

Notice To Members

National Association of Securities Dealers, Inc.

October 1990

Number 90 - 61**Suggested Routing:***

<input checked="" type="checkbox"/> Senior Management	<input type="checkbox"/> Internal Audit	<input type="checkbox"/> Operations	<input type="checkbox"/> Syndicate
<input type="checkbox"/> Corporate Finance	<input checked="" type="checkbox"/> Legal & Compliance	<input type="checkbox"/> Options	<input type="checkbox"/> Systems
<input type="checkbox"/> Government Securities	<input type="checkbox"/> Municipal	<input checked="" type="checkbox"/> Registration	<input type="checkbox"/> Trading
<input type="checkbox"/> Institutional	<input type="checkbox"/> Mutual Fund	<input type="checkbox"/> Research	<input type="checkbox"/> Training

*These are suggested departments only. Others may be appropriate for your firm.

MAIL VOTE

Subject: Proposed Amendments to Article III, Section 5(b) and Article IV, Sections 3 and 4 of the NASD By-Laws, and Article IV, Section 5 and Article V, Sections 1 and 3 of the NASD Rules of Fair Practice Re: Retention of Jurisdiction Over Member Firms and Associated Persons; Last Voting Date: November 5, 1990

EXECUTIVE SUMMARY

Members are invited to vote on proposed amendments to Article III, Section 5(b) and Article IV, Sections 3 and 4 of the NASD By-Laws, and Article IV, Section 5 and Article V, Sections 1 and 3 of the NASD Rules of Fair Practice. The amendments to the By-Laws would codify procedures currently employed by the NASD in processing terminations of associated persons and cancellations and revocations of member firms. The amend-

ments to the Rules of Fair Practice would clarify the obligation of members and persons who remain subject to the NASD's jurisdiction to respond to requests for information made by the NASD. The amendments to Article V, Sections 1 and 3 would conform those provisions to amendments to the Code of Procedure.

The text of the proposed amendments follows this notice.

BACKGROUND

A significant aspect of the NASD's self-regulatory activity is the investigation of members and associated persons to determine if their activities comply with the Association's rules and the federal securities laws. In addition to investigating the full range of potential violations, the Association also routinely investigates associated persons who have been terminated for cause to determine whether the circumstances leading to the termination involved violations of the NASD's

or other securities rules.

Currently, Article IV, Section 3(a) of the Association's By-Laws only provides the NASD limited authority to place on hold a termination for cause where any complaint or action that involves the associated person is pending, or so long as any examination of the member or associated person is in process. Where no complaint, action, or examination is in process, the NASD's practice has been to place a hold on terminations for cause when the Uniform Termination Notice for Securi-

ties Industry Registration ("Form U-5") indicates the possibility of misconduct to ensure adequate time to investigate such matters fully and to bring disciplinary action where appropriate. The effect of the hold is to prevent the termination from becoming effective and thus postpone the start of the one-year period within which, under Article IV, Section 4 of the By-Laws, an individual no longer associated with a member firm remains subject to the NASD's jurisdiction to file a complaint.

A similar issue arises in connection with the membership status of firms whose membership has been canceled or revoked. When a member firm resigns its membership voluntarily, Article III, Section 5(b) of the By-Laws currently provides that the firm remains subject to the NASD's jurisdiction to file a complaint for one year. Furthermore, a resignation does not take effect if a complaint, action, or examination is pending.

The membership of numerous firms has been canceled or revoked by the NASD for failure to pay dues, fees, and fines and to file financial reports with the NASD. However, because Article III, Section 5(b) of the By-Laws does not apply to canceled or revoked firms, the NASD does not cancel or revoke the membership of a firm as a matter of practice. Instead, the NASD holds the cancellation or revocation of the firm membership in abeyance pending completion of any investigation in which it is determined that formal disciplinary action may be warranted. This procedure frustrates the NASD's obligation to cancel or revoke the membership of firms that do not comply with NASD requirements and can lead to firms remaining in the securities business for an extended period of time.

Investigations of terminations for cause, as with other investigations, necessarily involve obtaining information from terminated individuals, typically by means of a request for information pursuant to Article IV, Section 5 of the Rules of Fair Practice. The NASD has consistently taken the position that an individual who remains subject to the filing of a complaint pursuant to Article IV, Section 4 of the By-Laws, or whose termination is subject to a hold, remains a "person associated with a member" for purposes of the individual's obligation to provide information requested by the NASD pursuant to Article IV, Section 5 of the Rules of Fair Practice. In addition, the NASD regards any failure by a member or associated per-

son to respond to Article IV, Section 5 requests for information to be a violation of Article III, Section 1 of the Rules of Fair Practice.

When required to provide information with regard to any matter involved in an NASD investigation, a member or associated person is required to testify on the record if so directed by any committee, or duly authorized agent of any such committee, in order to comply with Article IV, Section 5. The NASD's ability to require such persons to provide information regarding the circumstances of their termination and to impose sanctions for failure to do so is essential to the discharge of its regulatory obligations.

As a result of a significant number of recent disciplinary actions involving failure to provide information regarding terminations for cause and failure to provide information in response to NASD requests made pursuant to Article IV, Section 5, as well as cancellations and revocations of members and associated persons, the NASD Board of Governors decided to codify its practices to ensure the performance of its self-regulatory functions.

SUMMARY OF PROPOSED AMENDMENTS

Article III, Section 5 of the NASD By-Laws

The NASD is proposing to renumber current Section 5(b) to Article III of the By-Laws as new Section 6 and revise the provision to codify the NASD's current practice of retaining jurisdiction for one year over members whose membership has been canceled or revoked by the NASD for failure to pay a fee or fine or to file financial reports.

Article IV of the NASD By-Laws

Section 3 — The NASD is proposing to amend Article IV, Section 3(a) of the NASD By-Laws to codify the NASD's current practice of placing a hold on a termination for cause of a person associated with a member when the Form U-5 indicates that the circumstances surrounding the termination may have involved actionable misconduct. The proposed amendment would also codify the NASD's position that a hold may be imposed retroactively; that is, where a termination is permitted to become effective, the NASD may rescind the effective termination date based on the subsequent receipt of an amended Form U-5 or other information that discloses previously undiscovered misconduct. Any hold placed on the termination of

registration of an associated person operates only to preserve the Association's jurisdiction and does not affect the termination of the person's relationship with his firm.

Section 4 — Article IV, Section 4 of the NASD By-Laws currently provides that the NASD retains, for a period of one year following the effective date of termination, jurisdiction to bring a disciplinary action against a person formerly associated with a member alleging misconduct that occurred during the period of association. The NASD is proposing to amend Section 4 to codify the NASD's practice of extending the one-year jurisdictional period by placing a hold on a termination for cause and preventing the termination from taking effect. The amendment would also provide that failure of a person to respond to a request for information pursuant to Article IV, Section 5 of the Rules of Fair Practice during the period that a person is subject to the NASD's jurisdiction to file a complaint may be charged as a violation of the NASD's rules, notwithstanding that such failure occurred after the person ceased to be associated with an NASD member.

Article IV, Section 5 of the NASD Rules of Fair Practice

The NASD is proposing to amend Article IV, Section 5 of the Rules of Fair Practice to codify the NASD's position that the obligation to respond to a request for information extends to persons who remain subject to the NASD's jurisdiction to file a complaint. The NASD believes it essential that persons whose terminations are being investigated for possible misconduct be under an obligation to provide information necessary to enable staff to determine whether a complaint is warranted.

In addition, the NASD is proposing to amend Section 5 to provide that "failure" to respond to an Article IV, Section 5 request for information constitutes a violation of the NASD's rules, rather than a "refusal" as is presently provided. When a member or associated person is required to report with regard to any matter, the Association is also proposing that such person must testify on the record if so directed by any NASD committee or duly authorized agent of any such committee. Finally, the NASD is proposing that Section 5 be amended to provide that a request for information is properly made if it is sent to a member's or person's last address of record with the NASD.

CONFORMING AMENDMENTS

Article V, Sections 1 and 3 of the NASD Rules of Fair Practice

The NASD is also proposing to amend Article V, Sections 1 and 3 of the Rules of Fair Practice to conform those rules to proposed amendments to the Code of Procedure pending at the Securities and Exchange Commission (SEC), implementing the recommendations of the Special Committee on NASD Structure and Governance that would provide that the decisions of the National Business Conduct Committee (NBCC) are the final decisions of the NASD in disciplinary cases and would not require action by the full Board to become effective.¹ The proposed amendment to Section 1 would change the term "penalty" to "sanction" and empower the NBCC to impose sanctions for violations of NASD rules. The amendment to Section 3 would authorize the NBCC to impose costs of disciplinary proceedings on respondents.

The Board of Governors believes that the proposed amendments to Article III, Section 5(b) and Article IV, Sections 3 and 4 of the NASD By-Laws and Article IV, Section 5 and Article V, Sections 1 and 3 of the NASD Rules of Fair Practice are necessary and appropriate and recommends that members vote their approval. Prior to becoming effective, the proposed amendments also must be approved by the SEC.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be postmarked **no later than November 5, 1990.**

Questions concerning this notice may be directed to the Office of General Counsel at (202) 728-8294.

PROPOSED AMENDMENTS TO NASD BY-LAWS

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

ARTICLE III
Membership

¹Comments were requested on the amendments to the Code of Procedure in *Notice to Members 90-19* (April 1990) and Securities Exchange Act Rel. No. 34-28289 (July 31, 1990).

* * * * *

Resignation of Members

Current Section 5(a) is renumbered as Section 5.

Retention of Jurisdiction

[Sec. 5(b)] Sec. 6. A resigned member or a member that has had its membership canceled or revoked shall continue to be subject to the filing of a complaint under the Code of Procedure based upon conduct which commenced prior to the effective date of the member's resignation from the Corporation or the cancellation or revocation of its membership. Any such complaint, however, shall be filed within one year after the effective date of the resignation, cancellation or revocation.

Current Sections 6-9 are renumbered as Sections 7-10, respectively.

ARTICLE IV

Registered Representatives and Associated Person

* * * * *

Notification by Member to Corporation and Associated Person of Termination; Amendments to Notification

Sec. 3(a). Following the termination of the association with a member of a person who is registered with it, such member shall promptly, but in no event later than thirty (30) calendar days after such termination, give written notice to the Association on a form designated by the Board of Governors of the termination of such association, and concurrently shall provide to the person whose association has been terminated a copy of said notice as filed with the Association. A member who does not submit such notification in writing, and provide a copy thereof to the person whose association has been terminated, within the time period prescribed shall be assessed a late filing fee as specified by the Board of Governors. Termination of registration of such person associated with a member shall not take effect so long as any complaint or action is pending against a member and to which complaint or action such person associated with a member is also a respondent, or so long as any complaint or action is pending against such

person individually or so long as any examination of the member or person associated with such member is in process. The Corporation may in its discretion determine that termination of registration of such person associated with a member shall not take effect where the written notice thereof discloses that such person engaged or may have engaged in conduct that may constitute a violation of any statute, rule or regulation governing such person's activities while associated with a member. The Corporation, however, may in its discretion declare the termination effective at any time. The Corporation may also in its discretion declare the termination ineffective as of the date the Corporation first received notice of the termination if, during the period that such person remains subject to the Corporation's jurisdiction to file a complaint under the Code of Procedure as provided in Section 4 of this Article IV, the Corporation shall receive notice from any source that such person engaged or may have engaged in conduct that may constitute a violation of any statute, rule or regulation governing such person's activities while associated with a member.

(b) The member shall notify the Association in writing by means of an amendment to the notice filed pursuant to paragraph (a) above in the event that the member learns of facts or circumstances causing any information set forth in said notice to become inaccurate or incomplete. Such amendment shall be filed with the Association and provided to the person whose association with the member has been terminated not later than thirty (30) calendar days after the member learns of the fact or circumstances giving rise to the amendment.

Retention of Jurisdiction

Sec. 4. A person whose association with a member has been terminated and is no longer associated with any member of the Corporation or a person whose registration has been revoked shall continue to be subject to the filing of a complaint under the Code of Procedure based upon conduct which commenced prior to the termination or revocation or upon such person's failure, while subject to the Corporation's jurisdiction as provided herein, to provide information requested by the Corporation pursuant to Article IV, Section 5 of the NASD Rules of Fair Practice, but any such complaint shall be filed within one (1) year after

the effective date of termination of registration pursuant to Section 3 above, within one (1) year after the effective date of revocation of registration pursuant to Article V, Section 2 of the Association's Rules of Fair Practice or, in the case of an unregistered person, within one (1) year after the date upon which such person ceased to be associated with the member. In the event that the Corporation shall determine pursuant to Section 3 above that the termination of a person's association with a member shall not take effect, such person shall continue to be subject to the filing of a complaint as provided herein until, and for one (1) year following, the Corporation's determination to permit the termination to take effect.

**PROPOSED AMENDMENTS TO
NASD RULES OF FAIR PRACTICE**

ARTICLE IV

Complaints

* * * * *

**Reports and Inspection of
Books for Purposes of
Investigating Complaints**

Sec. 5. For the purpose of any investigation, or determination as to filing of a complaint or any hearing of any complaint against any member of the Corporation or any person associated with a member made or held in accordance with the Code of Procedure, any Local Business Conduct Committee, any District Business Conduct Committee, or the Board of Governors, or any duly authorized member or members of any such Committees or Board or any duly authorized agent or agents of any such Committee or Board shall have the right (1) to require any member of the Corporation, [or] person associated with a member, or person no longer associated with a member when such person is subject to the Corporation's jurisdiction to report, either informally or on the record, orally or in writing with regard to any matter involved in any such investigation or hearing, and (2) to investigate the books, records and accounts of any such member or person with relation to any matter involved in any such investigation or hearing. No such member or person [associated with a member,] shall [refuse] fail to make any report as required in this Section, or [refuse] fail to permit

any inspection of books, records and accounts as may be validly called for under this Section. Any notice requiring an oral or written report or calling for an inspection of books, records and accounts pursuant to this Section shall be deemed to have been received by the member or person to whom it is directed by the mailing thereof to the last known address of such member or person as reflected on the Corporation's records.

ARTICLE V

Sanctions [Penalties]

**Sanctions [Penalties] for
Violation of the Rules**

Sec. 1. Any District Business Conduct Committee, Market Surveillance Committee, the National Business Conduct Committee, any other committee exercising powers assigned by the Board, or the Board, [of Governors,] in the administration and enforcement of these Rules, and after compliance with the Code of Procedure, may (1) censure any member or person associated with a member, and/or (2) impose a fine upon any member or person associated with a member, and/or (3) suspend the membership of any member or suspend the registration of a person associated with a member, if any, for a definite period, and/or (4) expel any member or revoke the registration of any person associated with a member, if any, and/or (5) suspend or bar a member or person associated with a member from association with all members, and/or (6) impose any other fitting sanction [penalty] deemed appropriate under the circumstances, for each or any violation of any of these Rules by a member or person associated with a member or for any neglect or refusal to comply with any orders, directions or decisions issued by any such committee [District Business Conduct Committee, Market Surveillance Committee] or by the Board [of Governors] in the enforcement of these Rules, including any interpretative ruling made by the Board [of Governors], as any such c[Committee] or the Board, in its discretion, may deem to be just; provided, however, that no such sanction imposed by any such [District Business Conduct or Market Surveillance] c[Committee] shall take effect until the period for appeal therefrom or review thereof by the National Business Conduct Committee or the Board, as applicable, has expired[,] and any such appeal or review has been completed in ac-

cordance with [as provided in Article III, Section 1 of] the Code of Procedure; and provided, further, that all parties to any proceeding resulting in a sanction shall be deemed to have assented to or to have acquiesced in the imposition of such sanction unless a party aggrieved thereby shall have made application [to the Board of Governors] for review thereof pursuant to the Code of Procedure, within fifteen (15) days after the date of the decision rendered in such proceeding [such notice].

* * * * *

Costs of Proceedings

Sec. 3. Any member or any person associated with a [such] member disciplined pursuant to Section 1 of this Article shall bear the costs of the proceedings as [the District Business Conduct Committee] any committee referred to in such Section 1 or the Board [of Governors] deems fair and appropriate under the circumstances.

Notice To Members

National Association of Securities Dealers, Inc.

October 1990

Number 90 - 62**Suggested Routing:***

- | | | | |
|---|--|---------------------------------------|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

MAIL VOTE

Subject: Proposed Amendment Re: Use and Disclosure of Member Names; Last Voting Date: November 5, 1990

EXECUTIVE SUMMARY

The NASD invites members to vote on a proposed revision to an amendment to Article III, Section 35 of the NASD Rules of Fair Practice. The membership has previously approved an amendment to Section 35 to establish standards regarding the use and disclosure of member names in public communications, including business cards and letterhead.

Following membership approval, the NASD filed the proposed amendment with the Securities and Exchange Commission (SEC), which published the amendment for public comment. In response to comments that the

SEC received regarding the proposed amendment, the NASD proposes to make certain revisions to the planned amendment.

The revisions would create a limited exception to the general requirement that all advertising and sales literature contain the full name of a member. Under the proposed exception, advertising and sales literature would be permitted to include only a "derivative" of a member's name if the derivative name was used to promote a specific area of the member's business and was not misleading in context. The text of the amendment, as revised, follows this notice.

BACKGROUND AND SUMMARY

Pursuant to Board of Governors approval and membership vote, the NASD filed with the SEC a proposed amendment to Article III, Section 35 of the Rules of Fair Practice. The proposed amendment would establish standards regarding the use and disclosure of member names in public communications, including business cards and letter-

head. The proposed amendment reflects the concern of the Board that members of the public may be confused by public communications that either fail to refer to an NASD member firm by its registered name or include unclear references to both NASD member firms and entities that are not NASD members. The proposed amendment rests on the premise that, unless the identity of and the

products offered by an NASD member firm are made clear in such communications, there is a possibility that the public will be confused or misled regarding the identity of the entity that is, in fact, offering securities. The proposed amendment seeks to address this problem by establishing both general and specific standards governing the manner in which member names must be disclosed in communications with the public. Currently, Section 35(d)(2)(A) of the Rules requires the disclosure of the member's name in all advertising and sales literature.

The proposed amendment was submitted to the membership for comment in 1988. In response to the 41 detailed comment letters that were received, the NASD made significant modifications to the proposed amendment. *Notices to Members 88-65 and 89-22* should be consulted regarding the differences between the amendment as originally proposed and as approved by the membership. The proposed amendment was filed with the SEC on April 25, 1990, and was published for comment in the *Federal Register*. The SEC received three comment letters.

In response to these comment letters, the NASD proposes to revise the amendment so as to create a narrow exception to the general requirement that the full name of a broker-dealer appear in all of its advertising and sales literature. Under this proposed exception, a member would be permitted to use a "derivative" of its name, without also including the member's full name, if: (1) the derivative name was used to promote a specific area of the firm's business; and (2) use of the derivative would not be misleading in context. Thus, for example, if a member firm had a "derivative" name that it used to promote its investment banking business, the firm might be permitted to omit the full firm name from typical "tombstone" advertisements on the ground that the use of a derivative would not be misleading in the context of advertisements that are primarily directed to an institutional, nonretail audience.

The NASD contemplates that the availability of the proposed exception would be limited to instances in which the use of a derivative name would not be misleading in a particular context. In this regard, the NASD emphasizes that, while the use of derivative names (without disclosure of the full broker-dealer name) might not be misleading in the context of advertising and sales literature

directed to an institutional audience, the use of derivative names may well be deemed misleading if used in promotional materials disseminated to the general public.

EFFECTIVE DATE

If the foregoing proposal is approved by the membership and by the SEC, the Board of Governors believes that it is appropriate to provide members with sufficient time following SEC approval to use existing supplies of such business stationery as letterhead, business cards, confirmation forms, and similar printed material. Accordingly, the Board has concluded that, insofar as the proposed amendment affects printed business stationery, the amendment should not take effect until six months after publication of a *Notice to Members* announcing SEC approval of the amendment. The Board contemplates, however, that in all other respects the proposed amendment would become effective 30 days after the publication of a *Notice to Members* announcing SEC approval of the amendment.

The Board believes that the proposed revision to the amendment is necessary and appropriate and recommends that members vote their approval.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to The Corporation Trust Company. Ballots must be postmarked **no later than November 5, 1990**.

Questions concerning this notice can be directed to R. Clark Hooper, Director, NASD Advertising Department, at (202) 728-8330 or Anne H. Wright, Senior Attorney, NASD Office of General Counsel, at (202) 728-8815.

COMMUNICATIONS WITH THE PUBLIC

(Note: Language that has been deleted from the version of Section 35 that was previously approved by the membership is bracketed; language that has been added to that version is underlined.)

Sec. 35.

* * * * *

(d) Standards Applicable to Communications With the Public

(1) General Standards

* * * * *

(C) When sponsoring or participating in a seminar, forum, radio or television interview, or when otherwise engaged in public appearances or

speaking activities which may not constitute advertisements, members and persons associated with members shall nevertheless follow the standards of [paragraph] subsections (d) and (g) of this [s]Section.

(2) Specific Standards

In addition to the foregoing general standards, the following specific standards apply:

(A) Necessary Data: Advertisements and sales literature shall contain the name of the member, unless such advertisements and sales literature comply with subsection (g) of this Section. Sales literature shall contain the name of the person or firm preparing the material, if other than the member, and the date on which it is first published, circulated or distributed [(except that, in advertisements, only the name of the member need be stated and except also that, in any so-called "blind" advertisement used for recruiting personnel, the name of the member may be omitted)]. If the information in the material is not current, this fact should be stated.

* * * * *

(g) Standards Applicable to the Use and Disclosure of the NASD Member's Name

(1) In addition to the provisions of subsection (d) of this Section, members' public communications shall conform to the following provisions concerning the use and disclosure of member names. The term "communication" as used herein shall include any item defined as either "advertising" or "sales literature" in subsection (a) of this Section. The term "communication" shall also include, among other things, business cards and letterhead.

(2) General Standards

(A) Any communication used in the promotion of a member's securities business [(except those forms of advertising excluded under subsection (d)(2)(A) of this Section) shall] must clearly and prominently set forth the name of the NASD member. This requirement shall not apply to so-called "blind" advertisements used for recruiting personnel or to those communications meeting the provisions of subsection (g)(3) of this Section.

(B) If a nonmember entity is named in a communication in addition to the member, the relationship, or lack of relationship, between the member and the entity shall be clear.

(C) If a nonmember entity is named in a com-

munication in addition to the member and products or services are identified, no confusion shall be created as to which entity is offering which products and services. Securities products and services shall be clearly identified as being offered by the member.

(D) If an individual is named in a communication containing the names of the member and a non-member entity, the nature of the affiliation or relationship of the individual with the member shall be clear.

(E) Communications that refer to individuals may not include, with respect to such individuals, references to nonexistent or self-conferred degrees or designations, nor may such communications make reference to bona fide degrees or designations in a misleading manner.

(F) If a communication identifies a single company, the communication shall not be used in a manner which implies the offering of a product or service not available from the company named.

(G) The positioning of disclosure can create confusion even if the disclosures or references are entirely accurate. To avoid confusion, a reference to an affiliation (e.g., registered representative) shall not be placed in proximity to the wrong entity.

(H) Any reference to memberships (e.g., NASD, SIPC, etc.) shall be clearly identified as belonging to the entity that is the actual member of the organization.

(3) Specific Standards

[In addition to the foregoing general standards, the following specific standards apply:]

The foregoing standards set forth in subsections (g)(1) and (g)(2) shall apply to all communications unless at least one of the following special circumstances exists, in which case the standards set forth herein would supersede the standards in subsections (g)(1) and (g)(2).

(A) Doing Business As: An NASD member may use a fictional name in communications provided that the following conditions are met:

(i) Non-Required Fictional Name: A member may voluntarily use a fictional name provided that the name has been filed with the NASD and the SEC, all business is conducted under that name and it is the only name by which the firm is recognized.

(ii) Required Fictional Name: If a state or other regulatory authority requires a mem-

ber to use a fictional name, the following conditions shall be met:

- (1) The fictional name shall be used to conduct business only within the state or jurisdiction requiring its use.
- (2) If more than one state or jurisdiction requires a firm to use a fictional name, the same name shall be used in each, wherever possible.
- (3) Any communication shall disclose the name of the member and the fact that the firm is doing business in that state or jurisdiction under the fictional name, unless the regulatory authority prohibits such disclosure.

(B) Generic Names: An NASD member may use an "umbrella" designation to promote name recognition [or use altered versions of the firm name to promote certain areas of the firm's business], provided that the following conditions are met:

- (i) The name of the member shall be clearly and prominently disclosed[.];
- (ii) The relationship between the generic name and the member shall be clear[.]; and
- (iii) There shall be no implication that the generic name is the name of a registered broker/dealer.

(C) Derivative Names: An NASD member may use a derivative of the firm name to promote certain areas of the firm's business, provided that the name of the member is clearly and prominently disclosed. Absent such disclosure, the following conditions must be met:

- (i) The name used to promote a specific

area of the firm's business shall be a derivative of the member name; and,

- (ii) The derivative name shall not be misleading in the context in which it is being used.

(D) [(C)] "Division of": An NASD member firm may designate an aspect of its business as a division of the firm, provided that the following conditions are met:

- (i) The designation shall only be used by a bona fide division of the member. This shall include:

- (1) a division resulting from a merger or acquisition that will continue the previous firm's business; or
- (2) a functional division that conducts or will conduct one specialized aspect of the firm's business.

- (ii) The name of the member shall be clearly and prominently disclosed.
- (iii) The division shall be clearly identified as a division of the member firm.

(E) [(D)] "Service of/Securities Offered Through": An NASD member firm may identify its brokerage service being offered through other institutions as a service of the member, provided that the following conditions are met:

- (i) The name of the member shall be clearly and prominently disclosed.
- (ii) The service shall be clearly identified as a service of the member firm.

(F) [(E)] Telephone Directory Line Listings, Business Cards and Letterhead: All such listings, cards or letterhead shall conform to the provisions of Article III, Section 27(g)(2) of the Rules of Fair Practice.

Notice To Members

National Association of Securities Dealers, Inc.

October 1990

Number 90 - 63

Suggested Routing:*

- | | | | |
|---|--|---------------------------------------|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Trading |
| <input checked="" type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

MAIL VOTE

Subject: Amendment to Proposed Rule Re: Disclosure of Payment for Order Flow Practices On Customer Confirmations; Last Voting Date: November 5, 1990

EXECUTIVE SUMMARY

To improve disclosure of broker-dealer compensation for order flow and to make the disclosure more uniform, the NASD submitted a change to the Rules of Fair Practice to the Securities and Exchange Commission (SEC) in April 1990. The NASD Board of Governors has now approved a change to that proposal on which members are requested to vote. The change would require specific language to appear on each applicable customer confirmation disclosing that remuneration has been received by the firm for directing orders to particular market makers or market centers. Prior to becoming effective, the amendment must be filed with and approved by the SEC. The text of the proposed amendment follows this notice.

BACKGROUND AND EXPLANATION

In *Notice to Members 90-11*, the NASD submitted a rule proposal regarding enhanced disclosure of certain payment for order flow practices to the membership for vote. Members approved the proposal, and the rule was submitted to the Securities

and Exchange Commission (SEC) for approval. After discussions with the SEC and after reviewing comment letters filed by members and others, the Association is proposing an amendment to the rule proposal that would more specifically identify members' receipt of remuneration for directing orders to particular markets.

DISCLOSURE OF COMPENSATION

Rule 10b-10 under the Securities Exchange Act of 1934 prescribes information that a broker or dealer must disclose to its customer on the confirmation form. The rule requires, among other things, that the broker-dealer disclose whether additional remuneration has been or will be received in connection with a transaction, and that the source and amount of such payment will be furnished to the customer on written request.¹ Under this rule, therefore, payments received by a retail firm from a market maker in return for directing its order flow to the market maker are considered additional compensation and must be disclosed to the customer. The NASD Board of Governors believes that this disclosure must be more specifically stated than is the current practice and that the following language must appear on each customer

¹Rule 10b-10(a)(7), 17 CFR §240.10b-10(a)(7).

confirmation for a transaction that has been subject to a compensation plan:

The firm receives remuneration for directing orders to particular broker/dealers or market centers for execution. When such remuneration is received, it is considered compensation to the firm, and the source and amount of any compensation received by the firm in connection with your transaction will be disclosed upon request.

The proposed language differs from that previously submitted to the membership in that the new language is a more affirmative statement of payment practices. Rule 10b-10 requires the member to state *whether* it has received additional remuneration in connection with transactions, and the new language reflects this requirement. (Members that participate in payment for order flow arrangements may, of course, elect to identify that a specific payment has or has not been received on individual customer confirmations, rather than utilizing the language appearing above.) The Board of Governors approved the amended language for customer confirmations, believing that it will more clearly disclose these compensation arrangements. Therefore, the amendment will be submitted to the SEC for approval, if the membership approves the change.

Best Execution: The Board also reiterates its interpretation on best execution. The interpretation of the Board of Governors on Execution of Retail Transactions,² the "Best Execution Inter-

pretation," requires that:

[i]n any transaction for or with a customer, a member and persons associated with a member shall . . . buy or sell . . . so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

In accordance with long-standing NASD policy, this requirement is particularly applicable to situations in which firms direct their order flow to a selected dealer. Although examinations by the NASD indicate that firms that have entered into agreements for payment for order flow are obtaining the best execution of their customers' transactions, it is important for all firms to assure that they continue to obtain the best execution of trades subject to these arrangements. NASD examiners will continue to review this area during on-site examinations to ensure ongoing compliance.

The NASD Board of Governors believes this change to the Rules of Fair Practice is necessary and appropriate and recommends that members vote their approval. Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to The Corporation Trust Company. Ballots must be postmarked **no later than November 5, 1990.**

Questions or comments regarding this notice may be directed to P. William Hotchkiss, Director, Surveillance, at (202) 728-8235.

²NASD Manual (CCH) Art. III, Sec. 1, §2151.03, p. 2037.

Notice To Members

National Association of Securities Dealers, Inc.

October 1990

Number 90 - 64**Suggested Routing:***

- | | | | |
|---|--|---------------------------------------|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Amendments to the NASD By-Laws and to Schedule B Thereof to Modify the Size and Composition of the Board of Governors and the Number and Configuration of the Districts, Effective September 4, 1990

EXECUTIVE SUMMARY

The Securities and Exchange Commission has approved amendments to the NASD By-Laws and Schedule B thereof that restructure the size and composition of the NASD Board of Governors and the number and configuration of the NASD districts.

The amendments also give the Board the authority to make subsequent modifications in its composition and size and in the number and configuration of the NASD's districts.

In addition, the amendments implement other recommendations of the Special Committee on NASD Structure and Governance that were approved by the Board and the membership.

The text of the amendments follows this notice.

review the corporate structure and governance of the NASD and its subsidiaries in light of the far-reaching changes that have occurred in the securities markets and the industry serving those markets in recent years.

The Special Committee conducted an intensive study and developed a series of recommendations designed to ensure that the NASD's governance process fairly represents the increased diversity of the securities industry, that the volunteer members of the industry and the public who serve on the Board and its committees can address problems knowledgeably and efficiently, and that the process continues to command respect and confidence.

The recommendations of the Special Committee were set forth in a final report that was issued to the membership in *Notice to Members 90-19* (April 1990).

On September 4, 1990, the SEC approved a NASD rule change to restructure the size and composition of the Board and the number and configuration of the NASD districts. Also, the rule change gives the Board the authority to make subsequent modifications in its composition and size and in the number and configuration of the NASD's districts.

BACKGROUND

The Special Committee on NASD Structure and Governance ("Special Committee") was established by the Board of Governors ("Board") to

SUMMARY OF AMENDMENTS

The Board of Governors

Prior to these amendments, Article VII, Section 4(a) of the NASD By-Laws provided for a Board of 31 Governors. As amended, the provision gives the Board the authority to adjust its size to between 25 and 29 Governors in order to enhance the participation of individual Governors in the Board's deliberations and the Board's overall efficiency. Pursuant to this authority, the Board has resolved to reduce its size during the next two years to 29 Governors.

The composition of the Board has also been modified. Prior to the amendments, Article VII, Section 4 of the NASD By-Laws provided that the Board be comprised of 21 Governors elected from the districts; nine Governors elected by the Board from the securities industry, issuers and the public; and the President of the NASD. The amendments to Article VII, Section 4 require that the Board be comprised of 13 to 15 Governors elected from the districts; 11 to 13 Governors elected by the Board from the securities industry, issuers and public; and the NASD's President.

They also require that each district be represented on the Board by at least one Governor and that the total number of Governors elected from the districts constitute a majority of the Board. In addition, the Board has the authority to determine which districts shall elect more than one Governor so as to provide for fair representation of the NASD's members and of its various districts.

Of the Governors elected by the Board, one must represent the insurance industry, one must represent the investment company industry, at least three must represent investors, at least three must represent issuers, and at least three must be chosen from the members of the NASD. The amendments permit the Board to consider candidates for Governor to represent the insurance industry and the investment company industry who are not directly associated with a member.

Article X, Section 6 of the By-Laws has been amended to give the Board the authority to provide for compensation to Governors, the Chairman of the Board, and members of any committee of the Board or any district committee. Although the Board does not currently plan on providing such compensation, this amendment provides the Board with the authority to do so if it becomes necessary

to ensure successful recruitment of highly qualified candidates for services as Chairman or member of the Board, its committees, or the district committees.

Districts

Amendments to Article VII, Section 4(b), authorize the Board to consider from time to time the fairness of the representation of members by the current district structure. Whenever the Board finds any unfairness in such representation, it now is authorized to change the number and the boundaries of districts.

Pursuant to this authority, the Board has adopted specific changes to the districts set forth in Schedule B to the NASD By-Laws. Specifically, the Board has determined that the number of districts should be reduced from 13 to 11. These 11 districts will be represented on the Board by 15 of its 29 Governors. The 11 new districts will be as follows:

■ **New District 1** — The portion of existing District 2 referred to as District 2N (San Francisco), including northern California (the counties of Monterey, San Benito, Fresno, and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties), and Hawaii. Board representation: one Governor.

■ **New District 2** — The portion of existing District 2 referred to as District 2S (Los Angeles), including southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno, and Inyo) and southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye). Board representation: one Governor.

■ **New District 3** — Existing Districts 1 (Seattle) and 3 (Denver), including Alaska, Arizona, Colorado, Idaho, Montana, New Mexico, Oregon, Utah, Washington, and Wyoming. Board representation: one Governor.

■ **New District 4** — Most of existing District 4 (Kansas City) and certain neighboring states, including Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota. Board representation: one Governor.

■ **New District 5** — Most of existing District 5 (New Orleans) and certain neighboring states, including Alabama, Arkansas, Kentucky,

Louisiana, Mississippi, Oklahoma, and Tennessee. Board representation: one Governor.

■ **New District 6** — Existing District 6 (Dallas), consisting of Texas. Board representation: one Governor.

■ **New District 7** — Most of existing District 7 (Atlanta) and one neighboring state, including Florida, Georgia, North Carolina, South Carolina, Puerto Rico, the Canal Zone, and the Virgin Islands. Board representation: two Governors.

■ **New District 8** — Most of existing Districts 8 (Chicago) and 9 (Cleveland), including Illinois, Indiana, Michigan, Ohio, and Wisconsin, and part of upstate New York (the counties of Monroe, Livingston, and Steuben, and the remainder of the state west of such counties). Board representation: two Governors.

■ **New District 9** — Most of existing Districts 10 (Washington, DC) and 11 (Philadelphia), including the District of Columbia, Delaware, Maryland, Pennsylvania, Virginia, West Virginia, and southern New Jersey (the counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean, and Salem). Board representation: one Governor.

■ **New District 10** — Existing District 12 (New York) and northern New Jersey, including the five boroughs of New York City and the adjacent counties in New York (the counties of Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester) and northern New Jersey (the state of New Jersey except for the counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean, and Salem). Board representation: three Governors.

■ **New District 11** — Existing District 13 (Boston), with the exception of part of upstate New York, including Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, and New York (except for the counties of Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester; the counties of Monroe, Livingston, and Steuben, and the remainder of the state west of such counties; and the five boroughs of New York City). Board representation: one Governor.

Transition Plan

The amendments to the By-Laws and Schedule B to the By-Laws became effective September 4, 1990¹. Pursuant to its authority under Article VIII of the By-Laws, as amended, the Board

has approved a transition plan to govern the administration of the election and nomination process for the remainder of calendar year 1990 and to provide for the transition from the existing 13 District Committees and District Business Conduct Committees (DBCCs) to the District Committees and DBCCs of the 11 new and reconfigured districts.

For all matters and purposes relating to the districts (including for purposes of the Code of Procedure and for filing complaints, holding hearings and all other matters relating to the disciplinary process) other than the nomination and election process, the existing 13 District Committees and DBCCs shall maintain responsibility until the end of calendar year 1990 for all members located within the boundaries of the existing 13 Districts.

Miscellaneous Technical Amendments

The text of the amendments contains further miscellaneous technical amendments that the NASD encourages members to review.

Questions concerning this notice may be directed to P. William Hotchkiss, Director, Surveillance, at (202) 728-8235.

TEXT OF PROPOSED RULE CHANGE

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

AMENDMENTS TO THE NASD BY-LAWS

ARTICLE I

Definitions

When used in these By-Laws, and any rules of the Corporation, unless the context otherwise requires, the term:

* * * * *

(r) "Board" means the Board of Governors of the Corporation.

(s) "Governor" means a member of the Board.

ARTICLE VII

Board of Governors

* * * * *

Composition of Board

Sec. 4. (a) The management and administration of the affairs of the Corporation shall be

¹SEC Release No. 34-28289 (September 4, 1990).

vested in a Board of Governors composed of from twenty-five to twenty-nine Governors [thirty-one members], as determined from time to time by the Board. The Board shall consist of: (i) at least thirteen but not more than fifteen Governors [twenty-one] to be elected by the members of the various districts in accordance with the provisions of subsection[s] (b) [(1) through (5)] hereof;[,] (ii) at least eleven but not more than thirteen Governors [nine] to be elected by the Board [of Governors] in accordance with the provisions of subsection[s] (c) [(b)(6), (7) and (8)] hereof;[,] and (iii) the President of the Corporation to be selected by the Board [of Governors] in accordance with the provisions of Article X, Section 2 of the By-Laws. The Board, in exercising its power to determine its size and composition under this subsection (a), shall be required to select its members in a manner such that when all vacancies, if any, are filled, the number of Governors elected by the members of the various districts in accordance with subsection (b) hereof shall exceed the number of Governors (including the President) not so elected.

(b) The several districts shall be represented on the Board [of Governors]. Each district shall elect at least one Governor. The Board shall determine from time to time which districts, if any, shall elect more than one Governor, so as to provide fair representation of the Corporation's members and of its various districts on the Board. The determination of which districts shall elect more than one Governor need not be submitted to the membership for approval and shall become effective at such time as the Board may prescribe. [The elected members of the Board of Governors shall be chosen as follows:] The Board shall, from time to time, consider the fairness of the representation of members and of the various districts on the Board. Whenever the Board finds any unfairness in such representation to exist, it shall make appropriate changes in the number or boundaries of the districts or the number of Governors elected by each district to provide fair representation of members and districts.

[(1) Three members of the Board of Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 2;

(2) Two members of the Board of Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 8;

(3) Five members of the Board of Governors

shall be elected from and by the members of the Corporation eligible to vote in District No. 12;

(4) Two members of the Board of Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 13;

(5) One member of the Board of Governors shall be elected from and by the members of the Corporation eligible to vote in each of the remaining districts not referred to in Subsections (1), (2), (3) and (4) of this Section;]

(c) The Board shall elect (i) at least three Governors representative of investors, none of whom are associated with a member or any broker or dealer; (ii) at least three Governors representative of issuers, at least one of whom is not associated with a member or any broker or dealer; (iii) at least three Governors chosen from members; (iv) at least one Governor representative of the principal underwriters of investment company shares or affiliated members; and (v) at least one Governor representative of insurance companies or insurance company affiliated members.

[(6) One member of the Board of Governors shall be elected by the Board of Governors from among the principal underwriter members of investment company shares, and he shall be designated a Governor-at-Large;

(7) One member of the Board of Governors shall be elected by the Board of Governors from among insurance company members or insurance company affiliated members of the Corporation and he shall be designated a Governor-at-Large;

(8) Seven members of the Board of Governors shall be elected by the Board of Governors and they shall be designated Governors-at-Large. Any Governor-at-Large initially filling a Governor-at-Large office shall be elected at such time as the Board of Governors in its discretion deems appropriate;

(9) At least one member of the Board of Governors shall be representative of issuers and not be associated with a member, broker or dealer and at least one member of the Board of Governors shall be representative of investors and not be associated with a member, broker or dealer;

(10) The Board of Governors shall, from time to time, consider the fairness of the representation of the various districts on the Board of Governors, and whenever it finds any unfairness in such representation to exist, it shall recommend appropriate changes in these By-Laws to assure fair repre-

sentation of all districts.]

Term of Office of Governors

Sec. 5. Each [elected] Governor [member of the Board of Governors, including the Governors-at-Large], except as otherwise [herein] provided by these By-Laws or the Certificate of Incorporation, shall hold office for a term of three years, and until his successor is elected and qualified, or until his death, resignation or removal. The President of the Corporation shall serve as a member of the Board [of Governors] until his successor is selected and qualified, or until his death, resignation or removal.

Succession to Office

Sec. 6. (a) The office of a retiring Governor [member of the Board of Governors] elected under subsection[s (1) through (5)] (b) of Section 4 [3(b)] of this Article shall be filled by the election of a Governor [member] from the same district as that of the retiring Governor [member]. The office of a retiring Governor [-at-Large] elected under subsection (c) of Section 4 of this Article shall be filled by election by the Board [of Governors] as provided in subsection[s] (c) [(6), (7) and/or (8)] of Section 4 [3(b)] of this[e] Article[, as the case may be].

(b) Notwithstanding subsection (a) of this Section 6, the Board shall prescribe the succession of office in cases affected by a change in the number of Governors constituting the Board, the composition of the Board, the number or boundaries of districts, or the number of Governors elected by a district.

Election of Board Members

Sec. 7. The [elected members of the Board of] Governors elected under subsection (b) of Section 4 of this Article shall be chosen as follows:

* * * * *

Transitional Procedures

(d) Notwithstanding subsections (a), (b) and (c) of this Section 7, the Board shall prescribe the nomination and election procedures in cases affected by a change in the number of Governors constituting the Board, the composition of the Board, the number or boundaries of districts, or the number of Governors elected by a district.

Filling of Vacancies on Board

Sec. 8. All vacancies in the Board [of Governors] other than those caused[s] by the expiration of a Governor's term of office, shall be filled as follows:

(a) If the unexpired term of a Governor elected under subsection[s] (b) [(1) through (b)(5)] of Section 4 [3] of this Article[,], is for less than twelve months, such vacancy shall be filled by appointment by the District Nominating Committee of a representative of a member of the Corporation eligible to vote in the same district.

(b) If the unexpired term of a Governor[,], elected under subsection[s] (b) [(1) through (b)(5)] of Section 4 [3] of this Article[,], is for twelve months or more, such vacancy shall be filled by election, which shall be conducted as nearly as practicable in accordance with the provisions of Section 7 [6] of this Article.

(c) If the unexpired term is that of a Governor[-at-Large] elected by the Board, such vacancy shall be filled in accordance with the provisions of subsections (c)(i) through (c)(v) [(b)(6), (b)(7), and/or (b)(8)] of Section 4 [3] of this Article as the case may be.

ARTICLE VIII

**District Committees
Administrative Districts**

Sec. 1. For the purpose of administration, the United States is hereby divided into districts, the boundaries of which shall be established by the Board [of Governors]. The Board [of Governors] may from time to time make such changes in the number or boundaries of such districts as it deems necessary or appropriate. Neither the establishment nor any change in the number or boundaries of such districts need be submitted to the membership for approval, and the number or boundaries, as established or changed, shall become effective at such time as the Board [of Governors] may prescribe. The Board shall prescribe such policies and procedures as are necessary or appropriate to address the implementation of a new district configuration in the event of a change in the number or boundaries of the districts.

**District Committees and
District Business Conduct Committees**

Sec. 2. (a) For the purpose of effectuating a maximum degree of local administration of the af-

fairs of the Corporation, each of the districts created under Section 1 of this Article shall elect a District Committee, as hereinafter provided. Each such District Committee shall determine the number of its members so to be elected, but [in] no [event shall any] District Committee shall consist of more than twelve members[;] unless otherwise provided[,] [however, that] by resolution of the Board, [of Governors by resolution may increase, upon request, any such District Committee to a larger number.]

* * * * *

Transitional Provisions

Sec. 12. The Board, by resolution amending or supplementing the provisions of this Article and Article IX, shall have the authority to establish the policies and procedures applicable to District Committees affected by a change in the number or boundaries of the districts, including, without limitation, prescribing the procedures for nomination and election of District Committee members.

ARTICLE IX

Nominating Committees

Composition of Nominating Committees

Sec. 1. (a) Each of the Districts created under Section 1 of Article VIII of the By-Laws shall elect a Nominating Committee, as provided in Section 3 of this Article. Each such Nominating Committee shall consist of five members; provided, however, that the Board [of Governors] by resolution may increase any such Nominating Committee to a larger number. Members of the Nominating Committee in each District shall be members of the Corporation having places of business in the respective District, but shall not be members of the District Committee. All Nominating Committees shall include a majority of persons who have previously served on a [the] District Committee [and/] or who are current or former [on the Board of] Governors, and shall [, insofar as practicable,] include at least one current or former [member of the Board of] Governor[s].

* * * * *

Transitional Provisions

Sec. 7. The Board, by resolution amending or supplementing the provisions of this Article and Ar-

ticle VIII, shall have the authority to establish the policies and procedures applicable to District Nominating Committees affected by a change in the number or boundaries of the districts, including, without limitation, prescribing the procedures for nomination and election of District Nominating Committee members.

ARTICLE X

Officers and Employees

* * * * *

[Restrictions on] Compensation of Board and Committee Members

Sec. 6. [No member of] The Board [of Governors (except the President of the Corporation or the President pro tem), no member of any District Committee and no member of any other Committee, other than an Extended Hearing Committee as defined in Article I of the Corporation's Code of Procedure shall be entitled to] may provide for reasonable [received any] compensation of the Chairman of the Board, Governors, and the members of any committee of the Board or any District Committee from the Corporation. [for any work done in connection with his duties as a member of the Board of Governors, any District Committee or any other committee. However, such persons shall be entitled to] The Board may also provide for reimbursement of [for] reasonable expenses incurred by such persons in connection with the business of the Corporation.

ARTICLE XI

Committees

National [Standing] Committees

Sec. 1. The Board [of Governors] may appoint such [standing and other] committees or subcommittees as it deems necessary or desirable, and it shall fix their powers, duties and terms of office. Any such committee or subcommittee consisting of one or more Governors, to the extent provided by these By-Laws or by resolution of the Board, shall have and may exercise all powers and authority of the Board in the management of the business and affairs of the Corporation.

[District Standing]

Committees of the Districts

Sec. 2. Each District Committee, in the exercise of its powers and performance of its duties as

provided in the By-Laws, may, except as otherwise herein provided, appoint such [standing or other] committees or subcommittees as it deems necessary or desirable, and shall fix their powers, duties and terms of office.

Removal of Committee Member

Sec. 3. Any member of any committee or subcommittee appointed pursuant to [Sections 1 or 2 of] this Article XI may be removed from office, after appropriate notice from the District Committee appointing such member, or from the Board [of Governors], if it is the appointing authority, for refusal, failure, neglect or inability to discharge his duties, or for any cause the sufficiency of which shall be decided by the District Committee or the Board [of Governors], whichever is the appointing authority.

ARTICLE XIV

Powers of Board to Prescribe Sanctions

The Board [of Governors] is hereby authorized to prescribe appropriate sanctions applicable to members, including censure, fine, suspension or expulsion from membership, suspension or barring from being associated with all members, limitation of activities, functions and operations of a member, or any other fitting sanction, and to prescribe appropriate sanctions applicable to persons associated with members, including censure, fine, suspension or barring a person associated with a member from being associated with all members, limitation of activities, function and operations of a person associated with a member, or any other fitting sanction, for:

* * * * *

(d) refusal by a member or person associated with a member to abide by an official ruling of the Board [of Governors] or any committee [Uniform Practice Committee acting within its appropriate authority] exercising powers assigned [delegated] by the Board with respect to any transaction which is subject to the Uniform Practice Code; or

(e) failure by a member or a person associated with a member to adhere to any ruling, order, direction or decision of, or to pay any penalty, fine or costs, imposed by, the Board [of Governors], the National Business Conduct Committee, the Market Surveillance Committee, any other com-

mittee exercising powers assigned [delegated] by the Board or any District Business Conduct Committee.

AMENDMENTS TO SCHEDULE B OF THE BY-LAWS

Schedule B

The number and t[T]erritorial boundaries of the several districts established as provided in Section 1 of Article VIII and the number of Governors elected from the several districts established as provided in Section 4(b) of Article VII of the By-Laws of the Corporation[,] are as follows:

■ District No. 1 — State of Hawaii; in the State of California, the Counties of Monterey, San Benito, Fresno and Inyo, and the remainder of the State North or West of such Counties; and in the State of Nevada, the Counties of Esmeralda and Nye, and the remainder of the State North or West of such Counties. [States of Alaska, Idaho, Montana, Oregon and Washington.]

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 1.

■ District No. 2 — In the State of California, that part of the State South or East of the Counties of Monterey, San Benito, Fresno and Inyo; and, in the State of Nevada, that part of the State South or East of the Counties of Esmeralda and Nye. [States of California, Nevada and Hawaii.]

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 2.

■ District No. 3 — States of Alaska, Arizona, Colorado, Idaho, Montana, New Mexico, Oregon, Utah, Washington and Wyoming.

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 3.

■ District No. 4 — States of Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota [Oklahoma].

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 4.

■ District No. 5 — States of Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma and [in the State of] Tennessee[, the Counties of Montgomery, Dickson, Hickman, Lewis and Lawrence and the remainder of the State lying West of such Counties].

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 5.

■ **District No. 6** — State of Texas.

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 6.

■ **District No. 7** — States of Florida, Georgia, North Carolina, and South Carolina [, and, in the State of Tennessee, the Counties of Robertson, Cheatham, Williamson, Maury and Giles and the remainder of the State lying East of such Counties,]; Puerto Rico, Canal Zone and the Virgin Islands.

Two Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 7.

■ **District No. 8** — States of Illinois, Indiana, [Iowa,] Michigan, [Minnesota,] [North Dakota,] Ohio [South Dakota] and Wisconsin, and, in the State of New York, the Counties of Monroe, Livingston and Steuben, and the remainder of the State West of such Counties.

Two Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 8.

■ **District No. 9** — The District of Columbia, and the States of Delaware, Maryland, Pennsylvania, Virginia and West Virginia, and, in the State of New Jersey, the Counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean and Salem [States of Kentucky and Ohio].

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 9.

■ **District No. 10** — In the State of New

York, the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester, and the five Boroughs of New York City, and the State of New Jersey (except for the Counties of Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Mercer, Ocean and Salem) [The District of Columbia and the States of Maryland, North Carolina and Virginia].

Three Governors shall be elected from and by the members of the Corporation eligible to vote in District No. 10.

■ **District No. 11** — [The] States of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont and New York (except for the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester; the Counties of Monroe, Livingston and Steuben, and the remainder of the State West of such Counties; and the five Boroughs of New York City) [Delaware, Pennsylvania, West Virginia and New Jersey, except for the Counties of Bergen, Essex, Hudson, Passaic and Union].

One Governor shall be elected from and by the members of the Corporation eligible to vote in District No. 11.

■ **[District No. 12** — In the State of New York, the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester, and the five Boroughs of New York City, and, in the State of New Jersey, the Counties of Bergen, Essex, Hudson, Passaic and Union.]

■ **[District No. 13** — States of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont and New York, with the exception of the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester, and the five Boroughs of New York City.]

Notice To Members

National Association of Securities Dealers, Inc.

October 1990

Number 90 - 65

Suggested Routing:*

- | | | | |
|---|--|--|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Suggested Customer Suitability Statement and Agreement to Purchase Form for Members' Compliance With SEC Rule 15c2-6

EXECUTIVE SUMMARY

The NASD is publishing a suggested Customer Suitability Statement and Agreement to Purchase Form to assist members in complying with SEC Rule 15c2-6.

BACKGROUND AND SUMMARY

Effective January 1, 1990, the SEC adopted Rule 15c2-6, the so-called "Penny Stock/Cold Call Rule," in response to widespread unsuitable recommendations and other abusive sales practices by certain broker-dealers involving transactions in low-priced securities not listed on NASDAQ or the exchanges. The rule imposes special suitability and recordkeeping requirements on certain broker-dealers that recommend transactions in designated securities to persons who are not "established customers." Designated securities are generally defined as equity securities of companies having less than \$2 million in net tangible assets and are selling below \$5 per share. All securities listed on NASDAQ or a national securities exchange in the U.S. are exempt from the rule.

SEC Rule 15c2-6 prescribes specific procedures a firm must follow before such designated securities can be recommended to nonestablished

customers. Included is the requirement to obtain from each customer oral or written suitability information detailing such a customer's previous investment experience, investment objectives, and financial situation. The scope of the information gathered is very important. With that information, the firm must reasonably determine whether transactions in these designated securities are suitable for the particular customer.

If the firm determines that the securities are suitable for purchase by the customer, the firm must prepare a written statement of its reasons for making such a determination, deliver it to the customer, and secure a manually signed copy from the customer acknowledging receipt of the firm's suitability determination. The customer also must review and agree that the information contained on the form from which the suitability determination was made accurately reflects the customer's financial situation, investment objectives, and investment experience.

In addition, the firm must obtain the customer's written agreement for the first three purchase transactions involving designated securities. Both the customer suitability statement and the written agreement must be properly executed by the customer and then received by the firm prior to any transactions in designated securities.

NASD members have requested guidance con-

cerning the extent of customer information that must be gathered to make a suitability determination, and the proper text of both the firm's suitability determination and the customer's written agreement for the transaction. To assist members in complying with SEC Rule 15c2-6, the NASD, in collaboration with the SEC staff, is publishing a suggested Customer Suitability State-

ment and an Agreement to Purchase Form, which follow this notice. Please note that these suggested forms are intended to serve as models, not as requirements for use.

Questions concerning this notice should be directed to Gary Carleton or Daniel Sibears, NASD Compliance Division, at (202)728-8959.

Suggested Customer Suitability Statement and Agreement to Purchase Form

[INSERT BROKER-DEALER'S LETTERHEAD]

CUSTOMER SUITABILITY STATEMENT
(Required for Designated Securities¹)

I. Personal Information²

Name _____ Account # _____

Address _____

Soc. Sec. or Taxpayer ID # _____

Telephone: (Home) _____ (Business) _____

Marital Status: ___ Single ___ Married Number of Dependents _____

Age _____

Occupation _____ Position _____

Employer _____

Address _____

Length of Time Employed (If less than two years, provide name of previous employer.) _____

Highest Level of Education _____ Degree(s) _____

Annual Income: (check one)

___	Below \$20,000	___	\$20,000 to \$35,000	___	\$35,000 to \$50,000
___	\$50,000 to \$100,000	___	\$100,000 to \$200,000	___	Over \$200,000

Net Worth (excluding primary residence): (check one)

___	Below \$50,000	___	\$50,000 to \$100,000	___	\$100,000 to \$500,000
___	\$500,000 to \$1 million	___	Over \$1 million		

Liquid Net Worth (cash, equity securities, bonds, etc.): (check one)

___	Below \$10,000	___	\$10,000 to \$25,000	___	\$25,000 to \$50,000
___	\$50,000 to \$100,000	___	Over \$100,000		

¹Generally, Designated Securities are low-priced securities of companies that have less than \$2 million in net tangible assets and are not listed on NASDAQ or a national securities exchange located in the United States. Investments in Designated Securities are generally regarded as highly speculative in nature and could result in the loss of the customer's entire investment.

²For joint accounts, a separate sheet containing the personal information requested in Section I must be completed for each joint account holder.

Sources of Annual Income (as a percentage of total income):

Employment Compensation _____ %

Investment Income _____ %

Other (please specify): _____ %

New Account? Yes No If no, date account opened _____

Source of Information for Section I above: (check one)

Customer

Other (please identify): _____

II. INVESTMENT OBJECTIVES AND EXPERIENCE

Investment Objectives: (If more than one, give order of importance.)

Income (Cash-generating, high dividend stocks and bonds)

Growth (Long-term capital appreciation)

Safety of Principal/Income (Protection of investment plus income)

Safety of Principal/Growth (Protection of investment plus growth)

Speculation (High risk of loss)

Other (please specify): _____

Investment Experience:

	<u>Years of Experience</u>	<u>Trading Frequency</u>	<u>Type of Account Cash/Margin</u>	<u>Dollar Amount of Average Trade</u>
Non-NASDAQ/nonexchange ³ stocks priced less than \$5 per share				
Other stocks priced less than \$5 per share				
Stocks (other than above)				
Options				
Bonds				
Commodities				
Other (please specify): _____				

Source of Information for Section II above: (check one)

Customer

Other (please identify): _____

³This category refers to low-priced securities traded on the OTC Bulletin Board, in the "Pink Sheets," or any other interdealer quotation medium since those securities are traded neither on a securities exchange (such as the New York Stock Exchange, American Stock Exchange, etc.) nor on NASDAQ.

III. INVESTMENT ADVISER (If not applicable, check here .)

If there is no Investment Adviser for this account, check the box above and proceed to Section IV below. If you have retained an independent adviser to assist you in evaluation of the purchase of Designated Securities in this account, please provide the following information:

Name of Adviser _____

Business Address _____

Business Telephone _____

Credentials/Experience (to extent known by customer) _____

Length of Time Adviser Has Advised Customer _____

IV. OTHER INFORMATION

Customer may provide any other information he or she deems relevant to his or her financial status, investment objectives, or investment experience. Attach additional sheets if necessary.

V. SUITABILITY DETERMINATION

Dear Customer:

Based on the information provided in Sections I through IV above, regarding your financial situation, investment objectives, and investment experience, for the reasons set forth below, we have determined that transactions in Designated Securities are suitable for you. In addition, we have determined that you have sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in Designated Securities. The following analysis is the basis for this evaluation: (MUST BE COMPLETED)

Signature of Principal of Firm

Date

UNDER SECURITIES AND EXCHANGE COMMISSION RULE 15c2-6, IT IS UNLAWFUL FOR US TO EFFECT THE SALE OF DESIGNATED SECURITIES TO YOU UNLESS WE HAVE RECEIVED FROM YOU, PRIOR TO THE TRANSACTION, A WRITTEN AGREEMENT TO THE TRANSACTION.

WE ARE REQUIRED TO PROVIDE YOU WITH THIS STATEMENT AS TO THE SUITABILITY OF TRANSACTIONS IN DESIGNATED SECURITIES FOR YOU. PLEASE READ IT VERY CAREFULLY. YOU SHOULD NOT SIGN AND RETURN THIS STATEMENT IF IT DOES NOT ACCURATELY REFLECT YOUR FINANCIAL SITUATION, INVESTMENT OBJECTIVES, AND INVESTMENT EXPERIENCE, OR IF YOU DO NOT UNDERSTAND THE BASIS SET FORTH ABOVE, OF OUR DETERMINATION THAT TRANSACTIONS IN DESIGNATED SECURITIES ARE SUITABLE FOR YOU.

Signature of Customer(s)

Date

Signature of Customer(s)

Date

Comments: _____

Note: Do not return this completed form to the brokerage firm via facsimile transmission or any other form of electronic transfer. The firm must have the original copy of this form before it can effect transactions in Designated Securities.

[INSERT BROKER/DEALER'S LETTERHEAD]

AGREEMENT TO PURCHASE

UNDER SECURITIES AND EXCHANGE COMMISSION RULE 15c2-6, IT IS UNLAWFUL FOR US TO EFFECT THE SALE OF THE DESIGNATED SECURITIES IDENTIFIED BELOW UNLESS WE HAVE RECEIVED, *PRIOR TO THE TRANSACTION*, A WRITTEN AGREEMENT TO THE TRANSACTION.

By signing below, you are agreeing to the purchase of the shares identified below at a price that will be confirmed to you for your agreement by your account executive prior to execution of the transaction.

DESIGNATED SECURITIES:

Name of Issuer _____

Type of Security (common stock, units, warrants, etc.) _____

Number of Shares _____

Signature of Customer(s) Date

Signature of Customer(s) Date

Signature of Registered Representative Date