

# NASD NOTICE TO MEMBERS 96-52

## NASD Solicits Member Comments On Proposed Rules Relating To The Sale Of Variable Life Insurance Contracts And Variable Annuity Contracts

### Suggested Routing

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### Executive Summary

The NASD® requests member comments on proposed amendments that would revise existing rules applicable to the sale of variable life insurance contracts and establish new rules applicable to the sale of variable annuity contracts. The proposed amendments incorporate definitions and provisions from the current rules for variable contracts and investment company securities and the proposed rules pending with the Securities and Exchange Commission (SEC) to regulate the receipt of cash and non-cash compensation. The key provisions are a prohibition from favoring or disfavoring the sale of a variable life insurance or variable annuity contract on the basis of brokerage commissions received by a member and a requirement that categories of cash and non-cash compensation that may be received by a member or its associated persons in connection with the sale and distribution of variable life insurance or variable annuity contracts be disclosed in the prospectus.

Questions concerning this Notice should be directed to Clark Hooper, Senior Vice-President, Office of Disclosure and Investor Protection, NASD Regulation, Inc., at (202) 728-8325; and Robert J. Smith, Senior Attorney, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176.

### Background

Sales of both variable life insurance and variable annuities and their means of distribution have expanded significantly in the past two decades. Rule 2830 of the NASD's Conduct Rules (Investment Company Rule, formerly Article III, Section 26, NASD Rules of Fair Practice), the NASD's current rule governing sales and distribution of investment company products, has been amended

numerous times to reflect a similar expansion in the investment company industry. In contrast, Rule 2820 of the NASD's Conduct Rules (Variable Contracts Rule, formerly Article III, Section 29, NASD Rules of Fair Practice), the current rule governing variable life insurance and variable annuity products, was last amended in 1976.

During the development of the NASD proposed rule change to regulate the receipt of cash and non-cash compensation for the sale of investment company securities and variable products (Non-Cash Proposal), now pending with the SEC,<sup>1</sup> the NASD determined that other revisions to the Variable Contracts Rule would be appropriate in light of the increasing similarities of sales and distribution practices for both variable products and investment company securities. Although the current Variable Contracts Rule applies to all variable products, it was decided to develop separate rules for variable annuity contracts and variable life insurance contracts in view of the dissimilarities between the two products with respect to product design and sales-charge structures.

Rule 2820 was modified to apply to variable life insurance contracts (Variable Life Insurance Rule) and a similar but separate rule was drafted to apply specifically to variable annuity contracts (Variable Annuity Rule). Both proposed rules incorporate certain provisions from the current Investment Company Rule and Variable Contracts Rule as well as the proposed definitions and provisions for variable contracts from the Non-Cash Proposal pending before the SEC. The provisions incorporated from the Non-Cash Proposal are ital-

<sup>1</sup> Securities Exchange Act Release No. 37374 (June 26, 1996); 61 FR 35822 (July 8, 1996).

icized and, with the exception of proposed changes to those provisions, are not under consideration for member comment.

## **Description Application**

Both proposed rules apply, in lieu of the Investment Company Rule, to the activities of members in connection with variable life insurance and annuity contracts registered under the Investment Company Act of 1940 and the Securities Act of 1933. Thus, the proposed rules do not apply to private placements of variable contracts.

## **Definitions**

Both proposed rules contain similar definitions. The definitions in both rules for the terms “affiliated member,” “non-cash compensation,” and “offeror” were taken from the Non-Cash Proposal and reflect the NASD’s prior determination to apply these terms to the sale of variable products. These definitions are not proposed to be changed except to add the term “variable life insurance contract” or “variable annuity contract” as needed.

The terms “person,” “principal underwriter,” and “underwriter” in the definition section of both rules are defined as having the same definitions used in the Investment Company Act of 1940 and are based on an identical provision in the definition section of the current Investment Company Rule. The inclusion of these terms is appropriate for products that are registered and regulated under the Investment Company Act of 1940.

The definition in both rules of the term “cash compensation” also was taken from the Non-Cash Proposal. The definition of “cash compensation” which, as proposed in the Non-Cash Proposal, includes any

discount, concession, fee, service fee, commission, loan or override, is proposed to be broadened to include a “finder’s fee, administrative fee, marketing support fee, contribution to non-cash or cash incentive arrangements, and any other payment or expense reimbursement.” The definitional requirement that such compensation must be received in connection with the sale and distribution of variable life insurance contracts also has been broadened to include the receipt of such compensation for “providing services to the offeror.” These proposed changes reflect a recognition of the wide array of cash payments that a variable product issuer or affiliate may make, in addition to sales loads or other charges described in the prospectus, to entities and persons selling variable contracts. Such payments typically are not paid directly by variable contract holders or from the separate account assets underlying the variable contract, and are not required to be, and generally have not been, disclosed in variable product prospectuses under the federal securities laws.

The term “brokerage commissions” is taken from the Investment Company Rule and, as used in both proposed rules, is defined to include commissions on agency transactions, underwriting discounts and concessions, and fees paid to members in connection with tender offers. The addition of this definition reflects the inclusion in both rules of a provision taken from the Investment Company Rule that prohibits a member from favoring or disfavoring the sale or distribution of variable annuity or life insurance contracts on the basis of brokerage commissions received by the member from any source, including the offeror of such contracts.

The terms “premium” in the proposed Variable Life Insurance Rule and “purchase payment” in the proposed Variable Annuity Rule both

refer to the consideration paid for the variable life insurance/annuity contract and reflect the industry practice of the use of different terms for different products.

“Variable Life Insurance Contract” and “Variable Annuity Contract” are defined in both proposed rules as contracts funded by a separate account of a life insurance company and subject to regulation as such under the insurance laws of each state in which they are offered. However, variable life insurance contracts are defined as “contracts of life insurance;” whereas, variable annuity contracts are defined as “accumulation or annuity contracts.” This difference reflects the distinction that variable insurance contracts are intended primarily to provide, like traditional life insurance, a death benefit to a designated beneficiary; whereas, variable annuity contracts provide, in exchange for a lump-sum payment or series of payments by the contract owner during the “pay-in” period, a series of payments to the contract owner for life or a specified “pay-out” period.

The current Variable Contracts Rule imposes substantive limits on the payment of sales charges for the sale of variable annuity contracts, but does not contain a definition of sales charge. The proposed Variable Annuity Rule incorporates from the current Variable Contracts Rule a similar sales charge prohibition and proposes a new definition of “sales charge,” similar to the definition of “sales charge” in the current Investment Company Rule, but tailored to reflect certain insurance-related expenses and charges unique to variable annuities. Similar to the definition of “sales charges” in the Investment Company Rule, the term “sales charges” was defined to include all charges or fees that are paid to finance sales or sales promotion expenses, including front-end,

deferred and asset-based sales charges, excluding charges and fees for ministerial, recordkeeping or administrative activities, and investment management fees. However, the definition also excludes "mortality and expense charges" in recognition of the risk that an insurance company takes when it guarantees under the contract an annuity rate or an administrative expense risk based on mortality projections for future annuitants. Finally, the definition of "sales charges" states that, for purposes of the definition, members may rely on the sales-related fees and charges disclosed in the prospectus of a variable annuity contract. In this regard, "sales charges," as deductions from customer purchase payments or variable account assets, are distinguished from "cash compensation" payments, which generally are paid from other sources of the issuer or affiliates of the issuer.

The current Variable Contracts Rule does not impose substantive limits on the payment of sales charges for the sale of variable life insurance contracts. The proposed Variable Life Insurance Rule also does not impose substantive limits on the payment of sales charges and, therefore, does not contain a definition of sales charges. The NASD determined that the sales charge and distribution structures for variable life insurance products more closely resemble the sales charge and distribution structures for traditional life insurance products. Sales charges and commissions for such products generally are paid from sources other than deductions from premium or purchase payments, and therefore, a cap on these payments may not be meaningful.

### **Sales Charge Prohibition**

As mentioned above, the proposed Variable Annuity Rule imposes substantive sales charge limitations for the sale of variable annuity contracts

similar to the sales charge limitations imposed by the current Variable Contracts Rule. The proposed new sales charge provision prohibits members from participating in the offering or sale of variable annuity contracts issued by a separate account registered under the Investment Company Act of 1940, if the purchase payment is subject to a sales charge that is excessive. The sales charge provision states that in the aggregate, sales charges shall not be excessive if the sales charge stated in the prospectus does not exceed 8.5 percent of the total payments to be made as of a date not later than the end of the twelfth year of such payments, or 8.5 percent of the total payments made under a contract issued for any stipulated shorter payment period. The phrase "in the aggregate" is modeled after similar language in the current Investment Company Rule, and was added to ensure that all sales charges for variable annuity contracts, including front-end, deferred, and asset-based sales charges, are included in the calculation to determine whether sales charges are excessive.

### **Disclosure Of Deferred Sales Charges**

As a result of the addition of "deferred sales charges" to the definition of "sales charges" in the proposed Variable Annuity Rule, a provision contained in the current Investment Company Rule has been added to the proposed Variable Annuity Rule for the disclosure of deferred sales charges on written confirmations. The provision states that in addition to the disclosure requirements on written confirmations, the confirmation also shall include, for the purchase of variable annuity contracts that impose a deferred sales charge, the following legend on the front of the confirmation in at least 8-point type: "On cancelling or redeeming your contracts,

you may pay a sales charge. For the charge and other fees, see the prospectus."

### **Transmittal**

Both proposed rules contain the requirement, taken from the current Variable Contracts Rule, that every member shall promptly transmit to the offeror of variable life insurance or annuity contracts all applications received and at least that portion of the purchase payment/premium required to be transmitted to the offeror.

### **Selling Agreement**

Both proposed rules contain the prohibition, taken from the current Variable Contracts Rule, that no member who is a principal underwriter as defined in the Investment Company Act of 1940 may sell variable life insurance/annuity contracts through another broker/dealer unless the broker/dealer is a member, and there is a sales agreement in effect between the parties.

### **Execution Of Portfolio Transactions On Any Assets Underlying A Variable Life Insurance/Annuity Contract**

Both proposed rules contain a prohibition, taken almost verbatim from the current Investment Company Rule, against members favoring the distribution of variable life insurance or annuity contracts on the basis of brokerage commissions received from the issuers of such contracts. The general prohibition states that no member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular variable life insurance/annuity contract on the basis of brokerage commissions received or expected by such member from any source, including the offeror of a variable life insurance/annuity contract.

Under this provision, members also are prohibited from:

- demanding, requiring, or soliciting a promise of brokerage commissions as a condition to the sale or distribution of a variable life insurance/annuity contract;
- offering or promising to another member, brokerage commissions as a condition to the sale or distribution of a variable life insurance/annuity contract, or requesting or arranging for the direction to any member, brokerage commissions conditioned upon sales or promises of sales of a variable life insurance/annuity contract;
- circulating information regarding the amount or level of brokerage commissions received by the member from any offeror of a variable life insurance/annuity contract to anyone other than certain management personnel required to have access to such information; and
- encouraging or sponsoring, as underwriters of variable life insurance/annuity contracts, any incentive campaign or special sales effort of another member that is based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

With respect to a member's retail sales of variable life insurance/annuity contracts, the prohibition on the acceptance of brokerage commissions further prohibits members from:

- providing any incentive or additional compensation, including bonuses, preferred compensation lists, and sales incentive campaigns or contests, to salespersons, branch managers, or other sales personnel for the sale of specific variable life insurance/annuity contracts based

on the amount of brokerage commissions received or expected from any source, including offerors of variable life insurance contracts;

- recommending specific variable life insurance/annuity contracts to sales personnel, or establishing "recommended," "selected," or "preferred" lists of offerors of variable life insurance contracts on the basis of brokerage commissions received or expected from any source;
- granting to any associated person of a member any participation in brokerage commissions received from portfolio transactions of an offeror of a variable life insurance/annuity contract whose contracts are sold by the member, if such commissions are directed by, or identified with, the offeror; and
- using sales of variable life insurance/annuity contracts as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an offeror of a variable life insurance contract, whether such transaction is executed in the over-the-counter market or elsewhere.

Finally, the prohibition on the acceptance of brokerage commissions does **not** prohibit a member from:

- executing portfolio transactions of any offeror of a variable life insurance/annuity contract whose contracts the member also sells;
- selling shares of, or acting as underwriter for, an offeror of a variable life insurance/annuity contract that follows a policy, disclosed in its prospectus, of considering sales of the offeror's variable life insurance contract as a factor in the selection of broker/dealers to execute portfolio transactions, subject to the requirements of best execution; and

- compensating its associated persons based on total sales of variable life insurance/annuity contracts attributable to such associated persons, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular variable life insurance/annuity contracts on a basis prohibited by this subsection.

### **Prospectus Disclosure Of Cash And Non-Cash Compensation**

Both the proposed Variable Life Insurance Rule and the proposed Variable Annuity Rule contain a provision for member compensation regulating the receipt of cash and non-cash compensation in connection with the sale and distribution of variable life insurance/annuity contracts, which is based on an identical provision in the pending Non-Cash Proposal. A prospectus disclosure requirement has been added to the member compensation provision in both proposed rules that prohibits a member from participating in the sale of a variable annuity or life insurance contract, or providing services to an offeror of such contracts, unless the categories of cash and non-cash compensation that are or may be received by the member or its associated persons are described in the narrative section of the prospectus describing the distribution of the contract. Cash and non-cash compensation are defined broadly (see definitions above) to include a wide array of compensation practices.

The receipt of cash and non-cash compensation by members and associated persons for the sale of variable life insurance/annuity contracts has the potential to provide significant incentives to members and salespersons, and the NASD is concerned that investors generally are not aware of such incentives. The NASD pro-

posed rules are designed to ensure that investors have access to information to make them aware of all sources of compensation that a member or associated person receives or may receive for the sale of variable contracts. Although such compensation is not paid directly by the investor in the form of a deduction from premiums/purchase payments or from assets of the separate account which underlie the variable contracts, such payments may provide point-of-sale or other incentives that could compromise proper customer suitability determinations or otherwise create a general perception that a member's interests might not, in some circumstances, be fully aligned with the interests of customers. However, the NASD has determined that a disclosure approach, rather than substantive regulation such as the imposition of maximum payment limits, may be the appropriate approach for cash and non-cash payments that are not paid by the investor or deducted from the assets of the underlying accounts of variable contracts.

### Request For Comment

The NASD encourages all members and other interested parties to comment on the proposed amendments to Rule 2820 to create separate rules for Variable Life Insurance Contracts and Variable Annuity Contracts. Comments should be forwarded to:

Joan Conley  
Corporate Secretary  
National Association of  
Securities Dealers, Inc.  
1735 K Street, NW  
Washington, DC 20006-1500.

Comments should be received by  
September 30, 1996.

**Text Of Proposed Amendments**  
(Note: New text is underlined;

deletions are bracketed; text from pending Non-Cash Proposal is italicized and treated as if already adopted.)

## 2820. Variable Life Insurance Contracts Of An Insurance Company

### (a) Application

This Rule shall apply exclusively (and in lieu of Rule 2830) to the activities of members in connection with variable life insurance contracts registered under the Investment Company Act of 1940 and the Securities Act of 1933, to the extent such activities are subject to regulation under the federal securities laws.

### (b) Definitions

(1) [The term "purchase payment" as used throughout this Rule shall mean the consideration paid at the time of each purchase or installment for or under the variable contract.] *The terms "affiliated member," "cash compensation," and "non-cash compensation" [and "offeror"] as used in paragraph [(h)](f) shall have the following meanings:*

*"Affiliated Member" shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.*

*"Cash compensation" shall mean any discount, concession, fee, service fee, commission, loan or override, finder's fee, administrative fee, marketing support fee, contribution to non-cash or cash incentive arrangements, and any other payment or expense reimbursement received in connection with the sale and distribution of variable life insurance contracts or for providing services to the offeror.*

*"Non-cash compensation" shall mean any form of compensation*

*received in connection with the sale and distribution of variable life insurance contracts that is not cash compensation, including but not limited to merchandise, gifts and prizes, and payment of travel expenses, meals and lodging.*

(2) [The term "variable contracts" shall mean contracts providing for benefits or values which may vary according to the investment experience of any separate or segregated account or accounts maintained by an insurance company.] "Brokerage commissions," as used in subsection (e) of this section, shall include commissions on agency transactions, underwriting discounts and concessions, and fees paid to members in connection with tender offers.

(3) *"Offeror" shall mean an insurance company, a separate account of an insurance company, an adviser to a separate account of an insurance company, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities.*

(4) The terms "person," "principal underwriter," and "underwriter" shall have the same definitions used in the Investment Company Act of 1940.

(5) "Premium" shall mean the consideration paid for or under the variable life insurance contract.

(6) "Variable life insurance contract" shall mean a contract of life insurance funded by a separate account of a life insurance company and subject to regulation as a variable life insurance contract under the insurance laws of each state in which it is offered.

### [(c) Sales Charges]

[No member shall participate in the offering or in the sale of variable annuity contracts if the purchase pay-

ment includes a sales charge which is excessive:]

[(1) Under contracts providing for multiple payments a sales charge shall not be deemed to be excessive if the sales charge stated in the prospectus does not exceed 8.5% of the total payments to be made thereon as of a date not later than the end of the twelfth year of such payments, provided that if a contract be issued for any stipulated shorter payment period, the sales charge under such contract shall not exceed 8.5% of the total payments thereunder for such period.]

[(2) Under contracts providing for single payments a sales charge shall not be deemed to be excessive if the prospectus sets forth a scale of reducing sales charges related to the amount of the purchase payment which is not greater than the following schedule:]

[First \$25,000 - 8.5% of purchase payment

Next \$25,000 - 7.5% of purchase payment

Over \$50,000 - 6.5% of purchase payment]

[(3) Under contracts where sales charges and other deductions for purchase payments are not stated separately in the prospectus the total deductions from purchase payments (excluding those for insurance premiums and premium taxes) shall be treated as a sales charge for purposes of this rule and shall not be deemed to be excessive if they do not exceed the percentages for multiple and single payment contracts described in paragraphs (1) and (2) above.]

[(4) Every member who is an underwriter and/or issuer of variable annuities shall file with Variable Contracts Department of the Association, prior

to implementation, the details of any changes or proposed changes in the sales charges of such variable annuities, if the changes or proposed changes would increase the effective sales charge on any transaction. Such filings should be clearly identified as an "Amendment to Variable Annuity Sales Charges."]

#### [(d) Receipt of Payment]

[No member shall participate in the offering or in the sale of a variable life insurance contract on any basis other than at a value to be determined following receipt of payment therefore in accordance with the provisions of the contract, and, if applicable, the prospectus, the Investment Company Act of 1940 and applicable rules thereunder. Payments need not be considered as received until the contract application has been accepted by the insurance company, except that by mutual agreement it may be considered to have been received for the risk of the purchaser when actually received.]

#### [(e)](c) Transmittal

Every member who receives applications and/or [purchase payments] premiums for variable life insurance contracts shall transmit promptly to the [issuer] offeror all such applications and at least that portion of the [purchase payment] premium required to be [credited to the contract] transmitted to the offeror.

#### [(f)](d) Selling Agreement

No member who is a principal underwriter as defined in the Investment Company Act of 1940 may sell variable life insurance contracts through another broker/dealer unless (1) such broker/dealer is a member, and (2) there is a sales agreement in effect between the parties. [Such sales agreement must provide that the sales commission be returned to the issu-

ing insurance company if the variable contract is tendered for redemption within seven business days after acceptance of the contract application.]

#### [(g) Redemption]

[No member shall participate in the offering or in the sale of a variable contract unless the insurance company, upon receipt of a request in proper form for partial or total redemption in accordance with the provisions of the contract undertakes to make prompt payment of the amounts requested and payable under the contract in accordance with the terms thereof, and, if applicable, the prospectus, the Investment Company Act of 1940 and applicable rules thereunder.]

#### (e) Execution of Portfolio Transactions On Any Assets Underlying a Variable Life Insurance Contract

(1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular variable life insurance contract on the basis of brokerage commissions received or expected by such member from any source, including the offeror of a variable life insurance contract.

(2) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of a variable life insurance contract.

(3) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of a variable life insurance contract and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales

of a variable life insurance contract.

(4) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any offeror of a variable life insurance contract to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

(5) No member shall, with respect to such member's activities as underwriter of variable life insurance contracts, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the contracts of any offeror of a variable life insurance contract which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

(6) No member shall, with respect to such member's retail sales or distribution of variable life insurance contracts:

(A) provide to salesmen, branch managers or other sales personnel any incentive or additional compensation for the sale of specific variable life insurance contracts based on the amount of brokerage commissions received or expected from any source, including such offerors of variable life insurance contracts. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaign or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any variable life insurance contract based on brokerage commissions;

(B) recommend specific variable life insurance contracts to sales person-

nel, or establish "recommended", "selected", or "preferred" lists of offerors of variable life insurance contracts, regardless of the existence of any special compensation or incentives to favor or disfavor the contracts of such offeror(s) in sales efforts, if such offerors are recommended or selected on the basis of brokerage commissions received or expected from any source;

(C) grant to any associated person of a member any participation in brokerage commissions received by such member from portfolio transactions of an offeror of a variable life insurance contract whose contracts are sold by such member, if such commissions are directed by, or identified with, such offeror of a variable life insurance contract; or

(D) use sales of variable life insurance contracts as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an offeror of a variable life insurance contract, whether such transaction is executed in the over-the-counter market or elsewhere.

(7) Provided that the member does not violate any of the specific provisions of this subsection (e), nothing herein shall be deemed to prohibit:

(A) the execution of portfolio transactions of any offeror of a variable life insurance contract by members who also sell the offeror's variable life insurance contracts;

(B) a member from selling shares of, or acting as underwriter for, an offeror of a variable life insurance contract which follows a policy, disclosed in its prospectus, of considering sales of the offeror's variable life insurance contract as a factor in the selection of broker-dealers to execute portfolio transactions, subject to the requirements of best execution;

(C) a member from compensating its associated persons based on total sales of variable life insurance contracts attributable to such associated persons, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular variable life insurance contracts on a basis prohibited by this subsection (e).

#### ***(f) Member Compensation***

*In connection with the sale and distribution of variable life insurance contracts or for providing services to the offeror of such contracts:*

*(1) Except as described below, no associated person of a member shall accept any compensation, cash or non-cash, from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a company pays compensation directly to associated persons of the member, provided that:*

*(a) the arrangement is agreed to by the member;*

*(b) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or "no-action" letter issued by the Securities and Exchange Commission that applies to the specific fact situation of the arrangement;*

*(c) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of NASD rules; and*

*(d) the recordkeeping requirement in subparagraph (f)(2) is satisfied.*

*(2) Except for items as described in subparagraphs (f)(4)(a) and (b), a member shall maintain records of all compensation, cash and non-cash,*

received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, and the amount of cash, and the nature and, if known, the value of non-cash compensation received.

(3) No member shall participate in the sale of a variable life insurance contract or provide services to an offeror unless the categories of compensation, cash or non-cash, that are or may be received by the member or its associated persons are described in the narrative section of the prospectus describing the distribution of the contract.

([3]4) No member or person associated with a member shall directly or indirectly accept any non-cash compensation offered or provided to such member or its associated persons, except as provided in this provision. Notwithstanding the provisions of subparagraph (f)(1), the following items of non-cash compensation may be accepted:

(a) Gifts to associated persons of members that do not exceed an annual amount per person fixed periodically by the Board of Governors\* and are not preconditioned on achievement of a sales target.

(b) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment for persons associated with a member and, if appropriate, their guests, which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(c) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) the recordkeeping requirement in subparagraph (f)(2) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (d);

(iii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iv) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (d).

(d) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes variable life insurance contracts, is based on the total production of associated persons with respect to all variable life insurance contracts distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each variable life insurance contract is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated mem-

ber directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(iv) the recordkeeping requirement in subparagraph (f)(2) is satisfied.

(e) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (d).

([4]5) No person associated with a member shall directly or indirectly accept any cash compensation offered or provided to such person that is preconditioned on such person achieving a sales target, except that the following arrangements are permitted:

(a) Cash compensation arrangements preconditioned on the achievement of a sales target between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

(i) the member's or non-member's arrangement, if it includes variable life insurance contracts, is based on the total production of associated persons with respect to all variable life insurance contracts distributed by the member;

(ii) the arrangement requires that the credit received for each variable life insurance contract is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's

\* The current annual amount fixed by the Board of Governors is \$100.



organization of a permissible arrangement; and

(iv) the recordkeeping requirement in subparagraph (f)(2) is satisfied.

(b) Contributions by a non-member company or other member to a cash compensation arrangement preconditioned on the achievement of a sales target between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (a).

### **Variable Annuity Contracts Of An Insurance Company**

#### **(a) Application**

This Rule shall apply exclusively (and in lieu of Rule 2830) to the activities of members in connection with variable annuity contracts registered under the Investment Company Act of 1940 and the Securities Act of 1933, to the extent such activities are subject to regulation under the federal securities laws.

#### **(b) Definitions**

(1) [The term “purchase payment” as used throughout this Rule shall mean the consideration paid at the time of each purchase or installment for or under the variable contract.] *The terms “affiliated member,” “cash compensation,” and “non-cash compensation” [and “offeror”] as used in paragraph (h) shall have the following meanings:*

*“Affiliated Member” shall mean a member which, directly or indirectly, controls, is controlled by, or is under common control with a non-member company.*

*“Cash compensation” shall mean any discount, concession, fee, service fee, commission, loan or override, finder’s fee, administrative fee, marketing support fee, contribution to*

non-cash or cash incentive arrangements, and any other payment or expense reimbursement received in connection with the sale and distribution of variable annuity contracts or for providing services to the offeror.

*“Non-cash compensation” shall mean any form of compensation received in connection with the sale and distribution of variable annuity contracts that is not cash compensation, including but not limited to merchandise, gifts and prizes, and payment of travel expenses, meals and lodging.*

(2) [The term “variable contracts” shall mean contracts providing for benefits or values which may vary according to the investment experience of any separate or segregated account or accounts maintained by an insurance company.] “Brokerage commissions,” as used in subsection (e) of this section, shall include commissions on agency transactions, underwriting discounts and concessions, and fees paid to members in connection with tender offers.

(3) *“Offeror” shall mean an insurance company, a separate account of an insurance company, an adviser to a separate account of an insurance company, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities.*

(4) The terms “person,” “principal underwriter,” and “underwriter” shall have the same definitions used in the Investment Company Act of 1940.

(5) “Purchase payment” shall mean the consideration paid for or under the variable annuity contract.

(6) “Sales charge” and “sales charges” as used in subsection (c) of this section shall mean all charges or fees that are paid to finance sales or sales promotion expenses, including

front-end, deferred and asset-based sales charges, but excluding charges and fees for ministerial, recordkeeping or administrative activities, investment management fees, and mortality and expense charges. For purposes of this section, members may rely on the sales-related fees and charges disclosed in the prospectus of a variable annuity contract.

(A) A “front-end sales charge” is a sales charge that is deducted from the purchase payment for a variable annuity contract.

(B) A “deferred sales charge” is a sales charge that is deducted from the proceeds of the redemption or surrender of a variable annuity contract by an investor, excluding any such charges that are (i) nominal and are for services in connection with a redemption or surrender or (ii) to discourage short-term trading, that are not used to finance sales-related expenses, and that are credited to the net assets of the separate account.

(C) An “asset-based sales charge” is a sales charge that is deducted from the net assets of the separate account.

(7) “Variable annuity contract” shall mean an accumulation or annuity contract funded by a separate account of a life insurance company and subject to regulation as a variable annuity contract under the insurance laws of each state in which it is offered.

#### **(c) Sales Charges**

No member shall participate in the offering or in the sale of any variable annuity contract[s] issued by a separate account registered under the Investment Company Act of 1940 if the purchase payment [includes] is subject to a sales charge which is excessive. In the aggregate, sales charges shall not be deemed to be excessive if the sales charge stated in the prospectus does not exceed 8.5%

of the total payments to be made thereon as of a date not later than the end of the twelfth year of such payments, provided that if a contract be issued for any stipulated shorter payment period, the sales charge under such contract shall not exceed 8.5% of the total payments thereunder for such period.

[(1) Under contracts providing for multiple payments a sales charge shall not be deemed to be excessive if the sales charge stated in the prospectus does not exceed 8.5% of the total payments to be made thereon as of a date not later than the end of the twelfth year of such payments, provided that if a contract be issued for any stipulated shorter payment period, the sales charge under such contract shall not exceed 8.5% of the total payments thereunder for such period.]

[(2) Under contracts providing for single payments a sales charge shall not be deemed to be excessive if the prospectus sets forth a scale of reducing sales charges related to the amount of the purchase payment which is not greater than the following schedule:]

[First \$25,000 - 8.5% of purchase payment

Next \$25,000 - 7.5% of purchase payment

Over \$50,000 - 6.5% of purchase payment]

[(3) Under contracts where sales charges and other deductions for purchase payments are not stated separately in the prospectus the total deductions from purchase payments (excluding those for insurance premiums and premium taxes) shall be treated as a sales charge for purposes of this rule and shall not be deemed to be excessive if they do not exceed the percentages for multiple and sin-

gle payment contracts described in paragraphs (1) and (2) above.]

[(4) Every member who is an underwriter and/or issuer of variable annuities shall file with Variable Contracts Department of the Association, prior to implementation, the details of any changes or proposed changes in the sales charges of such variable annuities, if the changes or proposed changes would increase the effective sales charge on any transaction. Such filings should be clearly identified as an "Amendment to Variable Annuity Sales Charges."]

**(d) [Receipt of Payment] Disclosure of Deferred Sales Charges**

[No member shall participate in the offering or in the sale of a variable contract on any basis other than at a value to be determined following receipt of payment therefor in accordance with the provisions of the contract, and, if applicable, the prospectus, the Investment Company Act of 1940 and applicable rules thereunder. Payments need not be considered as received until the contract application has been accepted by the insurance company, except that by mutual agreement it may be considered to have been received for the risk of the purchaser when actually received.] In addition to the requirements for disclosure on written confirmations of transactions contained in Rule 2230 of the NASD's Conduct Rules, if the transaction involves the purchase of contracts of an offeror of a variable annuity contract that imposes a deferred sales charge on redemption, such written confirmation shall also include the following legend: "On cancelling or redeeming your contracts, you may pay a sales charge. For the charge and other fees, see the prospectus." The legend shall appear on the front of a confirmation and in, at least, 8-point type.

**(e) Transmittal**

Every member who receives applications and/or purchase payments for variable annuity contracts shall transmit promptly to the [issuer] offeror all such applications and at least that portion of the purchase payment required to be [credited to the contract] transmitted to the offeror.

**(f) Selling Agreement**

No member who is a principal underwriter as defined in the Investment Company Act of 1940 may sell variable annuity contracts through another broker/dealer unless (1) such broker/dealer is a member, and (2) there is a sales agreement in effect between the parties. [Such sales agreement must provide that the sales commission be returned to the issuing insurance company if the variable contract is tendered for redemption within seven business days after acceptance of the contract application.]

**(g) [Redemption] Execution of Portfolio Transactions On Any Assets Underlying a Variable Life Insurance Contract**

[No member shall participate in the offering or in the sale of a variable contract unless the insurance company, upon receipt of a request in proper form for partial or total redemption in accordance with the provisions of the contract undertakes to make prompt payment of the amounts requested and payable under the contract in accordance with the terms thereof, and, if applicable, the prospectus, the Investment Company Act of 1940 and applicable rules thereunder.]

(1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular variable annuity contract on the basis of brokerage commissions received or expected by such mem-

ber from any source, including the offeror of a variable annuity contract.

(2) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of a variable annuity contract.

(3) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of a variable annuity contract and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of a variable annuity contract.

(4) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any offeror of a variable annuity contract to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

(5) No member shall, with respect to such member's activities as underwriter of variable annuity contracts, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the contracts of any offeror of a variable annuity contract which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

(6) No member shall, with respect to such member's retail sales or distribution of variable annuity contracts:

(A) provide to salesmen, branch managers or other sales personnel

any incentive or additional compensation for the sale of specific variable annuity contracts based on the amount of brokerage commissions received or expected from any source, including such offerors of variable annuity contracts. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaign or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any variable annuity contract based on brokerage commissions;

(B) recommend specific variable annuity contracts to sales personnel, or establish "recommended", "selected", or "preferred" lists of offerors of variable annuity insurance contracts, regardless of the existence of any special compensation or incentives to favor or disfavor the contracts of such offeror(s) in sales efforts, if such offerors are recommended or selected on the basis of brokerage commissions received or expected from any source;

(C) grant to any associated person of a member any participation in brokerage commissions received by such member from portfolio transactions of an offeror of a variable annuity contract whose contracts are sold by such member, if such commissions are directed by, or identified with, such offeror of a variable annuity contract; or

(D) use sales of variable annuity contracts as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an offeror of a variable annuity contract, whether such transaction is executed in the over-the-counter market or elsewhere.

(7) Provided that the member does not violate any of the specific provisions of this subsection (e), nothing herein shall be deemed to prohibit:

(A) the execution of portfolio transactions of any offeror of a variable annuity insurance contract by members who also sell the offeror's variable annuity contracts;

(B) a member from selling shares of, or acting as underwriter for, an offeror of a variable annuity contract which follows a policy, disclosed in its prospectus, of considering sales of the offeror's variable annuity contract as a factor in the selection of broker-dealers to execute portfolio transactions, subject to the requirements of best execution;

(C) a member from compensating its associated persons based on total sales of variable annuity contracts attributable to such associated persons, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular variable annuity contracts on a basis prohibited by this subsection (g).

#### ***(h) Member Compensation***

*In connection with the sale and distribution of variable annuity contracts or for providing services to the offeror of such contracts:*

*(1) Except as described below, no associated person of a member shall accept any compensation, cash or non-cash, from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements where a company pays compensation directly to associated persons of the member, provided that:*

*(a) the arrangement is agreed to by the member;*

*(b) the member relies on an appropriate rule, regulation, interpretive release, interpretive letter, or "no-action" letter issued by the Securities*

and Exchange Commission that applies to the specific fact situation of the arrangement;

(c) the receipt by associated persons of such compensation is treated as compensation received by the member for purposes of NASD rules; and

(d) the recordkeeping requirement in subparagraph (h)(2) is satisfied.

(2) Except for items as described in subparagraphs (h)(4)(a) and (b), a member shall maintain records of all compensation, cash and non-cash, received by the member or its associated persons from offerors. The records shall include the names of the offerors, the names of the associated persons, and the amount of cash, and the nature and, if known, the value of non-cash compensation received.

(3) No member shall participate in the sale of a variable annuity contract or provide services to an offeror unless the categories of compensation, cash or non-cash, that are or may be received by the member or its associated persons are described in the narrative section of the prospectus describing the distribution of the contract.

~~([3] 4)~~ No member or person associated with a member shall directly or indirectly accept any non-cash compensation offered or provided to such member or its associated persons, except as provided in this provision. Notwithstanding the provisions of subparagraph (h)(1), the following items of non-cash compensation may be accepted:

(a) Gifts to associated persons of members that do not exceed an annual amount per person fixed periodically by the Board of Governors\* and are not preconditioned on achievement of a sales target.

(b) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment for persons associated with a member and, if appropriate, their guests, which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(c) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) the recordkeeping requirement in subparagraph (h)(2) is satisfied;

(ii) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not preconditioned by the member on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (d);

(iii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iv) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(v) the payment or reimbursement by the offeror is not preconditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (d).

(d) Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who

are associated persons of an affiliated member, provided that:

(i) the member's or non-member's non-cash compensation arrangement, if it includes variable annuity contracts, is based on the total production of associated persons with respect to all variable annuity contracts distributed by the member;

(ii) the non-cash compensation arrangement requires that the credit received for each variable annuity contract is equally weighted;

(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(iv) the recordkeeping requirement in subparagraph (h)(2) is satisfied.

(e) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (d).

~~([4] 5)~~ No person associated with a member shall directly or indirectly accept any cash compensation offered or provided to such person that is preconditioned on such person achieving a sales target, except that the following arrangements are permitted:

(a) Cash compensation arrangements preconditioned on the achievement of a sales target between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, provided that:

\* The current annual amount fixed by the Board of Governors is \$100.

*(i) the member's or non-member's arrangement, if it includes variable annuity contracts, is based on the total production of associated persons with respect to all variable annuity contracts distributed by the member;*

*(ii) the arrangement requires that the credit received for each variable annuity contract is equally weighted;*

*(iii) no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible arrangement; and*

*(iv) the recordkeeping requirement in subparagraph (h)(2) is satisfied.*

*(b) Contributions by a non-member*

*company or other member to a cash compensation arrangement preconditioned on the achievement of a sales target between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (a).*

# NASD NOTICE TO MEMBERS 96-53

## Approval Of Amendments To The Definitions Of Bona Fide Independent Market And Bona Fide Independent Market Maker

### Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

### Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to the definitions of "Bona Fide Independent Market" and "Bona Fide Independent Market Maker" in Rule 2720 of the NASD's Conduct Rules (Rule) (formerly Schedule E to the NASD's By-Laws). The approved amendments revise the definitions to determine eligibility for an exception from the qualified independent underwriter requirement in Rule 2720 for an equity offering of a member's own securities or securities of its parent, an affiliate, or an issuer with whom the member has a conflict of interest. The amendments are effective immediately and will apply to offerings filed after the publication of this *Notice to Members*.

Questions regarding this Notice should be directed to Richard J. Fortwengler, Associate Director, or Paul Mathews, Supervisor, Corporate Financing Department, both at (301) 208-2700; and Robert J. Smith, Senior Attorney, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176.

### Discussion

Rule 2720 ensures that public investors are adequately protected against conflicts of interest regarding the conduct of due diligence and pricing of securities when investing in public offering of securities issued by an NASD® member, its parent or an affiliate of a member that is going public, or by an issuer with whom the member has a conflict of interest.

The Rule prohibits a member from underwriting or participating in the underwriting or distribution of a Rule 2720 offering of equity or debt unless the price of the equity offering is established no higher, or the yield of the debt offering is established no

lower, than the price recommended by a qualified independent underwriter. The qualified independent underwriter also shall participate in the preparation of the registration statement and prospectus, offering memorandum, or similar document, and exercise usual standards of due diligence regarding the offering.

Rule 2720 provides an exception from the qualified independent underwriter requirement for offerings of equity securities for which a bona fide independent market exists. The amendments revise the definitions of bona fide independent market and bona fide independent market maker to incorporate new requirements for listing, public float, trading volume, price, number of bona fide independent market makers, and limitations on the relationship of the bona fide independent market maker to the issuer. Each of these requirements is discussed below.

### Bona Fide Independent Market Definition

#### *Registration Requirement*

The proposed rule change retains the current requirement in the definition of bona fide independent market that it must be a market in a security that is registered pursuant to Sections 12(b) or 12(g) of the Securities Exchange Act of 1934 or issued by a company subject to Section 15(d) of that Act.

#### *Price Requirement*

The previous definition of bona fide independent market did not contain a price requirement. The NASD is concerned that a public float requirement, as set forth below, without a corresponding standard for the market price of the securities may not establish a valid benchmark for a bona fide independent market. There-

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fore, a new provision in the definition of a bona fide independent market was added that requires the security to have a market price of at least \$5 a share as of the close of trading on the day immediately preceding the filing of the registration statement or offering circular, and have traded at a price of \$5 or more per share on at least 20 of the 30 trading days immediately preceding the date on which the offering circular or registration statement was filed.

### ***Listing And Market Maker Requirement***

The previous definition of bona fide independent market did not contain a listing requirement. However, a listing on a national securities exchange or The Nasdaq Stock Market<sup>SM</sup> indicates that the security has met certain qualitative standards and trades in an efficient, regulated, and active market subject to quote transparency and real-time transaction reporting. Therefore, the definition of a bona fide independent market now requires that the security, for at least 90 calendar days immediately preceding the filing of the registration statement or offering circular, must be listed on and in compliance with the requirements for continued listing on a national securities exchange, or The Nasdaq Stock Market, so long as the Nasdaq<sup>®</sup> listing has two bona fide independent market makers for a period of at least 30 trading days immediately preceding the filing of the registration statement or offering circular and the effective date of the offering. Securities quoted on the NASD OTC Bulletin Board<sup>®</sup> service and those traded in the general over-the-counter market, such as the pink sheets, cannot rely on this requirement.

The requirement that the security have at least two bona fide independent market makers for listing on The Nasdaq Stock Market replaces the current requirement of at least

three bona fide independent market makers. Given that a security is listed on The Nasdaq Stock Market, two independent market makers are sufficient to demonstrate the presence of a bona fide independent market away from any Rule 2720 affiliate that may also be making a market in the issuer's securities.

### ***Trading Volume And Public Float Requirement***

The previous definition of bona fide independent market contained independent requirements for trading volume and public float. Under those requirements, a security was considered to have a bona fide independent market if, for the 12 months immediately preceding the filing of the registration statement, it had **both** an aggregate trading volume of at least 100,000 shares **and** a minimum of 250,000 publicly held shares. Under the new definition, the requirements for trading volume and public float have been increased and are structured in the alternative. The new rule requires that a security in a bona fide independent market must have for the 90-calendar-day period immediately preceding the filing of the registration statement or offering circular **either** an aggregate trading volume of at least 500,000 shares **or** a minimum of 5,000,000 publicly held shares outstanding.

Increasing the current aggregate 12-month trading volume requirement of 100,000 shares to 500,000 shares in the 90-calendar-day period before the filing of the registration statement or offering circular provides a criterion that is more indicative of an active, current, and therefore, efficient market. Such greater price efficiency establishes a better benchmark for justifying an exemption from the requirement that a qualified independent underwriter establish the price of the offering.

The NASD determined that the alternative requirement of a five-million-share public float is the minimum necessary to assure that the market for an issuer's securities will not suffer undue volatility from the dilution that occurs when a large number of shares is offered to the public. In this regard, a typical follow-on offering of a company's stock adds between one and two million additional shares to the public float, which can result in up to a 40 percent dilution at the five-million-share level.

### ***Bona Fide Independent Market Maker Definition***

A bona fide independent market maker previously was defined as one who meets certain net capital requirements, publishes bona fide bid and ask quotations in a recognized inter-dealer quotation system; furnishes such quotes to other brokers and dealers on request; and stands ready, willing, and able to effect transactions at quoted prices with other brokers and dealers. These standards were developed at the time the Rule was adopted in 1972 as Schedule E and applied to all securities in the over-the-counter market.

The NASD determined that the previous standards for the definition of bona fide independent market maker are no longer necessary in light of the requirement in the new definition of bona fide independent market that the security be listed on The Nasdaq Stock Market. Market makers for securities listed on The Nasdaq Stock Market are required to meet certain net capital standards, publish bona fide bid and ask quotations in Nasdaq, which is a recognized inter-dealer quotation system; furnish quotes to other brokers and dealers on request; and stand ready, willing, and able to effect transactions at quoted prices with other brokers and dealers. Therefore, the prior standards have incorporated into a single

standard requiring that the market maker be registered as a Nasdaq market maker.

Additionally, the new definition states that a bona fide independent market maker must not be a recipient of any of the net proceeds of the offering; must not be an affiliate of the entity issuing the securities; and, together with its associated persons, does not in the aggregate beneficially own, at the time of the filing of the registration statement or offering circular, five percent or more of the outstanding voting securities of the entity issuing the securities, if a corporation, or a five percent or more partnership interest in the distributable profits or losses of the entity, if a partnership. Thus, the new definition of bona fide independent market maker provides investors with greater assurance that the market maker's activities are independent of any influences that may arise when the issuer's ownership of securities or interest in the offering becomes material.

These changes significantly improve the criteria used for determining that a market of sufficient depth and duration exists to constitute an efficient pricing mechanism for the securities to be distributed. The NASD believes that the new definitions will continue to permit members, in appropriate situations, to conduct a secondary offering without the burden and expense of engaging a qualified independent underwriter, while ensuring the public that the added protection of a qualified independent underwriter will be required in situations where the market cannot be relied on to price the securities appropriately.

### Text Of Amendments

(Note: New text is underlined; deletions are bracketed.)

### CONDUCT RULES

## 2000. BUSINESS CONDUCT

### 2700. SECURITIES DISTRIBUTIONS

#### 2720. Distribution of Securities of Members and Affiliates—Conflicts of Interest

##### (a) General

(1) and (2) No change.

##### (b) Definitions

For purposes of this Rule, the following words shall have the stated meanings:

(1) and (2) No change.

(3) Bona fide independent market—a market in a security which:

(A) is registered pursuant to the provisions of Sections 12(b) or 12(g) of the Act or issued by a company subject to Section 15(d) of such Act, unless exempt from those provisions;

[(B) has an aggregate trading volume for the 12 months immediately preceding the filing of the registration statement of at least 100,000 shares;]

[(C) has outstanding for the entire 12 month period immediately preceding the filing of the registration statement, a minimum of 250,000 publicly held shares; and]

[(D) in the case of over-the-counter securities, has had at least three bona fide independent market makers for a period of at least 30 days immediately preceding the filing of the registration statement and the effective date of the offering.]

(B) has a market price as of the close of trading on the trade date immediately preceding filing of the registration statement or offering circular of five dollars or more per share, and

which has traded at a price of five dollars or more per share in at least 20 of the 30 trading days immediately preceding the filing of the registration statement or offering circular; and

(C) for at least 90 calendar days immediately preceding the filing of the registration statement or offering circular with the Department:

(i) has been listed on and is in compliance with the requirements for continued listing on a national securities exchange; or

(ii) has been listed on and is in compliance with the requirements for continued listing on The Nasdaq Stock Market and has had at least two bona fide independent market makers for a period of at least 30 trading days immediately preceding the filing of the registration statement and the effective date of the offering; and

(D) for the 90 calendar day period immediately preceding the filing of the registration statement or offering circular:

(i) has an aggregate trading volume of at least 500,000 shares; or

(ii) has outstanding a minimum of 5,000,000 publicly held shares.

(4) Bona fide independent market maker—a market maker which:

[(A) continually maintains net capital as determined by Rule 15c3-1 under the Act, of \$50,000 or \$5,000 for each security in which it makes a market, whichever is less;]

[(B) regularly publishes bona fide competitive bid and offer quotations in a recognized interdealer quotation system;]

[(C) furnishes bona fide competitive



bid and offer quotations to other brokers and dealers on request; and]

[(D) stands ready, willing and able to effect transactions in reasonable amounts, and at his quoted prices, with other brokers and dealers.]

(A) is registered as a Nasdaq market maker in the security to be distributed pursuant to this Schedule;

(B) is not an affiliate of the entity issuing securities pursuant to paragraph (c) of this Schedule and, together with its associated persons, does not in the aggregate beneficially own, at the time of the filing of the registration statement and at the commencement of the distribution, five percent or more of the outstanding voting securities of such entity which is a corporation or beneficially own a

partnership interest in five percent or more of the distributable profits or losses of such entity which is a partnership; and

(C) is not a recipient of any of the net proceeds of the offering.

# NASD NOTICE TO MEMBERS 96-54

## NASD Regulation Reminds Members Of Reporting Obligations Of MSRB Rules G-37 And G-38, And Announces Sanction Guidelines For Failure To Report Form G-37/G-38

### Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

### Executive Summary

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) again reminds members of their reporting obligations under Municipal Securities Rulemaking Board (MSRB) Rules G-37 and G-38. Members are required to submit Form G-37/G-38 to the MSRB within 30 calendar days after the end of each calendar quarter if any one of the following occurred during the reporting period: reportable political contributions to issuer officials or payments to political parties were made; the dealer engaged in municipal securities business; or the dealer used consultants to obtain or retain municipal securities business (i.e., new or continuing relationships with consultants). Failure to timely report information required by Rules G-37 and G-38 and patterns of filing deficiencies could result in a monetary sanction, suspension, and/or bar. On July 18, 1996, the NASD Regulation National Business Conduct Committee (NBCC) approved Sanction Guidelines for G-37/G-38 reporting violations. These guidelines are effective immediately and are provided at the end of this Notice.

Questions regarding this Notice may be directed to Thomas R. Cassella, Vice President, NASD Regulation Compliance Department, at (202) 728-8237, or Samuel Luque, Jr., Associate Director, NASD Regulation Compliance, at (202) 728-8472.

### Background

MSRB Rule G-37 became effective on April 25, 1994, and is designed to reduce conflicts of interest, as well as the appearance of such conflicts, in the awarding of municipal securities business to dealers. Rule G-37 generally prohibits a dealer from engaging in any negotiated municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: the

dealer; any municipal finance professional associated with the dealer; or any political action committee (PAC) controlled by the dealer or any municipal finance professional of the dealer. Rule G-37 requires dealers to submit to the MSRB certain summary information as to their municipal securities business, as well as contributions to issuer officials and payments to political parties by dealers, municipal finance professionals, executive officers, and PACs controlled by dealers and municipal finance professionals.

"Municipal securities business" is defined in Rule G-37 as: negotiated underwritings (if the dealer was a manager or syndicate member); private placements; acting as a financial advisor to an issuer (on a negotiated basis); and acting as a remarketing agent (on a negotiated bid basis). A municipal finance professional is defined in paragraph (g)(4) of Rule G-37 and generally includes associated persons who are engaged in municipal securities business, including the solicitation of such business, direct supervisors of such persons, and certain executive and management officials.

MSRB Rule G-38 became effective on March 18, 1996, and requires members to have written agreements with consultants and to disclose such consulting arrangements directly to issuers and to the public through disclosure to the MSRB. Rule G-38 requires dealers to submit to the MSRB information on each consultant. Consultants are defined in Rule G-38(a)(i) as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by the person with an issuer on behalf of the dealer where communication is undertaken by the person in exchange for, or with the understanding of receiving, payment from the dealer or any other person.

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### **Form G-37/G-38**

Members are required to use Form G-37/G-38 to submit information required under Rule G-37 and Rule G-38 to the MSRB. Within 30 calendar days after the end of each calendar quarter, (i.e., by January 31, April 30, July 31, and October 31) two copies of Form G-37/G-38 must be submitted to the MSRB by certified or registered mail, or some other equally prompt means that provides a record of sending.

Members must submit Form G-37/G-38 if **any** one of the following occurred during the reporting period: reportable political contributions or payments to political parties were made; the dealer engaged in municipal securities business; or the dealer used consultants to obtain or retain

municipal securities business (i.e., new or continuing relationships with consultants). Members are not required to submit a Form G-37/G-38 **only** if none of these conditions existed during the reporting period.

### **G-37/G-38 Sanction Guidelines**

NASD Regulation is committed to enforcing strict compliance with Rules G-37 and G-38, including the reporting requirements. In support of this commitment, the NBCC approved Sanction Guidelines for Form G-37/G-38 reporting violations on July 18, 1996. Under the Sanction Guidelines, failure to file Form G-37/G-38 will result in a minimum \$250 to \$1,000 fine. Repeated violations and intentional violations result in even greater sanctions. Footnote

No. 1 of the G-37/G-38 Sanction Guidelines makes it clear that circumstances expressly **not** considered as mitigative below the indicated minimum sanctions include: absence of prior violations; misunderstanding of rule requirements; inadvertent failure to file the report; absence of political contributions or use of the consultant during the report period; and initiation of corrective measures to prevent recurrence.

For more information regarding compliance with MSRB Rule G-37 and G-38, members should reference the full text of both rules in the *MSRB Manual*, related MSRB Reports, and the MSRB Rule G-37 and Rule G-38 Handbook (March 1996).

## G-37/G-38 Reporting Violations MSRB Rule G-37/G-38

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar, or Other Sanctions
1) Prior or other similar misconduct.	\$250 to \$1,000 for an initial inadvertent violation. Repeated violations should carry a larger fine. Intentional violations should carry a substantially larger fine.	In an initial, unintentional violation, do not suspend either the firm or the responsible individual.
2) Type of violation (inaccurate or non-current report).		Where repeated violations exist, consider suspending the firm in all aspects of business for 1 to 30 business days. Also consider suspending the responsible individual for 1 to 30 days. Consider requalification by examination.
3) Whether inaccurate or non-current report was prepared with intent to deceive or to conceal facts, or as a result of negligence.		
4) Demonstrated corrective measures or controls to prevent recurrence.		
5) Other aggravating or mitigating factors. <sup>1</sup>		Where one or more materially inaccurate reports were intentionally prepared, or where a failure to file was intentional, consider a substantially longer suspension or bar for the responsible individual and/or a longer suspension or expulsion of the firm.

<sup>1</sup> Circumstances expressly not considered as mitigative below the indicated minimum sanctions include: absence of prior violations; misunderstanding of rule requirements; inadvertent failure to file report; absence of political contributions or use of consultant during report period; and initiation of corrective measures to prevent recurrence.

# NASD NOTICE TO MEMBERS 96-55

## NASD Regulation Offers Software To Help Members Comply With Continuing Education Requirements

### Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

### Executive Summary

Release 2.0 is the new, improved version of the Training Analysis and Planning Tool designed to help NASD® members comply with the Firm Element of the securities industry Continuing Education Program. The Firm Element applies to registered persons or their supervisors who deal directly with customers in conducting sales, trading, and investment banking activities for member firms. Industry rules require members to complete a training needs analysis and also to develop and implement a written training plan. Release 2.0, which comes in a user-friendly, picture-puzzle format, makes that easy.

Release 2.0 is fully compatible with and builds significantly on the capabilities and functionality of Release 1.0. Fueled by information provided by industry members, this upgraded version includes significant new features that help member firms prepare training schedules, track the progress of covered persons, and comply with the recordkeeping requirements of the Continuing Education Program. It also offers an indexed listing of more than 700 training resources from 50 vendors, enabling member firms to match their own training needs with the individual training needs of covered persons. While this unique software can help members meet their Continuing Education requirements, it should not be viewed as a "safe harbor."

For more information, contact NASD Regulation, Inc., Regulatory Systems hotline at (800) 321-NASD.

### Background

The minimum system requirements for Release 2.0 are:

- IBM PC-compatible platform;

- Preferably 8 MB of RAM (minimum of 4 MB of RAM);
- 3 1/2- to 5 1/4-inch floppy disk drive;
- Windows 3.1 or higher, but not Windows95;
- 16-color display, running in 640 x 480 resolution mode or higher;
- At least 10 MB free space on your computer's hard drive. Additional space requirements will depend on the size of your training plan files.

### The Regulatory Element

The Regulatory Element of the Continuing Education Program requires that all registered persons complete a prescribed computer-based training session within 120 days of the second, fifth, and tenth anniversary of their initial registration date. Failure to fulfill this requirement automatically prevents registered persons from participating in the securities business or collecting compensation. Persons registered for more than 10 years with no serious disciplinary action during the most recent 10 years are exempted.

The Regulatory Element of the computer-based training program is designed to transmit information that applies to all registered persons regardless of their job functions or registration status (such as Series 6 or Series 7). Individual performances are not rated. Instead, feedback is provided to all covered persons who take the computer-based training program within a given period. This information helps firms develop training plans that meet the requirements of the Firm Element.

### The Firm Element

Unlike the Regulatory Element,

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which applies only to persons registered for 10 years or less, the Firm Element applies to all persons and their immediate supervisors who have direct contact with customers in the securities sales, trading, or investment banking business of a firm. The Firm Element requires members to individually analyze their training needs then prepare an annual written training plan. Training plans must take into account the size of the firm, its organizational structure, scope and type of business activities, and the aggregate performance of covered registered persons in the Regulatory Element. Clear records must be maintained that demonstrate the content and completion of the programs by everyone subject to the training.

The Firm Element establishes minimum standards for training programs. When dealing with investment products and services, for example, such programs must identify their investment features, risk factors, suitability, and applicable regulatory requirements. Members may need to provide specific training to cover registered persons in any area specified by self regulatory organizations, either for certain individuals or groups within the firm, or within the entire industry.

### **Functions And Features**

Although Release 2.0 will not result in a "safe harbor," it helps users prepare a step-by-step needs assessment and training plan that meets the requirements of the Continuing Education Program Regulatory Element. This cutting-edge software includes nine sections and some exciting new features that make assessing and planning a training program even easier. As you work to meet the requirements of the Firm Element, these modifications should come in handy. Nine sections in Release 2.0 will help you plan your individualized training programs.

### **Background**

Release 2.0 will enable you to record general background information such as your firm's Central Registration Depository (CRD) registration number and address, the name of the person responsible for the analysis, the year for which the analysis is being prepared, and the objective of the training plan. The software will let you change the training plan throughout the year, and include information in the final analytical report that may prove useful in case of questions from federal or state securities regulators.

### **Characteristics**

To begin customizing your analysis, you'll need to identify the general characteristics of your firm and analyze the full line of products and services that it offers or represents. This portion of the new software allows you to input such information. For example, you might include corporate debt, equities, direct participation programs, retirement planning, investment advisory services, or any other products and services offered to your customers. Release 2.0 will also let you identify job functions such as institutional sales, retail sales, or investment advisory that covered employees perform. You will have the option of adding items to these lists, depending on the needs of your firm.

### **Groups**

This section of Release 2.0 lets you conveniently group employees, enabling better and simpler management of your training plan. You can use it to categorize and classify each covered employee. You can also identify products and services for which each of your firm's groups of covered persons require training. If your firm employs many covered persons, you can classify and categorize them within your training plan.

The software also will let you identify products and services for which groups of covered persons in your firm refuse training.

### **People**

The People section of Release 2.0 allows you to enter information and identify the products, services, and job functions of each covered person in your firm's training analysis or plan. It also targets individual training needs even for non-covered persons. With it, you can assign products, services, and job functions. Completion of this section requires entering the names, dates of hire, internal representative numbers, CRD numbers, phone numbers, and job functions of each covered employee.

### **Issues**

This section of Release 2.0 lets users enter issues identified during their needs assessment. This includes items of identifiable regulatory or ethical concern that can affect significantly a specific firm or the industry as a whole. This may simply relate to specific products and job functions within one firm, current or anticipated economic conditions, new products, legal and regulatory developments, or areas of concern identified by customer complaints. You can use the issues and training objectives identified in this section of the program to develop individual training plans for covered employees.

### **Course Catalog**

Release 2.0 heralds the arrival of the Course Catalog section, a foundation database that includes a list of training courses offered by numerous vendors who have supplied information to the NASD. The catalog enables you to modify course information as well as products, services, and job functions. By filtering the available information, you can cus-

customize a course catalog precisely to the needs of your firm. You may also add courses that are offered by other outside vendors or by your firm, and enter starting and completion dates for each course. It is the responsibility of your firm to make sure that courses listed in the index meet the firm's training needs and the requirements of the Firm Element.

### **Course Match**

The course match section of Release 2.0 allows you to select courses suitable for training your covered employees. Using it, you can link to an on-line catalog that offers courses that complement your firm's training

plan. The catalog lists courses and how much they cost. The software also provides the names of many third-party vendors who offer analytical services, in case you don't want to do the job yourself. The product/services and training needs that you identify will automatically be assigned later to each covered employee who must satisfy those needs. Remember, the Training Analysis & Planning Tool can help you analyze your training needs, but it provides no actual training.

### **Schedule**

This section of Release 2.0 provides tools to make sure that each covered

person completes the required training. It also allows you to customize your training plan as well as schedule and track training course dates for covered employees.

### **Reports**

This section allows you to analyze, refine, manage, and print reports of the training plans you've created. The reports you can print include information about your firm, the issues and training objectives you identified, and the training and schedules of covered employees.

### **Release 2.0 Features**

- ◆ Offers users access to an on-line database of vendors and training courses. In addition, it lets you add courses provided by other vendors. Or you may provide your own courses.
- ◆ Lets you match the training needs and issues of your firm to the index of courses.
- ◆ Tracks individual training plans that you prepare.
- ◆ Keeps track of important information about individuals, including their hire, termination, and registration dates.
- ◆ Classifies covered persons by groups.
- ◆ Lets you create training plans for non-covered persons.
- ◆ Enhances your report-generating capability, allowing you to better manage and evaluate your training plan.
- ◆ Maximizes your ability to print more complete information about individuals.





# NASD NOTICE TO MEMBERS 96-56

## Labor Day: Trade Date- Settlement Date Schedule

### Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

## Labor Day: Trade Date-Settlement Date Schedule

The Nasdaq Stock Market<sup>SM</sup> and the securities exchanges will be closed on Monday, September 2, 1996, in observance of Labor Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

<u>Trade Date</u>	<u>Settlement Date</u>	<u>Reg. T Date*</u>
Aug. 27	Aug. 30	Sept. 4
28	Sept. 3	5
29	4	6
30	5	9
Sept. 2	Markets Closed	—
3	6	10

\*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within five (5) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Reg. T Date."

Brokers, dealers, and municipal securities dealers should use the foregoing settlement dates for purposes of clearing and settling transactions pursuant to the NASD Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding the application of those settlement dates to a particular situation may be directed to the NASD Uniform Practice Department at (203) 375-9609.



# NASD NOTICE TO MEMBERS 96-57

Fixed Income Pricing  
System Additions,  
Changes, And Deletions  
As Of July 30, 1996

As of July 30, 1996, the following bonds were added to the Fixed Income Pricing System (FIPS<sup>SM</sup>).

Symbol	Name	Coupon	Maturity
MEOP.GA	Mesa Operating Company	10.625	7/1/06
MEOP.GB	Mesa Operating Company	11.625	7/1/06
LEAC.GA	Lear Corp	9.500	7/15/06
TCGI.GA	Teleport Communications Group Inc	9.875	7/1/06
TCGI.GB	Teleport Communications Group Inc	11.125	7/1/07
EX.GB	Exide Corp	12.250	12/15/04
RYL.GC	Ryland Group Inc	10.500	7/1/06
ICIX.GA	Intermedia Communications Inc	12.500	5/15/06
HAY.GB	Hayes Wheels Intl	11.000	7/15/06
NDCO.GB	Noble Drilling Corp	9.125	7/1/06
RENC.GA	Renco Metals Inc	11.500	7/1/03

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to trade-reporting rules should be directed to James C. Dolan, NASD Market Surveillance, at (301) 590-6460.

## Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

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# DISCIPLINARY ACTIONS

## Disciplinary Actions Reported For August

The NASD<sup>®</sup> has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, August 19, 1996. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this edition.

### **Firm Fined, Individual Sanctioned**

**Chatfield Dean & Co. (Greenwood Village, Colorado)** and **Scott Carothers (Registered Principal, Greenwood Village, Colorado)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$25,000, jointly and severally. Carothers was suspended from association with any NASD member as a financial and operations principal for 10 business days and required to requalify by exam as a financial and operations principal. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Carothers, conducted a securities business while failing to maintain its minimum required net capital.

### **Firms And Individuals Fined**

**A.R. Baron & Co., Inc. (New York, New York)** and **John J. McAndris (Registered Principal, Montvale, New Jersey)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$20,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanction and to the entry of findings that the firm, acting

through McAndris, conducted a securities business while failing to maintain its minimum required net capital.

**Chicago Partnership Board, Inc. (Chicago, Illinois)** and **James R. Frith, Jr. (Registered Principal, Chicago, Illinois)** submitted an Offer of Settlement pursuant to which the firm was fined \$27,500 and Frith was fined \$27,500. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Frith, effected the purchases and/or sales of limited partnership interests at prices that were not fair and reasonable under the circumstances.

### **Firm Fined**

**Gulf Financial Services, Inc. (Mobile, Alabama)** submitted an Offer of Settlement pursuant to which the firm was fined \$11,500. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to file Municipal Securities Rulemaking Board (MSRB) Form G-37 within 30 days after the end of the quarter and filed an inaccurate Form G-37. The findings also stated that the firm allowed an individual to act as a municipal securities principal without being registered as such with the NASD.

### **Individuals Barred Or Suspended**

**Mayer A. Amsel (Registered Principal, Brooklyn, New York)** was fined \$100,000 and barred from association with any NASD member in any capacity. The Securities and Exchange Commission (SEC) affirmed the sanctions following appeal of a June 1995 National Business Conduct Committee (NBCC) decision. The sanctions were based on findings that Amsel, as a part of a continuing scheme to conceal the

true ownership of securities, caused seven fictitious accounts to be established at his member firm and prepared false purchase and sales memoranda, thereby having his member firm's books and records reflect purchase and sales transactions in the fictitious accounts. In a scheme to unjustly enrich family-related accounts and himself, Amsel bought common stock from a customer account at his member firm and sold it to the family-related accounts at prices that were at or below the market. He also caused the same stock to be purchased from the family-related accounts at prices that were at or above the market and sold the stock to either his member firm's trading account or to other broker/dealers, resulting in an unjust profit in excess of \$55,000 for the family-related accounts. Amsel instructed his member firm's clearing firm to issue checks to the family-related accounts and have them delivered to him ostensibly for redelivery to the proper party. Whenever Amsel needed money, he endorsed some of the checks by signing the payees' names and negotiated the checks through third parties such that he received the proceeds and/or the benefits of the checks for his own use without notifying his member firm of his interest in the accounts. Furthermore, Amsel interpositioned the family-related accounts between the customer account and/or his member firm and the best available market and failed to time stamp order tickets. Amsel also failed to note on order tickets his checking with other dealers for the best available price and effected the purchase of shares of common stocks in the account of a public customer without the customer's prior knowledge or approval, resulting in a loss of \$4,750 when the positions were liquidated in the account.

**Charles G. Brashier (Registered Representative, Hoover, Alabama)** was fined \$270,000, barred from

association with any NASD member in any capacity, and required to pay \$303,913.05 in restitution to the appropriate parties. The sanctions were based on findings that Brashier received from public customers \$303,913.05 for investment purposes, failed to invest the funds on the customers' behalf and instead, converted the monies for his own use and benefit without the customers' knowledge or consent. Brashier also generated fictitious account statements that were sent to a public customer and failed to respond to NASD requests for information.

**Byron M. Britt (Registered Representative, Greensboro, North Carolina)** submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity with the right to reapply for association with a member after three years. Without admitting or denying the allegations, Britt consented to the described sanction and to the entry of findings that he forged the signatures of five customers on forms used to borrow money from insurance policies.

**Rosario O. Caldarazzo (Associated Person, Westchester, Illinois)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Caldarazzo consented to the described sanctions and to the entry of findings that he signed the names of public customers to insurance applications causing the cash values in their existing policies to be used for purchasing the new policies without the customers' knowledge or consent.

**William K. Cantrell (Registered Principal, Los Angeles, California)** was fined \$2,500, suspended from association with any NASD member as a financial and operations princi-

pal for 10 days, and ordered to requalify by exam as a financial and operations principal. The NBCC affirmed the sanctions following appeal of a Los Angeles District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that Cantrell permitted his member firm to effect securities transactions while failing to maintain the minimum required net capital.

This action has been appealed to the SEC and the sanctions are not in effect pending consideration of the appeal.

**James A. Crumrine (Registered Representative, Winter Park, Florida)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Crumrine failed to respond to an NASD request for information.

**James A. Edgar, Jr. (Registered Principal, Poughquag, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$25,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Edgar consented to the described sanctions and to the entry of findings that he caused a series of trade corrections to be effected for customer discretionary accounts by removing shares of profitable securities from customer accounts and causing the shares to be transferred to one or more of his personal securities accounts, resulting in immediate potential profits of \$33,800, at the expense of the customers.

**Steven S. Etkind (Registered Representative, Albuquerque, New Mexico)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$30,000, barred from association

with any NASD member in any capacity with the right to reapply to become associated with an NASD member after three years. Without admitting or denying the allegations, Etkind consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing written notification to his member firm. The findings also stated that Etkind offered securities subject to SEC Rule 10b-9 without complying with the Rule and engaged in activities for which broker/dealer registration is required without being registered as a broker/dealer.

**Carl A. Grimstad (Registered Representative, Nashville, Tennessee)** was fined \$5,000 and suspended from association with any NASD member in any capacity for two weeks and thereafter, until he demonstrates that all amounts under a New York Stock Exchange (NYSE) arbitration proceeding have been paid or that a payment schedule or other form of settlement has been agreed upon. The sanctions were based on findings that Grimstad failed to pay a \$36,874 NYSE arbitration award.

**Kraig Phillip Hanadel (Registered Representative, Bakersfield, California)** was fined \$10,000 and suspended from association with any NASD member in any capacity for 90 days and thereafter, until an arbitration award is satisfied. The sanctions were based on findings that Hanadel failed to pay a \$61,720.57 NASD arbitration award.

**Elijah Johnson, III (Registered Representative, Portland, Oregon)** was fined \$15,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Johnson failed to fully and timely respond to NASD requests for information about his termination from a member firm.

**Lamar Jones (Registered Representative, Philadelphia, Pennsylvania)** was fined \$5,000, suspended from association with any NASD member in any capacity for one year, and required to pay \$460 in restitution to a member firm. The sanctions were based on findings that Jones pledged a laptop computer that was the property of his member firm as collateral for a personal loan without the knowledge or consent of his member firm.

**Ronald H.V. Justiss (Registered Representative, Denver, Colorado)** was barred from association with any NASD member in any capacity. The SEC affirmed the sanction following appeal of a May 1995 NBCC decision. The sanction was based on findings that while taking the Series 65 exam Justiss was observed reviewing unauthorized materials that contained information relating to the exam.

**Charles E. Kautz (Registered Representative, Clearwater, Florida)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The SEC affirmed the sanctions following appeal of a July 1995 NBCC decision. The sanctions were based on findings that Kautz caused seven registered representatives under his supervision to list their names falsely as the representative of record on applications for annuities that he sold.

**Robert James Laws (Registered Representative, West Hempstead, New York)** was fined \$50,000, suspended from association with any NASD member in any capacity for 90 days, required to disgorge \$10,957.18 in commissions, and ordered to requalify by exam. The sanctions were based on findings that Laws functioned as a registered representative without being properly registered with the NASD. Laws also solicited and opened new accounts,

executed securities transactions on behalf of public customers, generated commissions totaling \$73,000, and took steps to conceal his misconduct from regulatory authorities.

**Christopher J. Maikisch (Registered Representative, Deltona, Florida)** was fined \$25,000 and barred from association with any NASD member in any capacity with the right to reapply to become associated with a member after two years. The sanctions were based on findings that Maikisch effected an unauthorized transaction in a public customer's account and failed to respond to NASD requests for information.

**Matthew E. Major (Registered Representative, Deerfield Beach, Florida)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Major consented to the described sanctions and to the entry of findings that he signed a customer's name to an application to convert the customer's term life insurance policy to a whole life insurance policy. The findings also stated that Major signed the name of the same customer's wife to an application for whole life insurance without authorization.

**Carl A. Marbury (Registered Representative, Pittsburgh, Pennsylvania)** was fined \$30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Marbury received \$1,700 from a public customer for investment purposes, but instead, retained the funds for his own use and benefit. Marbury also failed to respond to NASD requests for information.

**Gerard E. Miller (Registered Representative, Waupaca, Wisconsin)**

submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$37,500, barred from association with any NASD member in any capacity, and required to pay \$7,500 in restitution to a customer. Without admitting or denying the allegations, Miller consented to the described sanctions and to the entry of findings that he requested that his member firm issue a \$7,500 loan check to a public customer from the customer's insurance policy. The NASD found that Miller obtained and endorsed the check, deposited it in an account in which he had a beneficial interest, and used the funds for some purpose other than for the benefit of the customer without the customer's knowledge or consent.

**Roger James Molloy (Registered Principal, San Jose, California)** was fined \$302,500 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Molloy received \$132,173.97 from public customers for investment purposes but converted the funds for his own use and benefit. Molloy also prepared and provided to customers fictitious account statements reflecting that the customers owned stocks and failed to respond to NASD requests for information.

**David A. Nahmias (Registered Representative, Memphis, Tennessee)** was fined \$30,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that, unbeknownst to his member firm, Nahmias entered into an agreement with public customers to reimburse them \$102,480 for losses incurred in their account and provided them with a check that was not honored at his bank due to insufficient funds. Nahmias also failed to respond to NASD requests for information.

**John Pantelis (Registered Representative, Valley Stream, New York)** was fined \$20,000, barred from association with any NASD member in any capacity, and required to pay \$54,463 in restitution to a member firm. The sanctions were based on findings that Pantelis executed options transactions in the account of a public customer without the customer's knowledge or consent. Pantelis also failed to respond to NASD requests for information.

**James C. Placet (Registered Representative, Paradise Valley, Arizona)** was fined \$15,000 and barred from association with any NASD member in any capacity with a right to reapply after one year. The sanctions were based on findings that Placet misused customer funds totaling \$35,000 by using for his own benefit the proceeds of a check drawn on the customer's bank account that was made payable to his member firm.

**Victor B. Ponder (Registered Representative, Big Bend National Park, Texas)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$9,500, barred from association with any NASD member in any capacity, and required to pay \$18,000 in restitution to the appropriate parties. Without admitting or denying the allegations, Ponder consented to the described sanctions and to the entry of findings that he executed unauthorized purchase and sale transactions in the accounts of public customers without the customers' knowledge or consent and without having obtained a written third-party authorization allowing a customer's son to direct trades. The NASD also found that Ponder exercised discretion in the account of a public customer without having obtained prior written authorization from the customer and prior written acceptance of the account as discretionary by his member firm.

**Craig Thomas Puff (Registered Representative, Warren, Michigan)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$6,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Puff consented to the described sanctions and to the entry of findings that he participated in the offer and sale of securities to public customers on a private basis and failed to give prior written notice of, and to obtain prior written authorization from his member firm to engage in such activities.

**Wayne C. Rasch (Registered Representative, Athens, Georgia)** was fined \$20,000, barred from association with any NASD member in any capacity with the right to reapply after one year, and required to requalify by exam as a general securities representative. The sanctions were based on findings that Rasch engaged in private securities transactions outside the regular course or scope of his registration with his member firm without providing written notice of or obtaining approval from the firm. Rasch also failed to respond to NASD requests for information.

**Lawrence C. Schmelzer (Registered Principal, Shaker Heights, Ohio)** submitted an Offer of Settlement pursuant to which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Schmelzer consented to the described sanctions and to the entry of findings that he acted as a general securities principal without being registered or qualified. The findings also stated that Schmelzer failed to respond to NASD requests for information.

**Michael C. Sealey (Registered Representative, Baton Rouge, Louisiana)** was fined \$220,000,

barred from association with any NASD member in any capacity, and required to pay \$592,880.50 in restitution to the appropriate parties. The sanctions were based on findings that Sealey converted \$592,880.50 in customer funds for his own use and benefit without the customers' knowledge or consent and prepared and distributed at least 16 false customer account statements in an effort to conceal the conversion of funds. Sealey also removed a confirmation statement from the mailbox of a public customer and falsified the books and records of his member firm by providing the firm with a fictitious mailing address for a public customer. In addition, Sealey engaged in an unauthorized sale of stock in the account of a public customer and failed to respond to NASD requests for information.

**Jeffrey W. Shelton (Registered Representative, Tallahassee, Florida)** was fined \$20,000 and barred from association with any NASD member in any capacity with the right to reapply to become associated after one year. The sanctions were based on findings that Shelton failed to respond to NASD requests for information.

**Jin Hwy Shin (Registered Representative, Sunnyvale, California)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Shin failed to respond to NASD requests for information.

**John Edward Shryack (Registered Principal, Dallas, Texas)** was fined \$10,000, suspended from association with any NASD member in any capacity for five business days, and required to requalify by exam as a general securities representative. The sanctions were based on findings that Shryack made negligent misstatements and omissions of material fact to retail customers to induce them to

place purchase orders and commit to investment decisions.

**Eric J. Snee (Registered Representative, Dayton, New Jersey)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Snee failed to respond to NASD requests for information.

**Bodo B. Weber (Registered Representative, Los Altos, California)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Weber failed to respond to NASD requests for information. Weber also effected unauthorized transactions in the account of a public customer.

**Richard George Wiwi (Registered Representative, Moraga, California)** was fined \$50,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Wiwi participated in private securities transactions without providing prior written notice to his member firms.

#### Individuals Fined

**Scott L. Lencz (Registered Representative, Studio City, California)** was fined \$20,027. The NBCC imposed the sanction following appeal of a Los Angeles DBCC decision. The sanction was based on findings that Lencz engaged in the securities business without being registered with the NASD in any capacity, introduced customers to his member firm, and received compensation from the firm for such activities.

**Joshua Mondschein (Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$10,000. Without admitting or denying the allega-

tions, Mondschein consented to the described sanctions and to the entry of findings that he directed another employee to sign a public customer's name to a reinstatement application for a term life insurance policy without the knowledge or consent of the customer.

#### Suspensions Lifted

The NASD has lifted suspensions from membership on the date shown for the following firms, because they have complied with formal written requests to submit financial information.

**Freeman Financial Services Corporation**, San Mateo, California (June 27, 1996)

**Taylor, Pruitt & Sylvester, Inc.**, Houston, Texas (June 16, 1996)

#### Firm Suspended Pursuant To NASD Rule 9622 For Failure To Pay An Arbitration Award

The date the suspension commenced is listed after each entry.

**Jason MacKenzie Securities, Inc.**, Atlanta, Georgia (June 25, 1996)

#### Individuals Whose Registrations Were Revoked For Failure To Pay Fines, Costs, And/OR Provide Proof Of Restitution In Connection With Violations

**Terrence A. Buttler**, Denver, Colorado

**Michael L. Chaudron**, Johnson City, Tennessee

**Frederick Gasten**, Atlanta, Georgia

**Louis Guy Hagerty**, Fairfax Station, Virginia

**Thomas C. Kocherhans**, Orem, Utah



**Leonard J. Koenig**, Boca Raton,  
Florida

**Lester H. Lane**, Englewood,  
Colorado

**Howard J. Levy**, Los Angeles,  
California

**Robert S. Prisco**, Miller Place,  
New York

**Jailall I. Ramoutar, Jr.**, Staten  
Island, New York

**Steven W. Taylor**, Niwot, Colorado

**Oliver J. Williams, Jr.**, Miami,  
Florida

**Individuals Whose Registrations  
Were Canceled/Suspended  
Pursuant To NASD Rule 9622 For  
Failure To Pay Arbitration Awards**  
The date the suspension commenced  
is listed after each entry.

**George Evans Brooks**, Charlotte,  
North Carolina (June 25, 1996)

**Timothy J. Taylor**, Jacksonville,  
Florida (June 29, 1996)

**William Edward Young**, Downey,  
California (July 2, 1996)

# FOR YOUR INFORMATION

## **NASD Regulation Reminds Members About Payment For Order Flow Disclosures**

Securities and Exchange Commission (SEC) Rule 11Ac1-3 and certain amendments to SEC Rule 10b-10 require broker/dealers to provide payment-for-order-flow information to customers when a new account is opened, on an annual basis thereafter, and on confirmations. Despite a delay in the effective date until October 2, 1995, and possible confusion concerning the time frame set by the SEC for making the initial annual disclosure to existing customers, NASD Regulation, Inc., reminds members that they should be complying fully with these rules.

Rule 11Ac1-3 requires a broker/dealer to inform customers in writing, when a new account is opened, whether payment for order flow is received and to give a detailed description of any compensation received. In addition, a broker/dealer must provide information in new account documents about order-routing decisions, including an explanation of the extent to which unpriced orders can be executed at prices superior to the best bid or best offer at the time the order is received.

The rule also requires a broker/dealer to disclose payment-for-order-flow information to all customers on an annual basis. For all new accounts opened on or after October 2, 1995, the disclosures required by Rule 11Ac1-3 were effective immediately. For accounts in existence prior to the rule's effective date, the SEC provided firms with additional time to make necessary changes to systems and forms.

In its adopting release, which originally set an effective date of April 3, 1995, the SEC stated that the disclosures to existing customers should be made beginning with the first com-

mercially reasonable date after the effective date, but in no event, later than April 3, 1996. *Although the effective date of the rule was postponed until October 2, 1995, the deadline for providing the initial annual disclosure statement to existing customers remained April 3, 1996.*

Rule 10b-10, as amended, requires a broker/dealer to indicate on customer confirmations whether it receives (or does not receive) payment for order flow and that the source and nature of the compensation for a particular transaction be provided upon written request.

Members are urged to review their operations for full compliance regarding payment-for-order-flow disclosures. For additional information, members may refer to the SEC release in the November 2, 1994, *Federal Register*.

## **Corrections To The NASD Guide To Rule Interpretations**

The most recent version of the *NASD Guide to Rule Interpretations*, published in May 1996, does not reflect the following changes. On page eight under the subheading "Receivables," line 10 of the interpretation titled "Deficits In Cash Accounts" should read "...after five business days (not seven) beyond settlement date..." as the time frame for imposing charges on unpaid municipal securities transactions, other than C.O.D. transactions. On page 57 under the subheading "Appendix D—Subordinated Loans," the interpretation titled "British Pounds Used To Fund A Subordinated Loan" is no longer an active interpretation and should have been deleted from the Guide.

Members are urged to circulate this information to all employees who have copies of the Guide.

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