

ALERT

Effective April 13, 1989

SEC Approves Changes to NASD Supervision Rules

The Securities and Exchange Commission approved amendments to the NASD's supervision rules on October 13, 1988.

These amendments prescribe specific supervisory practices and procedures for all member firms and revise the definitions of branch office and office of supervisory jurisdiction (OSJ).

The amendments, effective April 13, 1989, substantially expand the specificity of Article III, Section 27 of the NASD Rules of Fair Practice regarding a member's supervisory obligations.

The amendments require each firm to, at a minimum:

- Establish and maintain specified written supervisory and review procedures.
- Designate appropriately registered principals for each type of business the firm engages in to carry out its supervisory obligations.
- Designate an OSJ for each location that meets the OSJ definition and any other locations if such designation is needed for the firm to supervise properly.
- Designate one or more appropriately registered person(s) in each OSJ, including the main office, and in each branch office to supervise the activities of that office.
- Assign each registered person to a supervisor.
- Make reasonable efforts to ensure that all supervisory personnel are properly qualified.
- Designate and identify to the NASD one or more principals to review the firm's supervisory prac-

tices and procedures, and take or recommend to senior management appropriate action to achieve member compliance with applicable rules and regulations.

- Meet with each registered representative, at least annually, to discuss compliance matters relevant to the activities of such representative(s).

- Establish a schedule for examining branch offices that accounts for the nature of the activity, volume of business, and number of persons at each office.

Under the changes, each firm has to maintain written supervisory procedures that describe the supervisory system implemented according to the above requirements and that list the titles, registration status, and locations of the required supervisory personnel and the specific responsibilities assigned to each.

A copy of these procedures or the applicable sections must be kept

and maintained at each OSJ and at each other location where supervision occurs.

The member must amend its procedures, as appropriate, within a reasonable time after the need arises and must communicate these changes throughout its organization.

Annual Review

Members also have to review, at least annually, their businesses in a manner reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable laws, regulations, and rules.

This will involve examining customer accounts, an annual inspection of each OSJ, and the inspection of branch offices according to the schedule in the supervisory procedures.

Finally, the member must keep a written record of the dates of each inspection and review.

Under the amendments, an OSJ is any business location of a member firm at which one or more of the following functions take place:

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NASD Efforts Continue in Non-NASDAQ OTC Market

Both the June and October editions of the NASD's Regulatory and Compliance Alert described various aspects of the increased emphasis being placed by the NASD on the examination, regulation, and enforcement of sales practice abuses involving non-NASDAQ OTC securities (NNOTC), with particular emphasis on penny stocks.

Since September 1, 1988, members executing principal transactions in non-NASDAQ securities have been required to electronically report price and volume on a daily basis if their aggregate volume of purchases or sales exceed either a minimum of 50,000 shares or \$10,000.

This reporting requirement, in accordance with new Schedule H to the NASD By-Laws, applies during Phase I to all NNOTC equity securities that are cleared through the National Securities Clearing Corporation (NSCC).

The second phase is expected to be in effect by the end of the first quarter of 1989 and will require price and volume reporting for all NNOTC securities regardless of whether the securities are cleared through NSCC.

This price and volume information is being used for regulatory purposes, as the NASD through its Market Surveillance and Anti-Fraud Departments is reviewing computerized exception reports based on the reported information which is generated when pre-established parameters have been exceeded.

The NASD also has announced a number of disciplinary actions it has taken that involved non-NASDAQ securities.

In furtherance of the increased emphasis by the NASD regarding NNOTC securities, the NASD is also engaged in a number of joint investigations with the SEC and the states, and is a major participant in inter-agency task forces looking into penny-stock fraud and abuses. These agencies include the SEC, FBI, IRS, and others.

Through its Anti-Fraud Department, the NASD is currently finalizing a number of disciplinary cases involving such matters as fraud in the offer and sale of securities, misrepresentations to the NASD Corporate Financing Department, and excessive markups.

Also in another matter, the NASD is investigating serious misconduct in the non-NASDAQ penny-stock market involving a number of fraudulently excessive markdowns by a member involving a security in which the member was the sole underwriter.

In line with past actions which the NASD has taken for similar type violations, sanctions in these cases could be levied involving fines, expulsions, and bars on members and associated persons for serious violations of securities laws and NASD rules. The following article summarizes such a case for which a final NASD decision has been issued.

NASD Disciplines Utah Member, Associated Persons in Non-NASDAQ OTC Penny-Stock Manipulation

The NASD has taken disciplinary action against Equity-One Corporation of Salt Lake City, Utah, and several other respondents. The disciplinary action was based on an investigation into the manipulation of the price of Freedom Coin Company, Inc. (Freedom Coin), a non-NASDAQ OTC issue.

In a decision rendered by the NASD's Board of Governors following the appeal of an action taken by the District Business Conduct Committee for District 3, sanctions were imposed that included the expulsion of Equity-One Corporation from NASD membership. In addition, both William Clark and Craig Broadhead, its operating heads, were barred as principals, suspended from association with any NASD member in any

capacity for six months, and each fined \$25,000. Kenneth Brailsford, an associated person of the firm, was barred from association with any NASD member in any capacity and fined \$100,000.

The NASD found that Kenneth Brailsford, an unregistered person associated with Equity-One Corporation, created and thereafter implemented and directed a scheme to manipulate the price of Freedom Coin.

Customers had paid from one cent to as much as \$1.11 per share for the stock that subsequently dropped in price to 12 cents per share when Brailsford left the firm and ceased his manipulative activity.

In connection with the manipulative scheme, the NASD found that Brailsford, using other in-

dividuals to conceal his involvement, effectively gained control of Freedom Coin stock at one cent per share and, thereafter, promoted the stock to Equity-One's registered representatives.

Customers were then solicited to purchase stock and as the price rose Brailsford liquidated his controlling interest at much higher prices through undisclosed nominees who were used to conceal Brailsford's involvement in the scheme.

Found to have aided and abetted the manipulation were Equity-One Corporation, William Clark, Craig Broadhead, David Robinson, and David Merrell, a representative of another member firm.

The NASD concluded that such parties substantially assisted in the manipulation and had actual

knowledge that Brailsford was orchestrating a manipulative scheme or, at least, acted in reckless disregard of the facts that would have given such knowledge.

The NASD found that Equity-One Corporation, through Clark and Broadhead, maintained an internal trading account that Brailsford used to effect transactions without revealing his involvement in the trading activity.

Meetings With Sales Staff

They further allowed Brailsford, whose registration had never become effective, to use the office facilities at Equity-One to hold meetings with sales staff to stimulate interest in Freedom Coin shares. Equity-One Corporation, Clark, Broadhead, Robinson, and Merrell then engaged in retail sales at increasing prices when they knew, or should have known, that the prices being charged their customers had no reasonable relationship to a free trading market, considering the one cent offering price, the lack of any significant business by Freedom Coin, Brailsford's substantial involvement and ownership of the stock, and the fact that the shares' price was sharply rising in spite of Equity-One's long position in the security.

Equity-One Corporation, Clark, and Broadhead also were found to have violated NASD rules by using the firm's trading account to conceal transactions by persons who were not registered to engage in securities sales. They were cited for their inadequate supervision of the activities of the sales force in connection with the manipulation of Freedom Coin stock.

In addition to the actions taken against salesmen at Equity-One, David Merrell, a representative of another member firm, assisted in the manipulation by liquidating 295,000 shares through a nominee account of Kenneth Brailsford.

The initial sale transactions in the aftermarket took place at 7 1/2 times the initial offering price even though there was no previously established market for the shares. David Merrell was censured, fined \$10,000,

ordered to disgorge to the NASD the sum of \$1,322, and suspended from association with any NASD member in any capacity for 90 days.

Brailsford and Merrell, along with sales representatives Kip D. Eardley, W. Kyle Klingler, Steven V. Harrison, David Robinson, and Stephen M. West, were found to have purchased Freedom Coin stock in private arrangements without their employers' knowledge or consent.

Stephen West additionally was found to have violated securities credit regulations by borrowing funds from a customer to pay for his personal purchase of Freedom Coin stock. Kip Eardley was censured, fined \$2,000, ordered to disgorge to the NASD the sum of \$3,000 (representing profits earned in connection with his private securities transactions) and suspended from association with any NASD member in any capacity for 15 days. Kyle Klingler and Steven Harrison were each censured, fined \$1,000, and suspended from association with any NASD member in any capacity for five days.

David Robinson was censured, fined \$10,000, and suspended from association with any NASD member in any capacity for 90 days.

Steven West was censured, fined \$2,500, and suspended from association with any NASD member in any capacity for 10 days.

Failure to Disclose

Western Capital & Securities, Inc., another member firm, was found to have accepted \$2,000 to act as a market maker in Freedom Coin shares, and failed to record the receipt of such funds on its books and records. The firm was found to have violated the NASD's rules when it failed to disclose such arrangement after being requested to do so by the NASD.

Western Capital & Securities, Inc., was jointly and severally fined \$5,000 with an individual respondent and was suspended from all market making for a period of five business days.

Western Capital has appealed

the NASD's finding of such violations to the Securities and Exchange Commission.

The investigation of this matter was conducted in cooperation with the State of Utah Securities Division. It is indicative of the NASD's increased enforcement efforts in the non-NASDAQ OTC penny stock market through broadened reporting requirements, automated market surveillance systems, and greater overall emphasis on anti-fraud activities.

The suspensions imposed commenced with the opening of business on Monday, November 7, 1988.

U.S. Treasury Sets Up Hotlines to Report Suspicious Transactions

The U.S. Treasury Department recently established toll-free Internal Revenue Service and Customs Department hotlines for reporting suspicious transactions. Members can use the IRS hotline, 1-800-BSA-CTRS, to report any transactions they suspect are arranged to evade the Bank Secrecy Act's requirement to report cash transactions of \$10,000 or more.

To report suspicious noncash transactions, members can use the Customs Department's hotline, 1-800-BE-ALERT. The NASD strongly urges its members to be aware of non-cash transactions (i.e., multiple cashier's checks, money orders, traveler's checks, and bank checks under \$10,000) and wire transfers that may involve illegal activities, such as money laundering.

Members are encouraged to keep a written record of the reports given to the IRS on suspicious currency transactions, as well as reports given to Customs on questionable noncash transactions. For further information, please contact Ms. Susan Lang, Senior Analyst, NASD Surveillance, at (202) 728-6969 or see the February edition of the NASD *Notices To Members*.

October 1987 Misconduct Draws Sanctions

NASD Bars, Suspends, and Fines Two Individuals For Manipulation of NASDAQ Securities During Market Break

The NASD has taken disciplinary actions against Stanley A. Aslanian, formerly the President and securities trader for Haas Securities Corporation, and Eugene K. Laff, formerly Haas' Chairman of the Board. The disciplinary action is based on an investigation into the price manipulation of the securities of a NASDAQ company, Cliff Engle Ltd.

Without admitting or denying the allegations of the Complaint, Aslanian and Laff, in their Offers of Settlement, consented to certain findings made and sanctions imposed by the NASD's Market Surveillance Committee. The Committee found that Aslanian violated Article III, Sections 1, 5, 15(b), and 18 of the NASD's Rules of Fair Practice, as alleged in the Complaint.

Section 18 is the NASD's anti-fraud provision which prohibits the use of any manipulative, deceptive or other fraudulent device in the purchase or sale of any security. Laff was found to have violated Article III, Sections 1 and 27 of the NASD's Rules of Fair Practice, as alleged in the Complaint.

Five-Year Bar

Pursuant to his Offer, Aslanian was barred from association with any NASD member in any capacity with the right to reapply for such association after five years, fined \$100,000, and censured.

Under Laff's Offer of Settlement, he was suspended for two years from association with any member in any supervisory capacity, fined \$15,000, and censured.

The Complaint alleged price manipulation by Aslanian and Haas of Cliff Engle common stock (CLIF) and Cliff Engle warrants (CLIFW), and fraud in the offer and sale of CLIF and CLIFW. The Complaint also alleged the publication and circulation by Aslanian and Haas of

non-*bona fide* quotations in nine other securities, namely, T.S. Industries, Inc. common stock (TNDS), Fountain Power Boat Industries, Inc. common stock (FPBT), Fountain Power Boat Industries, Inc. warrants (FPBTW), Big O Tires, Inc. common stock (BIGO), Flores de New Mexico common stock (FLWR), Satellite Auction units (SATLU), Satellite Auction common stock (SATL), Satellite Auction warrants (SATLW), Eagle Entertainment common stock (E EGL), as well as CLIF and CLIFW. Finally, the Complaint focused on allegedly inadequate supervision by Laff.

Manipulative Conduct

Specifically, the Complaint alleged that between October 1, 1987, and October 21, 1987, Aslanian and Haas manipulated the price of CLIF and CLIFW in that Aslanian, acting for Haas, placed increasingly higher quotations in the NASDAQ System for CLIF and CLIFW, and purchased CLIF and CLIFW at higher prices in the face of Haas' existing long inventory positions.

Through this allegedly manipulative conduct, the prices of CLIF and CLIFW reached their all-time high prices of \$14.00 each, on October 20, 1987 and October 21, 1987, respectively.

The Complaint also alleged that, in furtherance of the manipulative scheme, Aslanian and Haas effected unauthorized purchases of CLIF in customers' accounts; exercised discretionary power by purchasing CLIFW for customers' accounts without obtaining prior written authorization; frustrated customers' efforts to sell CLIFW and CLIF; made material misrepresentations and omitted to state material facts in connection with the sale of CLIFW and CLIF; and that Aslanian and Haas published and circulated non-*bona fide* quotes for CLIF,

CLIFW, and the other nine securities.

Regarding Laff, the Complaint alleged that during October 1987, Laff failed to supervise properly the activities of Aslanian, which contributed to the price manipulation of CLIFW and CLIF, the fraud perpetrated on Haas' customers, the use of discretionary power in customers' accounts without written authorization, and the publication and circulation of the non-*bona fide* quotations.

In its decision, the Market Surveillance Committee found that Haas underwrote the Cliff Engle initial public offering with another broker-dealer. It further found that from October 1, 1987, to October 20, 1987, a period encompassing the market break of October 19, 1987, the inside bid price of CLIF in the NASDAQ market increased 60 percent, from \$8.75 to \$14.00. Similarly, the inside bid price of CLIFW moved from \$6.25 to \$14.00 between October 1 and October 21, 1987, representing a 124 percent increase. Haas was responsible for the quotations that created the \$14.00 prices.

When considering total trading time during the period of the alleged manipulation, the Committee found that Haas was responsible for the dramatic price rise, with nearly 62 percent of the inside bid upticks in the common stock and approximately 95 percent of the inside bid upticks in the warrants.

Haas' pricing leadership was even more pronounced, according to the Committee, in that the firm represented the sole high bid over 58 percent of the time in the common stock and nearly 70 percent of the time in the warrants.

Frequent Upticks

The Committee also noted that Haas oftentimes upticked its own inside bid in both securities while showing a long inventory position in

both CLIF and CLIFW, with no apparent reason for wanting to accumulate additional inventory, particularly in light of the negligible interest shown by customers in the Cliff Engle securities. Specifically, the Committee found that there was virtually no retail demand at Haas for these securities.

Throughout the review period, Haas sold CLIF to only eight retail customers and sold CLIFW to 13 retail accounts, with certain purchasers of CLIF claiming that the transactions represented unauthorized purchases by Aslanian.

Hallmarks of Fraud

Also viewed by the Committee as hallmarks of fraud were sales to retail customers below the existing inside bid (evidencing the lack of retail demand and the fraudulent nature of Haas' quotes), and the immediate drop in the price of the Cliff Engle securities upon Haas' withdrawal as a market maker on October 28, 1987.

Specifically, when Haas withdrew as a market maker in CLIF and CLIFW, all other market makers withdrew shortly thereafter, causing the price of the common stock to drop from \$12.00 to zero within 15 minutes and the warrants to decline from \$13.125 to zero within 30 minutes of Haas' withdrawal. No market makers existed in either CLIF or CLIFW from October 28 until October 30, 1987, in the common stock, and until November 6, 1987, in the warrants. Thereafter, the price of CLIF stabilized in the \$1 to \$2 range and CLIFW was quoted at \$.375.

Regarding the allegedly inadequate supervision by Laff, the Decision states that there were numerous warning indications visible to Laff including, among many other things, complaints from customers in October that their orders to sell these securities were not being executed.

Haas Allegations Dismissed

Given the fact that Haas is in bankruptcy and being liquidated, and that appropriate action has been taken against Aslanian and Laff, the individuals responsible for the violative

activities, the allegations contained in the Complaint against Haas were dismissed.

The NASD investigation, which was conducted by its Anti-Fraud Section, is part of the NASD's stepped-up enforcement efforts in the area of securities fraud and price manipulation. In addition to carrying out its own investigations, the NASD routinely cooperates with other self-regulatory organizations, the SEC, and governmental law enforcement agencies.

Cooperative Regulation

In this regard, the NASD cooperated with the Office of the United States Attorney for the Southern District of New York in its investigation which resulted in the filing on January 5, 1989, of criminal charges relating to securities fraud against Aslanian.

The NASD intends to continue cooperating with federal and state authorities as part of its efforts to vigorously enforce the securities laws, particularly with regard to fraud and other serious sales practices abuses.

The sanctions imposed in the NASD action against Aslanian became effective on January 5, 1989. The sanctions imposed on Laff become effective February 1, 1989.

SEC Amends Its Lost and Stolen Securities Program

On December 27, 1988, the Securities and Exchange Commission adopted amendments to its Rule 17f-1, the Lost and Stolen Securities Program. Among other things, the amendments do the following:

- Expand the definition of reporting institution to include government securities broker-dealers.
- Amend the exemptions from registration to include a reporting institution that limits its activities exclusively to uncertificated securities or whose business activities do not in-

volve the handling of certificates.

- Identify the Federal Bureau of Investigation as the "appropriate law enforcement agency" to receive reports in instances of suspected criminal activity.

- Define the terms "customer" and "securities-related transaction" for purposes of the customer inquiry exemption.

- Revise the reporting and inquiry provisions to exempt uncertificated securities and to eliminate the exemption for registered-form government and agency securities.

For further information, please contact Ms. Roberta Donohue, Development Specialist, NASD Surveillance, at (202) 728-8203.

Employees Must Notify Members Of Outside Employment

The Securities and Exchange Commission recently approved a new NASD rule that prohibits any person associated with an NASD member from accepting employment or compensation from any other person based on any business activity outside the scope of the employment relationship with a member, unless the associated person had provided prompt written notice to the member.

Recent disciplinary cases have shown that prompt notice to a member by an associated person regarding outside business activities might have prevented regulatory problems for the firm.

Exempted Transactions

As adopted, the rule applies only to persons who are associated with a member in a registered capacity, and exempts passive investments and certain private securities transactions. In addition, the form of the written notice may be determined by the employer-member and therefore could include use of the Form U-4.

Manipulation of NASDAQ Security Found

NASD Expels Rooney, Pace Inc., Suspends and Fines Randolph Pace, and Sanctions Five Others

The NASD recently took disciplinary action against the former New York broker-dealer, Rooney, Pace Inc., Randolph Pace, its President, and five other individuals formerly associated with the firm, for manipulating American Educational Computer, Inc. (AEDC), a NASDAQ security.

Rooney, Pace was expelled from NASD membership, fined \$50,000, and censured. Randolph Pace was censured, fined \$100,000, and suspended from association with any NASD member in all capacities for two years.

At the conclusion of the two-year suspension, he will be suspended for an additional five years from association with any NASD member in any supervisory capacity.

Others Sanctioned

In addition, Joe P. Foor of Norman, Oklahoma, a Senior Vice President of the firm, and Coy E. Deal, the firm's Oklahoma City branch office manager, were each censured, separately fined \$50,000, and barred from association with any NASD member. Daniel Dispigno of Smithtown, New York, a securities trader at Rooney, Pace, responsible for trading AEDC, was censured, fined \$25,000, and suspended from association with any NASD member for two years.

Registered Representatives Terry L. Rogers and Thomas C. Henry, both of Oklahoma City, were each censured, separately fined \$10,000, and suspended from association with any NASD member for one year.

Pace and Henry have appealed the NASD decision to the Securities and Exchange Commission.

While the matter is being considered by the SEC, the sanctions against Pace and Henry are not effective.

The suspensions which are effective began January 3, 1989.

The NASD found that a manipulation occurred in AEDC stock between July 18, 1984, and January 31, 1985, a period during which Rooney, Pace dominated and controlled the market in the security.

The NASD determined that all Respondents participated in the AEDC manipulation, in violation of Article III, Section 18 of the NASD's Rules of Fair Practice, which prohibits the use of any manipulative, deceptive, or otherwise fraudulent devices in the purchase or sale of any security.

Price Climbs and Dives

Among other things, the Respondents engaged in large wholesale purchases and entered increasing quotations as a market maker which bore no relationship to the true state of the market in AEDC stock. During the manipulation, the price of AEDC rose 38 percent, from \$6.50 to \$9.00, despite deteriorating financial and operational results reported by the company.

On February 1, 1985, when Rooney, Pace ceased trading AEDC, the stock experienced a precipitous decline from \$9.00 to \$4.50.

As a part of the manipulation, the Respondents in Rooney, Pace's Oklahoma City branch office encouraged retail customers to buy AEDC, through the use of material misrepresentations concerning the safety of investing in the company and the future price and earnings of the stock, and failed to disclose material facts about the true nature of trading in AEDC and the fundamentals of the company.

All Buys, No Sells

Further, the Oklahoma City Respondents discouraged and refused to execute customer sell orders. In addition, Dean and Foor were found to

have engaged in unauthorized purchase transactions in a customer account and to have exercised discretionary power over customer accounts without prior written authorization.

The NASD found that Randolph Pace knew of the manipulation as early as October 1984.

He then established a separate trading account by which the firm sold AEDC short, anticipating the eventual decline in the price of AEDC, while continuing to recommend that its customers purchase the stock.

Inadequate Supervision

The NASD also found that Rooney, Pace's supervisory procedures and Randolph Pace's implementation of those procedures were wholly inadequate to control the manipulative trading in AEDC or the improper sales activities occurring in the Oklahoma City office.

Finally, the firm and Dispigno inaccurately reported to the NASDAQ System the firm's purchase and sale volume in AEDC, in violation of the NASD's By-Laws.

NASD Investigation

The NASD investigation was conducted by its Anti-Fraud Section. The action was initially heard before the NASD's Market Surveillance Committee (MSC), which consists of 12 executives of securities firms from across the country.

The MSC is responsible for maintaining the integrity of the NASDAQ market and for disciplining NASD members and their associated persons who fail to comply with market-related securities laws, including the prohibition of securities manipulation. The MSC's findings and sanctions were affirmed following proceedings on appeal before the NASD Board of Governors.

Arkansas Member, Individuals Cited For Overpricing Securities

The NASD took disciplinary action against United Capital Corporation of Little Rock, Arkansas; William D. McCord; Richard M. Brucki; Jarrel D. Odell; and Billy C. Martindale for violating the NASD's Rules of Fair Practice.

On November 3, 1988, the District Business Conduct Committee for District 5 accepted a Letter of Acceptance, Waiver, and Consent submitted by United Capital Corporation; William D. McCord, the firm's president; Richard M. Brucki, the firm's general securities principal and financial and operations principal; and two representatives, Jarrel D. Odell and Billy C. Martindale.

Pursuant to the consent proceeding, the firm was expelled from NASD membership and fined \$150,000, jointly and severally with McCord, Brucki, Odell, and Martindale.

In addition, McCord was barred from acting in any principal capacity, Brucki was suspended from acting in any principal capacity for 30 days and is required to requalify as a general securities principal within a period of 90 days after the effective date of this action, and Odell was suspended from association with any NASD member in any capacity for a period of one year.

Adjusted Trading

Without admitting or denying the allegations, the respondents consented to the sanctions imposed and findings made that the firm, McCord, Brucki, and Odell engaged in a practice known as "adjusted trading," whereby they entered into purchase and sale transactions in government securities with institutional customers at prices that were not reasonably related to the then current market price of the securities.

Institutional customers (includ-

ing municipalities, banks, savings and loan associations, and credit unions) were offered prices in excess of the current market price for their government securities in order to permit the avoidance or postponement of recognized losses in their accounts.

United Capital recouped its losses from the above-described transactions by selling other government securities to such institutional customers at prices in excess of the current market price.

This practice caused the falsification of the institutions' records because the "realized" losses on sales were concealed and the offsetting securities purchased were at inflated prices.

Misled Customers

The firm, McCord, and Odell also caused third parties (public customers) with an interest in the accounts to be misled concerning the performance of their investments. In some instances, United Capital's books and records did not reflect the fact that the adjusted purchase price in the transaction was conditioned upon a subsequent sale at an inflated price.

McCord and Brucki were found to have knowingly or recklessly assisted or substantially assisted the firm in these fraudulent activities and in the generation of inaccurate books and records.

In addition, the firm, acting through McCord, Brucki, and Odell, sold or caused to be sold government securities to institutions at prices that included excessive markups that were fraudulent in nature.

Customer Swaps

In some instances, these purchase and sale transactions were effected between institutional customers and represented another form of "adjusted trading" known as "customer swaps."

Brucki was also found to have assisted the firm in this fraudulent activity by approving such transactions in his capacity as principal.

The firm and Martindale also

were found to have failed and neglected to disclose to institutional customers the risks involved in the trading strategies employed, including the excessive nature of the transactions and the exposure incurred by the institutions.

McCord and Brucki were found to have assisted the firm and Martindale in these activities.

Further, the firm, acting through Odell, executed a repurchase agreement with an institutional customer when the securities were not available for delivery, which resulted in the institution being defrauded of the interest charged on the repurchase agreement.

The firm and Brucki also were found to have failed to compute accurately the firm's net capital for January 1988 and, as a result, to have filed an inaccurate FOCUS Part I report for the period.

In addition, they failed to issue buy-in instructions for bonds which were not received by settlement date, and failed to maintain signed options agreements for certain institutional customers conducting an options business.

Supervision

(continued from page 1)

- Order execution and/or market making.
- Structuring of public offerings or private placements.
- Maintaining custody of customers' funds and/or securities.
- Final acceptance (approval) of new accounts for the member.
- Review and endorsement of customer orders.
- Final approval of advertising or sales literature for use by persons associated with the member.
- Responsibility for supervising the activities of persons associated with the member at one or more other offices of the member.

Branch Office Definition

The amendment also redefines "branch office" as any business location of the member identified to the

public or customers by any means as a location at which the investment banking or securities business is conducted on behalf of the member.

The definition excludes any location identified solely in a telephone directory line listing or on a business card or letterhead, when such listing, card, or letterhead also sets forth the address and telephone number of the office of the member responsible for supervising the activities of the identified location.

These new provisions will help members comply with applicable laws, regulations, and rules.

The provisions will make firms review their businesses and construct and document a supervisory system designed to achieve compliance with the securities laws and regulations and NASD rules that apply to the various areas of members' business activities.

Prior to the rules' effective date, the NASD General Counsel's Office expects to issue a publication with more information on these changes.

Please send any questions or comments on these changes to:
Ms. Jacqueline D. Whelan
Senior Attorney
General Counsel's Office
NASD
1735 K Street, NW
Washington, DC 20006-1506.

SEC Approves Changes in Composition of Hearing Panels

The SEC has approved amendments to the NASD's Code of Procedures to reduce, from three to two, the minimum number of persons required for hearing panels before District Business Conduct Committees as well as the Market Surveillance Committee ("Committees"). The amendments also require that only one person on the panel be a member of the Committees.

Prior to this amendment, a subcommittee consisting of three or

more persons required that at least two be Committee members. During the last several years, the NASD's disciplinary cases have become more numerous and complex and have required significant time commitments on the part of Committee members.

As a result, the NASD has experienced increasing difficulty in conducting hearings because of the unavailability of hearing subcommittee members. These changes will help alleviate this problem.

SEC Approves Rule Amendments To Safeguard SOES

On December 15, 1988, The Securities and Exchange Commission (SEC) approved amendments to the Rules of Practice and Procedures for the NASD's Small Order Execution System (SOES) to preserve the integrity of SOES as a service for individual investors.

The SEC-approved rules do the following:

- Prohibit an NASD member or person associated with a member from entering in SOES on behalf of a professional trading account.

- Grant NASD the authority to identify an account as a professional trading account.

- Define the term "professional trading account" to mean

- an account in which five or more day trades have been executed through SOES during any trading day; or

- an account in which there has been a professional trading pattern in SOES as demonstrated by a pattern or practice of executing day trades, executing a high volume of day trades in relation to the total transactions in the account, or executing a high volume of day trades in relation to the amount and value of securities held in the account.

- Define the term "day trade" or "day trading" to mean the execu-

tion of offsetting trades in the same security for generally the same size during the same trading day.

The NASD automated surveillance systems are geared to monitor member compliance with these new requirements on an on-line basis.

Reason for SOES

SOES is the automated system created by the NASD for the immediate execution of small, retail customer agency orders of up to 1,000 shares of NASDAQ securities, at the best prices available at the time those orders are entered. NASD rules, in effect since SOES started in December 1984, have prohibited the use of the System to execute orders for the proprietary accounts of securities firms.

The rules have also prohibited SOES to be utilized for the splitting of customer orders of more than 1,000 shares into smaller segments to meet that SOES size limitations.

In recent months, the NASD has been extremely concerned that the execution of transactions of professional traders through SOES may distort the price at which retail investors are able to obtain executions.

SEC-Approved Remedies

To remedy the problem and with SEC approval, the NASD implemented rule interpretations that prohibit certain securities industry professionals, who have physical access to a terminal capable of entering orders in SOES, from using SOES for their personal accounts or for accounts of members of their immediate families. Other SEC-approved SOES rule interpretations permit the NASD to aggregate SOES trades entered within any five-minute period for accounts controlled by a securities industry professional or a customer in determining compliance with SOES order size limits.

The NASD believes that these interpretations and the amendments to the SOES rules will eliminate the abusive practices of SOES members or persons associated with members using SOES for the execution of

transactions for professional trading accounts. Such a practice is inconsistent with the original purpose of SOES, which is to provide an efficient and economical system to facilitate the execution of small retail orders by public customers.

For further information, please contact Ms. Mary Rose Murray, Investigator, Market Surveillance Department, (202) 728-6962.

Proposed Rules Would Improve Arbitration Process

A set of NASD proposals recently filed with the SEC for approval would improve and streamline the arbitration process; supply additional information on arbitrators' backgrounds to parties to arbitrations; and provide for more complete public disclosure of awards.

The proposed rule changes grew out of recommendations by the Securities Industry Conference on Arbitration (SICA). SICA includes the NASD, the seven stock exchanges, the Chicago Board Options Exchange, the Municipal Securities Rulemaking Board, four public participants from law and academia, and the Securities Industry Association.

The proposed changes include:

■ **A more restrictive definition of securities industry arbitrator.** An arbitrator will be from the securities industry if now associated with a broker-dealer, municipal securities dealer, government securities broker, or government securities dealer, or so associated within the last three years; retired but receiving compensation from such an entity; a spouse or other household member is associated with such a securities entity; or a professional outside the securities industry who has devoted 20 percent or more individual work time to clients within the industry during the last two years.

■ **Improved disclosure of arbitrators' backgrounds to the parties.** Currently, the rule mandates dis-

closure of only the names and business affiliations of arbitrators when they are appointed. The proposed change calls for also disclosing the employment histories of arbitrators for the past 10 years, with the disclosures made at least eight business days prior to the date of an initial hearing session.

■ **Public disclosure of awards.**

All awards in cases involving public customers and granted after the effective date of the proposed rule changes will be public. However, the awards will not identify the arbitrators.

■ **Improved pre-hearing procedures.** The code now requires parties to file all pleadings, including claims, answers, and third-party claims with the Director of Arbitration, who in turn serves all parties to a proceeding with a copy of each pleading. Under the proposed rule, the NASD would serve all initial claims, but the parties would have to serve each other and the NASD with copies of all subsequent pleadings.

The proposals also would appoint a single presiding arbitrator or other individual to conduct pre-hearing conferences and to resolve pre-hearing disputes, including discovery disputes, arising between the parties. Parties would have to exchange any exhibits and a list of witnesses before the initial hearing.

■ **Composition of panels.** The proposals expand the availability of expedited and less costly single-arbitrator decisions in disputes involving public customers, instead of more time-consuming rulings by three- to five-member panels. For matters involving public customers in which the amount in controversy does not exceed \$30,000 (up from \$10,000), the Director of Arbitration will appoint a single arbitrator not from the securities industry to decide the matter.

However, if the filing party requests or the single arbitrator considers it appropriate, the Director of Arbitration will appoint a panel of three arbitrators, at least a majority of whom are not from the securities in-

dustry.

In all arbitration matters involving public customers in which the amount in controversy exceeds \$30,000, a panel will consist of three arbitrators, with at least two from outside the securities industry, unless the customer requests otherwise.

For cases in which only NASD member firms and/or persons associated with member firms are involved ("industry cases") and the amount in controversy is less than \$30,000, the Director of Arbitration will appoint a single arbitrator who is from the securities industry to decide the matter. Upon request from either party, however, a panel of three arbitrators will be appointed, all of whom shall be from the industry.

■ **Expanded deposit requirements for customer disputes.** The proposal also would require deposits of parties prosecuting counter-claims, cross-claims, or third-party claims. The proposal is designed to equalize the obligations of all those experiencing the benefits of the arbitration process.

■ **Establishment of fee schedules for industry and clearing controversies.** Securities-industry and clearing-organization claimants would have to deposit \$200 for arbitrations of disputes involving \$10,000 or less; \$750 in cases involving amounts between \$10,000 and \$100,000; and \$1,000 for amounts of \$100,000 or more. The NASD now does not maintain a separate fee schedule for industry and clearing controversies.

The NASD and other securities industry self-regulators operate arbitration programs to resolve financial and other disputes between investors and broker-dealers, and also disputes within the securities industry.

"The program is fair, fast, and impartial, and much less expensive than litigation," said Deborah Masucci, NASD Director of Arbitration.

The NASD's Arbitration Department expects to process approximately 4,000 claim filings for 1988, up from 2,900 in 1987.

To adjudicate these claims, the

Department draws on a pool of 5,000 arbitrators nationally, who come from academia, law, and other professions, as well as from the securities industry.

The Arbitration Department has a staff of 74 persons who administer the program but do not serve as arbitrators. The staff is located in NASD offices in New York, Chicago, San Francisco, and Fort Lauderdale.

SEC-Approved Change Removes NASD Fine Ceiling

The SEC recently approved an NASD proposal to eliminate the ceiling on fines for rule violations. Since 1984, the maximum fine per violation has been capped at \$15,000.

Following a study of recent cases, the Board concluded that the \$15,000 limitation inhibited the NASD's ability to adequately redress violations for cases in which the number of alleged violations was small but the underlying misconduct was egregious and/or involved substantial sums.

With the fine ceiling removed, the DBCC, Market Surveillance Committee, and NASD Board are now in a position to craft more effective remedial sanctions in cases involving serious violations of the NASD's rules and activities in contravention of the federal securities laws.

Predispute Rule Proposal Generates Many Comments From Members

The NASD is evaluating the numerous comments received in response to its proposed amendment to require each member using a predispute arbitration clause in a customer agreement to highlight that clause and to include similarly highlighted disclosures on the nature of arbitration and the waiver of the customer's right to litigate disputes arising under the agreement. This evaluation is expected to be completed in time for the NASD Board of Governors meeting in January 1989.

The amendment also would prohibit the use of language in an agreement that limits or contradicts the arbitration rules of any self-regulatory organization, limits the ability of a party to file its claim in arbitration, or limits the ability of the arbitrators to make an award under applicable law as well as the arbitration rules of a self-regulatory

organization.

The proposal sets forth five affirmative statements that members must include in agreements with predispute clauses. These generally describe the effect of entering into a binding predispute arbitration agreement.

In addition, the proposal requires that members publish, just preceding the signature line in a customer agreement, a statement that the agreement contains a predispute arbitration clause.

The customer would have to initial the statement and acknowledge receipt of a copy of the entire agreement containing a predispute arbitration clause.

This proposal, based on a recommendation of the NASD's National Arbitration Committee, is similar to a proposal that recently was considered by the Securities Industry Conference on Arbitration.