

ALERT

Fines Total \$650,000

NASD Expels First Fidelity Capital, Bars President

The NASD has disciplined First Fidelity Capital Corp. of New York, New York, and Ted Lawrence Rubin, the firm's president, general securities principal, and trader.

The allegations of misconduct against the firm and Rubin involved fraudulently excessive markups, totaling more than \$510,000, that the firm charged its customers who purchased shares of Resource Network International, Inc. (RNI), an over-the-counter stock.

The NASD also sanctioned Rubin and the firm for violating Article III, Section 18 of the NASD's Rule of Fair Practice as well as various anti-fraud provisions of the federal securities laws, for misconduct in the underwriting involving the use of nominee accounts, and for failure to make a bona fide public distribution of the stock.

As a result of the egregious nature of the alleged violations, the NASD censured and, jointly and severally, fined First Fidelity Capital and Rubin \$650,000, expelled the firm from membership in the NASD, and barred Rubin from association with any NASD member in any capacity.

The sanctions followed the acceptance of an Offer of Settlement made by the firm and Rubin, pursuant to which they neither admitted nor denied the allegations against them.

Firm Underwrote Offerings

First Fidelity Capital Corp. underwrote the RNI initial public offering and sold 90 percent of the offer-

ing to its customers. The NASD found that, from the beginning of aftermarket trading in the stock on July 8, 1987, through July 24, 1987, the firm, acting through Rubin, dominated and controlled the market for RNI.

In 171 transactions during this time, customers who purchased the stock from the firm were charged fraudulently excessive markups totaling \$73,000, ranging from 14 percent to 52 percent above the prevailing market price of the securities, the findings stated.

First Fidelity Capital also acted as the underwriter for the secondary public offering of RNI in July 1988 and placed 100 percent of the securities offered with its customers. The NASD found that, during the period from September 1, 1988, through December 31, 1988, the firm, acting through Rubin, again dominated and

controlled RNI's market.

In 553 transactions during this time, customers who purchased the stock from the firm were charged fraudulently excessive markups totaling \$438,000, ranging from 18 percent to 95 percent above the prevailing market price of the securities, the findings stated.

Almost half of the RNI securities sold by First Fidelity Capital in the initial public offering were sold to customers of Rubin.

The NASD found that Rubin controlled the price, trading, and repurchase of RNI in the aftermarket and that he used the control arbitrarily to set the opening price for the stock at a premium.

It further found that Rubin used the inducement of the premium price to urge many of his own customers to sell their RNI stock back to the firm, which then resold the stock back to public customers at higher prices.

The NASD concluded that the customers of Rubin who bought

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shares at the public offering price were not bona fide public customers, but rather were nominees of Rubin, and that the RNI underwriting distribution continued until all of the stock distributed to and repurchased from these individuals came to rest in accounts of bona fide public customers.

Anti-Fraud Violations

Accordingly, the NASD found that First Fidelity Capital and Rubin violated SEC anti-fraud regulations Rules 10b-6 and 10b-9.

Rule 10b-6 prohibits an underwriter from bidding for or purchasing the securities offered until it has completed its participation in a distribution. The rule is intended to prevent persons benefiting from a distribution from engaging in market transactions to increase artificially the market price for those securities.

Rule 10b-9 requires that the proceeds of an all-or-none offering, such as the RNI issue, be refunded if all of the offering is not sold to the public within a specified time.

Sales to Family Members

The NASD also found that First Fidelity Capital's sales of 4,500 units (45,000 shares) of RNI to the wife of the president of another broker-dealer and 140 units (1,400 shares) to an associated person of a different broker-dealer violated the NASD's fair dealing rules and were in contravention of the NASD's "Free-Riding and Withholding Interpretation."

The interpretation prohibits the sale of "hot issue" securities (i.e., those that trade at a premium in the immediate aftermarket) to another broker-dealer, an associated person of a broker-dealer, or to a member of the immediate family of such person.

Joint Effort

Conducted jointly by the NASD's District 12 office in New York and the Anti-Fraud Department in Washington, D.C., this investigation is part of the nationwide NASD effort to eliminate sales and trading practice abuses in the OTC penny-stock market.

NASD Acquires PLATO Test Centers, Plans Expansion

The NASD recently exercised its option to acquire the nationwide network of PLATO Professional Development Centers from The Roach Organization, Inc. (TRO).

The acquisition, effective January 1, 1991, includes more than 60 test-center sites located in major U.S. cities, a staff of 200, and related equipment.

The NASD, the network's largest user, acquired the centers to gain increased efficiencies in carrying out its regulatory function of administering qualification examinations to prospective registered representatives and principals of member firms.

The NASD has been using the PLATO network for more than a decade to administer as many as 250,000 securities industry qualification tests a year on the centers' 600 computers.

In addition to conducting its own qualification examinations, the NASD administers a variety of examinations on behalf of other self-regulatory organizations, the states, the commodities industry, and other certifying organizations.

The entire securities industry qualification program is now delivered in automated form.

TRO Involvement

TRO will continue to manage the computer system and operating software for all centers, and it will market the system's unique computer-based testing services to certifying and licensing agencies in both the private and public sectors.

The NASD will retain responsibility for marketing the testing services to securities-related fields and banking.

Cost Control Cited

"We are inextricably involved

in the testing business, and direct ownership of the network will enable us to better control costs as well as upgrade the technology and software that drive the system," says NASD President Joseph R. Hardiman. "In partnership with TRO, new opportunities to provide testing and certification in fields outside the securities industry will be explored."

Proposals Would Increase Short-Sale Monitoring

The NASD recently filed with the SEC for approval two changes to its Prompt Receipt and Delivery Interpretation that deal with short sales and covering transactions. One amendment to the Interpretation addresses compliance with SEC Rule 10b-21.

Generally, Rule 10b-21 prohibits a person from covering a short position created during the period between the filing of a registration statement and the time that sales may be made pursuant to that statement, with shares obtained in a secondary offering.

Required Inquiries

Therefore, the proposed new language requires a broker-dealer that has effected short sales during this period, in addition to meeting its existing obligations under the Interpretation, to also inquire as to whether the customer's long-sale stock was obtained in the secondary offering before that member accepts the long sale.

Short selling before a secondary distribution can reduce the price of the security prior to the offering date, resulting in a lower offering price and reduced proceeds to issuers.

Because they know a new supply of shares is coming to market, short sellers with assured access to shares obtained in the offering under such circumstances can protect themselves from normal market risks asso-

ciated with covering their short sales.

With securities purchased in the distribution at the reduced offering price, they can cover the short positions they established earlier at the higher market price.

To counter this problem, Rule 10b-21 prohibits persons from shorting equity securities of the same class of securities offered and covering short positions with securities purchased from a participant in the offering.

Exempt Activities

Because Rule 10b-21 does not cover them, the NASD's proposal would not apply to best-efforts or Rule 415 "shelf" offerings.

In addition, the representation would not be required for customer transactions involving 3,000 shares or less effected through automated execution systems.

The second proposal would require a member to create a written record of the affirmative determination made before effecting a short sale.

For long sales, a member already has the obligation to create a written record of the affirmative determination on the order ticket at the time the order is placed. However, no such requirement currently exists for short sales.

Get It in Writing

To assist its investigatory and enforcement efforts, the NASD's proposal would require that the affirmative determination made before a customer or proprietary short sale be evidenced in writing and that the executing member maintain the written record.

The written record would include the customer's name, account number, and short-sale order information; the identity of the individual and firm contacted who offered assurances that the shares would be delivered or borrowed by settlement date; the identity of the person making the affirmative determination; and the time of the inquiry. Each member would decide for itself the form of documenting the determination.

Malone, Staff Sanctioned for Excessive "Penny Stock" Markups

The NASD recently disciplined Malone & Associates, Inc., of Denver, Colorado; Robert G. Malone, its president; Ted Paul Spires, Jr., the firm's former sales manager; and, J. Paul Carter, formerly a trader at the firm.

The misconduct involved fraudulently excessive markups in units of Chartwell Cable Fund, Inc., an over-the-counter penny stock, and a failure to supervise with respect to those markups.

Pursuant to a Letter of Acceptance, Waiver and Consent, without admitting or denying the allegations, the firm and Malone were censured and fined \$136,000, jointly and severally. Malone was suspended from association with any member in any capacity for 15 calendar days and was suspended for 75 calendar days from associating with any member in any principal or supervisory capacity.

Malone was also ordered to requalify as a principal by examination prior to acting in such a capacity.

Separate Fines

Separately, Spires, Carter, Malone, and the firm were fined \$25,000, jointly and severally. Spires was censured and suspended from associating with any member in any principal or supervisory capacity for 30 calendar days.

Spires was also ordered to requalify as a principal by examination before acting in such a capacity.

Carter was censured and suspended for 30 calendar days from associating with any member in any trading capacity. As part of the settlement, the firm also agreed to make certain changes to its business practices.

These changes include delivering shares to customers rather than holding them in street name for underwritings in which the firm sells 60

percent or more of the offering to its own customers.

Without admitting or denying the findings, all respondents consented to findings that they violated various NASD rules, including Section 18 of its Rules of Fair Practice. Section 18 prohibits the use of any manipulative, deceptive, or other fraudulent devices in the purchase or sale of any security.

Firm Underwrote IPO

The firm underwrote Chartwell's initial public offering dated December 4, 1987, and placed almost 95 percent of the offering with its own clients.

The NASD found that, from the beginning of aftermarket trading on January 7, 1988, through January 29, 1988, the firm, Malone, Spires, and Carter, while dominating and controlling the market for Chartwell units, charged fraudulently excessive markups of more than 10 percent above the firm's contemporaneous cost in its principal sales to retail customers.

The NASD also found that, during the same time period, the firm, Malone, and Spires failed to properly supervise the firm's associated persons and its over-the-counter trading department to assure compliance with the NASD's rules and policies on markups.

Conducted by the NASD's Anti-Fraud Department, this investigation is another in a series of nationwide NASD enforcement actions to address fraud and sales practice abuses in penny stocks.

The NASD's Market Surveillance Committee took the actual disciplinary action.

NASD Focuses On Trading Activity at End of The Day

The Market Surveillance Committee ("the Committee") has issued several decisions imposing significant sanctions against

individuals who engage in the practice referred to as "marking the close" of the market. This practice is the unlawful influencing of the closing price of a security through the entry of trades at or near the end of the day.

Pattern of Trading

While a number of the disciplinary actions in this area have involved the entry of fictitious trades, the Committee has recently reviewed cases that involve a pattern of entering actual or substantive trades at the close for the purpose of influencing the closing price of a security.

In many instances, the trader or salesman intentionally enters these orders at or near the end of the trading day to artificially influence the closing price because of an inventory position in a particular security, margin difficulties in his personal account or the accounts of his customers, or substantial holdings in the security by the registered representative or his customers.

The Committee urges all members to review their compliance procedures to ensure adequate supervision in this area.

To assist members in their monitoring for fictitious trades, each member's trade reports to the Nasdaq system are currently available to the member firm on request to the NASD Market Surveillance Department.

Electronic Format

The trades may then be cross-checked against the internal records of the firm. These trade reports will soon be available to be given back to members in an electronic format.

Members will be informed as to the availability of this new service which is currently being tested.

To guard against violations related to the pattern or practice of entering substantive or actual trades near the close, it is suggested that members regularly review the firm's trading to detect such practices. It is particularly important that each member consider its size and the number of trades it processes in assessing the

adequacy of its procedures.

Thus, the Committee believes that a large firm that effects numerous transactions daily should consider implementing systems that generate automated exception reports specifically designed to detect patterns of end-of-the-day trading in order to effectively carry out its supervisory responsibilities.

In reviewing cases that come to its attention, the Market Surveillance Committee will continue to look closely at the compliance and supervisory systems of firms that have failed to detect unlawful end-of-the-day trading and will consider whether those systems were adequate under the circumstances.

For further information, contact Katherine A. Malfa, Counsel, Market Surveillance at (301) 590-6445.

New Definition Targets Abusive SOES Trading by Professionals

Eliminating the abuse of the NASD's Small Order Execution System (SOES) by professional traders is the aim of a SOES rule change recently filed with the SEC. The proposal expands the definition of "professional trading account" to include new criteria for the NASD to consider when reviewing an account for professional trading activity in SOES.

The mere existence of these conditions would not mean an account is a professional trading account. However, they are factors to be considered when making such a determination and could cause the NASD to identify an account as such in the presence of SOES abuses. These new criteria include:

- Excessive frequency of short-term trading;
- Excessive frequency of short-sale transactions;
- Existence of discretion.
- Direct or physical access to SOES execution capability; or

- Direct or physical access to Nasdaq Level 2 service.

SOES now terms a professional trading account as one with five or more day trades executed through SOES during any trading day that demonstrates a specific method of trading in SOES. This includes a pattern or practice of day trading, executing a large volume of day trades in relation to the total transactions in the account, or executing a large volume of day trades in relation to the share amount and dollar value of securities held in the account.

Effect on Surveillance

By limiting the term to day trading, the existing rules don't cover other types of professional trading that result in the abuse and misuse of SOES. Based on experience, misuse of SOES by certain members is caused by other types of objectionable practices that exhibit professional characteristics outside the context of day trading.

For example, the NASD's Market Surveillance Department has received a number of complaints from member firms alleging that some firms have placed orders through SOES to take advantage of late-breaking news coming in over the news wires or while the market makers were updating their quotes. There are certain order-entry firms or market makers that trade through SOES on behalf of accounts for which the trader exercises discretion, thus using the system ostensibly for retail customers.

In addition, some firms let customers observe traders in the firms' trading rooms or directly contact traders through open telephone lines. These customers have access to electronic news and quotation services that permit them to place orders through SOES on news or before the last market maker at the inside has changed its quote to reflect market movement.

Advantage of Changes

In the NASD's view, the proposed changes would enable Market

Surveillance, when SOES abuses are detected, to apply the additional criteria when reviewing and considering the pattern and practice of trading in an account. These criteria would come into play only after Market Surveillance detects a pattern or practice of "professional" use of SOES.

After analyzing trading in suspect accounts, Market Surveillance, along with the Chairman of the Market Surveillance Committee, could prohibit access to SOES for an account evidencing characteristics of professional trading. These changes also permit a member to appeal a professional account designation to the Market Surveillance Committee and the NASD Board of Governors.

The proposal would also expand the definition of professional trading accounts to include accounts with day trades that have one or both sides executed through SOES.

Members Vote to Clarify NASD Jurisdiction, Codify Process

The NASD members recently voted to approve proposals to amend the NASD's By-Laws and Rules of Fair Practice, subject to SEC approval.

The By-Laws changes affect the manner in which the NASD processes terminations for cause and cancellations or revocations of members.

The changes 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 NASD requests for information. One change would apply the retention of jurisdiction provisions to limit the activity of canceled or revoked members during an NASD investigation.

Currently, such jurisdiction applies only to members that have voluntarily resigned from the NASD.

Another change would codify the NASD's current practice of placing a hold on a termination for cause when the individual's Form U-5 indi-

cates that the termination may have involved actionable misconduct. That amendment would also include the NASD's longstanding practice of imposing a hold retroactively.

An additional proposal would codify the NASD's current practice of extending its one-year jurisdiction over terminated persons by placing a hold on a termination for cause to prevent its effectiveness and ensure adequate time to investigate such matters.

The amendment would also make failure to respond to an NASD request for information during the extended jurisdictional period a violation of the NASD's rules, even if the failure occurred after the person ceased to be associated with an NASD member. In that connection, a change to the Rules of Fair Practice would codify the NASD's position that persons who remain subject to the NASD's jurisdiction to file a complaint must respond to NASD requests for information.

In addition, another change would provide that "failure" to respond to a request for information, rather than a "refusal" as is presently provided, constitutes a violation of the NASD's rules.

The NASD also proposes that when a member or associated person must report with regard to any matter, such person also must testify on the record if so directed by any committee or duly authorized agent of any such committee.

Finally, the NASD proposes 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.

Rule Requires Revoked Persons to Requalify

Persons whose registrations are revoked for failing to pay NASD-assessed penalties must now requalify by examination.

Before the rule change, an individual whose registration was terminated for any reason had two years to

reregister without taking the applicable qualification examination.

This requirement will assist the NASD in collecting fines and costs levied in disciplinary proceedings, as well as in collecting other fees due to the NASD.

NASD Imposes \$750,000 Fine on Lloyd Securities

The NASD recently took disciplinary action against Lloyd Securities, Inc., a former securities dealer located in Cheltenham, Pennsylvania, and its officers Michael W. Lloyd and Warren C. Nachmann.

The NASD based its actions on findings that Lloyd Securities, acting through Lloyd and Nachmann, made improper use of \$182,000 in customer funds by causing those funds to be withdrawn from accounts at another securities dealer and deposited in the personal bank account of Nachmann, without the authorization or permission of the customers.

In addition, the NASD found that they had engaged in business while failing to maintain a required minimum level of net capital, falsely recorded assets not owned by the corporation, falsely reported the firm's net capital to regulatory authorities, and failed to give required telegraphic notice of deficient net capital to the SEC and to the NASD. The findings also stated that Lloyd and Nachmann had violated its rules by failing to provide information in connection with the NASD's investigation.

Lloyd and Nachmann were fined \$250,000 each and barred from association with any securities dealer. Lloyd Securities, whose membership in the NASD had been revoked on May 31, 1990, for nonpayment of a fine imposed in a prior disciplinary proceeding, was fined \$250,000.

This proceeding and the sanctions are part of the NASD's continuing commitment to address fraud and other abuses in the securities indus-

try. The investigation was conducted by the NASD's District 11 office in Philadelphia, with the disciplinary action taken by the District's Business Conduct Committee.

Members Approve Expanded Notice Rule for Accounts of Employees

The NASD membership recently approved a rule change to require an associated person to provide written notice to his employing member *prior* to opening or placing an initial order in a securities account with another member.

In addition, the individual would have to provide notice in writing to the executing member of the employment relationship with the employing member.

The NASD now requires associated persons, before opening an account or executing trades at a firm other than the employing member, to inform the executing member of their status as associated persons.

Such notice is not currently required to be in writing, nor do the individuals have to inform their employer that they are executing trades through another firm.

The proposal is designed to address both of these areas.

Executing Member's Duty

Under existing provisions of the rule, it is the executing member's responsibility to notify the employing member and to provide duplicate confirmations or such other information as the employing member may require. In addition, many firms' internal procedures already require employees to notify them of such arrangements.

However, the Board believes the proposal provides additional assurances that the associated person, the employing member firm, and the executing member firm have fulfilled their regulatory obligations.

Improved Supervision

More importantly, because the employer member will be made aware of the existence of a securities account with another member, the proposals may allow such members to more directly detect possible rule violations, including potential insider trading by associated persons.

SEC Approves Restructuring of NASD District Offices

The SEC last month approved an NASD rule change to restructure the size and composition of the Board and the number and configuration of the NASD districts.

Also, the change gives the Board authority to make subsequent modifications in its composition and size and in the number and configuration of the NASD's districts.

"One of our obligations under the Securities Exchange Act of 1934 and the NASD By-Laws is to ensure that members in each of the districts are fairly represented on the Board of Governors," says NASD Executive Vice President John E. Pinto, Jr. "When the Special Committee [on NASD Structure and Governance] looked at the changes in the industry

and the resulting impact on the size, type of business, and the demographics of our members over the past years, it determined that restructuring of the NASD Board of Governors was necessary."

The amendments authorize the Board to adjust its size to between 25 and 29 Governors. The Board has decided to reduce its size during the next two years to 29 Governors from 31 now.

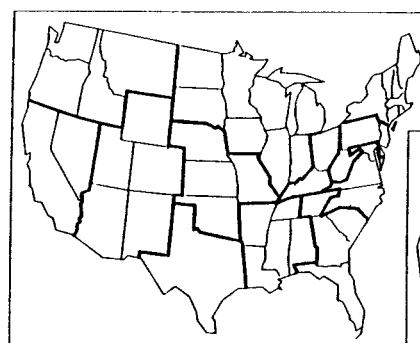
The changes also modify the Board's composition. The amendments require that the Board be comprised of 13 to 15 Governors (down from 21) elected from the districts; 11 to 13 Governors (up from 9) elected by the Board from the securities industry, issuers, and public; and the NASD's President.

They also require that each district have at least one Governor, and that the total number of Governors elected from the districts constitute a majority of the Board.

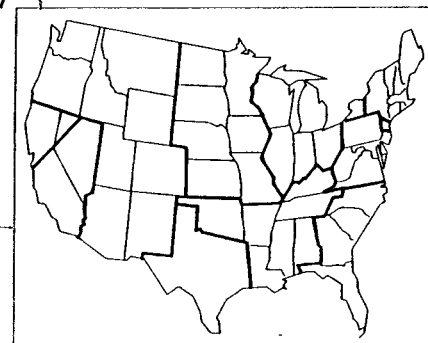
In addition, the Board may decide which districts are entitled to elect more than one Governor so as to provide for fair representation of the NASD's members and of its districts.

Representation by Governors

Of the Governors elected by the Board, one must represent the insurance industry, one the investment



EXISTING 13 DISTRICTS



NEW 11 DISTRICTS

Effective January 1, the NASD will have 11 districts with 14 district offices. These maps show existing and new district configurations.

company industry, at least three each must represent investors and issuers, and at least three must be chosen from the NASD membership. Under the changes, the insurance and investment company industry representatives need not be directly associated with a member.

The Board decided to reduce the number of districts from 13 to 11. Districts 7 (Atlanta) and 8 (Chicago) will have two Governors on the Board, while District 10 (New York) will have three Governors. The rest will have one Governor each.

District Configuration

As of January 1, the 11 new districts will be as follows:

New District 1 — The portion of existing District 2 referred to as District 2N, including northern California, northern Nevada, and Hawaii.

New District 2 — The portion of existing District 2 referred to as District 2S, including southern California and southern Nevada.

New District 3 — Existing Districts 1 and 3, including Alaska, Arizona, Colorado, Idaho, Montana, New Mexico, Oregon, Utah, Washington, and Wyoming.

New District 4 — Most of existing District 4 and certain neighboring states, including Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota.

New District 5 — Most of existing District 5 and certain neighboring states, including Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma, and Tennessee.

New District 6 — Existing District 6, consisting of Texas.

New District 7 — Most of existing District 7 and one neighboring state, including Florida, Georgia, North Carolina, and South Carolina, as well as Puerto Rico, the Canal Zone, and the Virgin Islands.

New District 8 — Most of existing Districts 8 and 9, including Illinois, Indiana, Michigan, Ohio, and Wisconsin, and part of upstate New York.

New District 9 — Most of existing Districts 10 and 11, including

the District of Columbia, Delaware, Maryland, Pennsylvania, Virginia, West Virginia, and southern New Jersey.

New District 10 — Existing District 12 and northern New Jersey, including the five boroughs of New York City and the adjacent counties in New York and northern New Jersey.

New District 11 — Existing District 13 (with the exception of part of upstate New York) including Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, and parts of New York.

NASD Elects Summers Chairman, Lynch Vice Chairman

The NASD recently elected new officers for its 1991 Board of Governors along with eight new Governors. The Board will formally install the new officers and Governors at its January meeting.

The incoming Chairman is William B. Summers, Jr., President and Chief Operating Officer of McDonald & Company Securities, Inc., in Cleveland. Ronald P. Lynch, Managing Partner of Lord, Abnett & Co. in New York is the Vice Chairman-Elect.

Philip S. Cottone, Vice President of MBI Equities Corp. in Cherry Hill, New Jersey was chosen as next year's Chairman of the National Business Conduct Committee (NBCC), which reviews disciplinary actions

taken by the NASD's 11 Districts. Jerry Roberts, President of Hill, Crawford & Lanford, Inc. in Little Rock, is the Committee's next Vice Chairman.

New Governors-at-Large

Three new Governors-at-Large, elected by the Board, are:

- John C. Burton, Ernst & Young Professor of Accounting and Finance at the Columbia University Graduate School of Business;

- Stephen J. Friedman, Executive Vice President and General Counsel for The Equitable Life Assurance Society of the United States; and

- Margo N. Alexander, Executive Vice President and Co-Director of Capital Markets of PaineWebber Incorporated.

New Governors

The five new Governors elected by the NASD's regional Districts to replace representatives whose three-year terms expire in January 1991 are:

- Norman Frager, Senior Vice President, Stifel, Nicolaus & Company, Incorporated, St. Louis;

- Peter B. Madoff, Director of Trading, Bernard L. Madoff Investment Securities, New York;

- James M. McMullan, Partner, William Blair & Company, Chicago;

- David Powell, Senior Vice President, Eppler, Guerin & Turner, Inc., Dallas; and

- Frederick M. Roberts, President, F. M. Roberts & Company, Inc., Los Angeles.

Incoming Chairman Summers became President of McDonald & Company in April 1989. At the



William B.
Summers, Jr.



Ronald P.
Lynch



Philip S.
Cottone



Jerry
Roberts

NASD, he is currently Chairman of the NBCC and a member of the Executive and Fixed Income Securities Committees. He is a former member of the District 9 Committee.

Incoming Vice Chairman Lynch is also Chairman of 10 of Lord, Abbett's mutual funds. At the NASD, he is currently Chairman of the Investment Companies and the Management Compensation/Development Committees and serves on the Finance and Audit Committee. He is also a member of the Board of Governors and the Executive Committee of the Investment Company Institute and Chairman of its Federal Legislative Committee.

Cottone, who will head the NBCC, is also President of Property Trust Advisory Corporation and Chairman of Ascott Investment Corporation. He serves on the NBCC and Direct Participation Programs/Real Estate Committee, and is a former Chairman of the District 11 Committee. While with the Port Authority of New York and New Jersey, he directed the acquisition of the property for the World Trade Center in Manhattan.

Roberts, the new NBCC Vice Chairman, has been President of his firm, Hill, Crawford & Lanford since 1965. He is now on the NBCC and Fixed Income Securities Committee. He served on the District 5 Business Conduct Committee from 1985 to 1987 and was the committee chairman in 1987.

Changes to Advertising Rule Cleared by Members

Revisions to a previously approved NASD rule change involving communications with the public have received membership approval.

The membership previously approved an amendment to Article III, Section 35 of the NASD Rules of Fair Practice to establish standards re-

garding the use and disclosure of member names in public communications, including business cards and letterhead.

Following that membership approval, the NASD filed the proposed amendment with the SEC, which published the amendment for public comment. In response to comments that the SEC received regarding the proposed amendment, the NASD revised its rule proposal.

The revision would 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.

Use of "Derivatives"

As proposed, a member could use a "derivative" of its name, without also including the member's full name, if:

- The derivative name was used to promote a specific area of the firm's business; and

- 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. The use of a derivative in this instance might not be misleading since such advertisements 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.

The newly approved amendments are subject to SEC approval.

Disciplinary Rule Change Would Help Aggrieved Investors

The NASD has asked members to comment on a proposed change to its Rules of Fair Practice that would allow the NASD, when imposing penalties in disciplinary actions, to permit indefinite suspensions.

Such suspensions would apply to findings of rule violations involving losses to customers and would affect members as well as associated persons. The current rule requires that suspension be imposed for a specific length of time.

Complicates Restitution

This precludes imposing any suspension such as one ordered to remain effective until the respondent proves restitution was made to the customer, or one that will continue unless the respondent makes restitution within a specified period of time.

Because many disciplinary actions involve losses to readily identifiable customers, NASD sanctions seek, where appropriate, to ensure that these customers are made whole by imposing bars and by the requirement of restitution.

However, because a bar may not be appropriate in all such cases, the NASD is seeking an alternative approach with this proposal to ensure refunds to customers who have been wronged.

Proof of Restitution

A suspension contingent on proof of restitution would, in the NASD's view, allow it to require customer remuneration without imposing an outright bar.

Such a measure would provide the NASD with greater flexibility in crafting sanctions that are fitting and appropriate to the violations found, and will assist customers in the recovery of their losses suffered because of the wrongdoing.

NASD Files Modified Payment For Order Flow Disclosure Rule

The NASD has filed its latest proposal on disclosure of broker-dealer compensation for order flow with the SEC for approval.

This version differs from one previously approved by the members and submitted for approval.

Specifically, it requires language to appear on each applicable customer confirmation disclosing that the firm received remuneration for directing orders to particular market makers or market centers.

The SEC's confirmation rule, 10b-10, requires broker-dealers to 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.

Revised Language

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 generally the current practice.

In addition, under the proposal, the following language must appear on each customer 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. Such remuneration 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 newly proposed language is a more affirmative statement of payment practices. That's in keeping

with Rule 10b-10, which requires the member to state *whether* it has received additional remuneration in connection with transactions.

Best-Execution Requirements

The Board also reiterates its interpretation on best execution. The interpretation of the Board of Governors on Execution of Retail Transactions, the "Best Execution Interpretation," 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.

This policy is particularly applicable to situations in which firms direct their order flow to a selected dealer. Although examinations by the NASD indicate that firms with agreements for payment for order flow do obtain the best execution for their customers, it is important for all firms to make certain they continue to get the best execution of trades subject to these arrangements. NASD examiners will actively review this area, as they have been, during on-site examinations to ensure ongoing compliance.

New Form Makes Compliance With Penny-Stock Rule Easier

The NASD recently published a form that members may use to comply with provisions in SEC Rule 15c2-6, the "penny stock/cold call rule."

15c2-6 is aimed at stopping unsuitable recommendations and other abusive sales practices by certain broker-dealers involving transactions in low-priced securities not listed on Nasdaq or the national exchanges.

The rule imposes special suitability and record-keeping requirements on certain broker-dealers that recommend transactions in desig-

nated securities to persons who are not "established customers."

Designated Securities

Designated securities are generally defined as equity securities of companies that have 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.

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.

Written Documents

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 desig-

nated securities.

To help members comply with SEC Rule 15c2-6, the NASD, in collaboration with the SEC staff, has published a suggested Customer Suitability Statement and an Agreement to Purchase Form, copies of which were published in the October 1990 NASD *Notices to Members* and may be obtained by contacting the district office in your region.

These suggested forms are intended to serve as models, not as requirements for use.

Treasury Seeks Additional Recordkeeping of Funds Transfers

In October 1989, the Treasury Department published an Advanced Notice of Proposed Rulemaking to deal with the problem of money laundering through the international funds transfer system.

Although at that time the focus was on fund transfers through banks, the current proposal includes recordkeeping by other financial institutions that are subject to the Bank Secrecy Act, including broker-dealers.

Under the proposal, NASD members that transmit funds for customers or on their own behalf, or receive funds from other financial institutions or foreign financial agencies for themselves or for payment to another person, would be required to retain specific information about these transmittals or receipts of funds.

This information includes the following:

- The name, address, Social Security number, and date of birth of the customer instructing that the funds be transmitted and the account number, if applicable.
- The identity of the person or financial institution receiving the funds on behalf of the recipient.
- The name of any person on whose behalf the funds were transmitted if different from above.

- The amount of funds transmitted.

- The date of the funds transmittal.

- Any payment instructions.

- The name and address of the recipient of the funds transmitted, and account number, if applicable.

- Any application or form completed by the person instructing the transmittal relating to the transmittal.

Verification Requirements

Prior to transmitting funds, members would have to verify the name and address of the person giving the instructions by examination of a document that contains the name and address of the person.

Members also would be required to record this information and indicate the type and number of the identification document reviewed.

Similarly, members would have to verify the name and address of the person receiving the funds prior to disbursing them.

In addition the required information must be retrievable by the name of the transmitting customer (or the recipient of the funds) and by the customer's account number, if applicable, and must be maintained at the location of the branch, agency, or office of the member making the transmittal or receiving the transmittal.

Like all other records under the Bank Secrecy Act, these records must be retained for five years.

Members should note that these proposals pertain to recordkeeping requirements only, although Treasury indicated that reporting requirements are still under consideration.

Other proposed changes include a number of definitions that relate to funds transfers and an amendment that expands Treasury's authority to issue target orders to include funds transfers.

For additional information, a copy of the Treasury release is available in the *Federal Register* of October 15, 1990.

Treasury is accepting comments through January 15, 1991. Comments should be addressed to:

Peter G. Djinis
Deputy Director
Office of Financial Enforcement
Department of the Treasury
Room 4320
1500 Pennsylvania Avenue, NW
Washington, DC 20220.

NASD Monitoring Compliance With MSRB Delivery of Documents Rules

The NASD is closely monitoring member compliance with Municipal Securities Rulemaking Board (MSRB) rules governing the delivery of official documents to customers. These requirements are set forth in MSRB Rules G-36, G-32, and G-8.

Effective July 1, 1990, any municipal securities dealer that acts as an underwriter in a primary offering of municipal securities must send to the MSRB two copies of the final official statement and two copies of completed Form G-36 containing the CUSIP numbers of each issue.

Official statements must be submitted within one business day after receipt of the final official statement from the issuer but no later than 10 business days after any final agreement to purchase, offer, or sell municipal securities.

Documents should be sent to the MSRB's office in Washington, D.C.

Rule G-32

Under Rule G-32, members selling new issue municipal securities are required to provide purchasers with the issuer's final official statement by settlement date.

If the issuer does not prepare a final official statement, members must provide their customers with a written notification to that effect.

Rule G-32 also requires financial advisers and managing underwriters to make the final official statement available in a timely manner and specifies the minimum number

of official statements a manager must provide to broker-dealers purchasing new issue securities.

Amendments to MSRB's recordkeeping Rule G-8 also became effective on July 1, 1990.

These changes require underwriters to keep records evidencing

compliance with Rule G-36.

MSRB Rule G-8 also requires members to maintain records concerning deliveries of G-32 disclosure to customers that include accounts.

The NASD urges all members to review and enforce their written supervisory procedures covering these

rules and to ensure that the appropriate persons understand and comply with the rules.

In line with standard policy, District Business Conduct Committees will review occurrences of non-compliance with these rules for possible disciplinary action.

Tap Into Our Resources

NASD and Nasdaq Publications for Sale

The NASD publishes many valuable educational and informational materials. These comprehensive references and newsletters contain handy, concise, and up-to-date information about matters directly affecting your day-to-day business activities. Here are some of the publications currently available.

July 1990 Nasdaq Company

Directory. This book lists all Nasdaq stock market companies, their securities' symbols, industry codes, addresses, media and investor relations contacts, and telephone numbers. (Approx. 150 pages) **\$15.**

NASD Guide to Rule Interpretations

(Net Capital Customer Protection Rules). This guide contains NASD interpretations of the SEC's Net Capital Rule (15c3-1) and Customer Protection Rule (15c3-3). Each interpretation has been distilled from one or more of the following sources: letters from the SEC Division of Market Regulation to the NASD; letters from the SEC to other self-regulatory organizations; letters from the SEC to attorneys, accountants, NASD members, and other parties; and discussions between self-regulatory organizations and the SEC. (1989. 85 pages) **\$25.**

NASD Subscription Service.

Members and others interested in the NASD and The Nasdaq Stock Market can take advantage of belonging to our Subscription Service. Subscribers receive the *NASD Annual Report*, *NASD Notices to Members*, *Nasdaq Fact Book*, *NASD Regulatory and Compliance Alert*, and *Nasdaq Subscriber Bulletin*. **\$350 annually.**

The Nasdaq Handbook.

In this hardcover book, corporate executives, scholars, consultants, journalists, and investment professionals explore the uses, efficacy, implications, and opportunities of the The Nasdaq Stock Market. The handbook profiles Nasdaq market investors, provides an overview of Nasdaq companies, and analyzes trends in liquidity, economic efficiency, trading characteristics, and market technology. (1987. 577 pages). **\$24.95.**

NEWSLETTERS

NASD Notices to Members.

A monthly compendium informing members about regulatory and other NASD developments, including actions taken at bi-monthly Board of Governors meetings. Requests for member votes and comments are disseminated through *Notices to Members*. **\$200 annually.**

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Nasdaq/NMS Qualifications Standards, Ohio Registration Experience, and the Price Performance of Initial Public Offerings. (April 1987)

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