), including securities to be issued in an exchange offer or in connection with a statutory amalgamation, merger, arrangement or other reorganization requiring the vote of shareholders of the participating companies (a "business combination").

B. This form may not be used for registration of derivative securities except:

(1) warrants, options and rights, provided that such securities and the underlying securities to which they relate are issued by the registrant, its parent or an affiliate of either; and (2) convertible securities, provided that such securities are convertible only into securities of the registrant, its parent or an affiliate of either.

Instruction. For purposes of this form, an "affiliate" of a person is anyone who beneficially owns, directly or indirectly, or exercises control or direction over, more than 10 percent of the outstanding equity shares of such person. The determination of a person's affiliates shall be made as of the end of such person's most recently completed fiscal year.

C. Form F-10 is available to any registrant that:

(1) Is incorporated or organized under the laws of Canada or any Canadian Province or Territory;

(2) Is a foreign private issuer;

(3) Has been subject to the continuous disclosure requirements of any securities commission or equivalent regulatory authority in Canada for a period of at least 36 calendar months immediately preceding the filing of this form, and is currently in compliance with such obligations, *provided, however*, that in case of a business combination, each participating company other than the successor registrant must meet such 36-month reporting obligation, except that any such participating company shall not be required to meet such reporting requirement if other participating companies whose assets and gross revenues, respectively, would contribute at least 80 percent of the total assets and gross revenues from continuing operations of the successor registrant, as measured based on *pro forma* combination of the participating companies' most recently completed fiscal years, each meet such requirement;

(4) Has an aggregate market value of its outstanding equity shares of (CN) $360 million or more, *provided, however*, that in the case of a business combination, the aggregate market value of the outstanding shares of each participating company other than the successor registrant is (CN) $360 million or more, except that any such participating company shall not be requiredä to meet such market value requirement if other participating companies whose assets and gross revenues, respectively, would contribute at least 80 percent of the total assets and gross revenues from continuing operations of the successor registrant, as measured based on *pro forma* combination of the participating companies' most recently completed fiscal years,

each meet such market value requirement; and

(5) Has an aggregate market value of the public float of its outstanding equity shares of (CN) $75 million or more, *provided, however*, that in the case of a business combination, the aggregate market value of the public float of the outstanding equity shares of each participating company other than the successor registrant is (CN) $75 million or more, except that any such participating company shall not be required to meet such public float requirement if other participating companies whose assets and gross revenues, respectively, would contribute at least 80 percent of the total assets and gross revenues from continuing operations of the successor registrant, as measured based on *pro forma* combination of the participating companies' most recently completed fiscal years, each meet such public float requirement; provided, further, that in the case of a business combination, such public float requirement shall be deemed satisfied in the case of a participating company whose equity shares were the subject of an exchange offer that was registered or would have been eligible for registration on Form F-8, Form F-9, Form F-10 or Form F-80, or a tender offer in connection with which Schedule 13E-4F or 14D-1F was filed or could have been filed, that terminated within the last 12 months, if the participating company would have satisfied such public float requirement immediately prior to commencement of such exchange or tender offer.

Instructions.

1. For purposes of this form, "foreign private issuer" shall be construed in accordance with Rule 405 under the Securities Act.

2. For purposes of this form, the "public float" of specified securities shall mean only such securities held by persons other than affiliates of the issuer.

3. For purposes of this form, "equity shares" shall mean common shares, non-voting equity shares and subordinate or restricted voting equity shares, but shall not include preferred shares.

4. For purposes of this form, the market value of outstanding equity shares (whether or not held by affiliates) shall be computed by use of the price at which such shares were last sold, or the average of the bid and asked prices of such shares, in the principal market for such shares as of a date within 60 days prior to the date of filing. If there is no market for any of such securities, the book value of such securities computed as of the latest practicable date prior to the filing of this form shall be used for purposes of calculating the market value, unless the issuer of such securities is in bankruptcy or receivership, or has an accumulated capital deficit, in which case one-third of the principal amount, par value or stated value of such securities shall be used.

D. In the case of an exchange offer, the issuer of the securities to be exchanged (the "subject securities") for securities of the registrant shall be incorporated or organized under the laws of Canada or any Canadian Province or Territory and be a foreign private issuer.

E. In the case of a business combination, each participating company shall be incorporated or organized under the laws of Canada or any Canadian Province or Territory and be a foreign private issuer.

F. In the case of an exchange offer, the securities to be registered on this form shall be offered to U.S. holders upon terms and conditions not less favorable than those offered to any other holder of the same class of subject securities.

G. In the case of a business combination, the securities to be registered on this form shall be offered to U.S. holders upon terms and conditions not less favorable than those offered to any other holder of the same class of such securities of the participating company.

Instructions.

1. For purposes of exchange offers, the term "U.S. holder" shall mean any person whose address appears on the records of the issuer of the subject securities, any voting trustee, any depositary, any share transfer agent or any person acting in a similar capacity on behalf of the issuer of the subject securities as being located in the United States.

2. For purposes of business combinations, the term "U.S. holder" shall mean any person whose address appears on the records of a participating company, any voting trustee, any depositary, any share transfer agent or any person acting in a similar capacity on behalf of a participating company as being located in the United States.

3. For purposes of this form, the class of subject securities shall not include any securities that may be converted into or are exchangeable for the subject securities.

H. With respect to registration of debt securities or preferred securities on this form, if the registrant is a majority-owned subsidiary, it shall be deemed to meet the requirements of I.C.(3), (4) and (5) above if the parent of the registrant-subsidiary meets the requirements of I.C. above, and fully and unconditionally guarantees the securities being registered as to principal and interest (if debt securities) or as to liquidation preference, redemption price and dividends (if preferred shares); *provided, however*, that the securities of the subsidiary are only convertible or exchangeable, if at all, for the securities of the parent.

I. If the registrant is a successor registrant subsisting after a business combination, it shall be deemed to meet the 36-month reporting requirement of I.C.(3) above if: (1) the time the successor registrant has been subject to the continuous disclosure requirements of any securities commission or equivalent regulatory authority in Canada, when added separately to the time each predecessor had been subject to such requirements at the time of the business combination, in each case equals at least 36 calendar months, *provided, however*, that any predecessor need not be considered for purposes of the reporting history calculation if the reporting histories of predecessors whose assets and gross revenues, respectively, would contribute at least 80 percent of the total assets and gross revenues from continuing operations of the successor registrant, as measured based on *pro forma* combination of such participating companies' most recently completed fiscal years immediately prior to the business combination, when combined with the reporting history of the successor registrant in each case satisfy such 36-month reporting requirement; and (2) the successor registrant has been subject to such continuous disclosure requirements since the business combination, and is currently in compliance with its obligations thereunder.

J. This form shall not be used for registration of securities if no takeover bid circular or issuer bid circular (in the case of an exchange offer) or information circular (in the case of a business combination) or rights offering circular (in the case of exempt rights offerings) or prospectus (in all other cases) is prepared pursuant to the requirements of any Canadian jurisdiction due to the availability of an exemption from such requirements.

K. This form shall not be used if the registrant or, in the case of an exchange offer, the issuer of the subject securities is an investment company registered or required to be registered under the Investment Company Act of 1940.

NASD NOTICE TO MEMBERS 93-89

NASD 1994 Holiday Schedule

Suggested Routing

- [ ] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [x] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [x] Operations
- [ ] Options
- [ ] Registration
- [ ] Research
- [ ] Syndicate
- [x] Systems
- [x] Trading
- [ ] Training

The NASD will observe the following holiday schedule for 1994:

February 21	Presidents' Day
April 1	Good Friday
May 30	Memorial Day
July 4	Independence Day
September 5	Labor Day
November 24	Thanksgiving Day
December 26	Christmas Day (Observance)

Note: The NASD and The Nasdaq Stock Market[SM] will be open on December 31, 1993, and January 3, 1994.

Questions regarding this holiday schedule may be directed to Linda Goodman, Human Resources, at (301) 590-6821.

NASD NOTICE TO MEMBERS 93-90

Trade Date-Settlement Date Schedule for 1994

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ■ Internal Audit
- ■ Legal & Compliance
- ■ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ■ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

Martin Luther King, Jr., Day: Trade Date-Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Martin Luther King, Jr., Day, Monday, January 17, 1994. On January 17, The Nasdaq Stock Market℠ and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date		Settlement Date	Reg. T Date*
Jan.	6	13	17
	7	14	18
	10	18	19
	11	19	20
	12	20	21
	13	21	24
	14	24	25
	17	24	26
	18	25	27

Note: January 17, 1994, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Transactions made on January 17 will be combined with transactions made on the previous business day, January 14, for settlement on January 24. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on January 17.

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*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

Presidents’ Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, February 21, 1994, in observance of Presidents’ Day. “Regular way” transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Feb. 11	18	23
14	22	24
15	23	25
16	24	28
17	25	Mar. 1
18	28	2
21	Markets Closed	—
22	Mar. 1	3

Good Friday: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Good Friday, April 1, 1994. “Regular way” transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Mar. 24	Mar. 31	Apr. 5
25	Apr. 4	6
28	5	7
29	6	8
30	7	11
31	8	12
Apr. 1	Markets Closed	—
4	11	13

Memorial Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, May 30, 1994, in observance of Memorial Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
May 20	May 27	Jun. 1
23	31	2
24	Jun. 1	3
25	2	6
26	3	7
27	6	8
30	Markets Closed	—
31	7	9

Independence Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, July 4, 1994, in observance of Independence Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Jun. 24	Jul. 1	Jul. 6
27	5	7
28	6	8
29	7	11
30	8	12
Jul. 1	11	13
4	Markets Closed	—
5	12	14

Labor Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, September 5, 1994, in observance of Labor Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Aug. 26	Sept. 2	Sept. 7
29	6	8
30	7	9
31	8	12
Sept. 1	9	13
2	12	14
5	Markets Closed	—
6	13	15

Columbus Day: Trade Date-Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Columbus Day, Monday, October 10, 1994. On this day, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Reg. T Date*
Sept. 29	Oct. 6	Oct. 10
30	7	11
Oct. 3	11	12
4	12	13
5	13	14
6	14	17
7	17	18
10	17	19
11	18	20

Note: October 10, 1994, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on Monday, October 10, will be combined with transactions made on the previous business day, October 7, for settlement on October 17. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on October 10.

Veterans' Day and Thanksgiving Day: Trade Date-Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Veterans' Day, Friday, November 11, 1994, and Thanksgiving Day, Thursday, November 24, 1994. On Friday, November 11, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans' Day. All securities markets will be closed on Thursday, November 24, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Reg. T Date*
Nov. 2	Nov. 9	Nov. 11
3	10	14
4	14	15
7	15	16
8	16	17
9	17	18
10	18	21
11	18	22
14	21	23
15	22	25
16	23	28
17	25	29
18	28	30
21	29	Dec. 1
22	30	2
23	Dec. 1	5
24	Markets Closed	—
25	2	6

Note: November 11, 1994, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on November 11 will be combined with transactions made on the previous business day, November 10, for settlement on November 18. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

Christmas Day and New Year's Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market[SM] and the securities exchanges will be closed on Monday, December 26, 1994, in observance of Christmas Day, and Monday, January 2, 1995, in observance of New Year's Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Dec. 16	Dec. 23	Dec. 28
19	27	29
20	28	30
21	29	Jan. 3, 1995
22	30	4
23	Jan. 3, 1995	5
26	Markets Closed	—
27	4	6
28	5	9
29	6	10
30	9	11
Jan. 2, 1995	Markets Closed	—
3	10	12

Brokers, dealers, and municipal securities dealers should use the foregoing settlement dates for purposes of clearing and settling transactions pursuant to the NASD Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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

NASD NOTICE TO MEMBERS 93-91

Nasdaq National Market® Additions, Changes, And Deletions as of November 26, 1993

Suggested Routing

- ☐ Senior Management
- ☐ Advertising
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ■ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ■ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☐ Syndicate
- ■ Systems
- ■ Trading
- ☐ Training

As of November 26, 1993, the following 105 issues joined the Nasdaq National Market®, bringing the total number of issues to 3,412:

Symbol	Company	Entry Date	SOES℠ Execution Level
DUCR	Duracraft Corp.	10/26/93	1000
ISCO	Illinois Superconductor Corporation	10/26/93	1000
KAMNZ	Kaman Corporation (Dep. Shrs)	10/26/93	200
MRIM	MRI Management Associates, Inc.	10/26/93	1000
RIMGW	Rimage Corporation (7/21/95 Wts)	10/26/93	500
JPEI	JPE, Inc.	10/27/93	1000
ORCI	Opinion Research Corporation	10/27/93	1000
SSPC	Seda Speciality Packaging Corp.	10/27/93	1000
SONOP	Sonoco Products Company (Pfd Ser A Cum Co)	10/27/93	200
CMOS	Credence Systems Corporation	10/28/93	1000
IFLM	Interfilm, Inc.	10/28/93	1000
MSLD	Masland Corporation	10/28/93	1000
PAGI	Penn-America Group, Inc.	10/28/93	1000
HLPH	Holophane Corporation	10/29/93	500
ITEG	IntegraCare, Inc.	10/29/93	1000
MERQ	Mercury Interactive Corporation	10/29/93	500
PTREF	PartnerRe Holdings Ltd.	10/29/93	1000
PETR	PetroCorp Incorporated	10/29/93	1000
CPSC	Carson Pirie Scott & Co.	11/1/93	1000
FFIN	First Financial Bankshares, Inc.	11/1/93	200
SDYNZ	Staodyn, Inc. (11/1/96 Wts Ser II)	11/1/93	500
DMMC	DM Management Company	11/2/93	1000
PTEN	Patterson Energy, Inc.	11/2/93	500
PTENW	Patterson Energy, Inc. (Redeem Wts)	11/2/93	500
TREX	Transnational Re Corporation (Cl A)	11/2/93	500
BJCT	Bioject Medical Technologies Inc.	11/3/93	1000
FSNM	First State Bancorporation	11/3/93	1000
FUNN	Mountasia Entertainment International, Inc.	11/3/93	1000
DERM	Penederm Incorporated	11/3/93	1000
AMRI	Amrion, Inc.	11/4/93	1000
FFCI	Fairfield Communities, Inc.	11/4/93	1000
VISX	VISX Incorporated	11/4/93	1000
ROCK	Gibraltar Steel Corporation	11/5/93	500
GASI	Greenwich Air Services, Inc.	11/5/93	1000
ITRI	Itron, Inc.	11/5/93	1000
MONFA	Monaco Finance, Inc. (Cl A)	11/5/93	1000
MONFW	Monaco Finance, Inc. (Cl A) (12/10/95 Wts)	11/5/93	1000
PTSI	P.A.M. Transportation Services, Inc.	11/8/93	1000
ASCA	Ameristar Casinos, Inc.	11/9/93	1000
BOST	Boston Chicken, Inc.	11/9/93	1000
PIPE	Consolidated Stainless, Inc.	11/9/93	1000

Symbol	Company	Entry Date	SOES Execution Level
GLDN	Golden Systems, Inc.	11/9/93	1000
PURS	Purus, Inc.	11/9/93	1000
URBN	Urban Outfitters, Inc.	11/9/93	1000
ASTX	Applied Science & Technology, Inc.	11/10/93	1000
ASTXW	Applied Science & Technology, Inc. (Redeem Wts)	11/10/93	1000
PTSF	Petstuff, Inc.	11/10/93	1000
SKYB	Skybox International, Inc.	11/10/93	1000
UFPI	Universal Forest Products, Inc.	11/10/93	500
TATWF	TAT Technologies Ltd. (Cl A)(3/31/94 Wts)	11/11/93	1000
TATTF	TAT Technologies Ltd. (Ord Shrs)	11/11/93	1000
VVTVA	ValueVision International, Inc. (Cl A)	11/11/93	1000
ZTEC	Zytec Corporation	11/11/93	1000
LOJN	LoJack Corporation	11/12/93	1000
MACE	Mace Security International, Inc.	11/12/93	1000
OSBC	Old Second Bancorp, Inc.	11/12/93	200
SBNP	State Bancshares, Inc.	11/12/93	500
HAVAB	Harvard Industries, Inc. (Cl B)	11/15/93	500
IREG	Information Resource Engineering, Inc.	11/15/93	500
FULCF	Fulcrum Technologies, Inc.	11/16/93	1000
HAVAP	Harvard Industries, Inc. (Pfd)	11/16/93	500
LAND	Landair Services, Inc.	11/16/93	500
QFAB	Quaker Fabric Corporation	11/16/93	1000
RBDS	Roberds, Inc.	11/16/93	1000
SCHN	Schnitzer Steel Industries, Inc. (Cl A)	11/16/93	1000
TOWR	Tower Air, Inc.	11/16/93	1000
ALCL	Allied Capital Lending Corporation	11/17/93	1000
ALFC	ALLIED Life Financial Corporation	11/17/93	500
BOLL	Bollinger Industries, Inc.	11/17/93	1000
CXIPY	Coflexip (ADR)	11/17/93	1000
DNFCR	D & N Financial Corporation (12/20/93 Rts)	11/17/93	1000
FTPS	FTP Software, Inc.	11/17/93	1000
SFSK	Safeskin Corporation	11/17/93	1000
PBSFR	Pacific Bank, N.A. (The) (12/2/93 Rts)	11/17/93	500
UNPH	Uniphase Corporation	11/17/93	1000
ASFC	Astoria Financial Corporation	11/18/93	1000
ISLSW	Intelligent Surgical Lasers, Inc. (11/17/2000 Wts Cl A)	11/18/93	200
ISLSL	Intelligent Surgical Lasers, Inc. (11/17/2000 Wts Cl B)	11/18/93	200
ISLSD	Intelligent Surgical Lasers, Inc.	11/18/93	500
MIKN	Mikohn Gaming Corporation	11/18/93	1000
WBLT	Welbilt Corporation	11/18/93	1000
ARRS	Arris Pharmaceutical Corporation	11/19/93	1000
ABEV	Atlantic Beverage Company, Inc.	11/19/93	1000
CMAX	CableMaxx, Inc.	11/19/93	1000
JCOR	Jacor Communications, Inc.	11/19/93	1000
JCORW	Jacor Communications, Inc. (1/14/2000 Wts)	11/19/93	500
FORMF	Jetform Corporation	11/19/93	1000
RTEX	RailTex Inc.	11/19/93	1000
UVSGA	United Video Satellite Group, Inc. (Cl A)	11/19/93	1000
WMAR	West Marine, Inc.	11/19/93	1000

Symbol	Company	Entry Date	SOES Execution Level
AMBI	Applied Microbiology, Inc.	11/22/93	500
TMTX	Temtex Industries, Inc.	11/22/93	1000
ATMI	Advanced Technology Materials, Inc.	11/23/93	1000
MATK	Martek Biosciences Corporation	11/23/93	500
OLYMP	Olympic Financial Ltd. (8% Conv Pfd Stk)	11/23/93	1000
PHTX	Photonics Corporation	11/23/93	500
QCSB	Queens County Bancorp, Inc.	11/23/93	1000
AAON	AAON, Inc.	11/24/93	1000
CDTC	Cable Design Technologies Corporation	11/24/93	1000
CCRO	ClinTrials Inc.	11/24/93	1000
LOFSY	London & Overseas Freighters Limited (ADR)	11/24/93	200
MONFZ	Monaco Finance, Inc. (12/11/93 Wts B)	11/24/93	1000
OTRX	OTR Express, Inc.	11/24/93	1000
UNSW	Union Switch & Signal Inc.	11/24/93	1000
AINN	Applied Innovation Inc.	11/26/93	1000

Nasdaq National Market Symbol and/or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since October 26, 1993:

New/Old Symbol	New/Old Security	Date of Change
HOENW/HOENW	Hoenig Group Inc. (10/31/94 Wts Cl A)/Hoenig Group Inc. (10/93 Wts Cl A)	10/27/93
SYMM/SILN	Symmetricom, Inc./Symmetricom, Inc.	11/01/93
NGCOW/NGCWV	National Gypsum Company (7/1/2000 Wts)/National Gypsum Company (7/1/2000 Wts)	11/2/93
ZALEW/ZALWV	Zale Corporation (Wts 7/29/98 Ser A)/Zale Corporation (Wts Ser A 7/29/98 WI)	11/2/93
CBSS/CBSS	Compass Bancshares, Inc./Central Bancshares South, Inc.	11/8/93
EWST/GFGC	Energy West, Inc./Energy West, Inc.	11/22/93

Nasdaq National Market Deletions

Symbol	Security	Date
CHEK	Checkpoint Systems, Inc.	10/29/93
SUNI	Sun Coast Plastics, Inc.	11/3/93
SEMIZ	All American Semiconductors, Inc. (Wts)	11/8/93
GOOD	Goody Products, Inc.	11/10/93
TPCA	Total Pharmaceutical Care, Inc.	11/10/93
CAMDW	California Micro Devices Corporation (Wts)	11/11/93
PABC	Pacific Bancorporation	11/11/93
CIVCR	Civic Bancorp (Rts)	11/15/93
AHLDY	Ahold N.V. (ADR)	11/15/93
BKLA	BKLA Bancorp	11/16/93
SALM	Salem Sportswear Corporation	11/16/93

Symbol	Security	Date
BYTX	Bytex Corporation	11/17/93
WWWM	W. W. Williams Company	11/17/93
MCCS	Medco Containment Services, Inc.	11/19/93
GATW	Gateway Fed Corporation	11/22/93
DNKG	Sofamor/Danek Group, Inc.	11/22/93
MSBKR	Mutual Savings Bank, f.s.b. (Rts)	11/23/93

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade reporting rules should be directed to Bernard Thompson, Assistant Director; NASD Market Surveillance, at (301) 590-6436.

BOARD BRIEFS

Actions Taken by the NASD Board of Governors in November

• **President's Report** — U.S. equity markets thus far in 1993 have been enjoying a solid performance and strong investor support. The Nasdaq Stock Market[SM] is no exception. Through October, total share volume stood at 54 billion shares with the market averaging 258 million shares a day. In September, Nasdaq recorded its highest average daily volume ever, 319 million shares. Overall market value for Nasdaq reached a record high of $782.9 billion with total dollar volume at a record $1.1 trillion.

The unprecedented volume in The Nasdaq Stock Market coupled with a strong initial public offering market will make 1993 a record year in both revenues and net income for the NASD and The Nasdaq Stock Market, Inc. To share these positive financial results with members and subscribers, particularly those most responsible for Nasdaq's success, the Boards of the NASD and The Nasdaq Stock Market, Inc., have decided to do the following:

— Increase the NASD gross income assessment discount for 1993 from 62 to 67 percent. This will be reflected as a credit to these members' initial assessment billing in 1994.

— Waive the SelectNet[SM] and the Small Order Execution System (SOES[SM]) fees for November and December 1993.

— Absorb the cost of installing the new communications network for those who are Nasdaq subscribers as of December 31, 1993, and for Fixed Income Pricing System (FIPS[SM]) leased-line participants who are included in the initial rollout of the product.

The NASD and The Nasdaq Stock Market are pleased to be able to pass along these savings, which in the aggregate are estimated to exceed $12 million, to members and users of our systems.

The Nasdaq Stock Market, Inc., Board of Directors approved the creation of a charitable foundation to support business and economics education. The foundation, which will be organized as a separate corporation and funded in 1993, will provide The Nasdaq Stock Market, Inc., with a continuing pool of funds to draw on to fund important educational efforts on an ongoing basis. The foundation will become active in 1994.

The long-standing NASD Policy Statement on Market Closings was extended for one year to December 31, 1994 by the Executive Committee. In effect since 1988, the Policy Statement provides that the NASD would comply with the "circuit breakers" that take effect during periods of extraordinary price volatility. These circuit breaker mechanisms require that trading be halted for one hour if the Dow Jones Industrial Average (DJIA) declines 250 points from its previous day's closing level and for two hours if the DJIA declines 400 points. Concern over the diminishing percentage relationship between the 250- and 400-point thresholds to today's higher DJIA motivated the Board to approve the extension for just one year. During that time the NASD will discuss reevaluation of the thresholds with the SEC and other self-regulatory organizations.

• **Board Elections** — The Board of Governors has also elected new officers for 1994, five new governors-at-large, and four governors from the districts, all of whom begin their new terms in January 1994.

The new Chairman of the Board is Joseph J. Grano, Jr. As President of

Retail Sales and Marketing for PaineWebber Inc., Mr. Grano is responsible for the firm's entire retail sales business, including product development, marketing, and overall management of the branch system. He is also a Board Director and member of PaineWebber's executive committee. The 1994 Vice Chairmen are David Brooke, a Director of J O Hambro & Company and Deputy Chairman of J O Hambro & Partners Ltd. in London, England, and Robert Kleinberg, Executive Vice President and General Counsel of Oppenheimer & Co., Inc.

The National Business Conduct Committee elected Richard G. McDermott, Jr., President, Chapdelaine & Co. in New York City, as its 1994 Chairman. The new Vice Chairman of the NASD's Business Conduct Committee is James S. Holbrook, Jr., President and Chief Executive Officer, Sterne, Agee & Leach, Inc., of Birmingham, Alabama.

Representing public investors as a Governor-at-Large is Alfred E. Osborne, Jr., Director of Entrepreneurial Studies Center in the John E. Anderson Graduate School of Management at the University of California, Los Angeles (UCLA). Leonard Abramson, founder and Chief Executive Officer of U. S. Healthcare, Inc., and C. Richard Kramlich, Managing General Partner of New Enterprises Associates Partnerships I-VI, were elected as representatives of issuers. Alice T. Kane, Executive Vice President, General Counsel and Secretary of New York Life Insurance Company, was chosen to represent insurance affiliated members. Bruce Clayton Hackett, Co-Head of Global US Equity Sales and Trading and a member of the Executive Committee for Salomon Brothers, Inc., was elected a securities industry-at-large representative.

The following individuals were elected by the districts:

District 2 — Carl E. Lindros, Founder and President of Santa Barbara Securities, Inc., in Santa Barbara, California.

District 4 — Mary Alice Brophy, First Vice President-Compliance for Dain Bosworth Incorporated, Minneapolis, Minnesota.

District 6 — Raymond E. Wooldridge, President, Chief Operating Officer and a director of Southwest Securities Group, Inc.

District 8 — William A. Rogers, Chief Operating Officer and Managing Partner with Wayne Hummer & Co., Chicago, Illinois.

• **Regulation** — The Board approved for filing with the Securities and Exchange Commission (SEC) a limitation to the previously proposed money market fund exemption from the disclosure requirement of the NASD's mutual fund sales-charge rule. If approved by the SEC, only money market funds with asset-based sales charges of 25 basis points or less could invoke the exemption from disclosure. All others would have to state in their prospectuses that "long term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by" the sales-charge rule.

Guidelines governing communications with the public about variable life insurance and variable annuities received Board approval and will now be filed with the SEC for final approval. These guidelines govern the preparation of advertisements and sales literature as well as member communications with the investing public. The specific standards portion of the guidelines covers such areas as fund performance predating inclusion in a variable product; product comparisons; use of performance rankings; insurance and investment features of variable life insurance; and hypothetical illustrations of rates of return in variable life insurance literature and personalized illustrations.

The Board approved for filing with the SEC for approval a number of changes to its Free-Riding and Withholding Interpretation. These changes intended to update the Interpretation were the subject of *Special Notice to Members 93-40,* which was published this past summer. That Notice solicited member comment on the proposals, which affect a variety of areas, including securities to be covered by the interpretation; the interpretation's applicability to secondary offerings; definition of immediate family; its applicability to persons with limited registration or limited purpose broker/dealers; and treatment of investment partnerships and venture capital investors.

• **Member Services** — The Board approved a measure specifying that arbitrators at the conclusion of a proceeding may refer matters arising or discovered during the course of an arbitration proceeding for disciplinary investigation. The proposal must now be filed with the SEC for final approval.

The Board also approved a proposal to establish, on a pilot basis, procedures for large and complex arbitration cases. The provision defines such cases as those where the amount in controversy is at least $1 million including punitive damages or where all parties agree to the use of the procedures. The measure also provides for an administrative con-

ference to iron out details of the arbitration, with any unresolved issues handled by the arbitration panel at the preliminary hearing. Given the level of difficulty inherent in such arbitrations, the proposal provides for additional arbitrator compensation above the normal honorarium as determined by the Director of Arbitration and based on the size and complexity of the case.

The Board has endorsed the recommendations of the Securities Industry Task Force on Continuing Education subject to the Board review and approval of the final continuing education program that the Industry/Regulatory Council will develop in 1994. The primary objective of the program is to expand investor protection and benefit the industry by increasing industry professionals' knowledge of, and enhancing their sensitivity to, regulatory and ethical standards. To this end, the subject matter should cover broadly applicable information relating to compliance, regulatory, ethical, and general sales-practice standards as well as job-related material for specific professional areas and products.

• **Market Services** — The Board approved for filing with the SEC several modifications to the NASD options rules. The proposals would create a two-year pilot program during which certain fully hedged OTC equity option positions would be automatically exempt from established position and exercise limits. The proposal also would expand the pilot to include convertible securities as eligible to serve as the basis for underlying equity hedge positions. In addition, the measure would increase the position and exercise limits for OTC options to conform to those of the options exchanges; would amend the record retention rule for options accounts to accommodate off-site storage; and would provide disclaimer language to limit liability for Nasdaq indexes.

Subject to SEC approval, the NASD would include two enhancements to the OTC Bulletin Board® service. The service would include direct participation programs and would mandate the use by market makers of a fifth character identifier with their symbols to disclose that a particular security trades at an office other than the member's main trading location.

A proposal by the Financial Accounting Standards Board (FASB) concerning stock options was considered by the Board. Under the FASB proposal, companies that issue stock options as compensation would have to account for them as compensation expense based on formulae and conditions specified by the FASB proposal. According to the Board, this treatment would serve to decrease corporate earnings with no material change to real operating results; increase the cost of capital for companies in both public and private markets; hamper growth companies from attracting and retaining critical employees; and negatively affect the country's ability to start and build innovative, potentially high-growth companies that heretofore used stock options to provide employees with equity participation in the company. The effect of this could be to decrease America's ability to compete on a global scale. In light of these considerations, the Board opposed accounting for stock options as compensation expense on any basis because such accounting would not be in the best interests of the United States and its global competitive position.

An amendment to Schedule D of the Rules of Fair Practice approved by the Board for filing with the SEC would incorporate a discretionary listing standard for the initial or continued inclusion of an issue in The Nasdaq Stock Market. The measure provides the NASD with broad discretionary authority over the initial and continued inclusion of securities in Nasdaq. Under this authority, the NASD may deny initial inclusion or apply additional or more stringent criteria for the initial or continued inclusion of particular securities or suspend or terminate the inclusion of particular securities based on any event, condition, or circumstance that may exist or occur that makes initial or continued inclusion of otherwise qualified issues in Nasdaq inadvisable or unwarranted in the opinion of the NASD. This standard is similar to those in place at the major U.S. stock exchanges.

NASD Disciplinary Actions

Disciplinary Actions Reported for December

The NASD® has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, December 20, 1993. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this edition.

Firms Suspended, Individuals Sanctioned

Smetek, Van Horn & Cormack, Inc. (Houston, Texas) and **Peter P. Smetek, Jr. (Registered Principal, Sugar Land, Texas)** submitted an Offer of Settlement pursuant to which they were fined $15,000, jointly and severally and each suspended from underwriting public offerings for 30 days. Smetek is also required to requalify by examination as a general securities principal. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Smetek, used instrumentalities of interstate commerce to effect transactions in nonexempt securities while failing to maintain its required minimum net capital. The NASD also found that the firm, acting through Smetek, failed to maintain its books and records and to include the firm's security inventory in its FOCUS Part I report.

In addition, the NASD determined that the firm, acting through Smetek, failed to file its FOCUS Part IIA report and conducted a securities business while failing to have a financial and operations principal associated with the firm. Furthermore, the findings stated that the firm, acting through Smetek, failed to file Forms U-5 with the Central Registration Depository within 30 days of the resignation of the firm's financial and operation principals and failed to file telegraphic notice of its net capital violations.

Sovereign Asset Management, Inc. (Dallas, Texas) and **Austin Starke Taylor, III (Associated Person, Dallas, Texas)** submitted an Offer of Settlement pursuant to which they were fined $2,500, jointly and severally. The firm was suspended from NASD membership for five days and Taylor was suspended from association with any NASD member in any capacity for five 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 Taylor, engaged in the offer and sale of securities to public customers when its NASD membership was not effective and while representing in writing to NASD staff that it had not and would not engaged in such activities until its membership was effective.

The NASD also found that the firm, acting through Taylor, sold nonexempt securities while failing to maintain its required minimum net capital and failed to promptly transmit customer checks to an escrow account in connection with the purchase of limited partnership interests. In addition, the NASD determined that the firm, acting through Taylor, permitted unregistered persons to become associated with the firm and to offer and sell securities to its customers.

U. S. Securities Clearing Corp. (San Diego, California) and **Anthony James Miranti**

(Registered Principal, San Diego, California). The firm was fined $55,000, jointly and severally with Miranti and the firm and Miranti were required to pay $396,846 in restitution to customers in whose accounts transactions were effected at prices in excess of 5 percent over the prevailing market price for the securities. In addition, the firm was suspended from effecting any principal transactions for 90 days and Miranti was suspended from association with any NASD member in any capacity for 90 days.

The National Business Conduct Committee (NBCC) imposed the sanctions following appeal of a Denver District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that the firm, acting through Miranti, executed 301 principal retail sales to public customers at unfair and unreasonable prices taking into consideration all relevant circumstances. These circumstances included the fact that the firm was not a market maker in these securities at the time the trades were effected and that the markups on these trades ranged from 5.1 to 150 percent over the prevailing market price for the securities at the time the trades were executed. In addition, the firm, acting through Miranti, failed to report its price and volume activity for its principal transactions in non-Nasdaq securities.

This action has been appealed to the Securities and Exchange Commission (SEC) and the sanctions are not in effect pending consideration of the appeal.

Firms Fined, Individuals Sanctioned

First Independence Group, Inc. (Garden City, New York), Frank Paul Giraldi (Registered Principal, East Norwich, New York), and **Mark Steven Milana (Registered Representative, Dix Hills, New York)**. The firm was fined $308,677.40, and Giraldi was fined $62,000 and barred from association with any NASD member in a supervisory or principal capacity. Milana was fined $40,000 and barred from association with any NASD member in a supervisory or principal capacity. Both Giraldi and Milana are required to requalify by examination if they desire to function in a registered representative capacity. In addition, Giraldi and Milana are prohibited from maintaining a proprietary interest in any NASD member other than a noncontrolling interest in a member whose shares are publicly traded and subject to the reporting requirements of Section 12 of the Securities Exchange Act of 1934.

The SEC affirmed the sanctions following appeal of a March 1992 NBCC decision. The sanctions were based on findings that, in contravention of the NASD's Mark-Up Policy, the firm, acting through Giraldi and Milana, engaged in a course of conduct that operated as a fraud on customers. The firm was not a market maker in any of the securities it sold to customers, and all transactions were effected on a riskless principal basis.

The prices at which the securities were sold included excessive and fraudulent markups ranging from 11.11 to 188.46 percent above the firm's contemporaneous cost for the securities. The NASD also found that the firm, acting through Giraldi, failed to disclose on customer confirmations the amount of the markups charged by the firm as required by SEC Rule 10b-10. In addition, the firm, acting through Giraldi, failed to establish and implement supervisory procedures to detect and prevent the aforementioned violations.

Furthermore, the firm, acting through Giraldi, failed to report through the non-Nasdaq reporting system the highest price at which it sold and the lowest price at which it purchased a common stock, as well as the total volume of purchases and sales executed in the stock. The firm, acting through Giraldi, also failed to report whether the trades establishing the highest price at which the firm sold and lowest price at which the firm purchased the same common stock represented an execution with a customer or with another broker/dealer, as required by Schedule H of the NASD By-Laws.

The firm, Giraldi, and Milana have appealed this action to the United States Court of Appeals for the Second Circuit, and the sanctions, other than the bars in a supervisory or principal capacity, are not in effect pending consideration of the appeal.

Pacific Southern Securities, Inc. (Denver, Colorado), Gerald M. Schechter (Registered Principal, Englewood, Colorado), and **William P. Snow (Registered Principal, Arvada, Colorado)**. The firm and Schechter were fined $50,000, jointly and severally and required to jointly and severally pay $124,065.20 in restitution to public customers. Schechter was also fined an additional $50,000, suspended from association with any NASD member in any capacity for six months, suspended from association with any NASD member in any principal or supervisory capacity for two years, and required to requalify by examination as a general securities representative. Snow was fined $50,000 and barred from association with any NASD member in any capacity. The NBCC

imposed the sanctions following appeal of a Market Surveillance Committee decision.

The sanctions were based on findings that the firm, acting through Schechter, effected transactions in, and induced others to effect transactions in, securities at prices that were not reasonably related to the prevailing market price of the securities. The firm, acting through Schechter, also engaged in deceptive and fraudulent devices and contrivances in the securities and sold shares of the common stocks to its retail customers with markups ranging from 11 to 89 percent over the prevailing market price. In addition, Snow failed to appear at two scheduled interviews with NASD staff in connection with the aforementioned activity.

Firms and Individuals Sanctioned

V.F. Minton Securities, Inc. (Fort Worth, Texas), Vernon F. Minton (Registered Principal, Fort Worth, Texas), and **Joseph W. Bishop (Registered Representative, Grapevine, Texas)**. The firm was debarred from applying for reinstatement of its NASD membership and Minton was suspended from association with any NASD member in any principal capacity for six months. Bishop was fined $100,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Dallas DBCC decision.

The sanctions were based on findings that the firm, acting by and through Bishop, executed or caused to be executed, unauthorized purchases of a common stock in the accounts of customers. Furthermore, the firm, acting through Bishop, sold the stock to customers, promised them that the stock would soon rise in price, represented that they would only have to pay for transactions if they realized a profit, and promised that the firm would purchase another stock from such customers at above-market prices. In addition, the firm, acting through Minton and Bishop, failed to comply with and circumvented a 90-day freeze imposed by their clearing firms on customer accounts pursuant to Reg 220.8(c) of Regulation T issued by the Board of Governors of the Federal Reserve System after the customers failed to pay for purchases of a common stock.

Firms and Individuals Fined

Lew Lieberbaum & Co., Inc. (Garden City, New York) and **Seymour S. Burack (Registered Representative, Staten Island, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined $10,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Burack, failed to exercise proper supervision over the activities of a registered representative.

Individuals Barred or Suspended

Melvyn Edward Albin (Registered Representative, Mt. Dora, Florida) was fined $20,000 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of an Atlanta DBCC decision. The sanctions were based on findings that Albin effected the purchase of units for the account of a public customer while knowing that the customer did not have sufficient funds for the purchase. In an effort to avoid a sellout, Albin obtained, completed, and signed a check drawn on the same customer's account for payment of such transaction without the customer's knowledge or consent. In addition, Albin failed to respond to an NASD request for information.

Albin has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

William Bernard Anderson, III (Registered Representative, Dallas, Texas) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Anderson failed to respond to NASD requests for information concerning his activities at a member firm.

Linden D. Barnette (Registered Representative, Tuscaloosa, Alabama) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for two weeks. Without admitting or denying the allegations, Barnette consented to the described sanctions and to the entry of findings that he endorsed the names of three public customers on checks for the purpose of purchasing new insurance policies without their prior written consent.

Bryan Gregory Blakeman (Registered Representative, Houston, Texas) was fined $30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Blakeman executed options transactions in the account of a public customer without the customer's knowledge or consent. In addition, Blakeman failed to

respond to NASD requests for information.

Robert Murray Brooke (Registered Representative, Bozeman, Montana) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that, on two occasions, Brooke completed a *Uniform Application for Securities Industry Registration* (Form U-4) that contained false and misleading information.

Roy Michiel Capshaw (Associated Person, Kaufman, Texas) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Capshaw failed to respond to NASD requests for information concerning the books and records of a former member firm.

Frank J. Custable, Jr. (Registered Representative, Glendale Heights, Illinois) was fined $100,000 and barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of an April 1992 NBCC decision. The sanctions were based on findings that Custable executed unauthorized transactions in the accounts of public customers.

In addition, Custable used deceptive or fraudulent practices to induce customers to pay for securities. Specifically, Custable guaranteed the customers a profit and informed them that they could get a quick return on their money when, in fact, the company had suffered financial hardships and its stock had been delisted.

Daniel Gordon DeWeert (Registered Representative, Missoula, Montana) was fined $25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that DeWeert received from a public customer a $9,000 check for investment purposes. DeWeert failed to follow the customer's instruction and deposited the funds into a bank account in which he had a beneficial interest. DeWeert also failed to respond to NASD requests for information.

John Wayne Ezell (Registered Representative, Arlington, Texas) submitted an Offer of Settlement pursuant to which he was fined $15,000, suspended from association with any NASD member in any capacity for 15 days, and ordered to disgorge $35,077.69. Without admitting or denying the allegations, Ezell consented to the described sanctions and to the entry of findings that he recommended the purchase and sale of securities to public customers without having reasonable grounds for believing that such recommendations were suitable for the customers based on their financial situations and needs, and fraudulently induced the purchase of securities by such public customers.

John P. Goldsworthy (Registered Representative, Metairie, Louisiana) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $5,000 and suspended from association with any NASD member in any capacity for 15 days. Without admitting or denying the allegations, Goldsworthy consented to the described sanctions and to the entry of findings that he became registered as an investment adviser even though his member firm's written supervisory procedures did not permit district agency representatives to become registered or to act in the capacity of an investment adviser.

The NASD also found that Goldsworthy formed a company but failed to update his Form U-4 to reflect his outside business activities. In addition, the NASD determined that Goldsworthy failed to notify his member firm in writing that he had opened an account with another member firm and to give written notice to the member firm where he opened the account that he was affiliated with his member firm.

Harold W. Gorden (Registered Principal, Castle Rock, Colorado) submitted an Offer of Settlement to the SEC pursuant to which he was fined $75,000 and suspended from association with any NASD member in any capacity for 60 days. Gorden consented to the described sanctions and left undisturbed SEC findings that a former member firm, acting through Gorden, effected securities transactions with retail customers in a common stock that included fraudulent and unfair markups ranging from 11 to 150 percent above the firm's contemporaneous costs.

Gorden's suspension commenced November 8, 1993, and will conclude January 6, 1994.

Bernard J. Hartken, III (Registered Representative, Erie, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined $25,000 and suspended from association with any NASD member in any capacity for one month. In addition, Hartken must requalify by examination before again becoming a registered representative. Without admitting or denying the allegations, Hartken consented to the described sanctions and to the entry of findings that he engaged in private securities transactions while failing to provide prior written notice of such activities to his member firm.

Edwin H. Haw, Jr. (Registered Representative, Chicago, Illinois) was fined $57,500 and barred from association with any NASD member in any capacity. The NBCC imposed the sanctions following appeal of a Chicago DBCC decision. The sanctions were based on findings that Haw received from his member firm six checks totaling $7,910 made payable to a public customer. Haw failed to deliver the checks to the customer, forged the customer's signature on the checks, and used the funds for his personal use and benefit. Haw also failed to respond to NASD requests for information.

Bobby Richard Hsia (Registered Representative, Lenexa, Kansas) submitted an Offer of Settlement pursuant to which he was fined $10,000 and suspended from association with any NASD member in any capacity for two weeks. Without admitting or denying the allegations, Hsia consented to the described sanctions and to the entry of findings that he established securities accounts for a public customer at two member firms other than his member firm without giving prior written notice to his member firm. In addition, the NASD found that Hsia misused customer funds totaling $55,290.46 by depositing the funds into a bank account under his control and subjecting the funds to claims by his creditors.

Stephen Farrell Isserman (Registered Representative, Monroe City, Missouri) submitted an Offer of Settlement pursuant to which he was fined $20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Isserman consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information concerning his termination from a member firm.

Ala Jasim Kadhim (Registered Principal, Fort Worth, Texas) was fined $100,000, barred from association with any NASD member in any capacity, and required to pay $26,320 in restitution to his former member firm and its customers. The sanctions were based on findings that Kadhim made unauthorized use of, and converted to his own use and benefit, securities belonging to his member firm and its customers.

John A. Malach (Registered Representative, Rochester, New York) was fined $20,000 and barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of a June 1992 NBCC decision. The sanctions were based on findings that Malach failed to respond to NASD requests for information concerning customer complaints and his termination from a member firm.

William R. McCarty, Jr. (Registered Principal, Nashville, Tennessee) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $60,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, McCarty consented to the described sanctions and to the entry of findings that he exercised discretion in the accounts of public customers without having obtained prior written authorization from the subject customers and prior written acceptance of the accounts as discretionary by his member firm.

In addition, the NASD found that McCarty recommended and engaged in margin transactions in the account of a public customer without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customer based on her financial situation, investment objectives, and needs.

Andrew J. McGowan (Registered Representative, Sewaren, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $15,000 and suspended from association with any NASD member in any capacity for three years. Without admitting or denying the allegations, McGowan consented to the described sanctions and to the entry of findings that he effected 145 fictitious end-of-day transactions in 17 securities.

William Louis Morgan (Registered Principal, Danville, California) was barred from association with any NASD member in any capacity. The SEC affirmed the sanctions following appeal of a November 1992 NBCC decision. The sanctions were based on findings that Morgan participated in private securities transactions without providing prior written notification to his member firm.

James Anthony Morrill (Registered Representative, Saratoga Springs, New York) was fined $10,000 and barred from association with any NASD member in any capacity. However, the bar may be reduced to a three-day suspension in any capacity if Morrill demonstrates that he has fully satisfied the arbitration award. The NBCC imposed the sanctions following appeal of a New York DBCC decision. The sanctions were based on findings that Morrill failed to pay a $14,278.78 NASD arbitration award.

Morrill has appealed this action to the SEC, and the sanctions, other than the bar, are not in effect pend-

ing consideration of the appeal.

Joseph W. Ronecker (Registered Representative, El Paso, Texas) was fined $120,000, barred from association with any NASD member in any capacity, and required to pay $83,449.49 in restitution to public customers. The sanctions were based on findings that Ronecker made improper use of customer funds totaling $83,449.49 which he obtained under the false pretext that such funds were to be invested in annuities and mutual funds through his member firm when, in reality, he converted the funds to his own use and benefit. In addition, Ronecker failed to respond to NASD requests for information.

James Richard Sawyer (Registered Representative, Victoria, Texas) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Sawyer failed to respond to NASD requests for information concerning his alleged receipt and use of customer funds.

Charles William Schmitz (Registered Representative, Dallas, Texas) was fined $20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Schmitz failed to respond to NASD requests for information concerning customer complaints.

John Eric Schmitz (Registered Principal, Dallas, Texas) submitted an Offer of Settlement pursuant to which he was fined $5,000, suspended from association with any NASD member in any capacity for 14 days, and suspended from association with any NASD member in any principal capacity for two years. Without admitting or denying the allegations, Schmitz consented to the described sanctions and to the entry of findings that a member firm, acting through Schmitz, failed to maintain its books and records. The NASD also found that they offered and sold fractional, undivided interests in a common stock using an offering memorandum that failed to disclose that another corporation under common control with the firm was selling the same securities on different terms and conditions. In addition, the findings stated that the firm, acting through Schmitz, sold these securities without a registration statement being in effect with the SEC and failed to deposit promptly customer checks received from the aforementioned sale into an escrow account.

Furthermore, the NASD determined that Schmitz, acting for the firm, failed to file advertising materials with the NASD and made false and misleading statements in its advertising. The findings also stated that the firm, acting through Schmitz, used instrumentalities of interstate commerce to effect transactions in nonexempt securities while failing to maintain its required minimum net capital.

Bernard L. Smith, III (Registered Principal, Oxford, Mississippi) submitted an Offer of Settlement pursuant to which he was fined $200,000, barred from association with any NASD member in any capacity, and required to pay $2.4 million in restitution to the appropriate parties. Without admitting or denying the allegations, Smith consented to the described sanctions and to the entry of findings that he engaged in the sale of shares in an unregistered mutual fund. The NASD also found that Smith induced two public customers to purchase shares of the mutual fund by means of fraudulent and deceptive devices and contrivances by misrepresenting the nature of the fund. Furthermore, the findings stated that, in the aforementioned activity, Smith engaged in private securities transactions without prior written notice to and approval from his member firm.

The findings also stated that Smith caused checks totaling $60,000 to be issued as loans on insurance policies held by a public customer, deposited the checks into a checking account he controlled, and converted the funds to his own use and benefit without the customer's knowledge or consent. In addition, the NASD determined that Smith caused a $17,466.35 check from the account of a public customer to be sent to a post office box under his control, deposited the check into a checking account he controlled, and converted the funds to his own use and benefit. In an attempt to conceal this activity, the NASD found that Smith prepared and sent a fictitious account statement to the customer.

Margaret W. Stalnaker (Associated Person, Elkins, West Virginia) was fined $45,000, barred from association with any NASD member in any capacity, and required to pay $8,835 in restitution to the appropriate parties. The sanctions were based on findings that Stalnaker failed to disclose, when completing a Form U-4, her indictment by a Mississippi Grand Jury for willful, unlawful, and felonious embezzlement of funds. Stalnaker also obtained from public customers checks totaling $8,835 intended for payment of shares of a common stock and, instead, converted the proceeds to her own use and benefit without the customers' knowledge or consent. In addition, Stalnaker forged, or caused to be forged, the name of one of the aformentioned payees on a check, thereby, converting the proceeds to

her own use and benefit.

Thomas John Stiener (Registered Representative, Union Lake, Michigan) submitted an Offer of Settlement pursuant to which he was fined $8,000 and suspended from association with any NASD member in any capacity for five business days. In addition, Stiener must requalify by examination as a registered representative. Without admitting or denying the allegations, Stiener consented to the described sanctions and to the entry of findings that he executed unauthorized transactions in customer accounts. Stiener also failed to respond timely to NASD requests for information.

Avery Don Trumbo (Registered Representative, Dallas, Texas) submitted an Offer of Settlement pursuant to which he was fined $10,000, barred from association with any NASD member in any capacity, and ordered to disgorge $46,735. Without admitting or denying the allegations, Trumbo consented to the described sanctions and to the entry of findings that he effected unauthorized securities transactions and engaged in excessive trading in customer accounts. The NASD also found that Trumbo made unsuitable recommendations concerning the purchase and sale of securities to customers.

In addition, the NASD determined that Trumbo exercised inappropriate discretionary power and authority over and in customer accounts and induced securities transactions by customers through the use of manipulative, deceptive, and fraudulent devices or contrivances. Furthermore, the findings stated that Trumbo made improper use of customer funds and securities and recommended the purchase of unsuitable option contracts to public customers.

Individuals Fined

Michael J. Bishop (Registered Representative, Memphis, Tennessee) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000. Without admitting or denying the allegations, Bishop consented to the described sanction and to the entry of findings that he exercised discretion in the account of an institutional customer without obtaining prior written authorization from the customer or prior written acceptance of the account as discretionary by his member firm.

Rankin R. Rawlings (Registered Representative, McComb, Mississippi) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined $10,000. Without admitting or denying the allegations, Rawlings consented to the described sanction and to the entry of findings that he exercised discretion in the joint account of public customers without obtaining their prior written authorization or receiving prior written acceptance of the account as discretionary by his member firm. In addition, the NASD found that Rawlings failed to mark the order tickets for the subject transactions as discretionary, in contravention of SEC Rule 17a-3(a)(6).

Leon William Snearly, Jr. (Associated Person, Arlington, Texas) submitted an Offer of Settlement pursuant to which he was fined $10,000. Without admitting or denying the allegations, Snearly consented to the described sanction and to the entry of findings that he acted in the capacity of a registered representative of a member firm without being registered.

Stanford Kenneth Sokoloff (Registered Representative, Staten Island, New York) was fined $11,262.41. The sanctions were based on findings that Sokoloff failed to disclose on his Form U-4 that he had pleaded guilty to unlawful use of a credit card and forgery. In addition, Sokoloff engaged in a securities business with a member firm while subject to a statutory disqualification.

James Igor Weiss (Registered Representative, New York, New York) submitted an Offer of Settlement pursuant to which he was fined $2,500 and ordered to disgorge $14,280 to public customers. Without admitting or denying the allegations, Weiss consented to the described sanctions and to the entry of findings that he effected sales of a common stock to public customers at prices that were unfair and unreasonable in that the total markup charged represented approximately 50 percent of the total cost to the customer.

Firms Expelled for Failure to Pay Fines, Costs and/or Provide Proof of Restitution in Connection With Violations

Bachus & Stratton Securities, Incorporated, Pompano Beach, Florida

Touchstone Capital Corporation, Dallas, Texas

Firms Suspended

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of Article IV, Section 5 of the

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

EDI Ventures, Inc., Columbia, South Carolina (October 29, 1993)

Nippon Securities, Inc., Burbank, California (November 3, 1993)

Sanborn Capital Management Securities Corp., Larkspur, California (October 25, 1993)

Worthington & Dunn Securities, Inc., Dallas, Texas (October 29, 1993)

Individuals Whose Registrations Were Revoked for Failure to Pay Fines, Costs, and/or Provide Proof Of Restitution in Connection With Violations

Christopher L. Apitz, Wellesley Hills, Massachusetts

Richard S. Chancis, New York, New York

Mark C. Chestnut, Fort Walton Beach, Florida

Harry A. Fredrick, III, Memphis, Tennessee

Timothy B. Lloyd, Bryant, Arkansas

Kenneth E. Nightingale, Cockeysville, Maryland

Richard D. O'Reilly, Ocean, New Jersey

Donna Pavlos, Michigan City, Indiana

Thomas E. Trench, Aurora, Colorado

Michael R. Waldman, Henderon, Nevada

Edward R. Yaman, New York, New York

NASD Assesses $1.5 Million Fine Against The Equitable Life Assurance Society of the United States

The NASD has taken disciplinary action against The Equitable Life Assurance Society of the United States (Equitable) headquartered in New York, New York, for supervisory violations in the sale of certain insurance securities products. Equitable, a major insurance company with offices throughout the United States, is an SEC-registered broker/dealer and NASD member.

Pursuant to a Letter of Acceptance, Waiver and Consent, in which the firm neither admitted nor denied the allegations, Equitable was censured and fined $1.5 million. The NASD waived collection of $500,000 of the fine in consideration of restitution Equitable paid to its customers. In addition, Equitable must comply with the undertakings described in its Statement of Mitigation to implement improvements to its supervisory, compliance, and management structures.

The NASD found that Equitable failed to establish and maintain adequate written supervisory procedures to ensure proper supervision of two registered representatives based in the Detroit, Michigan, area, for sales practices used in the offer and sale of Equitable's variable life insurance products, and failed to supervise properly certain of its Milford, Connecticut, based registered representatives in connection with private securities transactions involving limited partnerships issued by the now-bankrupt Colonial Realty Company. The NASD also found that, during a five-year period, Equitable permitted individuals to act as officers and principals without being properly registered as principals with the NASD.

As to the two Detroit-area representatives, the NASD found that Equitable failed to establish and maintain adequate written supervisory procedures to ensure the proper supervision of these representatives to prevent the following rule violations by them: use of material misrepresentations and omissions; recommendation of the purchase of variable life insurance products without reasonable grounds for believing the recommendations were suitable for the customers based on the facts disclosed to them concerning the customers' financial situations and needs; failure to disclose timely to the NASD that some 150 customer complaints had been filed against the two representatives; and use by one of the representatives of inaccurate, incomplete, and misleading radio advertise-ments.

Regarding the Connecticut agents, the NASD found that Equitable failed to supervise properly the representatives to prevent the sale of Colonial Realty limited partnerships without prior written notice to and prior written authorization from Equitable as required by NASD rules.

In addition to the censure and fine, Equitable agreed to comply with the undertakings described in its Statement of Mitigation. In this connection, Equitable has undertaken to direct its Chief Compliance Officer to conduct a review of its supervisory procedures and make

recommendations for improvements in those procedures within 90 days of acceptance of the settlement by the NASD. Among the areas to be included in the review are sales practices, advertising, suitability, private securities transactions, and timely reporting of customer complaints to the NASD. Within a specific time period thereafter, Equitable has undertaken to implement these recommendations.

This disciplinary action was taken on a coordinated basis by the NASD's Boston and Chicago DBCCs, which exercise jurisdiction over members with main and branch offices in Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont, Illinois, Indiana, Michigan, Ohio, and Wisconsin.

For Your Information

CMO Advertising Prefiling Requirement

On November 9, 1993, the Securities and Exchange Commission (SEC) approved a temporary extension for one year of the prefiling requirement relating to advertisements concerning collateralized mortgage obligations (CMOs). The prefiling requirement in Article III, Section 35(c)(2) of the NASD Rules of Fair Practice was adopted in 1992 and was set to expire on November 16, 1993. The temporary extension causes the prefiling requirement to continue in effect until November 16, 1994.

The NASD has also proposed in a separate rule filing making the CMO advertising prefiling requirement permanent. The temporary extension announced here will continue the requirement in effect until the SEC has completed its consideration of the NASD's proposal to make the requirement permanent.

NASD Member Voting Results

As a member service, the NASD publishes the result of member votes on issues presented to them for approval in the monthly Notices to Members. Most recently, members voted on the following issue:

• ***Notice to Members 93-61***—NASD Solicits Member Vote on New Rule Governing the Pricing of Open Orders; **Last Voting Date: October 29, 1993**. Ballots For 1,682; Against 232; and Unsigned 11.

Questions regarding these items should be directed to Stephen Hickman, President's Office, at (202) 728-8381.

The Nasdaq Stock Market[SM] Launches Two New Indexes and Modifies Two Others

On November 1, The Nasdaq Stock Market[SM] responded to requests for better performance indicators for Nasdaq-listed companies by launching two new indexes—Biotechnology and Computer—and changing the Utilities Index to the Telecommunications Index to reflect more accurately its composition. In addition, on October 26, the Nasdaq-100 Index®, a widely watched barometer of large-capitalization growth stocks trading on Nasdaq, was modified.

The Biotechnology and Computer Indexes—both market-value weighted—will include stocks listed in the Nasdaq National Market® and The Nasdaq SmallCap Market[SM].

When accessing these indexes on the Nasdaq Workstation®, the symbol for the Biotechnology Index is IXBIO, for the Computer Index it is IXCOM, and for the Telecommunications Index it is IXUT. To access through other services such as Quotron, etc., use the symbols IXB, IXR, and IXU, respectively.

On November 1, The Nasdaq Stock Market also changed its existing Utilities Index to a Telecommunications Index. During the past several years, the Nasdaq Utilities Index has become increasingly dominated by telecommunications issues, which last year comprised more than 90 percent of this index. Because the telecommunications issues have driven this index to its new record highs, the index needs to reflect its changing composition. The utilities issues have been moved to the Industrial Index, and the Telecommunications Index has been reset at a base value of 200.

The Nasdaq-100 Index was changed to better reflect the changing mix of Nasdaq's 100 largest non-financial companies. The new Nasdaq-100 Index will provide investment managers with a better means to build portfolios with many of Nasdaq's largest, non-financial growth companies. Options will soon be traded on the Nasdaq-100 Index by the Chicago Board Options Exchange, which has filed with the SEC to trade options and LEAPS (Long-term Equity Anticipation Securities) on the Nasdaq-100 Index.

Correction to *Notice to Members 93-76*

Notice to Members 93-76 in the November edition contains an error. The second line of the fifth paragraph under "Background and Description of the Proposal" on page 449 should read as follows:

"The NASD is proposing to amend the section to apply the preuse requirement to all investment company advertisements or sales literature that incorporate rankings or comparisons either *not* [emphasis added] generally published or created directly or indirectly by the investment company, its underwriter, or an affiliate."

The word "not" was omitted from the final version. Please note the correction in your November copy of *Notices to Members*.