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96-99

**SEC ANNOUNCES SETTLEMENT WITH NASD
AND ISSUES REPORT OF INVESTIGATION**

Washington, D.C., Thursday, August 8, 1996 -- The U.S. Securities and Exchange Commission today found that the National Association of Securities Dealers, Inc. ("NASD") failed to enforce compliance with its own rules and the federal securities laws. The findings were set forth in a Report of Investigation regarding the NASD and the Nasdaq market. The SEC simultaneously announced the institution of an administrative enforcement proceeding and the NASD's consent, without admitting or denying the Commission's findings, to the entry of an order censuring the NASD. The Order notes that in lieu of a financial penalty, the NASD has committed to spend an aggregate \$100 million over the next 5 years to enhance enforcement, surveillance, and examination of Nasdaq trading rules. The NASD also has been ordered to:

- adopt a rule explicitly prohibiting improper market maker coordination;
- design and implement a state-of-the-art audit trail to provide for better surveillance of trading rules;
- improve surveillance and enforcement of trade reporting violations;
- improve surveillance and enforcement of backing away violations, including the establishment of a complaint center to respond immediately to backing away complaints;
- improve the surveillance and examination of order handling to ensure that customer orders are executed appropriately;
- establish objective membership admission standards;
- provide for greater involvement by representatives of the public and other NASD constituencies on the NASD's Boards and policy committees;
- insulate the NASD staff from the commercial interests of NASD members;

- establish an effective, independent internal audit office reporting solely to the NASD's Board of Governors;
- establish professional hearing officers for disciplinary hearings
- retain an independent consultant to report to the Board of Governors and the Commission on compliance with these undertakings.

As discussed in the Report, the Commission's investigation found that the Nasdaq market did not consistently operate in an open and freely competitive manner. Nasdaq market makers engaged in a variety of abusive practices to suppress competition and mislead customers. As the primary regulator of the Nasdaq market, the NASD failed to carry out its obligations to oversee the market and the conduct of its market makers.

- Nasdaq market makers widely followed an anticompetitive pricing convention in which many securities were quoted only in even-eighths (i.e., $\$1/4$, $\$1/2$, $\$3/4$, and 0). As a result, these securities were quoted with minimum inside spreads of $\$1/4$, thereby increasing the transaction costs paid by many investors when buying or selling those stocks. This pricing convention was generally treated by market makers as an ethic, tradition, or professional norm that other market makers were expected to follow, and was sometimes enforced through intimidation and other conduct. The NASD failed to investigate the pricing convention and other allegations of market maker improprieties even though the NASD was aware of these practices since at least 1990.
- The investigation found that numerous market makers coordinated their quotes, transactions, and trade reports in ways that misled the market and disadvantaged their customers and other market participants.
- The NASD failed to vigorously enforce significant rules applicable to its market makers. Numerous market makers failed to honor their quotations and repeatedly failed to report their trades on time, as required by SEC and NASD rules. Certain market makers also refused to honor their trades in a discriminatory fashion against disfavored market participants such as options traders, competing specialists, shortsellers, and

others. The NASD's surveillance and enforcement of these important market integrity rules was inadequate. Certain other rules applicable to market makers and other major NASD member firms (including the MSRB's ban on political contributions to obtain municipal bond underwritings) also were not adequately enforced.

- The investigation found that Nasdaq market makers unduly influenced the NASD's regulatory processes including rulemaking, enforcement, and membership admissions.

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