

ALERT

Effective January 1, 1990

SEC Adopts Penny-Stock Sales Practice Regulation

Responding to the widespread incidence of misconduct by certain broker-dealers involving transactions in low-priced securities not listed on NASDAQ or the exchanges, the SEC recently adopted new Rule 15c2-6, which takes effect January 1, 1990.

The new rule imposes sales-practice requirements on broker-dealers that recommend transactions in equity securities issued by companies with less than \$2 million in net tangible assets to persons who are not "established customers."

The rule defines an "established customer" as a customer who has maintained an account for at least one year, or has had three purchases of designated securities on separate days involving different issuers.

Suitability Procedures

It also establishes procedures that must be followed before securities covered by the rule can be recommended to nonestablished customers.

Included is the requirement to obtain oral or written information concerning a new customer's previous investment experience, investment objectives, and financial situation.

With that information, the broker or dealer must reasonably determine whether transactions in these securities are suitable for the particular customer.

If the securities are determined to be suitable for purchase by the customer, the firm must prepare a written statement of its finding of

suitability, deliver it to the customer, and secure a signed copy from the customer as a condition for opening the account.

The firm must do this for each of the first three purchase transactions with a customer in securities covered by the rule.

The objectives of these requirements, the SEC said, are to provide the customer with an opportunity to make an investment decision "outside of a pressured telephone conversation with a salesperson," and enable the customer to decide whether the broker-dealer has made a good-faith attempt at a suitability determination.

The rule exempts the following from its provisions:

- Transactions in which the price of the security is \$5 or more;
- Transactions by a broker-dealer that is not a market maker in the designated security that is the subject of the transaction, and which does not derive sales-related revenue

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Task Force Gets Results

NASD Referrals Bring Indictments In California

The Southern California Securities and Commodities Fraud Task Force recently obtained indictments against six former securities salesmen for misappropriating clients' funds. The task force is part of a nationwide plan announced by U.S. Attorney General Richard Thornburgh to attack fraud in the U.S. securities and commodities markets.

The Los Angeles task force includes representatives from the NASD's District 2 office, the U.S. Attorney's Office in Los Angeles, the Federal Bureau of Investigation, the U.S. Postal Inspection Service, the Internal Revenue Service, the Securities and Exchange Commission, the Commodities Futures Trading Commission, and the California Department of Corporations.

In addition to the L.A. group,

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VOL. 3, NO. 3
NOVEMBER 1989

Members Favor Proposal to Let NASD Nullify Certain Trades

The NASD's Board has decided to adopt a proposal to permit the NASD to declare clearly erroneous trades null and void and to establish the procedures for making and appealing such decisions. The measure will now go to the SEC for approval before becoming effective.

Before this measure, the NASD had no rules to address clearly erroneous trades.

Up until now, in situations where a trade was obviously in error, it was up to the members involved to resolve the matter, even though the error could be detrimental to the fair and orderly functioning of the market.

Under the Board's proposal:

■ The NASD, like exchange-floor governors, will be able to resolve disputes involving obvious errors expeditiously;

■ This capability will benefit members by providing an efficient mechanism to settle disputes; and

■ Any such capability will provide for appellate review.

The proposal provides the NASD with the authority to declare a transaction null and void because one or more terms of the transaction are clearly erroneous in cases where the NASD "deems it necessary to maintain a fair and orderly market, and to protect investors and the public interest."

The authority will extend to any transactions involving NASD-administered automated systems approved by the SEC, such as the Order Confirmation Transaction (OCT) system.

Expeditious Procedures

The amendments set forth expeditious procedures for declaring a transaction void. A member may initiate the procedure orally (with written confirmation) on the same busi-

ness day the transaction occurs by contacting a designated NASD officer to ask that a transaction be declared null and void.

The initiating member and all other members involved in the transaction will have to provide the NASD with any information requested.

Under the procedures, the designated NASD officer may determine that the transaction is "clearly erroneous and detrimental to the maintenance of a fair and orderly market and the protection of investors and the public interest," and may declare the transaction null and void.

The officer may also decline to act if the error, although obvious, has no bearing on the functioning of the market or would be better resolved through another channel such as arbitration.

Written Procedures

The procedures will require a written decision, although in most cases oral notice of the decision probably will be given as well. Members will have four market hours to appeal the decision to the SOES Review Committee, which the NASD selected to hear appeals. The committee will have to act within two business days of the designated officer's decision.

Under the procedures, the committee will consider the matter based either on the facts and information presented or after a hearing, if it so ordered. The committee's decision will constitute final NASD action. However, members can appeal the decision to the SEC.

New Sales-Practice Rule

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from transactions in designated securities exceeding 5 percent of its total sales-related revenue from securities transactions;

■ Transactions in which the purchaser is an accredited investor or an established customer of the broker-dealer; and

■ Transactions not recommended by the broker-dealer.

The rule's recordkeeping re-

quirements are partly designed to provide the basis for "simple and direct enforcement actions against broker-dealers that fail to comply."

The NASD will aggressively enforce compliance with the requirements of SEC Rule 15c2-6.

NASD Activities

The NASD supports increased enforcement efforts to eliminate fraudulent, deceptive, and manipulative acts and practices in the penny stock market. For its part, the NASD continues to commit significant resources to its regulatory efforts in order to reach this objective.

Working on its own cases, as well as in cooperation with the SEC, state securities administrators, and federal law-enforcement agencies, the NASD has concluded or filed in excess of 200 disciplinary actions involving penny stocks, producing sanctions including expulsions of firms, bars of individuals, and fines in excess of \$500,000.

Investigations Underway

More than 175 additional investigations are actively under way. Furthermore, certain of these cooperative efforts with federal law-enforcement agencies have resulted in criminal prosecution relating to securities fraud.

In announcing adoption of the rule, the SEC noted the NASD's program that requires broker-dealers to report to the NASD volume and price information concerning their transactions in non-NASDAQ over-the-counter securities.

SEC Cites Benefits

"This program should provide assistance to regulators in monitoring the non-NASDAQ OTC market, and in identifying fraudulent or manipulative trading activities in that market," the Commission said.

"This, coupled with a comprehensive program to deter fraud in this area, is necessary in order to address the sales practices of broker-dealers actively involved in selling such securities to new customers," the SEC added.

Board Approves Mandatory Close-Out for Short Sales

The NASD Board has approved for filing with the SEC a rule proposal that would impose on the short-seller's broker a mandatory close-out. This measure parallels the provision of SEC Rule 15c3-3, the customer protection rule, that applies when a customer, selling long, fails to deliver the securities to the broker within 10 business days of settlement date. The broker must then purchase securities of like kind and quantity to close out the customer's position.

Similarly, the proposed mandatory close-out for short sales would occur if delivery has not occurred within 10 days after normal settlement date for a short sale of certain NASDAQ securities for customer accounts as well as members' proprietary accounts. The rule would apply only to NASDAQ securities with an aggregate clearing short position of 10,000 shares or more that equals or exceeds one half of one percent of the total shares outstanding.

Transactions exempted from the rule include short sales that result from bona fide market-making activity and short sales in which the resulting position is fully hedged or arbitrated.

Aimed at curbing "naked" or abusive short selling in NASDAQ securities, the proposed mandatory close-out rule specifically addresses "problem situations," e.g., where the ratio of shorts to the clearing corporation represents a significant number of shares relative to the company's total shares outstanding.

These securities would be placed on a "restricted list," meaning that any subsequent short-sale transactions not completed by delivery of shares within the prescribed time frames would be subject to a mandatory close-out. As proposed, the rule would impose a mandatory close-out for short sales in restricted-list

securities if a fail-to-deliver exists 10 days after the normal settlement date.

Related Action Approved

In a companion action, the NASD issued a regulation designed to guarantee delivery of stock purchased from short sellers for the account of public investors. The SEC has approved the new rule, which is now effective.

The rule stipulates that when broker-dealers doing business in NASDAQ securities find it necessary to "buy in" stock to obtain delivery of customers' securities that a short seller has failed to deliver to the clearing corporation, the buy-in transaction must be for guaranteed delivery.

The guaranteed delivery buy-in rule aims to ensure that delivery of securities to purchasing customers is not repeatedly frustrated by additional failures to deliver on the part of short sellers with which close-out transactions were executed under standard buy-in procedures.

Short-selling problems addressed by the rule occur when a short seller fails to borrow and deliver shares to the clearing corporation. This in turn precludes the clearing corporation from delivering shares to the purchaser.

"This rule ensures that attempts to obtain delivery of securities for public customer accounts will not be frustrated by the repeated rolling over of short positions by short sellers," says NASD President Joseph R. Hardiman. "Buy-ins for customer accounts will now be for guaranteed delivery."

NASD Disciplines Firm, Trader for "Backing Away" Violations

The NASD disciplined Datek Securities Corp., located in Brooklyn, New York, and Sheldon Maschler, a Datek trader, for practices relating to a failure to execute transactions at prices that were displayed in the NASDAQ System

by Datek or quoted by Datek in the non-NASDAQ over-the-counter (NNOTC) market. This practice is generally known as "backing away."

The Market Surveillance Committee, which initiated the action, accepted an Offer of Settlement in which neither Datek or Maschler admitted or denied the allegations in the complaint. Datek was fined \$25,000 and suspended for 14 calendar days from acting as a market maker in the securities referenced in the complaint; Maschler was fined \$25,000 and suspended from association with any member in any capacity for 30 calendar days. Also, as part of their Offer of Settlement, Datek and Maschler agreed to implement procedures designed to prevent a recurrence of similar violations, including a method for monitoring and supervising Datek's communications with other market makers. Datek and Maschler consented to findings that they violated the NASD's Rules of Fair Practice by failing to execute transactions in several different securities for at least a normal unit of trading at the price which Datek displayed on the NASDAQ System in securities for which Datek was a registered market maker.

Additionally, Datek and Maschler consented to findings that they engaged in a continued pattern or practice of failing to execute transactions in NNOTC securities at prices quoted verbally to other NASD members, failing to provide quotations, and failing to respond to inquiries concerning quotations from other members in certain NNOTC securities for which Datek was listed as a market maker in the National Quotation Bureau "Pink Sheets" on a name-only basis.

The Market Surveillance Committee's complaint was authorized as a result of the NASD's Market Surveillance investigation into the trading practices of the respondents during the October 1987 market break.

Thereafter, the complaint was amended to reflect a continuing pattern and practice of backing away through the date of the filing of the

amended complaint in June 1988.

In accepting the Offer of Settlement, the Committee stated that "[a] market maker's failure to honor a quotation calls into question the validity of the prices the market maker has quoted on the system. The NASDAQ system's display of bid and ask quotations is the mechanism by which investors and members receive continuous information concerning the market value of NASDAQ traded securities. If a member refuses to execute a transaction at its stated price, it becomes questionable whether the stated price is bona fide."

The NASD's Market Surveillance Committee, which consists of 12 executives of securities firms across the country, is charged with the responsibility of maintaining the integrity of the NASDAQ market and with disciplining NASD members and their associated persons who fail to comply with market-related securities laws and regulations.

NASD Bars, Fines Individual for Misrepresentation And Fraud

The NASD recently took disciplinary action against Edward Eugene Dockray of North Providence, Rhode Island.

Dockray was censured, barred from association with any member of the NASD in any capacity, and fined \$700,000.

The sanctions were imposed pursuant to an Offer of Settlement in which Dockray neither admitted nor denied the allegations contained in the NASD's complaint and consented to the described findings and sanctions for violations of the NASD's Rules of Fair Practice.

Among other things, the complaint against Dockray alleged that, from May 1987 to April 1988, he engaged in fraudulent conduct involving the promotion, solicitation, and sale of the securities of Electronic Whiteboard Leasing Program.

Units in the programs were sold to 140 investors in Rhode Island, Massachusetts, Connecticut, and other states at a total cost of \$1,435,000.

Unregistered Units

The units were not registered pursuant to the Securities Act of 1933 and were offered and sold on the basis of misrepresentations and omissions of material facts relating to the use of proceeds from the investments and the company's business operations.

The NASD found that Dockray engaged in private securities transactions in connection with the solicitation and sale of Electronic Whiteboard securities without providing prior written notification to his member firm.

The NASD also found that, as branch manager of the member firm, Dockray failed to enforce the firm's written supervisory procedures and permitted registered representatives to engage in private securities transactions.

All of the foregoing constituted violations of federal securities laws and/or the NASD's Rules of Fair Practice, including Article III, Section 18.

This section prohibits any manipulative, deceptive, or other fraudulent device in the purchase or sale of any security.

Four Individuals Suspended

NASD Censures And Fines Firm For Stock Trading Violations

The NASD recently took disciplinary actions against Bailey, Martin and Appel, Inc., (BMA), Philadelphia, Pennsylvania, and Donald A. Bailey, Francis A. Martin, Howard M. Appel, and Leonard D. Segal.

The actions related to the artificial pricing of Northgate Industries, Inc., common stock, subsequently

known as Starcom Entertainment International, Inc., a non-NASDAQ over-the-counter (NNOTC) issue, excessive markups charged by BMA in principal sales of Northgate to its customers, and inadequate supervisory procedures.

The respondents neither admitted nor denied the allegations of the complaint.

Offers of Settlement

Pursuant to their Offers of Settlement, the NASD censured all of the respondents and fined them \$50,000, jointly and severally.

In addition, the NASD suspended BMA from membership for three months and Bailey was suspended from association with any member in any capacity for three months.

Martin, who is currently not in the securities industry, agreed not to seek to become associated with any NASD member in any capacity for six months.

Appel was suspended from association with any NASD member in any capacity for 30 days and thereafter suspended for an additional 30 days from association with any NASD member in a supervisory or principal capacity and Segal was suspended from association with any NASD member as a trader for 45 days.

The NASD Market Surveillance Committee charged all respondents with violations of Article III, Sections 1 and 18 of the Rules of Fair Practice. 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.

The committee also charged all respondents except Bailey with violations of Article III, Section 4 of the Rules of Fair Practice, specifically relating to markups, and the firm was charged with violations of Article III, Section 27 of the Rules of Fair Practice, relating to supervision.

Shell Corporation

The complaint charged that Northgate was a public shell corpora-

tion with no assets. When Northgate merged with Starcom on April 16, 1986, Northgate had 342,000 shares of freely tradable stock owned by at least 300 shareholders. No market maker had executed a trade in the stock since at least June 1985. Starcom was a private entertainment company with no operating history or revenues.

The complaint charged that, in the late fall of 1985, BMA entered into an investment banking relationship with Starcom and advised Starcom to merge with an existing public shell and thereafter fund the company through a public financing.

On April 4, 1986, approximately two weeks prior to the merger, BMA bought 240,500 freely tradable shares of Northgate from former officers and directors of the shell for \$48,150, or about 20 cents per share. After purchasing these shares, BMA owned 70 percent of the freely tradable stock (240,500 out of 342,000 shares).

The complaint charged that on April 18, 1986, BMA entered its opening quotes in the "Pink Sheets" of $1\frac{3}{4}$ bid, $2\frac{1}{4}$ offer. From that date until June 30, 1986, respondents increased the price of Northgate to \$3 per share, an increase of 1,400 percent over BMA's 20 cents per share acquisition cost by, among other things:

- Entering quotes in the "Pink Sheets" unrelated to the forces of supply and demand.
 - Dominating and controlling the market for Northgate.
 - Bidding for, purchasing, and selling Northgate at successively higher prices despite substantial long inventory positions and limited wholesale and retail demand for the stock.
 - Failing to advise customers when soliciting them to purchase Northgate that BMA had recently acquired 70 percent of the public float of Northgate at 20 cents per share, was dominating and controlling the market for Northgate, and was artificially increasing its stock price.
- In addition to the allegations relating to the artificial pricing of

Northgate shares, the complaint also charged that BMA, acting through Martin and/or Appel and Segal, in at least 26 principal transactions, sold Northgate to its retail customers at excessive markups ranging from 18 percent to 67 percent above the prevailing market price for Northgate, resulting in customers being overcharged more than \$22,500.

The disciplinary action was taken by the NASD's Market Surveillance Committee, which is responsible for maintaining the integrity of the NASDAQ and non-NASDAQ OTC markets.

Waiting Periods Reinstated

NASD Prohibits Members' Parking Registrations for Inactive RRs

The SEC recently approved changes to the NASD's registration and examination rules as part of its review of the NASD's qualification system to ensure that persons associated with NASD members are knowledgeable and professional.

Under the new rules governing registration, members may submit applications and maintain the registrations for only those principals and representatives who intend to engage or are engaged in the securities business of the member.

Specifically, members may not maintain registrations for persons who no longer function as principals or representatives of the firm.

Application of Changes

The changes also apply to those who no longer are active in the member's investment banking or securities business or who wish to avoid the re-examination requirement applicable to persons who are not registered for more than two years.

In addition, members may not sponsor an application for registration if they do not intend to employ the individual following the examination.

However, members may maintain or make application for the registration of those persons who are engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary.

The NASD believes these changes fit with the historic intent of the qualification and registration program by preventing such unacceptable practices as "parking" registrations and using NASD membership to gain a competitive advantage in operating a commercial training business.

Waiting Periods

In another rule change, the NASD has reinstated waiting periods between attempts to pass qualification examinations.

The waiting periods for all examinations, except for the Series 7 examination, are identical to those of the Municipal Securities Rulemaking Board — 30 days between the first and second attempts, 30 days between the second and third attempts, and six months after the third and all subsequent attempts.

For the Series 7 examination, the waiting period is based on the monthly administration of that examination.

Automation's Effect

Waiting periods were part of the NASD's qualification program until 1979. However, the extensive automation of the testing process enabled applicants to take and retake the tests within very brief periods.

The NASD was concerned that this practice of taking the tests in rapid succession promoted "test learning" rather than a proper understanding of the substantive material covered in the various qualification examinations.

Professional Approach

"The new waiting periods will encourage a more professional approach to both the examination process and applicant training," says John E. Pinto, NASD Executive Vice President, Compliance, "as well as protect the integrity of the qualification examinations."

Interpretations To Financial Responsibility Rules Published

The NASD recently published the *NASD Guide to Rule Interpretations*. Every member has been sent a complimentary copy of the guide, with additional copies available at \$25 each.

Members are responsible for ensuring compliance with interpretations contained in the new guide, which includes current NASD and SEC-approved interpretations to the SEC's Net Capital Rule (15c3-1) and the Customer Protection Rule (15c3-3). Each interpretation has been distilled from one of these 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, members, and others.
 - Discussions between self-regulatory organizations and the SEC.
- To obtain additional copies of the guide, send a check made out to the NASD for \$25 each to:
- NASD Book Order Department
P.O. Box 9403
Gaithersburg, MD 20898-9403
- To expedite the order, enclose a gummed return mailing label.

Task Force Shows Results

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other regional task forces are working in many areas around the country including San Francisco, New York, Chicago, Denver, Salt Lake City, and Kansas City. Four of the six criminal indictments resulted from referrals by the District 2 Los Angeles office and involved the following individuals:

- Peter M. Parrot of Los Angeles, California, formerly a stockbroker in the Westwood, California, branch office of E.F. Hutton & Company, Inc. Parrott is charged with misappropriating approximately \$350,000 from two clients.

- David O. Naulin of Huntington Beach, California, formerly a stockbroker at Drexel Burnham Lambert and, prior to that, E.F. Hutton & Company, Inc. Naulin is charged with falsely posing as a stockbroker at Diehl and Company and using approximately \$150,000 from a customer in unauthorized index options trading.

- Carlos Medina-Valenzuela of Covina, California, was formerly employed as a marketing representative at John Hancock Mutual Life Insurance Company. Medina-Valenzuela is charged with diverting to his own use approximately \$20,000 from at least 10 clients.

- Daniel Kai Tam of Ontario, California, was charged with fraud while employed as a representative at New York Life Securities. Kai Tam is alleged to have diverted approximately \$62,124 in funds from his clients.

SEC Proposes Increases in Minimum Net Capital

Under recently proposed amendments to the net capital rule, the SEC would require certain broker-dealers to maintain significantly higher amounts of minimum net capital than it requires now. The proposal would phase in these increases during a four-year period. Interested persons have until December 18, 1989, to comment on these increases.

The proposals would raise the minimum net capital requirement from \$25,000 or \$100,000 to \$250,000 for general securities firms that hold customer funds or securities. Those firms that clear customer transactions but do not hold customer funds or securities would have to maintain at least \$100,000 instead of the current \$25,000.

Introducing broker-dealers would have to maintain \$50,000 or \$100,000, up from \$5,000, depending on whether they occasionally or

routinely receive customer funds and securities. A residual \$5,000 minimum net capital requirement would apply to those broker-dealers that do not receive customer funds or securities.

The \$5,000 level would also include firms that deal exclusively in direct participation programs. Finally, the minimum net capital requirement for mutual fund broker-dealers would increase from \$2,500 to \$25,000. However, mutual fund firms that neither handle customer funds or securities nor deal in direct wire orders could maintain the \$5,000 net capital level.

In addition, market makers would have to maintain greater net capital than they do now and fulfill a higher capital requirement based on the number of securities in which they make markets. As proposed, the first change would increase the present ceiling of \$100,000 net capital required of market makers on their positions to \$1 million.

The second would raise the requirement for each security priced at \$5 or less per share to \$1,000 from \$500. (The current charge of \$2,500 for each security priced above \$5 remains unchanged.)

For example, a firm making markets in 100 securities priced in excess of \$5 and 50 securities priced below \$5 would have a minimum net capital requirement of \$300,000.

Reasons for Change

In announcing its initiative, the SEC noted that the minimums had not changed since 1975 despite significant changes in the relative value of the dollar and the nature of the securities industry.

Broker-dealers have also expanded the variety of their activities involving more complex products, such as interest-rate swaps, foreign currencies, mortgages, mortgage-backed securities, and over-the-counter options.

In addition, the SEC estimates that the holdings of customer funds and securities have increased tenfold since the early 1970s.

For these reasons, the SEC

views it as important that potential broker-dealers have enough capital to maintain solvency.

Most importantly, according to the SEC, raising minimum capital requirements would protect the investing public and the Securities Investor Protection Corporation's fund by requiring a greater pool of liquid assets for satisfying customer claims.

Persons interested in more detailed information on this proposal should refer to NASD *Notice to Members 89-69*, which includes a reprint of the SEC release containing a complete text of the proposed rule.

U.S. Treasury Considers Input On Bank Secrecy Amendment

The U.S. Department of the Treasury is considering comments it received concerning a proposed amendment to the Bank Secrecy Act designed to discourage money laundering by persons seeking to camouflage illegally-acquired profits under the guise of legitimate transactions.

The amendment would require financial institutions to verify and record, in chronological logs, the identity of any purchaser of cashier's checks, traveler's checks, money orders, or bank checks in amounts of \$3,000 or more in currency before the institution issues or sells these instruments.

The main provisions of the proposal are:

- All financial institutions subject to the Bank Secrecy Act regulations must maintain a monthly chronological log or logs of their sales of bank checks and drafts, cashier's checks, money orders, and traveler's checks to customers who purchase these instruments with currency in amounts of \$3,000 to \$10,000.

- The amendment stipulates detailed information that must be recorded on the log regarding purchasers who are account holders, as

well as those who are nonaccount holders, and also how the financial institution must verify the identity of these purchasers.

- Contemporaneous purchases of the same or different types of instruments totaling \$3,000 or more shall be treated as one purchase.

- Multiple purchases during one business day totaling \$3,000 or more shall be treated as one purchase if an individual employee, director, officer, or partner of the financial institution has knowledge that these purchases have occurred.

- The financial institution may maintain a single centralized chronological log or separate chronological logs by branch. If the financial institution maintains a separate log for each branch, the firm must send these to a centralized location by the 15th day after the end of the calendar month for which the log was compiled. Financial institutions with out-of-state branches may centralize the logs by state. In addition, a financial institution may keep a separate log for each type of instrument sold.

- The financial institution must retain chronological logs for a period of five years.

Although this amendment applies primarily to banks, any other financial institution issuing drafts, traveler's checks, or the like as a convenience to its customers would have to comply with these new requirements.

NASD Extends Price and Volume Reporting to All OTC Securities

With the August 1, 1989, implementation of Phase II of Schedule H, all NASD members now must report price and volume for about 47,000 non-NASDAQ over-the-counter (NNOTC) equity securities, including foreign and preferred stock.

Phase I, which began in Septem-

ber 1988, involved the reporting of price and volume for the 5,700 non-NASDAQ securities cleared through the National Securities Clearing Corporation.

The NASD adopted the reporting requirements under Schedule H to identify questionable trading practices in the NNOTC market. Using computers, the NASD analyzes the reported data to detect indications of manipulation, fraudulent pricing and markups, and other serious sales practices or trading violations.

Under Schedule H, all members executing principal transactions in NNOTC equity securities must report electronically if their aggregate daily volume of purchases or sales exceeds either a minimum of 50,000 shares or \$10,000. Members subscribing to NASDAQ must report this information through their NASDAQ/Harris terminals, NASDAQ Workstation™ terminals, and other authorized terminals. All other firms are required to use the NASD's Automated Regulatory Reporting System to meet these electronic reporting obligations.

SEC Approves Order-Taker Registration Category and Examination

The Securities and Exchange Commission recently approved an NASD proposal establishing a new registration category for Assistant Representative-Order Processing (AR-OP) as well as the accompanying qualifications examination. The NASD is installing the AR-OP exam on the PLATO system and will publish an availability date for the exam as well as procedures for taking it in the December issue of *Notices to Members*.

Persons to be registered in this category may accept only unsolicited customer orders for existing accounts. They may not solicit orders, open new accounts, give investment advice, make recommendations to

customers, or effect transactions for members.

Members will be permitted to compensate their AR-OPs only on an hourly wage or salary basis. They may not compensate them based on the number or size of the customers' transactions they handle.

However, AR-OPs may participate in members' bonus or profit-sharing plans that apply to all other employees. Another condition of registration is that AR-OPs may work only at members' offices that are under the direct supervision of appropriately registered principals.

NASD Targets Abusive Late Trade Reporting

The Market Surveillance Committee (MSC) reminds members of their obligation to report transactions in NASDAQ National Market securities within 90 seconds after execution.

The Committee is concerned with the number of instances of transactions (particularly block-size transactions) not reported until after the market is closed. They are then reported with the ".SLD" modifier, indicating that the transaction was reported late.

The MSC believes that, in some instances, traders may be withholding transaction reports so as not to disclose the execution of these blocks to the marketplace during trading hours.

This clearly violates the intention of the 90-second reporting requirement — to ensure that critical up-to-the-minute transaction information is provided to all NASDAQ market participants.

A pattern or practice of marking transactions as ".SLD" could be considered a violation of just and equitable principles of trade and could subject members engaging in this practice to possible disciplinary action.

This is an area of concern to the MSC. Member practices in complying with all aspects of Schedule D

therefore will be closely monitored.

In other matters, the Committee has taken several disciplinary actions against certain members and individuals who have engaged in a practice commonly referred to as "marking the close" of the market.

This practice involves influencing the closing price of a security through the entry of fictitious trade reports, quotation changes, or actual transactions.

The Committee alerts members of their supervisory responsibilities to review for instances of marking-the-close situations through end-of-the-day fictitious trade reports or otherwise.

Audits Recommended

In this regard, the Committee suggests that all reporting members perform regular audits of transactions executed at or near the close to ensure that the trades reported are bona fide transactions.

The NASD, through its Market Surveillance Department, is willing to assist members in carrying out their supervisory obligations by providing a listing of a member's transaction reports on any given day.

These transactions may then be spot-checked against the internal records of the firm. These audit procedures should be done on a periodic, surprise basis.

For further information on how to obtain transaction reports, contact Leon Bastien, Assistant Director, Market Surveillance Department, at 301-590-6429.

Members Satisfy Filing Obligations Through ARRS

The NASD has urged members to use its new Automated Regulatory Reporting System (ARRS) to fulfill several of their regulatory filing requirements.

These filings include Regulation T/SEC Rule 15c3-3 extension requests; mandatory electronic price and volume reporting for non-NASDAQ over-the-counter

(NNOTC) securities, and monthly NASDAQ short-interest reports. Planned enhancements to ARRS will enable members to file FOCUS I and II reports the same way.

By subscribing to ARRS, members can submit these filings directly through their own personal computers. ARRS subscribers can access the service through direct dial-up via Telenet, the GTE public network phone system. With ARRS, members can:

- Eliminate the delays in postal and delivery services.
- Verify NASD receipt of filings immediately.
- Improve accuracy with on-line edits and data validation.
- Reduce paperwork by making hard copies obsolete.
- File up to the last minute without missing a deadline.
- Get advance word on new programs and enhancements to ARRS.

Service Costs

Except for NNOTC filings, the only costs for the service are the time to input the data and the local phone charge to transmit it.

For NNOTC filings, there is a one-time \$5 hook-up fee, a monthly \$4 fee for accessing GTE's network, and a local phone charge that varies in amount based on location.

For copies of informational brochures on the ARRS service and the filing services available through it, members should contact their local NASD district office or the NASD's Automated Reports Department at (800) 537-8192.

NASD-Sponsored Group Life Plan Mails Dividends To Members

The trustees of the NASD-sponsored group insurance program for members and their employees recently mailed out dividend checks amounting to 35 percent of premiums to firms enrolled in

the group life plan insured by State Mutual Life Assurance Company of America. Firms enrolled as of April 30, 1989, were eligible for the payout based on premiums paid during part or all of the preceding plan year. In August, the trustees also reduced group life premium rates for member firms by 15 percent.

The NASD Insurance Committee is preparing a 12 percent refund in the Registered Personnel (Individual) group life plan insured by CIGNA, payable to insured persons in the plan as of November 30, 1989, but based on premiums paid by them during the 12 months ending November 30, 1989.

Insurance policies available to both member firms and their employees at group rates include accidental death and dismemberment, major medical, dental, and term life. Policies offered at group rates to individuals only include disability income protection, short-term medical insurance, major medical, and term life.

The NASD believes these plans merit serious consideration on the basis of both cost and benefits. For more information on any of the plans, call 1-202-898-0727 or contact: Group Administrators, Inc. 1030 15th Street, NW Suite 200 Washington, DC 20005.

Taped Broadcasts About NASDAQ And NASD Are Now Available

Money Matters, a community service cable television series geared to investors, recently featured an in-depth look at NASDAQ and the NASD in two special segments.

Hosted by Larry Adam, Senior Vice President, Investments, at Dean Witter Reynolds, the programs are sponsored by the Community College Satellite Network.

The network's 69 community colleges in 29 states reach an es-

timated 3.5 million households. Taped in August, the first program aired in late September and the second broadcast aired in mid-November.

In two separate half-hour interviews, NASD President Joseph R. Hardiman describes the NASDAQ market and mechanics of operation, recent market performance, international developments, and improvements made to the market in response to the October 1987 break.

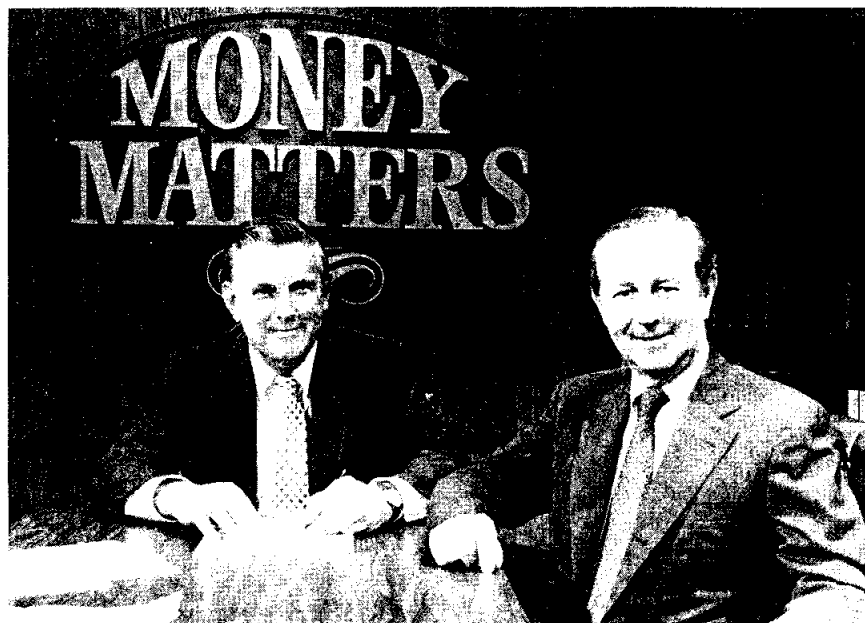
The NASD segment discusses the Association's investor protection efforts including new state-of-the-art

market surveillance capabilities, current areas of regulatory focus, the broker-dealer relationship, and a major milestone — the NASD's 50th anniversary.

Videocassettes of these *Money Matters* programs may be obtained by contacting:

C. Edward Cavert
N. Virginia Community College
Telecommunications Center
8333 Little River Turnpike
Annandale, VA 22003
(703) 323-3350

Copies are in VHS format and cost \$35.



NASD President Joseph R. Hardiman (right) responds to questions about the NASD and NASDAQ on the set of the Community College Satellite Network's investor finance program, "Money Matters." Interviewing him is host Larry Adam (left), of Dean Witter Reynolds.

Membership Approves New Rule On Handling Customer Limit Orders

The NASD membership has overwhelmingly approved a proposed rule governing how members handle customer limit orders. Subject to SEC approval, the new rule would codify the NASD's longstanding position that on accepting a customer limit order while continuing to make a market in the security that is the subject of the limit order, a member undertakes a fiduciary obligation.

As a result, it cannot trade for its own account at prices more favorable than the customer limit order unless there is an understanding by the customer as to the priorities that will govern the order.

The rule would set forth the specifics of how a member firm may meet its existing responsibilities to disclose the circumstances under which it accepts limit orders, and the firm's policies and procedures in han-

ding those orders. Market-making firms that accept customer limit orders but do not grant those orders priority over transactions for their own accounts would have to provide each existing and new customer with a written statement to that effect.

The rule provides sample language that can be use in written statements to customers to comply with the required disclosures in the rule as follows:

"By accepting your limit order for transactions in securities in the NASDAQ or over-the-counter

market, we undertake to monitor the interdealer market and to seek to execute your order only if the inside bid (in the case of a limit order to sell, the highest price at which a dealer is being quoted as willing to buy securities) or the inside asked (in the case of a limit order to buy, the lowest price at which a dealer is being quoted as willing to sell securities) reaches your limit price. We reserve the right, while your limit order remains unexecuted, to trade for our own market-maker account at prices equal to or better than your

limit order price and not to execute your order against incoming orders from other customers. For example, if the inside market is 10 bid, 10 $\frac{1}{4}$ asked, and you place a limit order to sell securities at 10 $\frac{1}{8}$, we will seek to execute your order only if the inside bid reaches your limit price of 10 $\frac{1}{8}$ (exclusive of any markdown or commission equivalent that we may charge in connection with the transaction) and, while your order remains unexecuted, we may continue to sell securities for our market-maker account at prices at or above 10 $\frac{1}{8}$."