

SPECIAL NASD NOTICE TO MEMBERS 97-67

NASD Regulation Institutes Firm Quote Compliance

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

To ensure that members fully comply with Securities and Exchange Commission (SEC) Rule 11Ac1-1 (Rule 11Ac1-1 or the firm quote rule), NASD Regulation, Inc., has developed an automated surveillance system (the Firm Quote Compliance System or FQCS) to permit the resolution of backing-away complaints on a real-time basis. FQCS will also, in the absence of complaints, identify firms that demonstrate a pattern of non-response to SelectNetSM liability orders. By utilizing the Firm Quote Compliance System, NASD RegulationSM is able to address backing-away complaints on a real-time basis with the intent of resolving such complaints with a contemporaneous trade execution, if warranted, and will look, on a historical basis, for patterns of behavior indicative of potential violations of Rule 11Ac1-1.

A backing-away occurs when a member firm is not complying with its obligations under Rule 11Ac1-1(c). This rule requires a market maker to execute an order "presented" to it at a price at least as favorable as its published quotation up to its published quotation size. A market maker's obligation to fill an order begins at the time the order is "presented," regardless of how the order is transmitted to the market maker. Exceptions to Rule 11Ac1-1 exist only if: (i) the market maker revises its quoted price or size to The Nasdaq Stock MarketSM prior to presentation of an order; or (ii) the market maker has effected or is in the process of effecting a transaction at the time an order is presented and, immediately upon completion of that transaction, communicates a revised quotation to The Nasdaq Stock Market. Violations of Rule 11Ac1-1 may also violate Conduct Rule 3320 and Marketplace Rule 4613(b), which require a market maker to trade at its quotation and up to its quotation size when presented with an order.

In light of the establishment of the Firm Quote Compliance System, NASD Regulation's Market Regulation Department has instituted procedures to immediately address complaints during the trading day. Any potential backing-away complaint should be brought to the attention of the Market Regulation Department within five (5) minutes of the alleged backing-away by calling (800) 925-8156. If a complaining firm does not contact the staff within five (5) minutes, it will be difficult for the staff to obtain a contemporaneous trade execution, if warranted, from the market maker. Firms also are encouraged, but not required, to contact the other firm to seek resolution of their complaint. Firms that contact the other side first will not be held to the five- (5) minute time period of contacting the Market Regulation Department. However, they must contact the other side within five minutes and, if there is no resolution, they must contact the Market Regulation Department *immediately* after their contact with the other firm. Also, although the staff will review and investigate complaints which are faxed or received by telephone after the five- (5) minute period, the staff may not be able to assist in obtaining a contemporaneous trade execution for those complaints. **Failure of the complaining firm to contact the market maker or the staff within five (5) minutes of the alleged backing-away is not, and has never been interpreted by NASD Regulation as, a defense to a backing-away violation.**

In processing the alleged backing-away complaints and other potential rule violations identified by the Firm Quote Compliance System, NASD Regulation will not pursue immediate disciplinary action for an individual backing-away complaint in which a contemporaneous trade execution is obtained or offered. However, the staff will keep a record of, and gather information concerning, such inci-

dents to determine if a firm has demonstrated a pattern of non-compliance with the firm quote rule. Thus, these violations could result in disciplinary action. **The staff will investigate individual instances of backing-away and consider disciplinary action if the staff believes that a contemporaneous execution is warranted, but the market maker refuses to provide the fill upon the staff's request.**

Members are also encouraged to carefully read the applicable sections of the SEC Section 21(a) report, which contains a discussion of a market maker's obligations under Rule 11Ac1-1 as well as specific situations which the SEC considers to be violations of the firm quote rule. Following are some guidelines that market makers should be aware of:

1. Cancellation of Preferred SelectNet Liability Orders. The fact that a preferred SelectNet order is canceled by the order entry firm before the three-minute time period does not eliminate a firm's firm quote obligation with respect to that order while it was "live." Patterns of delay in filling liability orders may indicate non-compliance with Rule 11Ac1-1. A market maker's obligation to fill an order begins when the order is presented, not upon expiration of the three-minute time period.

2. Failure to Act on a Preferred SelectNet Liability Order. The fact that preferred SelectNet liability orders may have scrolled off the screen on the Nasdaq Workstation terminal is not an exception to Rule 11Ac1-1. Members should take whatever steps they deem appropriate to ensure that preferred liability orders received through SelectNet are monitored and responded to in conformance with the firm quote rule.

3. No Trade-Ahead Exception for SOES Executions Received After a

Preferred SelectNet Liability Order. A trade-ahead exception will not be permitted for Small Order Execution SystemSM (SOESSM) executions received after presentment of a preferred SelectNet liability order. As stated in the SEC's Section 21(a) report, "[b]ecause SOES executions are automatic and instantaneous, a market maker could not have been in the process of executing a SOES order that was received after a SelectNet order."

4. No Automatic Trade-Ahead Exception. A trade-ahead exception for trades that are reported after the presentment of a liability order will not be permitted if a market maker executes a trade absent proof, such as the time of order entry, that the market maker was in the process of executing the order prior to presentment of the preferred SelectNet liability. Additionally, the market maker must immediately update its published quotation subsequent to the execution.

5. Late quote update. A quote update without any accompanying trade report must occur prior to, or simultaneous with, the presentment of a SelectNet liability order or telephone order to be considered an exception to Rule 11Ac1-1.

6. System Problems, Extreme Weather, Flood of SelectNet Liability Orders. Situations such as firm system problems, extreme weather conditions, and a flood of other SelectNet orders surrounding a SelectNet liability order may be viewed as mitigating factors, but not exceptions, to Rule 11Ac1-1.

On July 16, 1997, the SEC sent a letter to the National Association of Securities Dealers, Inc. (NASD[®]) and NASD Regulation providing guidance on a variety of firm quote compliance issues. (The NASD's July 7, 1997 inquiry and the SEC's July 16, 1997 letter in response are attached to this *Notice*.) Based on the guid-

ance provided in the SEC's letter dated July 16, 1997, the staff will continue to analyze the SOES/SelectNet "double-hit" issue on a facts-and-circumstances basis and will continue to review firms that demonstrate a pattern of non-responsiveness to SelectNet liability orders *after presentment*. In addition, the SEC's letter implicitly reiterates the SEC staff's position that a preferred SelectNet order is deemed to be presented to the recipient of that order for purposes of Rule 11Ac1-1 upon delivery of that order to the firm. Indeed, the SEC's letter reaffirms statements made in the SEC's Section 21(a) report that, "[t]he firm quote rule is triggered when an order is 'presented' to the market maker. Because all directed SelectNet orders are delivered electronically to a particular market maker, the presentment of an order is readily ascertainable."

Member firms should discuss the items set forth in this *Notice* and the SEC's letter dated July 16, 1997, with their traders and remind them of their obligations under Rule 11Ac1-1. Member firms should also implement adequate written supervisory procedures to detect and deter potential firm quote violations. Failure to have an adequate supervisory system in place may result in disciplinary action. In addition, firms should ensure that they have adequate staff and/or systems technology to immediately respond to SelectNet orders. In the near future, NASD Regulation will publish a *Notice to Members* to provide firms with general guidance on implementing supervisory procedures relating to the firm quote rule and other areas.

Questions regarding this *Notice* may be directed to NASD Regulation's Market Regulation Department, at (800) 925-8156.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.



National Association of Securities Dealers, Inc. ■ 1735 K Street, NW ■ Washington, DC 20006-1500 ■ 202-728-8000

July 7, 1997

Dr. Richard Lindsey
Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Dear Dr. Lindsey:

This letter requests the Commission's interpretive views regarding the application of Rule 11Ac1-1 under the Securities and Exchange Act ("Firm Quote Rule") to orders received through the Nasdaq Stock Market's Selectnet System. We appreciate very much the attention the Commission staff has already given to this issue as well as the constructive suggestions you personally have made regarding longer term system and NASD rule changes that might relieve the present Firm Quote compliance burdens. Nevertheless, we believe that a response to the interpretive questions set forth below will be extremely helpful in clarifying the application of the Firm Quote Rule and thereby enhancing the ability of NASDR to enforce compliance with the Rule.

First, the Commission has previously stated that orders sent through the Selectnet System are "presented" to a market maker at the time the Selectnet order is displayed on its terminal. The Commission has further stated that the fact an order quickly scrolls off a market maker's trading screen does not excuse traders from complying with the Firm Quote Rule. We would appreciate the Commission's views as to the application of the Firm Quote Rule in the following example. The market maker receives on its terminal a preferenced Selectnet buy order at its quoted offer price at 10:10:00. Before the market maker becomes aware of the Selectnet order it executes a second order over the telephone, its proprietary execution system or SOES at 10:10:15. At 10:10:20 the market maker becomes aware of the Selectnet order. Is the market maker obliged by the Firm Quote Rule to execute the Selectnet order? Would the response to this question be different if the market maker had executed an order over the telephone or through its proprietary execution system at 10:09:55 but had not yet updated its quotation when it became aware of the Selectnet Order at 10:10:20? Would the answer to either of these fact scenarios change if the market maker was displaying a customer limit order as its quotation and had no interest in trading for its proprietary account at that price?

Dr. Richard Lindsey
Page Two


Second, we would appreciate the Commission's staff view as to whether a market maker's obligation under the Firm Quote Rule is affected in any way by the cancellation of a Selectnet order. For example, assume again that a market maker received a Selectnet buy order at its quoted offer price at 10:10:00. Assume further that the market maker states that it had not become aware of the Selectnet order prior to the time that the order was cancelled. Does the market maker's failure to execute the Selectnet order prior to cancellation violate the Firm Quote Rule? If the answer to this question is yes, what is the legal obligation which requires the market maker to respond prior to the system expiration time? Is there some period of time (e.g., 15-30 seconds), during which the market maker's failure to respond prior to a cancellation would not constitute a violation? Finally, would a market maker who becomes aware that a preferenced order has scrolled off a screen and timed out, meet its firm quote obligations if it then executed the transaction without involvement of NASDR or a complaint from the order entry firm?


Third, we would appreciate the Commission's staff view as to whether the order entry firm's conduct in entering and cancelling multiple orders through the Selectnet system is relevant to the fact situation discussed above. For example, if an order entry firm entered seven broadcast buy orders and three preferenced buy orders into the Selectnet system between 10:09:50 and 10:10:10 and then, after receiving an execution of one broadcast order at 10:10:15 cancelled all (or most) of its other Selectnet orders, have the market making firms who received the three preferenced Selectnet orders violated the Firm Quote Rule even though the order entry firm appeared to succeed in its strategy?

Finally, is it relevant in any of the backing away fact situations discussed above that the market making firm can demonstrate that on numerous occasions in the past it has executed Selectnet preferenced orders received from the same and other order entry firms.

We appreciate very much your response to these questions and look forward to continuing to work with you to ensure that the Firm Quote Rule is fully and fairly enforced.

Sincerely yours,


Mary Schapiro


Richard Ketchum *by mrs*



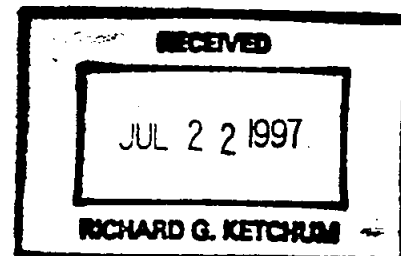
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

July 16, 1997

Mr. Richard G. Ketchum
Executive Vice President & Chief Operating Officer
National Association of Securities Dealers, Inc.

Ms. Mary L. Schapiro
President
NASD Regulation
1735 K Street, N.W.
Washington, D.C. 20006-1506



Dear Mr. Ketchum and Ms. Schapiro:

In the undertakings specified in the Commission's administrative proceeding against the NASD,^{1/} the NASD committed to substantially upgrade its capability to enforce Rule 11Ac1-1 under the Securities Exchange Act of 1934 ("Firm Quote Rule"). NASD efforts to date include the establishment of a real-time procedure for resolving backing away complaints, and new draft parameters and protocols for processing such complaints.

In your letter of July 7, 1997, you indicated that you would like more guidance on what types of activity may be deemed backing away under the Firm Quote Rule.^{2/} You have requested the Division's views regarding this conduct so as to enhance NASDR's ability to enforce compliance with the Firm Quote Rule.

Many of your questions involve a market maker's duty to honor its quote when the market maker receives two or more orders in close conjunction via Nasdaq's SelectNet System and the Small Order Execution System ("SOES") or the telephone.^{3/}

^{1/} See Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD, the Nasdaq Market, and Nasdaq Market Makers, Securities Exchange Act Release No. 37542 (August 8, 1996).

^{2/} See Letter from Richard G. Ketchum, Executive Vice President & Chief Operating Officer, NASD, and Mary L. Schapiro, President, NASDR, to Richard R. Lindsey, Director, Division of Market Regulation, SEC, dated July 7, 1997.

^{3/} The double execution problem arising from Nasdaq providing two automated order delivery systems could be eliminated by integrating these two systems.

Mr. Richard G. Ketchum
Ms. Mary L. Schapiro
July 16, 1997
Page 2

The Division acknowledges that the receipt of simultaneous orders in SOES, SelectNet and over the telephone raises questions regarding firm quote compliance for market makers.^{4/} Nonetheless, it is not feasible in this context to articulate a "bright-line" test on what conduct constitutes backing away. Instead, NASDR should examine the particular facts and circumstances surrounding a market maker's conduct to determine if a market maker violated its firm quote obligations.

For example, when an order entry firm cancels its order quickly after presentment in SelectNet,^{5/} NASDR should analyze that

^{4/} For example, some market makers claim that other market participants are (1) sending a market maker a preferenced SelectNet order at the market maker's quote; (2) cancelling the order quickly before the market maker can fill it; and (3) filing a backing away complaint against the market maker. Another alleged practice is for a firm to send a preferenced SelectNet order virtually contemporaneously with a similar order via SOES. In this situation, the SelectNet order arrives shortly before the market maker receives confirmation of an automatic execution in SOES. The order entry firm then will file a backing away complaint if the market maker does not honor the SelectNet order. Market makers are concerned that this practice subjects them to double executions.

^{5/} Although a market maker may often be able to react within 10 seconds of presentment of a SelectNet order, the 10 second cancellation prohibition is not meant to establish a per se backing away time threshold. See Securities Exchange Act Release No. 38185 (January 21, 1997), 62 FR 3935 (January 27, 1997) (approving a ten second minimum life for a preferenced SelectNet order). As an initial matter, the Division believes that an order entry firm that directs multiple SelectNet orders to a market maker within a relatively brief time, with the intent of cancelling these orders shortly after entry for the purpose of deliberately deterring order execution, could be in violation of the federal securities laws and should be examined under the appropriate NASD rules. Although market makers have a responsibility to stand behind their published quotations when receiving order flow from order entry systems, in the situations where order entry firms are deliberately deterring execution of these orders, the market maker should not be held to be in violation of the Firm Quote Rule. Nonetheless, because of the serious problems involving unwarranted backing away by market makers in the past, the NASDR must ensure that a market maker's allegations of order

Mr. Richard G. Ketchum
Ms. Mary L. Schapiro
July 16, 1997
Page 3

market maker's pattern of execution for orders it receives via SelectNet. On one hand, if the analysis reveals that the market maker generally executes orders from market makers or other firms within a few seconds of presentment, a backing away violation may be indicated where the market maker waits significantly longer to execute orders from the order entry firm involved in the complaint. On the other hand, if a market maker can show that it generally fills most SelectNet orders promptly and in a non-discriminatory fashion, failure to fill a particular SelectNet order cancelled quickly after presentment may not rise to the level of backing away, depending on the facts and circumstances of a particular case.

A similar analysis should be employed for the SOES/SelectNet double hit question. There should be no "bright line" test that would excuse a market maker from executing the SelectNet order without violating its obligations. The determination would have to be made on a facts and circumstances basis.^{6/} Of course, the Firm Quote Rule does not allow a market maker to decline to fill an order based on the receipt of a subsequent order. Therefore, in deciding a backing away complaint, the NASD should determine the time the SOES order was entered by factoring in the time it takes a market maker to receive the execution confirmation from the point of order entry.

NASD policy is that firms with timely backing away complaints may receive a contemporaneous trade execution. The Division notes, however, that the fact that a market maker gives a customer a fill in response to a complaint or otherwise reimburses the customer is not determinative of whether a violation has occurred. Although it may be appropriate to consider contemporaneous fills as a mitigating factor for individual violations, it would not be conclusive for market makers that have demonstrated a pattern of backing away violations.

Finally, some market makers have complained that the large volume of SelectNet orders may cause preferenced orders to rapidly scroll off the screen before a trader can see them, subjecting the firm to backing away complaints. The Division does not believe that a firm should escape Firm Quote Rule responsibility based on

entry firm "gaming" in response to a backing away complaint be substantiated.

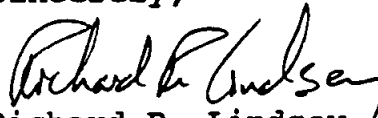
^{6/} Some factors to consider include the times that the orders were entered and whether both orders were sent by the same firm.

Mr. Richard G. Ketchum
Ms. Mary L. Schapiro
July 16, 1997
Page 4

claims that a trader failed to see a SelectNet order due to the "scrolling effect." The Division understands that many market makers now are able to separate the SelectNet preferenced orders from general broadcast orders on their individual screens, which would reduce the scrolling problem.

The Division reiterates that improved backing away surveillance is integral to the NASD's ability to satisfy its self-regulatory obligations. If you have additional questions regarding this matter, please do not hesitate to contact me.

Sincerely,


Richard R. Lindsey
Director

NASD NOTICE TO MEMBERS 97-68

SEC Approves Amendment To Definition Of Qualified Independent Underwriter In Conduct Rule 2720; Effective September 4, 1997

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

On September 4, 1997, the Securities and Exchange Commission (SEC) approved an amendment to the definition of "qualified independent underwriter" in Rule 2720 of the National Association of Securities Dealers, Inc. (NASD®) Conduct Rules that eliminates the requirement that a member intending to act as a qualified independent underwriter in a public offering record net income in three of the five years immediately preceding the offering.¹ The net income requirement was found to be an unreliable indicator of a member's ability to fulfill the responsibilities of a qualified independent underwriter. The amendment is effective as of the date of SEC approval with respect to all offerings of securities that have not, as yet, commenced sales of securities.

Questions concerning this *Notice* may be directed to Richard J. Fortwengler, Associate Director, Corporate Financing, NASD Regulation, Inc., at (202) 974-2700.

Background

When a member proposes to participate in the distribution of a public offering of its own or an affiliate's securities, or of securities of a company with which it otherwise has a conflict of interest, NASD Rule 2720 requires that the price at which an equity issue or the yield at which a debt issue is to be distributed to the public must be established at a price no higher or a yield no lower than that recommended by a member acting as a "qualified independent underwriter." The qualified independent underwriter must also participate in the preparation of the offering document and is expected to exercise the usual standards of due diligence in respect thereto. The participation of a qualified independent underwriter assures the public of the independence of the pricing and due diligence functions in a situation where a member

is participating in an offering where the member has an affiliation or conflict of interest.

Because of the important investor protections provided by qualified independent underwriters, they must meet certain standards as prescribed in Rule 2720 of the Conduct Rules. Qualified independent underwriters must have a certain level of experience as demonstrated by having been engaged in the investment banking and securities business for at least five years; by recording net income in three of the five years immediately preceding the offering (net income requirement); by a majority of directors (or general partners) having been actively engaged in the investment banking and securities business for five years; and by acting as manager or co-manager in the underwriting of offerings of a similar size and type for a five-year period prior to the offering. Further, qualified independent underwriters may not be affiliates or own more than five percent of certain securities of the issuing company; are subject to provisions ensuring that associated persons of the member have not been convicted, suspended, barred or otherwise disciplined for actions related to an offering; and must agree to accept the legal responsibilities and liabilities of an underwriter under Section 11 of the Securities Act of 1933.

The net income requirement referenced above was adopted in 1972 as part of the original provisions of Rule 2720, and was viewed as a gauge for monitoring a member's ability to act as a qualified independent underwriter. In the ensuing years, however, amendments to the definition of qualified independent underwriter have imposed more specific requirements that are more pertinent to ensuring that members have the experience and ability to be effective qualified independent underwriters.

In particular, the definition of qualified independent underwriter was amended in 1988 to preclude a member from acting as a qualified independent underwriter if, within the previous five-year period, any of its associated persons having supervisory responsibility for organizing, structuring, or performing due diligence with respect to corporate public offerings of securities have been convicted, enjoined, suspended, barred, or otherwise subject to disciplinary action by the NASD, SEC or other self-regulatory organizations for violation of the anti-fraud provisions of the federal or state securities laws for distribution-related activities.³ In addition, the 1988 amendments require a qualified independent underwriter to have experience in managing or co-managing public offerings of a size and type similar to the proposed offering. This latter requirement is the most pertinent, since it most directly measures the member's experience in performing the duties and responsibilities necessary of a qualified independent underwriter.

Finally, the 1988 amendments restrict the beneficial ownership of the issuer's voting equity securities by the qualified independent underwriter to less than five percent. Later amendments in 1994 extended these ownership restrictions to non-voting equity securities, preferred equity, and subordinated debt. Taken together, these modifications to the definition of "qualified independent underwriter" have significantly improved confidence in the ability, quality, and integrity of qualified independent underwriters.

Adoption of Amendment

NASD RegulationSM believes that the net income requirement now operates as an arbitrary standard for assessing the abilities of potential qualified independent underwriters, particular-

ly where members intentionally avoid experiencing net income for tax reasons. This occurs where a member is organized as either a sole proprietorship, partnership, or subchapter S corporation that routinely distributes its net income to the owner, partners, or shareholders to minimize taxes. The application of a net income requirement is not appropriate in these cases, as the legal structure of the member is a business decision within the discretion of the member that is unrelated to the firm's underwriting activities.

In addition, a lack of net income may not be directly connected to the profitability of the member's underwriting activities and, thus, not a reliable indicia of underwriting experience, since the overall profitability of a member can be impacted by the performance of other business lines within multi-functional members. Losses in one or more departments of a member can unnecessarily disqualify the firm from acting as a qualified independent underwriter. The lack of net income can also reflect accounting anomalies related to infrequent events that result in charges against earnings for mergers, consolidations, restructurings, or divestitures.

Finally, net income is also subject to the vagaries of the market, when a decline in income is often attributable to trading activities rather than underwriting. This was apparent during the five-year periods following the market breaks that occurred in October 1987 and October 1989, when a number of members failed to meet the net income requirement.

In light of the foregoing, NASD Regulation has amended Rule 2720 to eliminate the net income requirement from the definition of "qualified independent underwriter." as it may operate as an unfair barrier or restraint that disqualifies otherwise qualified firms from acting as qualified inde-

pendent underwriters. The elimination of the net income requirement allows the staff of NASD's Corporate Financing Department to focus on these more substantive requirements when approving members to be qualified independent underwriters.

The amendment was approved by the SEC on September 4, 1997, and is effective as of that date with respect to public offerings to be filed after that date with the Corporate Financing Department for review, and with respect to public offerings that have been filed with the Corporate Financing Department but have not, as yet, commenced sales of securities.

Text Of Amendment

(Note: Deletions are bracketed.)

CONDUCT RULES

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

(a) No change.

(b) Definitions

(15) Qualified independent underwriter—a member which:

(A) is actively engaged in the investment banking or securities business and which has been so engaged, in its present form or through predecessor broker/dealer entities, for at least five years immediately preceding the filing of the registration statement;

[(B) in at least three of the five years immediately preceding the filing of the registration statement has had net income from operations of the broker/dealer entity or from the *pro forma* combined operations of predecessor broker/dealer entities, exclusive of extraordinary items, as computed in accordance with generally accepted accounting principles;]

Paragraphs (C) through (G) redesignated as (B) through (F).

Endnotes

¹ Securities Exchange Act Release No. 39021 (September 4, 1997).

² *NASD Notice to Members 88-89* (November 1988).

³ In the opinion of the Association and the Commission the full responsibilities and liabilities of an underwriter under the Securities Act of 1933 attach to a “qualified indepen-

dent underwriter” performing the functions called for by the provisions of paragraph (c) hereof.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

NASD NOTICE TO MEMBERS 97-70

Broker/Dealer And Agent Renewals For 1998

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

The 1997-98 National Association of Securities Dealers, Inc. (NASD®) broker/dealer and agent registration renewal cycle begins in early November. This program simplifies the registration renewal process through the payment of one invoiced amount that will include fees for NASD personnel assessments, NASD branch office fees, and American Stock Exchange (ASE), Chicago Board Options Exchange (CBOE), New York Stock Exchange (NYSE), Pacific Stock Exchange (PSE) and Philadelphia Stock Exchange (PHLX) maintenance fees. The invoice also includes state agent renewal fees and state broker/dealer renewal fees.

Members should read this *Notice* and the instructional materials to be sent with the November invoice package to ensure continued eligibility to do business in their respective states, effective January 1, 1998.

Questions concerning this *Notice* may be directed to your firm's assigned Quality and Service Team or NASD's Gateway, at (301) 590-6500.

Initial Renewal Invoices

In early November, initial renewal invoices will be mailed to all member firms. The invoices will include fees for NASD personnel assessments, NASD branch office fees, ASE, CBOE, NYSE, PSE and PHLX maintenance fees, state agent renewal fees, and state broker/dealer renewal fees. **The NASD must receive full payment of the November invoice no later than December 15, 1997.**

NASD personnel assessments for 1998 will be based on the number of registered personnel with an approved NASD license as of December 31, 1997. That personnel assessment is \$10 per person. NASD branch office assessments are \$75 per

branch, based on the number of active branches as of December 31, 1997.

Agent renewal fees for ASE, CBOE, NYSE, PSE, PHLX and state affiliations are listed in a matrix enclosed with each invoice. The matrix includes a list of broker/dealer renewal fees for states that participate in the broker/dealer renewal program. ASE, CBOE, NYSE, PSE and PHLX maintenance fees—collected by the NASD for firms that are registered with those exchanges as well as the NASD—are based on the number of ASE-, CBOE-, NYSE-, PSE- and PHLX-registered personnel employed by the member.

If a state does not participate in this year's broker/dealer renewal program, members registered in that state must contact the state directly to ensure compliance with renewal requirements. In addition, some participating states may require steps beyond the payment of renewal fees to complete the broker/dealer renewal process. Members should contact states directly for further information on state renewal requirements.

Payment of the initial invoice should be by check, made payable to NASD Regulation, Inc., or by bank wire transfer. The check should be drawn on the member firm's account, with the firm's Central Registration Depository (CRDSM) number included on the check. **Submit the check, along with the top portion of the invoice, and mail in the return envelope provided with the invoice. All payments should be mailed to: NASD, Finance Department, 15201 Diamondback Drive, Rockville, MD 20850-3389.** To ensure prompt processing, the renewal invoice payment *should not* be included with other forms or fee submissions. Members should be advised that failure to return payment to the NASD by the December 15,

1997 deadline could result in an immediate ineligibility to do business in their states, effective January 1, 1998.

Filing Forms U-5

Members may avoid paying unnecessary renewal fees by filing Forms U-5 for agents terminating in one or more jurisdictions. Due to the positive feedback received by the NASD from its member firms that used post-dated Forms U-5 for renewals, the NASD will again accept post-dated agent termination notices on the Forms U-5. From November 1 to December 15, the NASD will accept and process Forms U-5 (both partial and full terminations) with *post-dated dates of termination*. Under this procedure, if the Form U-5 indicates a termination date of December 31, 1997, an agent may continue doing business in a jurisdiction until the end of the calendar year without being assessed renewal fees for that jurisdiction. **Please ensure that Forms U-5 are filed by the renewal deadline date of December 15, 1997. Also, post-dated Forms U-5 cannot be processed if the date of termination indicated is after December 31, 1997.**

Members should exercise care when submitting post-dated Forms U-5. The NASD will process these forms as they are received but *cannot* withdraw a post-dated termination once processed. To withdraw a post-dated termination, a member would have to file a new Form U-4 *after* the termination date indicated on the Form U-5.

The NASD encourages members having access to the Firm Access Query System (FAQS) to utilize electronic filings for the submission of all Forms U-5 and page 1 of Form U-4. FAQS offers several advantages to firms in this regard, including the ability to **immediately** process terminations, ensure in-house control over

agent registrations, and reduce normal and express mailing costs as well as long-distance telephone charges. FAQS also allows members to quickly and efficiently handle the large filing volumes that typically occur at this time every year. Because of that, the NASD will provide an additional service to FAQS users by expanding the on-line user hours for November and December 1997. The system will be operational from 7 a.m. to 11 p.m., Eastern Time (ET), Monday through Friday and will also be available on Saturdays from 9 a.m. to 5 p.m., ET, during these months.

Filing Forms BDW

The CRD Phase II program, now in its eighth year, allows firms requesting terminations (either full or state only) to file their Forms BDW with the CRD to avoid the assessment of renewal fees in those jurisdictions that are designated on the Form BDW, *provided that the jurisdiction is a CRD Phase II participant*. Currently, there are five jurisdictions that are *not* participating in Phase II. They are:

Michigan
Puerto Rico
American Stock Exchange
New York Stock Exchange
Pacific Stock Exchange

Firms requesting termination in any of the above-listed jurisdictions must submit a Form BDW directly to the jurisdiction as well as to the CRD.

The deadline for receipt of Forms BDW by the CRD for firms desiring to terminate an affiliation before year end 1997 is December 15, 1997. This same date applies to the filing of Forms BDW with the jurisdictions that are not participating in Phase II. Post-dated Forms BDW filed with the CRD *will be* accepted and processed in the same manner as post-dated Forms U-5.

Removing Open Registrations

The initial invoice package will include a roster of firm agents whose NASD registration is either terminated or purged due to the existence of a deficient condition for more than 180 days, but who have an approved registration with a state. This roster should aid in the reconciliation of personnel registrations prior to year end. Firms may terminate obsolete state registrations through the submission of Form U-5 or reinstate the NASD licenses through the filing of page 1 of Form U-4. *No roster will be included if a firm does not have agents within this category.*

Final Adjusted Invoices

Beginning January 15, 1998, the NASD will mail final adjusted invoices to its members. These invoices will reflect the final status of firm and agent registrations as of December 31, 1997. Any adjustments in fees owed as a result of registration terminations or approvals subsequent to the initial invoice mailing will be made in this final reconciled invoice. If a member has more agents and/or branch offices registered at year end than it did on the November invoice date, additional fees will be assessed. If a member has fewer agents and/or branch offices registered at year end than it did in November, a credit/refund will be issued.

Included with this adjusted invoice will be the member renewal rosters, which will list all renewed personnel with the NASD, ASE, CBOE, NYSE, PSE, PHLX, and each state. Persons whose registrations are approved in any of these jurisdictions during November and December will automatically be included in this roster, while registrations that are pending approval or are deficient at year end *will not* be included in the renewal process. Firms will also receive an NASD branch office roster

that lists all branches for which they have been assessed.

Firms then will have a two-month period in which to reconcile any discrepancies on the rosters. *All jurisdictions should be contacted directly in writing.* Specific information and instructions concerning the final

adjusted invoice package will appear in the January 1998 issue of *Notice to Members*, as well as on the inside cover of the renewal roster. Firms may also refer to their Renewal Edition of "Membership on Your Side" for details concerning the renewal process.

This year's final invoice package will also include a breakdown of fees assessed by billing code for firms that use billing codes in the registration process. This breakdown will aid firms in their internal research and allocation of fees.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

NASD NOTICE TO MEMBERS 97-71

NASD To Deduct Unpaid Arbitration Fees From Member Deposit Accounts

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

Effective January 1, 1998, the National Association of Securities Dealers, Inc. (NASD[®]) will deduct delinquent unpaid arbitration fees from member funds maintained in member Central Registration Depository (CRDSM) accounts. Members will receive at least two notices that arbitration fees are due and payable as part of the normal billing and collections process. If a payment is received prior to the established deadline, the NASD will not deduct funds from the member's CRD account. Members are responsible for replenishing the funds on deposit to ensure that there are no delays in processing registration applications or any other CRD-related obligation.

Questions regarding this *Notice* may be directed to Deborah Masucci, Vice President and Director, Office of Dispute Resolution, NASD Regulation, Inc., at (212) 858-4400; Todd Diganci, Vice President and Controller, Finance Department, NASD, at (301) 590-6203; or Elliott R. Curzon, Assistant General Counsel, Office of General Counsel, NASD RegulationSM, at (202) 728-8451.

Background

The Office of Dispute Resolution has a substantial and growing problem with unpaid member surcharges and arbitration forum fees owed by members who are or have been involved in arbitration proceedings. Examples of these types of fees are member surcharges assessed to member firms that are named in an arbitration proceeding or to member firms that employed an associated person named in an arbitration proceeding. Another example is a forum fee, which is the hearing cost assessed to a party in an arbitration award.

Member surcharges are assessed and become due and payable when an arbitration complaint is served on the member. Forum fees are assessed and become payable when a case is

completed and the award is served. In the award, the arbitrators will specify how much each party must pay in forum fees. The NASD provides a statement of account to each party showing the fees that are owed.

Many members maintain funds on deposit with the NASD in order to expedite processing of employee registrations, examinations, and fingerprint processing. Increasingly, however, members are asking that on-deposit funds be reallocated for payment of other NASD/NASD Regulation obligations such as Advertising Fees and Gross Assessment Fees, and for purchasing MediaSourceSM materials such as fingerprint cards or other reference materials. It is appropriate, therefore, for member on-deposit funds to be used for other obligations owed to the NASD.

Accordingly, for cases filed on or after January 1, 1998, the NASD will deduct member surcharges that are more than 60 days past due from the funds that the member maintains on deposit. In addition, beginning with cases that are closed on or after January 1, 1998, the NASD will deduct forum fees that are more than 60 days past due from the funds that the member maintains on deposit. Under the current invoicing and dunning procedures, members will be given sufficient notice of their obligation to permit them to pay or dispute the resulting charge with the Dispute Resolution Department prior to the deduction of funds from their CRD account. Written confirmation of each reallocation will be provided to the member's compliance officer. Members whose account balances are insufficient to cover an unpaid debt, and who do not make other payment arrangements, may have their membership and registration suspended or cancelled pursuant to Article VI, Sec. 3 of the NASD By-Laws.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

NASD NOTICE TO MEMBERS 97-72

Veterans' Day And Thanksgiving Day: Trade Date-Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Veterans' Day, Tuesday, November 11, 1997, and Thanksgiving Day, Thursday, November 27, 1997. On Tuesday, November 11, The Nasdaq Stock MarketSM and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans' Day. All securities markets will be closed on Thursday, November 27, in observance of Thanksgiving Day.

	Trade Date	Settlement Date	Reg. T Date*
	Nov. 4	Nov. 7	Nov. 11
Veteran's Day And Thanksgiving Day: Trade Date-Settlement Date Schedule	5	10	12
	6	12	13
	7	13	14
	10	14	17
	11	14	18
	21	26	Dec. 1
	24	28	2
	25	Dec. 1	3
	26	2	4
	27	Markets Closed	—
28	3	5	
Suggested Routing			
<input type="checkbox"/> Senior Management			
<input type="checkbox"/> Advertising			
<input type="checkbox"/> Continuing Education			
<input type="checkbox"/> Corporate Finance			
<input type="checkbox"/> Government Securities			
<input type="checkbox"/> Institutional			
<input type="checkbox"/> Insurance			
<input checked="" type="checkbox"/> Internal Audit			
<input checked="" type="checkbox"/> Legal & Compliance			
<input checked="" type="checkbox"/> Municipal			
<input type="checkbox"/> Mutual Fund			
<input checked="" type="checkbox"/> Operations			
<input type="checkbox"/> Options			
<input type="checkbox"/> Registered Representatives			
<input type="checkbox"/> Registration			
<input type="checkbox"/> Research			
<input checked="" type="checkbox"/> Syndicate			
<input checked="" type="checkbox"/> Systems			
<input checked="" type="checkbox"/> Trading			
<input type="checkbox"/> Training			
<input type="checkbox"/> Variable Contracts			

Note: November 11, 1997, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Transactions made on November 11 will be combined with transactions made on the previous business day, November 10, for settlement on November 14. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

*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 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 titled "Reg. T Date."

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

NASD NOTICE TO MEMBERS 97-73

Fixed Income Pricing
System Additions,
Changes, And Deletions
As Of September 23,
1997

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

As of September 23, 1997, the following bonds were added to the Fixed Income Pricing SystemSM (FIPSSM).

Symbol	Name	Coupon	Maturity
UH.GC	U.S. Home Corp	8.250	08/15/04
UH.GD	U.S. Home Corp	8.880	08/15/07
HU.GA	Huntsman Polymers Corp	11.750	12/01/04

As of September 23, 1997, the following bonds were deleted from FIPS.

Symbol	Name	Coupon	Maturity
FXTL.GA	Forstmann Textiles Inc.	14.750	04/15/99
ALLY.GA	Alliance Gaming Corp	12.875	06/30/03
SFXB.GA	SFX Broadcasting Inc.	11.375	10/01/00
NMEP.GA	National Medical Enterprise Corp	7.375	09/01/97

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to FIPS trade-reporting rules should be directed to Stephen Simmes, NASD RegulationSM Market Regulation, at (301) 590-6451.

Any questions regarding the FIPS master file should be directed to Cheryl Glowacki, Nasdaq[®] Market Operations, at (203) 385-6310.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

NASD NOTICE TO MEMBERS 97-74

SEC Approves Amendments To Legal Definition Of Short Sale

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

On September 26, 1997, the Securities and Exchange Commission (SEC) approved an amendment to the National Association of Securities Dealers, Inc. (NASD[®]) short sale rule to provide that a "legal" short sale can be effected at a price equal to or greater than the offer price when the inside spread is less than 1/16th. The rule change has been approved on a temporary basis effective immediately through January 15, 1998, at which time the SEC will consider permanent approval of the rule change as well as permanent approval of the NASD's short sale rule.

Questions regarding this rule change should be directed to Andrew S. Margolin, Senior Attorney, The Nasdaq Stock Market, Inc., at (202) 728-8869.

Background And Summary

The NASD's short sale rule¹ prohibits member firms from effecting short sales² at or below the current inside bid, as disseminated by The Nasdaq Stock MarketSM (Nasdaq[®]) whenever that bid is lower than the previous inside bid.³ Previously, the rule provided that a short sale is a "legal" short sale in a "down" bid situation if it is effected at a price at least 1/16th above the inside bid ("Minimum Increment Rule"). The Minimum Increment Rule was implemented to ensure that short sales were not effected at prices so close to the inside bid during down markets that they were inconsistent with the underlying purposes of the short sale rule (*i.e.*, to prohibit market destabilizing and abusive short sales in declining markets).

Now that all Nasdaq stocks can potentially trade with a 1/16th spread or less due to, among other things, the new SEC Order Execution Rules, and in light of the movement toward

smaller minimum quotation variations generally, consideration was given to modifying the Minimum Increment Rule for stocks with an inside spread less than 1/16th.

Accordingly, the NASD has amended the Minimum Increment Rule to provide that a "legal" short sale must be effected at a price equal to or greater than the offer price when the inside spread is less than 1/16th. There would be no change to the current definition for stocks with a spread of 1/16th or greater. For example, if the inside market for ABCD is 10 1/4 – 10 5/16, a legal short sale in a down market would have to be effected at a price equal to or greater than 10 5/16 (*i.e.*, 1/16th above the current inside bid). However, if the inside market is 5 1/32 – 5 2/32, a legal short sale in a down market could be effected at a price of 5 2/32.

In addition, to help ensure that market participants do not adjust their quotations to circumvent the short sale rule, the NASD is proposing an amendment to the Minimum Increment Rule to provide that a market maker or customer could not bring about or cause the inside spread for a stock to narrow in a declining market (*e.g.*, lowering its offer to create an inside spread less than 1/16th) for the purpose of facilitating the execution of a short sale at a price less than 1/16th above the inside bid.

Text Of Amendments

(Note: New language is underlined.)

IM-3350 Short Sale Rule

(a) No Change

(b) (1) Rule 3350 requires that no member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the cur-

rent best (inside) bid when the current best (inside) bid as displayed by The Nasdaq Stock Market is below the preceding best (inside) bid in the security. The Association has determined that in order to effect a "legal" short sale when the current best bid is lower than the preceding best bid the short sale must be executed at a price of at least 1/16th point above the current inside bid when the current inside spread is 1/16th point or greater. The last sale report for such a trade would, therefore, be above the inside bid by at least 1/16th of a point. If the current spread is less than 1/16th of a point, however, the short sale must be executed at a price equal to or greater than the current inside offer price.

(2) Moreover, the Association believes that requiring short sales to be a minimum increment of 1/16th point above the bid when the current spread is 1/16th or greater and equal to or greater than the offer when the current spread is less than 1/16th ensures that transactions are not effected at prices inconsistent with

the underlying purpose of the Rule. It would be inconsistent with Rule 3350 for a member or customer to cause the inside spread for an issue to narrow when the current best bid is lower than the preceding best bid (e.g., lowering its offer to create an inside spread less than 1/16th) for the purpose of facilitating the execution of a short sale at a price less than 1/16th above the inside bid.

(c) No Change

Endnotes

¹ The short sale rule was originally adopted in June of 1994 for Nasdaq National Market securities on a pilot basis with a termination date of March 5, 1996. See Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994). The pilot has been extended several times, most recently through January 15, 1998. See Exchange Act Release No. 39140 (September 26, 1997). On August 11, 1997, the NASD filed a proposed rule change with the Commission to implement the short sale rule on a permanent basis. See Exchange Act Release No. 38979 (August 26, 1997), 62 FR 46537 (September 3, 1997).

² A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale, members must adhere to the definition of a "short sale" contained in Exchange Act Rule 3b-3, 17 CFR 240.3b-3, which rule is incorporated into Nasdaq's short sale rule as NASD Rule 3350(k)(1).

³ Nasdaq calculates the inside bid or best bid from all market makers in the security (including bids on behalf of exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up bid" or a "down bid." Specifically, an "up bid" is denoted by a green "up" arrow and a "down bid" is denoted by a red "down" arrow. Accordingly, absent an exemption from the rule, a member can not effect a short sale at or below the inside bid for a security in its proprietary account or a customer's account if there is a red arrow next to the security's symbol on the screen.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

DISCIPLINARY ACTIONS

Disciplinary Actions Reported For October

NASD Regulation, Inc. (NASD RegulationSM) has taken disciplinary actions against the following firms and individuals for violations of National Association of Securities Dealers, Inc. (NASD[®]) rules; federal 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, October 20, 1997. The information relating to matters contained in this *Notice* is current as of the end of September 22.

Firms Fined, Individuals Sanctioned

Gilbert Marshall & Company, Inc. (Greeley, Colorado) and Michael A. Usher (Registered Principal, Greeley, Colorado) submitted an Offer of Settlement pursuant to which they were fined \$15,000, jointly and severally, and Usher was suspended from association with any NASD member in any principal capacity, excluding the capacities of financial and operations principal and registered options principal, for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Usher, settled customer complaints with a settlement agreement that contained an agreement by the customer not to initiate or pursue any regulatory complaint. The NASD also determined that Usher failed to provide accurate and truthful information in response to NASD requests for information.

Investment Management & Research, Inc. (St. Petersburg, Florida) and Kenneth Craig Krull (Registered Representative, Marysville, Washington). The firm was fined \$10,000, required to submit satisfactory written supervisory procedures to the NASD, and required to pay \$42,785.21 in restitu-

tion to customers. Krull was fined \$20,000, barred from association with any NASD member in any principal or supervisory capacity, suspended from association with any NASD member in any capacity for one year, required to pay \$171,140.93 in restitution to customers, and required to requalify by exam as a general securities representative. The National Business Conduct Committee (NBCC) imposed the sanctions following appeal of a Seattle District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that Krull recommended unsuitable mutual fund switches in the accounts of public customers without having reasonable grounds for believing that such transactions were suitable for the customers in view of the frequency of the transactions, the type of transaction being recommended, and the customers' financial situations, circumstances, and needs. The firm failed to ensure that Krull's sales activities were adequately reviewed and monitored to ensure those sales activities were not in contravention of the NASD's Rules. Furthermore, the firm also failed to have supervisory procedures that were reasonably designed to detect mutual funds switches in Krull's branch office.

Krull has appealed this action to the Securities and Exchange Commission (SEC) and the sanctions, other than the bar, are not in effect pending consideration of the appeal.

Firms And Individuals Fined Chesapeake Securities Research Corporation (Towson, Maryland) and Thomas T. Taylor (Registered Principal, Towson, Maryland) submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$10,000, 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 Taylor, conducted a securities business while failing to maintain its minimum required net capital. The findings also stated that the firm, acting through Taylor, conducted offerings of limited partnership interests, failed to return customer funds when the terms of the contingency were not met, and extended the termination date and lowered the offering contingency when there were no current offering documents or documented subscriber approval for a continuation of the offering. Furthermore, the NASD found that the firm, acting through Taylor, failed to obtain subscription agreements from subscribers and failed to obtain signed copies of amendments to the offering from investors. Moreover, the NASD determined that the firm, acting through Taylor, failed to maintain a checks received and delivered blotter.

Excel Financial, Inc. (Salt Lake City, Utah) and **Gary R. Beynon (Registered Principal, Salt Lake City, Utah)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$20,000, jointly and severally. The firm also shall provide to the NASD, with respect to private placements of securities for which it functions as the sole or lead placement agent, an opinion of counsel that the offering was made in conformity with all applicable provisions of the federal securities laws and regulations promulgated thereunder, and Beynon was required to requalify by exam as a general securities 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 Beynon, participated in a private placement offering and failed to return investors' funds when the terms of the contingency offering were not met. The NASD also deter-

mined that the firm, acting through Beynon, conducted a securities business while failing to maintain its minimum required net capital.

First Analysis Securities Corporation (Chicago, Illinois) and **Janet Irene Lloyd (Registered Principal, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Lloyd, allowed an individual to be involved in the banking and securities business of the firm despite the fact the individual was not registered with the NASD and had failed to complete the regulatory element of the NASD's Continuing Education Program. The findings also stated that the firm, acting through Lloyd, failed to establish and maintain adequate written supervisory procedures with respect to the NASD's Continuing Education Program.

L. B. Saks, Inc. (New York, New York) and **Victor J. Puzio (Registered Principal, Rutherford, New Jersey)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$10,000, 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 Puzio, conducted a securities business while failing to maintain its minimum required net capital.

Shamrock Partners, Ltd. (Media, Pennsylvania) and **James T. Kelly (Registered Principal, Newtown Square, Pennsylvania)** were fined \$15,000, jointly and severally, and required to pay \$10,674.22 in restitution to customers, jointly and severally, demonstrate corrective action with regard to their mark-up and mark-

down policy, and submit to a staff interview. The NBCC affirmed the sanctions following appeal of a Philadelphia DBCC decision. The sanctions were based on findings that the firm, acting through Kelly, effected in a principal capacity purchases of common stock from public customers at prices that were not fair and reasonable in that the mark-downs on the purchases exceeded five percent.

The firm and Kelly have appealed this action to the SEC and the sanctions are not in effect pending consideration of the appeal.

Southern Farm Bureau Fund Distributor, Inc. (Jackson, Mississippi) and **William H. Risher, Jr. (Registered Principal, Brandon, Mississippi)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which they were fined \$50,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Risher, maintained registrations for 197 individuals who were not actively engaged in the securities business of the firm. The findings also stated that the firm, acting through Risher, failed and neglected to exercise reasonable and proper supervision over its registered representatives, and failed and neglected to establish, maintain, and enforce supervisory procedures. Furthermore, the NASD determined that the firm, acting through Risher, failed and neglected to comply with the continuing education requirements of the NASD in that the firm did not prepare a needs analysis, or prepare a training program and procedures for implementing the regulatory or firm elements for continuing education.

Firms Fined

Charlotte S. Cohen & Company, Inc. (St. Louis, Missouri) submitted an Offer of Settlement pursuant to which the firm was fined \$17,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it made erroneous computations in computing its special reserve requirement and contravened SEC Rule 15c3-3 by withdrawing funds from its special reserve account without an accompanying reserve computation upon which the withdrawal was based. The findings also stated that the firm conducted a securities business while failing to maintain its minimum required net capital and failed to prepare its books and records properly.

Herzog, Heine, Geduld, Inc. (Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was fined \$11,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to contemporaneously execute customers' limit orders when obligated to do so. Furthermore, the NASD found that the firm failed to report an order entry identification to Automated Confirmation Transaction ServiceSM (ACTSM) and incorrectly reported third market transactions with the improper order entry/market maker designation by the "give up" reporting side executing dealer. The findings also stated that the firm failed to establish, maintain, and enforce adequate written supervisory procedures with respect to its limit order activity.

Needham & Company, Inc. (New York, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanction and to

the entry of findings that it was a registered market maker in securities, was presented orders at its published bid or offer, and failed to execute the orders, thereby failing to honor its published quotation. The findings also stated that the firm failed to maintain and enforce written supervisory procedures reasonably designed to achieve compliance with the applicable securities laws and regulations concerning the SEC Firm Quote Rule and other related rules.

Troster Singer Corp., A Division of Spear, Leeds & Kellogg (Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it was a registered market maker in securities, was presented orders at its published bid or offer, and failed to execute the orders, thereby failing to honor its published quotation. The findings also stated that the firm failed to maintain and enforce written supervisory procedures reasonably designed to achieve compliance with the applicable securities laws and regulations concerning the SEC Firm Quote Rule and other related rules.

Individuals Barred Or Suspended
Edwin Aponte (Registered Representative, Yonkers, New York) submitted an Offer of Settlement pursuant to which he was fined \$5,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Aponte consented to the described sanctions and to the entry of findings that he changed a public customer's address to Aponte's sister-in-law's address, forged the customer's name on a surrender of policy form, and received a \$565.74 check representing the surrender value of the customer's policy. The

NASD found that Aponte forged the customer's endorsement to the check, negotiated the check, and converted the funds for his own personal use. The findings also stated that Aponte failed to disclose on a Form U-4 that he was the subject of a consumer-initiated complaint.

John R. Atchley (Registered Representative, Belle Chasse, Louisiana) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$25,000 and suspended from association with any NASD member in any capacity for two weeks (deemed served). Without admitting or denying the allegations, Atchley consented to the described sanctions and to the entry of findings that, at the request of a public customer, he deposited \$189,211.37 of the public customer's funds into his personal checking and securities accounts, used the funds to purchase bearer bonds on behalf of the customer, and in doing so, falsified his member firm's books and records in that he concealed the true identity of the purchaser of the bonds.

Glenn E. Backus (Registered Representative, Alexandria, Virginia) submitted an Offer of Settlement pursuant to which he was fined \$100,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Backus consented to the described sanctions and to the entry of findings that he recommended purchase and sales transactions to public customers without having reasonable grounds for believing such recommendations were suitable for the customers taking into consideration their other security holdings, financial situations, and needs and in view of the frequency and nature of the transactions and Backus' improper short selling and excessive use of margin in the customers' accounts. The findings also stated that Backus

executed unauthorized trades in a customer's accounts and improperly exercised discretion over customer accounts without their prior authorization. Furthermore, the NASD found that Backus failed to disclose to a customer the risks associated with trading on margin and short selling, and improperly misrepresented to the customer that the customer's monies were invested in municipal bonds when they were not.

Vincent E. Barborka (Registered Representative, Midvale, Utah) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$500,000, barred from association with any NASD member in any capacity, and required to pay \$97,592.33 in restitution to a customer. Without admitting or denying the allegations, Barborka consented to the described sanctions and to the entry of findings that he forged the signature of a public customer on several life insurance surrender forms, change of ownership forms, and loan request forms, and then forged the customer's signature on the checks issued as a result of the forged forms and endorsed the checks to himself. The NASD found that, as a result of this, Barborka converted at least \$97,592.33 to his control and used those monies for personal purposes.

Ira Warren Bassin (Registered Principal, Plainview, New York) submitted an Offer of Settlement pursuant to which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Bassin consented to the described sanctions and to the entry of findings that he failed to respond timely to NASD requests for information.

Mark A. Bavosa (Registered Representative, Boynton Beach, Florida) submitted an Offer of Settlement

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, Bavosa consented to the described sanctions and to the entry of findings that he signed a customer's name to disbursement request forms and a disbursement check relating to an insurance policy owned by the customer without the customer's knowledge or authorization. The findings also stated that Bavosa failed to respond to an NASD request for information.

Charles Sung Beck (Registered Representative, Chino Hills, California) and **Paul Mitchell Curtis (Registered Representative, Los Angeles, California)**. Beck submitted an Offer of Settlement pursuant to which he was fined \$5,000 and suspended from association with any NASD member in any capacity for eight months. In a separate decision, Curtis was fined \$50,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Beck consented to the described sanctions and to the entry of findings that Beck and Curtis participated in private securities transactions and failed to provide prior written notice to their member firms describing in detail the proposed transactions and their proposed role therein, and stating whether they had received or may receive selling compensation in connection with the transactions. Curtis also failed to respond to NASD requests for information.

Daniel Beimel (Registered Principal, New Kensington, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined \$100,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Beimel consented to the described sanctions and to the entry of findings that, in conduct

toward public customers, he disregarded his duty of fair dealing with customers and disregarded his duty to research securities recommended to customers. The NASD also found that Beimel misled the customers by making material misrepresentations, including priced predictions, and omitted material negative information during the offer, purchase, and sale of securities. Furthermore, the findings stated that Beimel effected transactions in securities for customers' accounts without their prior authorization or consent.

R. Scott Bennett (Registered Representative, Richmond, Virginia) 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, Bennett consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Jeffrey D. Berkoff (Registered Representative, Jupiter, Florida) submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Berkoff consented to the described sanction and to the entry of findings that he participated in outside business activities and failed to notify his member firm.

Miriam R. Black (Registered Representative, Denver, Colorado) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined \$10,000, suspended from association with any NASD member in any capacity for one year, and ordered to disgorge \$9,015 in commissions. Without admitting or denying the allegations, Black consented to the described sanctions and to the entry of findings

that she recommended and effected mutual fund switches for the accounts of five public customers that were not suitable based on their financial situation and needs.

Robert W. Campbell, Jr. (Registered Representative, Tucker, Georgia) was fined \$5,000, suspended from association with any NASD member in any capacity for six months, and ordered to requalify by exam as an investment company and variable contracts products representative. The sanctions were based on findings that Campbell signed the name of a public customer to an investor disclosure form without the customer's knowledge or authorization.

Peter Casali (Registered Representative, Bronx, New York) was fined \$30,000, barred from association with any NASD member in any capacity, and required to pay \$3,882.81 plus interest in restitution to a customer. The sanctions were based on findings that Casali received a \$4,400 check from a public customer intended as an insurance policy payment, deposited the check in a personal account, made an initial insurance payment of \$517.19, and converted the remaining \$3,882.81 for his own use and benefit. Casali also failed to respond to NASD requests for information.

James Anthony Contacessa (Registered Representative, Glen Head, New York) was fined \$50,000, barred from association with any NASD member in any capacity, and ordered to disgorge \$239,835.95. The sanctions were based on findings that Contacessa arranged to have an impostor take the Series 7 exam on his behalf. Contacessa also failed to respond to NASD requests for information.

Harold Davlin (Registered Representative, Washington, D.C.) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$70,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Davlin consented to the described sanctions and to the entry of findings that he provided general subscriber information to other persons, which those persons subsequently used improperly to participate in a conversion of the mutual shares of a savings bank to the common stock of a holding company. The NASD found that these persons improperly executed stock order forms in the names of the actual depositors, participated in the conversion, and had the opportunity to profit when the trading of the common stock opened for secondary trading. The NASD determined that these persons provided two checks to Davlin totaling \$785.34, issued in the names of two bank depositors whose names were signed without their authorization, and that Davlin deposited the checks into his bank account for his own use and benefit. The findings also stated that Davlin failed to respond to an NASD request to appear for an on-the-record interview.

Dominick Salvatore DeLorenzo (Registered Representative, Brooklyn, New York) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that DeLorenzo failed to respond to NASD requests for information.

Joseph F. DeSanto (Registered Principal, Hillsboro Beach, Florida) and **Robert B. DiMarco, Jr. (Registered Principal, Boca Raton, Florida)** submitted an Offer of Settlement pursuant to which they were fined \$60,000, jointly and severally, suspended from association with any NASD member in any principal or

supervisory capacity for three years, and required to requalify by exam as general securities sales representatives. In addition, DiMarco was suspended from association with any NASD member in any capacity for one year and DeSanto was suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that a member firm, acting through DiMarco and DeSanto, carried an inventory position, the value of which was greater than 50 percent of the firm's previous month's excess net capital by amounts ranging from approximately \$1.5 million to \$10.8 million, in violation of the firm's restrictive agreement.

Rene DeScartin (Registered Representative, Houston, Texas) 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, DeScartin consented to the described sanctions and to the entry of findings that he forged policyholder signatures and misappropriated \$6,750.20.

James W. DiBella, Jr. (Registered Representative, Marlton, New Jersey) submitted an Offer of Settlement pursuant to which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, DiBella consented to the described sanctions and to the entry of findings that he recommended and effected the purchase of securities in the account of a public customer without having reasonable grounds to believe the recommendations were suitable for the customer. The findings also stated that, in inducing and effecting purchases, DiBella engaged in

deceptive and/or fraudulent devices or practices, made false and misleading statements of material facts, and/or failed to disclose material facts about the stock. Furthermore, the NASD determined that DiBella effected unauthorized transactions in a customer's account.

DiBella's suspension began September 15, 1997 and concludes October 14, 1997.

Michael R. Euripides (Registered Representative, Virginia Beach, Virginia) was fined \$5,000, required to pay \$15,488.92 plus interest in restitution, suspended from association with any NASD member in any capacity for 60 days, and required to requalify by exam as a general securities representative. The NBCC affirmed the sanctions following appeal of a Washington DBCC decision. The sanctions were based on findings that Euripides made unsuitable recommendations to a public customer regarding the purchase of stock, and made misrepresentations and omissions of material facts in the sale of securities to the customer. Euripides also executed unauthorized transactions in the account of a public customer.

Cameron Freeland Evans (Registered Representative, Manhattan Beach, California) was fined \$750,000, barred from association with any NASD member in any capacity, and ordered to pay \$150,000 in restitution to a public customer. The sanctions were based on findings that Evans converted \$150,000 from a public customer intended for investment purposes without the knowledge or consent of the customer.

Hubert L. Ford (Registered Representative, Wilmington, Delaware) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were

based on findings that Ford failed to respond to NASD requests for information.

Michael A. Furr (Registered Representative, Lake Forest, California) was fined \$270,000, barred from association with any NASD member in any capacity, and ordered to pay \$42,500 in restitution to a public customer. The sanctions were based on findings that Furr received \$50,000 from a public customer for investment purposes and failed to deposit the funds into a securities account. Instead, Furr deposited the funds into a bank account and improperly used the funds. Furr also failed to respond to NASD requests for information.

John Nicholas Giartonia, III (Registered Representative, Aurora, Illinois) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$210,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Giartonia consented to the described sanctions and to the entry of findings that he received from public customers checks totaling \$22,000 intended for the purchase of a life insurance policy and for investment purposes. The NASD found that Giartonia cashed the checks, deposited the funds in an account in which he had a beneficial interest, and used the funds for some purpose other than for the benefit of the customers.

Robert E. Hines (Registered Representative, Brooklyn, New York) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Hines failed to appear and provide testimony and to respond to an NASD request for information.

Charles M. Hogan (Registered Representative, Winston-Salem, North Carolina) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was suspended from association with any NASD member in any capacity for five business days and required to disgorge \$187.50 to the NASD. Without admitting or denying the allegations, Hogan consented to the described sanctions and to the entry of findings that he purchased shares of stock that traded at a premium in the immediate aftermarket in violation of the Board of Governors' Free-Riding and Withholding Interpretation. Furthermore, the NASD found that Hogan failed to notify his current member firm of the existence of an account with another member firm and failed to advise his former member firm that he had become associated with his current member firm.

Timothy P. Kelly (Registered Representative, Longwood, Florida) submitted an Offer of Settlement pursuant to which he was fined \$7,000, suspended from association with any NASD member in any capacity for 30 days, and further suspended until he requalifies by exam. Without admitting or denying the allegations, Kelly consented to the described sanctions and to the entry of findings that he functioned as a general securities representative, and made at least two sales of investment company securities to public customers when he was not registered with the NASD. The findings also stated that Kelly failed to disclose a four percent sales charge (front-end load) on the purchase of investment company securities to customers.

Alan Krouk (Registered Representative, Jamesburg, New Jersey) 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 registered

capacity for five years. Without admitting or denying the allegations, Krouk consented to the described sanctions and to the entry of findings that he received funds from certain customers in payment of insurance policy premiums, and caused the funds to be applied and credited in payment of other customers' policies for which payment was due but had not been received. The NASD determined that thereafter, when funds were received from customers whose policies had been improperly credited, Krouk caused those customers' funds to be credited to policies of customers whose funds had been previously misapplied.

Alan J. LaCava (Registered Representative, Philadelphia, Pennsylvania) was fined \$15,000, suspended from association with any NASD member in any capacity for 30 days, and ordered to requalify as a general securities representative. The sanctions were based on findings that LaCava recommended to public customers, and effected in their accounts, the purchases of securities without having reasonable grounds to believe that securities he recommended were suitable for the customers. Furthermore, the NASD determined that, in inducing and effecting the purchases, LaCava intentionally, recklessly, or negligently engaged in deceptive and/or fraudulent devices or practices, made false and misleading statements of material facts, and/or failed to disclose material facts. The findings also stated that LaCava effected unauthorized transactions in a customer's account.

Wade S. Lawson (Registered Representative, West Hollywood, California) was fined \$57,500, barred from association with any NASD member in any capacity, and required to pay \$100,000 in restitution to a public customer. The sanctions were based on findings that Lawson recommended and engaged in a private

securities transaction without prior written notice to and approval from his member firm. Furthermore, Lawson recommended and engaged in a purchase transaction on behalf of a public customer without having reasonable grounds for believing that this recommendation and the resultant transaction were suitable for the customer on the basis of his age, financial situation, objectives, and needs. Lawson also engaged in the sale of unregistered securities to a public customer.

Albert E. Lee (Registered Representative, Decatur, Georgia) was fined \$25,000, barred from association with any NASD member in any capacity, and ordered to pay \$706.91 in restitution. The sanctions were based on findings that Lee received cash payments totaling \$706.91 from public customers intended as insurance policy premium payments, failed to remit the payments to his member firm, and converted the funds to his own use and benefit. Lee also failed to respond to an NASD request for information.

Deborah L. Leonard (Registered Representative, Muncy, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined \$20,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Leonard consented to the described sanctions and to the entry of findings that she failed to respond fully to NASD requests for information.

Gerard H. Lilley (Registered Representative, Chandler, Arizona) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$25,000, barred from association with any NASD member in any capacity, and required to pay \$5,031.35 in restitution to a customer. Without admitting or deny-

ing the allegations, Lilley consented to the described sanctions and to the entry of findings that he received from a public customer a \$4,700 check made payable to him intended for investment purposes. The NASD found that Lilley deposited the funds into his personal account, used the fund for his own benefit, and misled the customer to believe the funds were invested.

Harold A. Litwin (Registered Principal, Miami Beach, Florida) submitted an Offer of Settlement pursuant to which he was fined \$7,500, suspended from association with any NASD member in any principal or supervisory capacity for two years, and barred from association with any NASD member as a financial and operations principal. In addition, Litwin was fined \$5,000, jointly and severally with a member firm. Without admitting or denying the allegations, Litwin consented to the described sanctions and to the entry of findings that a member firm, acting through Litwin, failed to pay an arbitration award and conducted a securities business while failing to maintain its minimum required net capital. The findings also stated that a member firm, acting through Litwin, failed to maintain complete, current, and accurate books and records, and filed false and inaccurate FOCUS Part I and IIA reports. Furthermore, the NASD determined that Litwin functioned as a financial and operations principal at a member firm without being registered as such. The NASD also found that a member firm, acting through Litwin, effected customer sales of municipal bonds without having a registered municipal securities principal as required by MSRB Rules G-2 and G-3 and in violation of the firm's restriction agreement with the NASD.

Samuel J. Lopez (Registered Representative, Denver, Colorado) submitted a Letter of Acceptance,

Waiver and Consent pursuant to which he was fined \$110,000, barred from association with any NASD member in any capacity, and required to pay \$10,000 in restitution to a customer. Without admitting or denying the allegations, Lopez consented to the described sanctions and to the entry of findings that he received \$20,000 from public customers for investment purposes, deposited the funds into a bank account under his control, and used the funds for his benefit. The findings also stated that Lopez prepared and delivered a document purporting to confirm to a public customer that the customer had purchased shares of an annuity when no such purchase had been made. Furthermore, the NASD found that Lopez presented to his member firm copies of checks purporting to represent the reimbursement of funds to customers when he knew the checks were drawn on an account that lacked sufficient funds.

Stephen F. Maertzig, Sr. (Registered Representative, Philadelphia, Pennsylvania) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Maertzig failed to respond to NASD requests for information.

Patrick Wayne Maloy (Associated Person, Kingfisher, Oklahoma) was fined \$55,000, barred from association with any NASD member in any capacity, and ordered to pay \$25,430 in restitution to a customer. The sanctions were based on findings that Maloy was actively engaged in the management of the securities business of a member firm without being registered as a principal of the firm. Maloy also provided a written guarantee against loss to a customer and failed to respond to NASD requests for information.

Leonard Van McLendon, Jr. (Registered Representative, San Juan Capistrano, California) was fined \$175,000, barred from association with any NASD member in any capacity, and ordered to pay \$27,000 in restitution to customers. The sanctions were based on findings that McLendon received checks totaling \$27,000 from public customers for investment purposes and, instead, cashed the checks and converted the funds. McLendon also failed to respond to NASD requests for information.

Julio C. Meade (Registered Representative, Centreville, Virginia) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Meade consented to the described sanctions and to the entry of findings that he participated in private securities transactions while failing to provide prior written notice to his member firms of his participation in such transactions.

Meade's suspension begins on October 4, 1997 and will conclude on November 2, 1997.

Patricia A. Means (Registered Representative, Justice, Illinois) submitted an Offer of Settlement pursuant to which she was fined \$10,000, barred from association with any NASD member in any capacity, and required to pay \$645 in restitution. Without admitting or denying the allegations, Means consented to the described sanctions and to the entry of findings that she submitted a false life insurance application and a \$300 money order to an affiliate of her member firm, thereby causing the firm to pay her \$945 in commissions to which she was not entitled.

Lawrence M. Mosko (Registered Representative, Naperville, Illinois) was fined \$22,500 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Mosko prepared and delivered to public customers sales literature without obtaining prior approval by a registered principal of his member firms. Mosko also failed to respond to NASD requests for information.

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

Thomas A. Ortwein (Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$25,000, suspended from association with any NASD member in any capacity for 10 business days, and suspended from association with any NASD member in any supervisory capacity for three months (suspensions served). Without admitting or denying the allegations, Ortwein consented to the described sanctions and to the entry of findings that he attempted to affect the closing price of a stock by entering a trade on behalf of a public customer at a time when he knew that the transaction was not a bona fide customer order and, in fact, was done without the customer's prior knowledge, authorization, or consent. The findings also stated that Ortwein executed a purchase transaction on behalf of a customer account without the customer's prior knowledge and/or written authority.

Philip A. Palarchio (Registered Representative, Haslett, Michigan) submitted a Letter of Acceptance, Waiver and Consent pursuant to

which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Palarchio consented to the described sanction and to the entry of findings that he requested that his member firm issue checks totaling \$74,098.23 to public customers who maintained life insurance policies with his member firm; obtained, endorsed, and deposited the checks in his personal bank account; and used the funds for some purpose other than the benefit of the customers, without the customers' knowledge or consent.

Richard S. Pearl (Registered Principal, Pembroke Pines, Florida) submitted an Offer of Settlement pursuant to which he was fined \$15,000 and suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, Pearl consented to the described sanctions and to the entry of findings that he recommended to a public customer a course of trading including short-term stock trading, the purchase and sale of listed options, margin trading, and short selling, without having a reasonable basis for believing that such trading was suitable for the customer.

Richard B. Perry (Registered Representative, Southampton, Pennsylvania) submitted an Offer of Settlement pursuant to which he was fined \$1,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Perry consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Eric Dean Pokross (Registered Representative, Valley Stream, New York) was fined \$20,000 and barred from association with any NASD member in any capacity. The

sanctions were based on findings that Pokross failed to respond to NASD requests to appear for an on-the-record interview.

Jeffrey Pokross (Registered Principal, New York, New York) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Pokross failed to respond to NASD requests to appear for an on-the-record interview.

Alan E. Pomeranz (Registered Representative, Boca Raton, Florida) submitted an Offer of Settlement pursuant to which he was fined \$50,000, required to disgorge \$302,748 in commissions to customers, and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Pomeranz consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written notice to or obtaining approval from his member firm regarding the transactions.

Bobby L. Porter (Registered Representative, Palm Harbor, Florida) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Porter failed to respond to NASD requests for information.

John Ranay (Registered Representative, Englewood, Colorado) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. Without admitting or denying the allegations, Ranay consented to the described sanctions and to the entry of findings that he submitted a Form U-4 that contained

false and incomplete information.

Michael Shane Rummel (Registered Representative, Evansville, Indiana) submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Rummel consented to the described sanction and to the entry of findings that he completed and submitted to his member firm a request for the withdrawal of \$7,500 from a public customer's money market fund without the customer's knowledge, consent or authorization and in the absence of written or oral authorization to Rummel to exercise discretion in the account. Furthermore, the NASD found that Rummel caused a customer to issue a \$7,500 check to him by claiming that a previous withdrawal check the customer received was issued in error, and without the customer's knowledge or consent, negotiated the check and used the funds for some purpose other than for the benefit of the customer.

Jan Sanders (Registered Representative, Lake Forest, California) was fined \$29,240, suspended from association with any NASD member in any capacity for 30 days, and required to requalify by exam as a general securities representative. The sanctions were based on findings that Sanders recommended to a public customer the purchase and sale of securities without having reasonable grounds for believing the recommendations were suitable for the customer in view of the size, frequency and nature of the recommended transactions, and the facts disclosed by the customer as to his other securities holdings, financial situation, circumstances, and needs.

Jerome Neal Schneider (Registered Principal, Vancouver, British Columbia) and **Peter Alan Provence (Registered Principal, Pasadena, California)** submitted an Offer of Settlement pursuant to which Schneider was fined \$32,000 and suspended from association with any NASD member in any capacity for 30 days. Provence was fined \$10,000 and suspended from association with any NASD member in any capacity for five days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Schneider, exercising discretion granted pursuant to oral and written authority, implicitly recommended transactions for the account of a public customer that were unsuitable for the customer in light of the size and frequency of the transactions, including the use of margin, in view of the financial resources and character of the account, the customer's other security holdings, and financial situation and needs.

The findings also stated that Schneider submitted a Form U-4 to the NASD that failed to disclose a customer complaint. Furthermore, the NASD determined that Provence failed to supervise properly and adequately Schneider's activities to assure compliance with the NASD Conduct Rules in that, among other things, Provence failed to adequately review and monitor the discretionary trading activity in a customer's account to detect and prevent transactions that were excessive in size or frequency in view of the financial resources and character of the account. The NASD also found that Schneider and Provence failed to establish adequate written or unwritten procedures to carry out supervision of discretionary trading, as engaged in by Schneider, to ensure his compliance with the applicable Conduct Rules.

Robert F. Scholl, Jr. (Registered Representative, Atlanta, Georgia) was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Scholl failed to respond to NASD requests for information.

James Kenneth Smith (Registered Representative, Ypsilanti, Michigan) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$5,000, barred from association with any NASD member in any capacity, and required to pay \$627.97 in restitution to a member firm. Without admitting or denying the allegations, Smith consented to the described sanctions and to the entry of findings that he requested a member firm to withdraw and issue a check in the amount of \$627.97 from public customers' securities account, obtained and endorsed the check, and deposited it in his bank account without the knowledge or consent of the customers.

Robert L. Swick (Registered Representative, Towson, Maryland) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$50,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Swick consented to the described sanctions and to the entry of findings that he forged the signatures of policyholders on takeover request forms and letters requesting he be assigned as agent of record for their policies.

Arthur W. Taylor (Registered Representative, Phoenix, Arizona) submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Taylor consented to the described

sanction and to the entry of findings that he completed a Form U-4 that failed to disclose SEC injunctive proceedings and a Consent Order.

Steven M. Usarzewicz (Registered Representative, Hamilton, New Jersey) submitted an Offer of Settlement 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, Usarzewicz consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Robert Wayne Vallair (Registered Principal, Houston, Texas) was fined \$5,000, suspended from association with any NASD member in any capacity for five business days, and required to requalify by exam. The sanctions were based on findings that Vallair engaged in outside business activities without notifying his member firm.

Lance E. Van Alstyne (Registered Representative, Laguna Niguel, California) was fined \$95,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Van Alstyne engaged in the management of the securities business of a member firm without being registered as a principal of the firm. Furthermore, Van Alstyne offered and sold securities to public customers for which a registration statement was not filed and in effect with the SEC and for which no exemption was applicable. In addition, Van Alstyne failed to respond to NASD requests for information and to appear for an on-the-record interview.

Carl Julius Winkler, III (Registered Representative, Carmel, Indiana) was fined \$5,745,395.50, barred from association with any

NASD member in any capacity, and ordered to pay \$1,145,079.10 in restitution to the appropriate parties. The sanctions were based on findings that Winkler obtained \$1,160,079.10 by requesting from his member firm withdrawals from annuity accounts and insurance policies of public customers and soliciting premium payments and, without the knowledge or consent of the customers, deposited the funds into a bank account he owned and controlled, and used the money for some purpose other than for the benefit of the customers. Winkler also failed to respond to NASD requests for information.

Kimberly Lynn Woodward (Registered Representative, Chandler, Arizona) submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined \$200,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Woodward consented to the described sanctions and to the entry of findings that she converted to her own use monies totaling \$195,543.09 from the account of a public customer. The findings also stated that Woodward created falsified statements for a mutual fund, purporting to show that the monies had been deposited into that fund in the customer's name when, in fact, the funds were deposited into checking accounts she controlled.

Fusung Peter Wu (Registered Principal, Plano, Texas) submitted an Offer of Settlement pursuant to which he was fined \$2,000, jointly and severally, with a member firm, suspended from association with any NASD member in any capacity for 60 days, required to requalify by exam prior to associations with any NASD member in a principal capacity, and required to file advertisements with the NASD at least 10 days prior to use for two years. Without admitting or denying the allegations, Wu

consented to the described sanctions and to the entry of findings that a member firm, acting through Wu, failed to file advertisements with the NASD at least 10 days prior to use. The findings also stated that a member firm, acting through Wu, published an advertisement reflecting recommendations relating to specific securities that omitted material facts and/or qualifications, causing the advertising to be misleading. Furthermore, the NASD found that a member firm, acting through Wu, published and/or caused to be published, advertisements that reflected recommendations relating to specific securities and corporate equities without providing, or offering to furnish upon request, available information supporting the recommendation and failed to reflect the price at the time the recommendation was made.

James Wallace Wullschleger (Registered Representative, Piedmont, California) submitted an Offer of Settlement pursuant to which he was fined \$6,300 and suspended from association with any NASD member in any capacity for 30 days (suspension deemed served). Without admitting or denying the allegations, Wullschleger consented to the described sanctions and to the entry of findings that he sold limited partnerships to public customers while misrepresenting the liquidity and safety of the securities, and the risk of the investments. The findings also stated that Wullschleger sold limited partnership interests to customers that were unsuitable for the customers based upon the facts disclosed by them as to their other security holdings and their financial situations and needs.

Individuals Fined

Michael E. Ellis (Registered Principal, Jackson, Mississippi) submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was

fined \$35,000 and required to participate in a compliance conference conducted by the NASD and to undergo training specifically designed to address his supervision of his firm's mutual funds sales activities, as a portion of the firm element of his firm's Continuing Education Program. Without admitting or denying the allegations, Ellis consented to the described sanctions and to the entry of findings that he solicited and failed to return \$41,699 to various mutual fund companies representing funds paid by the mutual fund companies in excess of the costs of sponsoring an educational meeting. Furthermore, the NASD found that Ellis did not obtain from his member firm advance written approval for a meeting in accordance with firm procedures, and retained possession of a \$5,000 check received from a mutual fund company that was erroneously deposited into his personal cash management account.

Leonard John Ialeggio (Registered Representative, Danville, California) was fined \$15,000 and ordered to requalify by exam as a general securities representative. The NBCC imposed the sanctions following a remand as to sanctions from the SEC. The sanctions were based on findings that Ialeggio submitted expense vouchers to his member firm's parent company and received payment for travel expenses totaling \$9,868.50, to which he was not entitled. Ialeggio also induced the company to pay \$35,000 for his country club dues, a payment to which he was not entitled.

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

Decisions Issued

The following decisions have been issued by the DBCC and have been appealed to the NBCC as of September 29, 1997. The findings and sanctions imposed in the decision may be increased, decreased, modified, or reversed by the NASD. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

Thomas J. Karem (Registered Principal, Louisville, Kentucky)

was fined \$100,000, suspended from association with any NASD member in any capacity for two weeks, and required to requalify by exam as a general securities representative. The sanctions were based on findings that Karem recommended and engaged in securities transactions in the account of a public customer without having reasonable grounds for believing that these recommendations and resultant transactions were suitable for the customer on the basis of her financial situation, investment objectives, and needs. In addition, Karem engaged in a pattern of trading in the customer's account that resulted in a concentration of stock in the customer's account that ranged from 7.61 to 100 percent of the value of her portfolio. Furthermore, Karem 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.

Karem has appealed this action to the NBCC and the sanctions are not in effect pending consideration of the appeal.

Steven Alan Vejraska (Registered Representative, Bellevue, Washington) was fined \$10,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Vejraska submitted a Form U-4 that

contained false and misleading information.

Vejraska has appealed this action to the NBCC and the sanctions are not in effect pending consideration of the appeal.

Complaints Filed

The following complaints were issued by the NASD. Issuance of a disciplinary complaint represents the initiation of a formal proceeding by the NASD in which findings as to the allegations in the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding the allegations in the complaint.

Cindy R. Kolb (Registered Principal, San Marcos, Texas)

was named as a respondent in an NASD complaint alleging that she engaged in a course of business that operated as a fraud or deceit and constituted the use of devices, schemes, or artifices to defraud. Kolb is also alleged to have converted approximately \$357,000 from three public customers. In addition, Kolb allegedly forged customers' signatures to wire transfer letters of authorization and effected discretionary securities transactions in the accounts of public customers without having obtained written acceptance of the account as discretionary by her employer member firm. Further, Kolb is alleged to have engaged in excessive and unsuitable trading in four public customers' accounts, in that the size and frequency of such trading was excessive and unsuitable for the customers on the basis of their financial situation, investment objectives, and needs.

Douglas Magnuson (Registered Representative, Lindenhurst, New York) was named as a respondent in an NASD complaint alleging that he made material misrepresentations and omissions and fraudulent price predictions in soliciting customers to purchase securities. Magnuson is also alleged to have engaged in unauthorized trading in customer accounts, and failed to follow instructions of his customers to sell securities when told to do so.

Francisco A. Pimentel (Registered Representative, Brentwood, New York)

was named as a respondent in an NASD complaint alleging that he made material misrepresentations and fraudulent price predictions in soliciting a customer to purchase securities. Pimentel is also alleged to have failed to provide truthful on-the-record testimony to the NASD.

Michael Sabato (Registered Representative, Lindenhurst, New York)

was named as a respondent in an NASD complaint alleging that he made material misrepresentations and omissions and fraudulent price predictions in soliciting customers to purchase securities. Sabato is also alleged to have failed to follow instructions of one of his customers to sell securities when told to do so.

Wyder L. Tutiven (Registered Representative, Patchogue, New York)

was named as a respondent in an NASD complaint alleging that he made material misrepresentations and omissions and fraudulent price predictions in soliciting customers to purchase securities. Tutiven is also alleged to have engaged in unauthorized trading in a customer account, and failed to follow instructions of a customer to sell securities when told to do so.

Michael A. Woloshin (Registered Representative, Medford, New Jersey) was named as a respondent in an

NASD complaint alleging that he recommended to a public customer a series of purchases and sales of securities without having a reasonable basis to believe the recommendations were suitable for the customer.

Firm Expelled For Failure To Pay Fines, Costs And/Or Provide Proof Of Restitution In Connection With Violations Brooklyn, Capital & Securities Trading, Inc., Brooklyn, New York

Firms Suspended

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of NASD Rule 8120 and Article VII, Section 2 of the NASD By-Laws. The date the suspensions commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

BG Capital, Inc., Syosset, New York (September 3, 1997)

Gateway Capital Investment Group, Inc., Jersey City, New Jersey (September 3, 1997)

Neo-Strategies Marketing Alliances, Inc., Dallas, Texas (September 3, 1997)

Nova Financial, Inc., Dallas, Texas (September 3, 1997)

Sintra Financial Services, Inc., La Jolla, California (September 3, 1997 to September 10, 1997)

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

Michael V. Eaton, Tewksbury, Massachusetts

Thomas R. Garcia, Grand Prairie, Texas

Craig S. Gioia, Highland, New York

Gary A. Hill, Rio Rancho, New Mexico

Raymond R. India, Chicago, Illinois

Bennett L. Jones, Bedford, Texas

Robert J. Lancellotti, Valley Cottage, New York

Edward A. McKay, Jr., New York, New York

Eric C. Noe, Denver, Colorado

Steven F. Perdie, Port Jefferson Station, New York

David Rybstein, Brooklyn, New York

David J. Yorwerth, Stamford, Connecticut

NASD Regulation Disciplinary Committee Bars La Jolla Capital From Penny Stock Transactions; Orders Fines And Restitution Of More Than \$950,000

NASD Regulation, Inc., announced that its Los Angeles District Business Conduct Committee (DBCC) has ordered that San Diego-based La Jolla Capital Corp. be permanently barred from selling penny stocks and that five of its senior officials should be sanctioned for circumventing the penny stock rules. Penny stocks are unlisted securities that trade over-the-

counter and are priced under \$5 per share.

As a result of a 16-day hearing by the DBCC, La Jolla Capital and its President Harold B.J. Gallison were fined more than \$400,000 and are jointly responsible for repaying more than 100 investors from 26 states, the District of Columbia, and British Columbia almost \$400,000. The remaining four senior officials were fined a total of more than \$150,000.

Initial actions, such as this, by an NASD Regulation District Committee are final after 45 days, unless they are appealed to NASD Regulation's National Business Conduct Committee (NBCC), or called for review. The sanctions are not effective during this period.

The decision in this case has been appealed to the NBCC, and the findings may be increased, decreased, modified, or reversed.

The sales practice abuses at La Jolla Capital were uncovered after a lengthy investigation by NASD Regulation's District Offices in Los Angeles, San Francisco, and Denver. The DBCC found that from January 1994 through May 1995, La Jolla Capital and certain senior officials circumvented investor protection laws in approximately 140 transactions involving 15 separate securities. All of the transactions involve penny stocks.

The violations occurred at La Jolla Capital's offices in San Diego, CA; New York, NY; Las Vegas, NV; Bethesda, MD; and Modesto, CA.

The following senior officials were sanctioned:

Harold B.J. Gallison, President, and La Jolla Capital were fined a total of \$401,380. He was also suspended in all capacities for 30 days; permanent-

ly barred from participating in penny stock transactions; permanently barred from acting as a supervisor; and censured.

Robert C. Weaver, Executive Vice President and Chief Legal Counsel, was fined \$25,000; suspended as a supervisor for 15 business days; ordered to retake the qualifying examination to become a supervisor, and censured.

Gregory K. Mehlmann, National Branch Compliance Officer, was fined \$10,000; suspended as a supervisor for 10 business days; ordered to retake the qualifying examination to become a supervisor; and censured.

Christopher S. Knight, Branch Manager, was fined \$120,854; permanently barred from acting as a supervisor; permanently barred from participating in penny stock transactions; and censured.

Gerald J.R. Budke, Branch Manager, was fined \$5,150; suspended from participating in penny stock transactions for one year; ordered to retake

the qualifying examination to become a supervisor; and censured.

Gallison, Weaver, and Budke are still employed by La Jolla Capital.

The 15 securities involved and sold by La Jolla Capital were: Affordable Housing Constructors, Inc.; Ambra Royalty, Inc.; Drucker Industries, Inc.; Environmental Recovery Systems, Inc.; Exten Industries, Inc.; HEARx Limited; InfoServe, Inc.; Interactive Telesis, Inc. (formerly known as INN Investment News Network Limited); Largo Vista Group Ltd.; Longport, Inc.; Modern Records, Inc.; Peppermint Park Productions, Inc.; Photo Acoustic Technology, Inc.; Quadratech, Inc.; and XO Corp. There is no allegation that the affected companies knew of, or were involved in, these violations.

The DBCC found that La Jolla Capital designed a system to circumvent the Securities and Exchange Commission's (SEC) strict penny stock rules, which ensure that investors receive honest and candid information about risk disclosure and suit-

ability issues before they invest. La Jolla Capital had investors sign a misleading document that purported to exempt the transactions from the penny stock rule requirements. The letters were portrayed to investors as a "formality," and in some cases investors' signatures were forged. La Jolla also was found to have implemented misleading and deficient supervisory policies and procedures designed to foster the improper claim of this exemption.

Between February 1996 and October 1996, 22 other La Jolla Capital brokers and supervisors, without admitting or denying liability, were fined and disciplined in connection with this case. La Jolla Capital employs 140 brokers in 11 offices in California, New York, Georgia, Utah, Nevada, and Texas.

The DBCCs are comprised of elected representatives from the securities industry who serve three-year terms.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

FOR YOUR INFORMATION

SEC Extends Arbitration Rules

On September 5, 1997, the Securities and Exchange Commission (SEC) approved a five-year extension of the rules governing large and complex cases in National Association of Securities Dealers, Inc. (NASD[®]) arbitration—Rule 10334 of the NASD Code of Arbitration Procedure (Code)—to August 1, 2002. In addition to extending the rules for five years, the rule was amended to make its application entirely voluntary. Prior to the change, the parties in any case involving more than \$1 million in dispute were required to participate in an Administrative Conference to discuss whether the case would be administered under the Procedures for Large and Complex Cases or under the regular procedures of the Code. Under the amended rule, participation in the Administrative Conference will be voluntary.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.

SPECIAL NASD NOTICE TO MEMBERS 97-75

**Mail Vote—NASD Solicits
Member Vote On
Amendments To NASD
By-Laws To Reconfigure
NASD Board; Last Voting
Date: November 13, 1997**

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

The National Association of Securities Dealers, Inc. (NASD[®] or Association) invites members to vote to approve amendments to the NASD By-Laws intended to provide for a more efficient and effective corporate structure for the Association. The last voting date is November 13, 1997. The text of the proposed amendments follows this *Notice*. Questions concerning this *Notice* may be directed to T. Grant Callery, Senior Vice President and General Counsel, NASD, at (202) 728-8285.

Background

The proposed amendments are part of a comprehensive revision of the NASD, NASD Regulation, Inc., and The Nasdaq Stock Market, Inc., By-Laws intended to provide for a more efficient and effective corporate structure for the Association, to make the Association's corporate documents more consistent with one another, and to conform the corporate documents to the recently amended Code of Procedure and membership procedures. In particular, the proposed corporate structure is designed to streamline the decisionmaking process to be more responsive to investor interests; improve communication among Board members and the staff; enable the Association to act quickly and decisively when necessary; and preserve the principles set forth in the September 15, 1995, *Report of the NASD Select Committee on Structure and Governance to the NASD Board of Governors* (Select Committee Report) and undertakings agreed to as part of the Association's settlement with the Securities and Exchange Commission (SEC or Commission).¹

The text of the proposed rule change is attached as Attachment A. Proposed new language is underlined; proposed deletions are in brackets.

To achieve the corporate objectives set forth above, the Association will retain the current three-corporation structure, but reduce the overall number of board members for the three corporations. The Nasdaq[®] and NASD RegulationSM Boards will be smaller and become part of an expanded NASD Board.² As a result, the Association will reduce the overall number of board members from 49 to 27, reduce the number of board meetings from 17 to seven, and reduce the number of board committees from nine to five.

The NASD Board will consist of 21 to 27 Governors and include a nucleus of Governors who will not serve as directors on either subsidiary board. The subsidiary boards each will have five to eight Directors, all of whom will be NASD Governors. The number of directors on each subsidiary board will be equal, thereby enabling the nucleus of individuals who serve only as NASD Governors to perform a tie-breaking function on the parent board.

The NASD Board will retain its current authority to review and ratify or reject certain actions of the subsidiaries, although the process of exercising this authority will be expedited by transferring certain functions to new entities under each subsidiary board and changing several meeting schedules. First, the functions of the National Business Conduct Committee, a committee of the NASD Regulation Board composed entirely of Directors, will be transferred to a new entity, the National Adjudicatory Council, which will be appointed by the NASD Regulation Board after nomination by the National Nominating Committee. Similarly, the functions of the Nasdaq Listing and Hearing Review Committee will be transferred to a new Listing Council, whose members will be appointed by the Nasdaq Board after nomination

by the National Nominating Committee. Except for the Chair of the National Adjudicatory Council, members of the councils will not serve on any of the Association's boards. These new councils will meet at least 15 days before the subsidiary boards and will provide written reports of their decisions to their respective boards no later than 15 days before the subsidiary board meetings. The subsidiary board meetings then will be scheduled to occur one day before the meetings of the NASD Board. Although matters delegated to each subsidiary will, as a matter of general practice, be considered by the subsidiary boards before proceeding to the NASD Board, the time required for final disposition will be significantly reduced by these structural and scheduling changes. Under the current structure and meeting schedule, the subsidiaries may have to delay issuing disciplinary, listing, and other decisions and filing rule proposals with the Commission until a parent board meeting is held, which may occur several weeks after the subsidiary board takes action. This delay will be eliminated by the new corporate structure and meeting schedule.

In addition to compressing the time between subsidiary and parent board meetings, the structural refinements will facilitate other efficiencies because members of the revamped subsidiary boards will constitute a subset of NASD Board members. For example, an NASD Regulation rule amendment that clearly warrants consideration by the NASD Board can be taken directly to the NASD Board for action, avoiding the need for duplicative discussions of the same matter. The same will be true of rule amendments that require NASD Board review under the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries (Delegation Plan).³ Thus, action on significant or controversial matters

can be accomplished in one step, rather than the two steps that are currently required. Furthermore, because the Directors of both subsidiary boards will be Governors of the NASD Board, the consideration of matters at the NASD Board level always will have the benefit of subsidiary board participation.

To further expedite decisionmaking, the NASD Board will be specifically authorized by the Delegation Plan to take action on its own initiative. Thus, subsidiary board action on a matter within its sphere of delegated authority will not be a prerequisite to action by the NASD Board.

These changes are consistent with the core principles of corporate governance outlined in the Select Committee Report: maintaining a balanced governance structure, an independent corporate structure, an independent and autonomous operating structure, and a clear and distinct role for each corporation. The amended By-Laws maintain a balanced governance structure by providing for diversity among Industry Governors and Directors; by providing for a majority of Non-Industry Governors on the parent board, including at least five Public Governors; and by providing for at least 50 percent Non-Industry and Public Directors on the boards of each subsidiary. Maintaining two separate, wholly owned subsidiaries with their own Presidents ensures that independent corporate structures continue to exist. Preserving separate and independent professional staffs and substantial deference to the subsidiaries in their areas of jurisdiction reinforces an independent and autonomous operating structure. Finally, each corporation retains its clear and distinct role under the proposed rule change: the NASD continues to resolve conflicts between the subsidiaries and retain ultimate responsibility for statutory obligations, including its responsibilities as

a self-regulatory organization; NASD Regulation continues to regulate broker/dealers and supervise surveillance of Nasdaq and other over-the-counter markets; and Nasdaq continues to own and operate The Nasdaq Stock MarketSM and develop and implement rules governing that market.

The proposed corporate structure also is consistent with the undertakings set forth in the Association's August 8, 1996, settlement with the Commission. Specifically, the amended By-Laws ensure the balancing of the Association's boards and committees; place primary day-to-day responsibility for regulatory matters with NASD Regulation; provide for the autonomy and independence of the regulatory staff of the NASD and its subsidiaries; and ensure the existence of a substantial, independent internal audit staff that reports directly to an audit committee of the NASD Board.

Amendments To The NASD By-Laws

The expanded NASD Board will function much as it does today, with ultimate responsibility for the regulatory and market operation functions that are delegated to the subsidiary boards. Substantive changes to the NASD By-Laws are set forth below. Key changes related to the corporate restructuring are found in Article VII, Sections 4, 5, 9, 10, and 13; Article VIII, Section 1; Article IX, Sections 3 through 6; Article XV, Section 4(b); Article XVI, Section 1; and Articles XX and XXI. Stylistic changes and other minor, non-substantive changes are not described.

Article I. Definitions

Several substantive amendments have been made to Article I, which sets forth definitions for the NASD By-Laws. The following definitions have been moved from the Delegation

tion Plan to the NASD By-Laws: "Industry Director"; "Industry Governor" or "Industry committee member"; "National Nominating Committee"; "Non-Industry Director"; "Non-Industry Governor" or "Non-Industry committee member"; "Public Director"; "Public Governor" or "Public committee member." These changes will be found at Article I (n), (o), (bb), (cc), (dd), (ff), and (gg). Parallel changes have been made to the By-Laws of NASD Regulation and Nasdaq.

Refinements have been made to the definitions of "Industry Governor," "Industry committee member," "Non-Industry Governor," and "Non-Industry committee member." A person who is or was an outside director of a broker or a dealer, or a director not engaged in the day-to-day management of a broker or dealer, is excluded from the definition of "Industry Governor or committee member." Included in the definition of "Industry Governor, Director, or committee member" is any person who: (1) is an employee of an entity that owns more than five percent of the equity of a broker or dealer, if the broker or dealer accounts for more than 10 percent of the gross revenues received by the consolidated entity; (2) owns more than 10 percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed five percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (3) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Governor or committee member, or 20 percent or more of the gross revenues received by the Governor's or committee member's firm or partnership; or (4) provides professional services to a director, officer, or employee of a broker, dealer, or cor-

poration that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director's, officer's, or employee's professional capacity and constitute 20 percent or more of the professional revenues received by the Governor or committee member, or 20 percent or more of the gross revenues received by the Governor's or committee member's firm or partnership.

The Association believes that any person engaged in the day-to-day management of any broker/dealer, including a limited purpose broker/dealer, should be considered an Industry Governor or committee member and, therefore, has deleted from the definition of "Non-Industry Governor or committee member" the following specific references because they are unnecessary: (1) persons affiliated with brokers and dealers that operate solely to assist the securities-related activities of the business of non-member affiliates, such as a broker or dealer established to distribute an affiliate's securities which are issued on a continuous or regular basis, or process the limited buy and sell orders of the shares of employee owners of the affiliate; and (2) employees of an entity that is affiliated with a broker or dealer that does not account for a material portion of the revenues of the consolidated entity, and who are primarily engaged in the business of the non-member entity.

The term "person associated with a member" has been amended by the addition of a clause clarifying that the term includes any natural person registered under the Rules of the Association.

The definition of "rules of the Corporation" has been deleted to avoid confusion with the more commonly used, but differently defined term, "Rules of the Association." The term "rules of the Corporation" has been used to refer collectively to the

NASD Certificate of Incorporation, the NASD By-Laws, and the Rules of the Association, but, with the restructuring of the NASD into three legal entities, such a collective term for all of the corporate documents of the Association is no longer useful. Similarly, the definitions of "Boards" and "Corporations" have been deleted and the By-Laws instead refer to each corporate entity by name, as appropriate. The term "Rules of the Association" or "Rules" is defined to mean the numbered rules set forth in the NASD Manual beginning with the Rule 0100 Series, as adopted by the NASD Board pursuant to the NASD By-Laws, as amended or supplemented. A cross-reference from the Rules of the Association to the NASD By-Laws is included in Rule 0121.

Article II. Offices

A new Article II states the location of the registered corporate office of the NASD. This change makes the NASD By-Laws consistent with the NASD Regulation and the Nasdaq By-Laws, which both include such a provision.

Article III. Qualifications of Members and Associated Persons

Current Article II, Qualifications of Members and Associated Persons, is renumbered as Article III. Section 3, which addresses ineligibility of certain persons for membership or association, has been conformed to the Rule 9520 Series, which sets forth rules for the Association's eligibility proceedings. Specifically, Section 3(d) as amended clarifies that members, but not applicants for membership, may use eligibility proceedings to obtain relief from the Association's eligibility requirements, *e.g.*, to resolve a statutory disqualification problem.

Section 3(d)(2), which addresses the

status of members or persons engaged in eligibility proceedings, has been deleted because that subject is addressed in the Rule 9520 Series. This change does not result in a substantive change in the Association's practice. Specifically, if a person is already associated with a member at the time a statutory disqualification is discovered, the person may remain associated with the member until final action is taken under the Rules of the Association. If the person is a prospective employee, the person may not become associated with the member until the Association takes final action under the Rule 9520 Series.

A new Section 3(g) clarifies that the Board may delegate its authority under Section 3 in a manner not inconsistent with the Delegation Plan.

Finally, Section 4(h) has been amended to conform it to the Securities Exchange Act of 1934.

Article IV. Membership

Current Article III, Membership, has been renumbered as Article IV. Section 1(a)(3), which requires members to release the Association from liability except for willful malfeasance, has been deleted. Section 7 has been conformed to changes in the Rule 1010 Series, which sets forth procedures for membership applications and changes in a member's operations.

Article V. Registered Representatives and Associated Persons

Current Article IV, Registered Representatives and Associated Persons, has been renumbered as Article V. Section 2(a)(2), which requires registered representatives to release the Association from liability except for willful malfeasance, has been deleted.

Article VI. Dues, Assessments, and Other Charges

Current Article V, Dues, Assessments, and Other Charges, has been renumbered as Article VI. A new Section 5 states that the NASD may delegate its authority regarding dues, assessments, and other charges in a manner not inconsistent with the Delegation Plan.

Article VII. Board of Governors

Current Article VI, Board of Governors, has been renumbered as Article VII. Section 1(c) has been amended to make clear that to the fullest extent permitted by applicable law, the Restated Certificate of Incorporation, and the By-Laws, the NASD may delegate any power of the NASD or the Board to a committee appointed pursuant to Article IX, Section 1, to the NASD Regulation Board, to the Nasdaq Board, or to NASD staff, in a manner not inconsistent with the Delegation Plan. Parallel provisions have been added to the NASD Regulation and the Nasdaq By-Laws.

Section 2, which authorizes the Board to cancel or suspend the membership of a member or suspend the association of a person associated with a member for failure to provide requested information, has been amended to provide for reinstatement pursuant to the Rules of the Association. *See, e.g.*, Rules 8225 and 9516. The delegation to the Chief Executive Officer has been replaced with a delegation provision consistent with other provisions set forth in the proposed NASD By-Laws: that the Board be permitted to delegate its authority under this section in a manner not inconsistent with the Delegation Plan and otherwise in accordance with the Rules of the Association.

Section 4, which addresses the composition and qualifications of the

Board, has been amended to conform to the new corporate structure. The NASD Board will consist of the Chief Executive Officer and the Chief Operating Officer of the NASD, the Presidents of NASD Regulation and Nasdaq, the Chair of the National Adjudicatory Council, and at least 16 and not more than 22 Governors elected by the members of the NASD. Thus, the By-Laws authorize a Board of 21 to 27 Governors in total. Section 4(a) further provides that the Governors elected by the members will include a representative of an issuer of investment company shares or an affiliate of such an issuer, a representative of an insurance company, and a Nasdaq issuer. A majority of the Governors will be Non-Industry Governors, and the Non-Industry Governors will include five or six Public Governors, depending on the size of the Board. Section 4(b) has been amended to prohibit the Chair of the National Adjudicatory Council from serving as Chair of the Board. The Association believes that the responsibilities of each chairmanship require the attention of one individual.

Section 5, Term of Office of Governors, has also been amended to reflect the Board structure. The Chief Executive Officer and the Chief Operating Officer of the NASD and the Presidents of NASD Regulation and Nasdaq will serve as Governors until a successor is selected, or until death, resignation, or removal. The Chair of the National Adjudicatory Council will serve as a Governor for a term of one year, and will generally not serve more than two consecutive terms.⁴ Section 5 also provides that a former Chair of the National Adjudicatory Council may serve as a Governor elected by the members of the NASD. The Governors elected by the members of the NASD will be divided into three classes and serve three-year terms. Such Governors generally may not

serve more than two consecutive terms.

A new Section 6 addresses the disqualification of a Board member and states that a Governor's term of office immediately terminates if the Board determines that: (a) the Governor no longer satisfies the classification (Industry, Non-Industry or Public Governor) for which the Governor was elected; and (b) failure to remove the Governor would violate the compositional requirements of the Board set forth in Section 4. If a Governor's term of office terminates under this Section and the remaining term of office of such Governor was not more than six months, then during the period of vacancy, the Board would not be deemed to be in violation of its compositional requirements by virtue of such vacancy. Section 6 replaces a provision currently in the Delegation Plan that provides for "automatic removal" if a Governor no longer satisfies the classification for which he or she was elected without describing any process for such removal. This change eliminates any potential for the Board to take an *ultra vires* action in the event that a Governor fails to notify the Board promptly of a change in his or her classification and continues to sit on the Board and cast votes before such removal takes place.

Current Section 6, which addresses the filling of vacancies on the Board, has been renumbered as Section 7. In addition, the current provisions of the Delegation Plan that address the filling of vacancies have been moved to this Section. The Section provides further that, if the remaining term of office of the governorship to be filled is more than one year, then the replacement Governor must stand for election in the next annual election.

Current Section 7, which describes nomination and election procedures, has been expanded and renumbered

as Sections 9 through 14. Section 9 sets forth the powers of the National Nominating Committee. The National Nominating Committee nominates Industry, Non-Industry, and Public Governors for each vacant or new Governor position on the NASD Board; Industry, Non-Industry, and Public Directors for each vacant or new position on the NASD Regulation Board and the Nasdaq Board; Industry, Non-Industry, and Public members for each vacant or new position on the National Adjudicatory Council; and Industry and Non-Industry members for the Nasdaq Listing and Hearing Review Council.

Section 9 also includes and clarifies the compositional requirements for the National Nominating Committee previously set forth in the Delegation Plan. Under the amended provision, a National Nominating Committee member may be removed for cause (specifically, refusal, failure, neglect, or inability to discharge such member's duties) by a majority vote of the NASD Board. This same standard for removal is used throughout the Association's corporate documents for committee and council members.

Section 9 also includes a new provision that requires the Secretary of the NASD to collect from each nominee for Governor such information as is reasonably necessary to serve as the basis for a determination of the nominee's classification as an Industry, Non-Industry, or Public Governor. The Secretary will certify to the National Nominating Committee each nominee's classification to ensure that the compositional requirements of each Board are met.

Section 10 replaces current Section 7(c) and adds provisions regarding contested elections currently located in the Delegation Plan. Conforming references also have been made to Article XXI, a new article that pro-

vides for meetings of the membership. Section 10 clarifies the procedures for contested elections and changes the number of members that must sign a petition to support adding a candidate to the ballot for NASD Board elections from two percent of the members of the NASD to three percent. As is currently the case, a petition may be signed only by a member's Executive Representative. Section 10 also transfers the authority to certify the additional candidate from the National Nominating Committee to the Secretary, since the Secretary maintains the records of Executive Representatives and will be charged with reviewing information regarding the classification (Industry, Non-Industry, or Public) for each governorship.

Sections 11, 12, and 15 are new provisions that parallel new provisions added to the NASD Regulation and the Nasdaq By-Laws. Section 11 prohibits the NASD, the Board, the National Nominating Committees, other committees, and NASD staff from taking any official position regarding a contested nomination or election under the proposed NASD or NASD Regulation By-Laws. Section 11 permits Board and committee members to communicate their views with respect to a candidate in a contested election only if the Board or committee member acts solely in his or her individual capacity and disclaims any intention to communicate in any official capacity. Section 12 limits administrative support to the candidates in a contested NASD election to two mailings; any other administrative support in any NASD or NASD Regulation contested election or nomination is prohibited. Section 15 adds resignation provisions.

Section 13, Election of Governors, is largely parallel to current Section 7(a), with conforming amendments to Sections 9 through 12 and a new cross-reference to Article XXI,

which sets forth procedures for membership meetings.

Section 14 is a new procedure that requires each Governor to update the information submitted to the NASD Secretary under Section 9(e) regarding his or her classification as an Industry, Non-Industry, or Public Governor at least annually and upon request of the Secretary, and to report immediately to the Secretary any change in such classification. There are parallel provisions in the NASD Regulation and the Nasdaq By-Laws. These submissions and reports will help the Association ensure that the compositional requirements of the Board and its committees are maintained.

Section 8, which addresses meetings, quorums, and voting of the Board, has been amended to provide that a quorum consists of a majority of the Board then in office, including not less than 50 percent of the Non-Industry Governors. This change ensures that Industry Governors alone can not constitute or dominate a quorum of the Board.

Article VIII. Officers, Agents, and Employees

Current Article VII, Officers, Agents, and Employees, has been renumbered as Article VIII. Section 1 has been amended to require that the Board elect a Secretary and a Chief Operating Officer. These changes have been made in recognition of the number of responsibilities assigned to the Secretary under the By-Laws, the Board's practice of always electing a person to such position, and the fact that the Chief Operating Officer serves on the Board pursuant to Article VII, Section 4.

Section 3 has been amended to specify that agents and employees shall be under the supervision and control of the officers, unless the Board, by res-

olution, provides that an agent or employee shall be under the supervision and control of the Board. Generally, agents and employees are under the supervision and control of the officers, but the Board may wish in certain circumstances to retain control over an employee or agent, as in Section 4, when the Board determines that it wishes to retain counsel.

Current Section 5, which provides for compensation of Board and committee members, has been moved to its own Article, Article X, Compensation of Board and Committee Members.

New Sections 5, 6, and 7 have been added to Article VIII to conform it to Article VII of the NASD Regulation By-Laws and Article VI of the Nasdaq By-Laws. Section 5 permits the Board to delegate the duties and powers of any officer to any other officer. Section 6 provides for the resignation and removal of officers. Section 7 permits the NASD to secure the fidelity of its officers, agents, and employees by bond or otherwise.

Article IX. Committees

Current Article VIII, Committees, which addresses the formation and powers of committees, is renumbered as Article IX. Section 1 has been amended to cross-reference Article VII, Section 1(c), which limits the Board's authority to delegate its powers and authority.

A new Section 2 is designed to help the Association maintain the compositional requirements of certain committees. Undertakings 1 and 6 under the SEC Settlement require certain committees' to have a particular balance of Industry, Non-Industry, and Public committee members. The compositional requirements for the National Nominating Committee and the Audit Committee are found in the

NASD By-Laws. The compositional requirements of the National Adjudicatory Council are found in the NASD Regulation By-Laws. The compositional requirements for the remaining committees are found in the Delegation Plan. To help ensure that compositional requirements are maintained for committees appointed by the NASD Board, Section 2 authorizes the Secretary to collect from each prospective member of a committee that must be balanced such information as is reasonably necessary to serve as the basis for a determination of the prospective committee member's classification as an Industry, Non-Industry, or Public committee member. The Secretary must certify to the Board each prospective committee member's classification. Each committee member must update the information submitted at least annually and upon request of the Secretary of the NASD, and must report immediately to the Secretary any change in such classification. Parallel provisions are set forth in the NASD Regulation and the Nasdaq By-Laws.

Current Section 2, which addresses removal of a committee member, has been renumbered as Section 3 and amended to clarify that a committee member can only be removed for refusal, failure, neglect, or inability to discharge his or her duties by majority vote of the whole Board.

New sections have been added specifically to authorize the appointment of an Executive Committee and a Finance Committee and to require, consistent with Undertaking 6, the appointment of an Audit Committee. Section 4 authorizes the NASD Board to appoint an Executive Committee composed of five to nine members of the NASD Board, with a Non-Industry majority. The Executive Committee will include the NASD CEO/Chairman, at least one member each of the NASD Regula-

tion and Nasdaq Boards, and at least two Governors who are not Directors of NASD Regulation or Nasdaq. A quorum for the transaction of business at Executive Committee meetings will be a majority of Committee members then in office, including at least 50 percent of the Non-Industry Committee members.⁶

Section 5 contains the provisions relating to the Audit Committee currently found in the Delegation Plan, except that the compositional provisions have been amended to require two (rather than one) Public Governors to serve on the Committee.

Section 6 authorizes the Board to appoint a Finance Committee composed of at least four Governors, including the Chief Executive Officer of the NASD. The Finance Committee will be balanced, with the number of Non-Industry Governors equaling or exceeding the Industry Governors plus the Chief Executive Officer.

If any officer of the NASD, NASD Regulation, or Nasdaq serves as a member (other than as an *ex officio* member) of a committee appointed under the By-Laws of any of the three corporations, that officer will be counted among the Industry committee members for the purpose of any compositional or quorum requirements.

Article X. Compensation of Board and Committee Members

As noted previously, current Article VII, Section 5, which addresses compensation of Board and committee members, has been renumbered as Article X, Compensation of Board and Committee Members.

Article XI. Rules

Current Article IX, Rules, which authorizes the NASD to adopt rules, has been renumbered as Article XI.

Article XII. Disciplinary Proceedings

Current Article X, Disciplinary Proceedings, which authorizes disciplinary proceedings, has been renumbered as Article XII.

Article XIII. Powers of Board to Impose Sanctions

Current Article XI, Powers of Board to Prescribe Sanctions, which authorizes the Board to impose sanctions, has been renumbered as Article XIII. Section 1(e) has been amended and a new Section (2) added to clarify that any delegation under the Article must be in conformity with the Delegation Plan.

Article XIV. Uniform Practice Code

Current Article XII, Uniform Practice Code, has been renumbered as Article XIV. Section 2 has been amended to provide that the Board may delegate its authority with respect to administering the Uniform Practice Code to the NASD Regulation Board and Nasdaq Board in accordance with the Delegation Plan.

Article XV. Limitation of Powers

Current Article XIII, Limitation of Powers, has been renumbered as Article XV.

Section 4 addresses conflicts of interest and has been amended by redesignating it as Section 4(a), and therein prohibiting any Governor or committee member from directly or indirectly participating in any adjudication of the interests of any party if the Governor or committee member has a conflict of interest or bias, or if circumstances otherwise exist where his or her fairness might reasonably be questioned. Section 4(a) further requires the Governor or committee member to recuse himself or herself

or be disqualified in accordance with the Rules of the Association (*e.g.*, Rule 9160). Current Section 4 simply references the Rules of the Association. The standard set forth in Section 4(a) is consistent with the conflict of interest standard in Rule 9160.

In addition, a new Section 4(b) has been added to address conflicts of interests in non-adjudicatory matters in a manner consistent with the By-Laws of the NASD Regulation Board and the Nasdaq Board. Section 4(b) provides that a contract or transaction between the NASD and a Governor or officer, or between the NASD and any entity in which a Governor or officer is a director or officer, or has a financial interest, is not void or voidable solely for this reason, or solely because the Governor or officer is present at the meeting of the Board or committee that authorizes the contract or transaction, or solely because the Governor's or officer's vote is counted for such purposes if: (1) the material facts pertaining to such relationship or interest are disclosed or are known to the Board or the committee, and the Board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested Governors; or (2) the contract or transaction is fair to the NASD as of the time it is authorized, approved, or ratified by the Board or committee. Section 4(b) provides that only disinterested Governors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which authorizes the contract or transaction. A contract or transaction between the NASD and one of its subsidiaries would not be subject to Section 4(b).

Finally, Section 6, which limits the Association's rulemaking authority over government securities activities, has been deleted to conform the By-Laws to changes previously made to

the Association's authority over the government securities activities of its members.

Article XVI. Procedure for Adopting Amendments to By-Laws

Current Article XIV, Procedure for Adopting Amendments to By-Laws, has been renumbered as Article XVI and amended to provide that committees appointed by the Board may propose By-Law amendments.

Article XVII. Corporate Seal

Current Article XV, Corporate Seal, has been renumbered as Article XVII.

Article XVIII. Checks

Current Article XVI, Checks, has been renumbered as Article XVIII.

Article XIX. Annual Financial Statement

Current Article XVII, Annual Financial Statement, has been renumbered as Article XIX.

Article XX

A new Article XX, Record Dates, has been added. Section 1 permits the Board to fix a record date to determine the members that are entitled to notice of, or to vote at, member meetings. Section 2 provides for a

default record date if the Board does not fix such a date. Section 3 provides that a determination of members of record also applies to an adjournment of a member meeting.

Article XXI

A new Article XXI, Meetings of Members, has been added. Section 1 authorizes the Board to designate a time and place and set an agenda for annual meetings of members. Section 2 sets forth procedures for setting the agenda of special meetings. Section 3 sets forth notice requirements for meetings. Section 4 describes voting procedures. Section 5 states that the Chief Executive Officer of the NASD acts as Chair of the meeting and authorizes the Board to adopt rules and regulations for the conduct of meetings.

Endnotes

¹ Securities Exchange Act Rel. No. 37538 (August 8, 1996), 62 S.E.C. Docket 1346, Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, *In the Matter of National Association of Securities Dealers, Inc.*, Administrative Proceeding File No. 3-9056.

² Currently, the NASD Board has 11 Governors, the NASD Regulation Board has 24 Directors, and the Nasdaq Board has 14 Directors.

³ The Delegation Plan is the blueprint for the coordinated efforts of NASD, NASD Regulation, and Nasdaq, and sets forth the purposes, functions, and governance procedures of the three corporations working together.

⁴ The Chair of the National Adjudicatory Council, who serves a term of one year, simultaneously will serve as a Governor of the NASD Board and a Director of the NASD Regulation Board. This change ensures that the terms for each of these positions run concurrently.

⁵ Undertaking 1 sets forth compositional requirements for "the National Nominating Committee, the Trading/Quality of Markets Committee, the Arbitration Committee, the Market Surveillance Committee, the National Business Conduct Committee, the Management Compensation Committee, and all successors thereto." Undertaking 6 sets forth compositional requirements for an audit committee. The current names of such committees are the National Nominating Committee, the Quality of Markets Committee, the National Arbitration and Mediation Committee, the Market Regulation Committee, the National Business Conduct Committee, the Management Compensation Committee, and the Audit Committee.

⁶ This quorum requirement has been applied also to the Audit, Finance, and National Nominating Committees.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.