

# Notice To Members

National Association of Securities Dealers, Inc.

February 1989

## Number 89-18

### Suggested Routing:\*

- Senior Management
- Corporate Finance
- Government Securities
- Institutional

- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Systems
- Trading
- Training

\*These are suggested departments only. Others may be appropriate for your firm.

### Subject: Presidents' Day: Trade Date-Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Monday, February 20, 1989, in observance of Presidents' Day. "Regular way" transactions made on the preceding business days will be subject to the settlement date schedule listed below.

#### Trade Date-Settlement Date Schedule For "Regular Way" Transactions

Trade Date	Settlement Date	Regulation T Date*
February 10	17	22
13	21	23
14	22	24
15	23	27
16	24	28
17	27	March 1
20	Markets Closed	—
21	28	2

These settlement dates should be used by brokers, dealers, and municipal securities dealers for purposes of clearing and settling transactions pursuant to the NASD Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding the application of these settlement dates to a particular situation may be directed to the NASD Uniform Practice Department at (212) 858-4341.

\*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 seven business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Regulation T Date."

# Notice To Members

National Association of Securities Dealers, Inc.

February 1989

## Number 89-19

### Suggested Routing:\*

- |  |  |  |   |
|--|--|--|---|
| <input type="checkbox"/> Senior Management     | <input checked="" type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate          |
| <input type="checkbox"/> Corporate Finance     | <input type="checkbox"/> Legal & Compliance        | <input type="checkbox"/> Options               | <input checked="" type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal                 | <input type="checkbox"/> Registration          | <input checked="" type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional         | <input type="checkbox"/> Mutual Fund               | <input type="checkbox"/> Research              | <input type="checkbox"/> Training           |

\*These are suggested departments only. Others may be appropriate for your firm.

### Subject: NASDAQ National Market System Additions, Changes, and Deletions as of January 12, 1989

As of January 12, 1989, the following 26 issues joined the NASDAQ National Market System, bringing the total number of issues in NASDAQ/NMS to 2,881:

Symbol	Company	Entry Date	SOES Execution Level
HIFS	Hingham Institution for Savings	12/13/88	1000
FMCO	FMS Financial Corporation	12/14/88	1000
BLIS	Bliss & Laughlin Industries, Inc.	12/16/88	1000
FRCC	First Financial Caribbean Corporation	12/19/88	1000
TTOWV	Tyco Toys, Inc. (6-7-93 Wts) (WI)	12/19/88	200
CSTB	California State Bank	12/20/88	500
CBPA	Community Bancorp, Inc.	12/20/88	200
CSAV	Continental Savings of America	12/20/88	200
FFFG	F.F.O. Financial Group, Inc.	12/20/88	1000
HRIZ	Horizon Gold Shares, Inc.	12/20/88	1000
HOMG	Homeowners Group, Inc.	12/20/88	1000
IRON	Ironstone Group, Inc.	12/20/88	1000
LEPGY	LEP Group, Plc	12/20/88	1000
OBPI	Otisville BioPharm, Inc.	12/20/88	1000
OBPIW	Otisville BioPharm, Inc. (Wts)	12/20/88	200
PABC	Pacific Bancorporation	12/20/88	200
RNBO	Rainbow Technologies, Inc.	12/20/88	1000
TGDGF	TOTAL Energold Corporation	12/20/88	500
CNSB	Centennial Savings Bank	12/22/88	200
MLRC	Mallon Resources Corporation	12/23/88	1000
HENG	Henley Group, Inc. (The) (CI A)	1/3/89	1000
HBUF	Homestyle Buffet, Inc.	1/3/89	1000
IFEI	Imagine Films Entertainment, Inc.	1/3/89	500

IFEIW	Imagine Films Entertainment, Inc. (Wts)	1/3/89	500
ODEP	Office Depot, Inc.	1/3/89	1000
PNTK	Pentech International, Inc.	1/3/89	1000

### NASDAQ/NMS Pending Additions

The following issues have filed for inclusion in NASDAQ/NMS upon effectiveness of their registration statements with the SEC or other appropriate regulatory authority. Their inclusion may commence prior to the next regularly scheduled phase-in date.

Symbol	Company	Location	SOES Execution Level
MTTL	Mobile Telecommunications Technologies Corp.	Jackson, MS	500
NETG	Network General Corporation	Mountain View, CA	500
NUCZV	Nucorp, Inc. (Wts) (WI)	Chicago, IL	200
STHPV	Stanley Interiors Corporation (Pfd) (WI)	Stanleytown, VA	1000

### NASDAQ/NMS Symbol and/or Name Changes

The following changes to the list of NASDAQ/NMS securities occurred since December 13, 1988.

New/Old Symbol	New/Old Security	Date of Change
OCGI/HFSA	Omni Capital Group, Inc./Home Federal Savings Bank	12/20/88
RPAL/RPAL	Royal Palm Savings Bank/Royal Palm Savings Association	12/20/88
PSBN/PSBN	Pioneer Bancorp, Inc./Pioneer Savings Bank, Inc.	12/28/88
COFD/COFD	Collective Bancorp, Inc./ Collective Federal Savings & Loan Association	1/3/89
EDSE/EDSE	ESELCO, Inc./Edison Sault Electric Company	1/3/89
EMPR/EMPR	Empire Financial Corp./Empire Savings Bank, SLA	1/3/89
FCBK/BKST	Fairfield County Bancorp, Inc./Bank of Stamford	1/3/89
FLFE/FLFE	Florida Federal Savings Bank/ Florida Federal Savings & Loan Association	1/3/89
HOGI/HOGI	Harken Energy Corp./Harken Oil and Gas, Inc.	1/3/89
HMSD/HMSD	Homestead Holding Corporation/ Homestead Savings Association	1/3/89
RFED/RFED	Roosevelt Financial Group, Inc./ Roosevelt Bank, A Federal Savings Bank	1/3/89
WHGP/HENG	Wheelabrator Group, Inc. (The)/Henley Group, Inc. (The)	1/3/89
NWNL/NWNL	NWNL Companies, Inc. (The)/ Northwestern National Life Insurance Co.	1/4/89
PVSA/PVSA	Parkvale Financial Corporation/Parkvale Savings Association	1/6/89
QNTX/QNTX	Qintex Entertainment, Inc./HRI Group, Inc.	1/10/89

### NASDAQ/NMS Deletions

Symbol	Security	Date
SOUT	Southernnet, Inc.	12/15/88
CITN	Citizens Financial Group, Inc.	12/16/88
GOTLF	Gotaas-Larsen Shipping Corporation	12/16/88
SOMB	Somerset Bancorp, Inc.	12/16/88
THFR	Thetford Corporation	12/16/88
AHST	Associated Hosts, Inc.	12/19/88
FGRP	Farmers Group, Inc.	12/19/88
FINH	First NH Banks, Inc.	12/19/88
GVMF	Golden Valley Microwave Foods, Inc.	12/19/88
DYANW	Dyansen Corp. (Cl A Wts)	12/20/88
SHNA	Shawmut National Corporation	12/21/88

Notice to Members 89-19

IHBI	Indian Head Banks, Inc.	12/22/88
SMCH	Service Merchandise Company, Inc	12/22/88
BULR	Buehler International, Inc.	12/23/88
CVGT	Convergent, Inc.	12/23/88
WATFY	Waterford Glass Group, Plc	12/23/88
RPSAS	Resources Pension Shares 1	12/28/88
RPSBS	Resources Pension Shares 2	12/28/88
RPSCS	Resources Pension Shares 3	12/28/88
DDDI	Downey Designs International, Inc.	12/29/88
CNRD	Canrad, Inc.	12/30/88
ORIR	Orion Research Incorporated	12/30/88
WLTN	Wilton Enterprises, Inc.	12/30/88
BKVT	Bank Vermont Corp	1/3/89
FFKZ	First Federal Savings & Loan Association of Kalamazoo	1/3/89
ETRE	Entre Computer Centers, Inc.	1/5/89
HDGH	Hodgson Houses, Inc.	1/6/89
NENB	Nevada National Bancorporation	1/6/89
HPSCW	HPSC, Inc. (Wts)	1/9/89
TRIA	Triangle Industries, Inc. (Cl A)	1/10/89
MNCF	MNC Financial, Inc.	1/12/89
TRIAP	Triangle Industries, Inc. (Pfd)	1/12/89

Questions regarding this notice should be directed to Kit Milholland, Senior Analyst, NASDAQ Operations, at (202) 728-8281. Questions pertaining to trade reporting rules should be directed to Leon Bastien, Assistant Director, NASD Market Surveillance, at (202) 728-8192.

# Disciplinary Actions

National Association of Securities Dealers, Inc.

February 1989

## DISCIPLINARY ACTIONS REPORTED FOR FEBRUARY

The National Association of Securities Dealers, Inc. (NASD), is taking disciplinary actions against firms and individuals for violations of the NASD Rules of Fair Practice and/or the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions begin with the opening of business on Monday, February 6, 1989.

### 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 action was based on the provisions of Article IV, Section 5 of the NASD Rules of Fair Practice and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after each entry. If the firm has complied with the request for information, the listing also includes the date that the suspension concluded.

**Sandstone Securities Corporation**, Wilton Manors, FL (December 1, 1988, to December 16, 1988)

**Diversified Income Investments, Inc.**, Stuart, FL (December 1, 1988, to December 22, 1988)

**Penmark Equity Group, Inc.**, Coconut Grove, FL (December 1, 1988, to December 30, 1988)

### FIRM AND INDIVIDUAL FINED

**Delcutt Securities, Inc. (Hinsdale, IL)**, **Richard H. Delashmutt (Registered Principal, Hinsdale, IL)**, and **Steven H. Cutler (Registered Principal, Hinsdale, IL)** submitted an Offer of Settlement pursuant to which the firm was fined \$10,000, jointly and severally with Richard H. Delashmutt, and \$10,000, jointly and severally with Steven H. Cutler. Without admitting or denying the allegations, the firm, Delashmutt, and Cutler consented to the sanctions imposed and findings that, in connection with two all-or-none offerings of limited partnership units, they failed to transmit funds received from investors for the purchase of units to an account that complied with

SEC Rule 15c2-4 and failed to hold the investors' funds in the account in which the funds were deposited until the requisite contingency had occurred. Further, with respect to one of said offerings, when all units had not been sold in *bona fide* sales by the stated termination date, the respondents failed to return investors' funds as required by SEC Rule 10b-9. The firm, acting through Delashmutt and Cutler, also conducted a securities business while failing to maintain minimum required net capital and failed to record in any record of original entry the date of receipt and transmission of subscribers' funds. Delashmutt and Cutler are required to successfully complete the Direct Participation Programs Principal Examination before becoming associated with any member of the NASD in the capacity of a Direct Participation Programs Principal.

**Robert Ainbinder & Co., Inc. (New York, NY)**, **Robert E. Ainbinder (Registered Principal, New York, NY)**, and **Stephen D. Gellas (Registered Principal, New York, NY)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm, Ainbinder, and Gellas were fined \$15,000, jointly and severally. Without admitting or denying the allegations, the firm, Ainbinder, and Gellas consented to the described sanctions and findings that they conducted a securities business after having signed a cease agreement on December 30, 1987, for not complying with the Net Capital Rule as of September 30, 1987. Further, as of November 30, 1987, December 31, 1987, and January 13, 1988, the respondents conducted a securities business while failing to maintain the firm's minimum required net capital. The respondents also submitted a Focus Part II Report that failed to reflect accurately the firm's true

financial position. Ainbinder will not apply for registration as a principal and will refrain from acting in any principal capacity for one (1) year. Gellas' registration as a Financial and Operations Principal will be suspended for two (2) weeks.

### INDIVIDUALS BARRED AND SUSPENDED

**Barbara Cahane Aber (Registered Principal, New York, NY)** submitted an Offer of Settlement pursuant to which she was fined \$2,500, jointly and severally with her employer, suspended from association with any NASD member as a Financial Operations Principal for two (2) years, and is required to requalify by examination before again acting in that capacity. Without admitting or denying the allegations, Aber consented to the described sanctions and findings that she failed to compute accurately the amount required to be on deposit in her firm's Special Reserve Bank Account for the Exclusive Benefit of Customers, failed to make required deposits to correct such deficiencies, and failed to maintain a record of the computation of the amount required to be deposited in the account. Aber also maintained an inaccurate stock record in that it did not correctly reflect the number of shares in the firm's omnibus account for 21 positions and failed to properly reconcile two bank accounts and two omnibus accounts. In addition, Aber executed 11 transactions in customer accounts, charging both disclosed commissions and undisclosed markups or markdowns. Further, the firm's 1986 NASD assessment report was inaccurately completed.

**N. Thomas Barninger (Registered Representative, Hanover, PA)** was fined \$25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Barninger received a check from a customer in the amount of \$18,801.89, of which \$14,500 was intended for the purchase of two mutual funds, and another check in the amount of \$12,129.89 intended for the purchase of a money-market trust that he failed to remit as intended, instead depositing the funds to his own bank account. Barninger also solicited, on four occasions, mutual fund applications on which he listed himself as Registered Representative of a member firm, the dealer of record, when neither at the time of the submission of the applications nor at any other time has he been a representative of this member. In addition, Barninger failed to respond to the NASD's four requests for informa-

tion made pursuant to Article IV, Section 5 of the Rules of Fair Practice concerning the submission of the mutual fund applications and his failure to remit customer funds for their intended purpose.

**Gregory A. Blaine (Registered Principal, Golden, CO)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$5,000 and suspended from association with any NASD member in any capacity for ten (10) business days. Without admitting or denying the allegations, Blaine consented to the described sanctions and findings that he effected unauthorized transactions in four customer accounts.

**David William Bodner (Registered Representative, Odessa, FL)** 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 five (5) business days. Without admitting or denying the allegations, Bodner consented to the described sanctions and findings that he executed two unauthorized transactions in the account of a customer.

**Guy W. Courtney (Registered Principal, Palatine, IL)** submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for fifteen (15) business days. Without admitting or denying the allegations, Courtney consented to the described sanction and findings that he executed five (5) unauthorized transactions in a customer's account. Courtney also failed in one instance to follow the customer's order and exercised discretionary control over the account in the absence of written authorization from the customer.

**Oscar Echman (Registered Principal, New York, NY)** submitted an Offer of Settlement pursuant to which he was fined \$5,000, jointly and severally with his employer-member, and suspended from association with his employer-member as a general securities principal for five (5) business days. Without admitting or denying the allegations, Echman consented to the described sanctions and findings that he permitted his firm to fail to comply with Schedule C of the NASD By-Laws by failing to designate and register a Limited Principal — Financial and Operations at times when the firm's business activity required such.

**Michael Freshour (Registered Representative, Terre Haute, IN)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which

he was fined \$15,000, barred from association with any NASD member in any capacity, and required to submit proof of restitution in connection with any application to become associated with an NASD member. Without admitting or denying the allegations, Freshour consented to the described sanctions and findings that he received \$1,200 in cash from a customer together with instructions to open an account, purchase 100 shares of common stock, and place the remaining funds in a money-market account. Freshour failed to follow the customer's instructions, instead retaining the funds for his own use and benefit. When the customer instructed Freshour to sell the 100 shares and use the proceeds to purchase 100 shares of another security, Freshour failed to disclose to the customer that he had not made the original purchase and that the customer did not have a money-market account or other funds to effect a purchase. Freshour also received a check in the amount of \$400 from the customer for the purchase of 25 shares of common stock, with instructions to withdraw the balance needed for the purchase from the customer's money-market account. Thereafter, Freshour caused an account to be opened for the customer and ordered the purchase when he knew that the money-market account had not been established and insufficient funds were available for such a purchase.

**Lawrence J. Gollin (Registered Principal, Sunrise, FL)** submitted an Offer of Settlement pursuant to which he was fined \$1,500 and suspended from association with any NASD member in any capacity for ten (10) days. Without admitting or denying the allegations, Gollin consented to the described sanctions and findings that during an NASD examination of his employer-member, he failed to comply with requests to provide and make available certain books and records.

**Dow M. Irons (Registered Representative, Loch Arbour, NJ)** was fined \$5,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Irons failed to respond to the NASD's three requests for information made pursuant to Article IV, Section 5 of the NASD Rules of Fair Practice concerning a securities transaction effected for the account of a customer.

**Vadim Neyman (Registered Representative, Philadelphia, PA)** was fined \$5,000 and barred from association with any NASD member

in any capacity. The sanctions were based on findings that Neyman failed to respond to the NASD's three requests for information made pursuant to Article IV, Section 5 of the NASD Rules of Fair Practice concerning the execution of options transactions for the account of a customer.

**Arthur David Pomerantz (Registered Representative, Atlanta, GA)** submitted an Offer of Settlement pursuant to which he was fined \$250 and suspended from association with any NASD member in any capacity for ten (10) business days, or until he has, after December 19, 1987, re-taken and passed the Series 7 Examination, whichever period is longer. Without admitting or denying the allegations, Pomerantz consented to the sanctions imposed and findings that, while taking the NASD's Series 7 Examination, he compromised the examination by talking to another candidate contrary to instructions given prior to the commencement of the examination.

**William Eric Potter (Registered Representative, Bradenton, FL)** was fined \$5,000 and suspended from association with any NASD member in any capacity for five (5) years. The sanctions were based on findings that Potter opened a nominee account with his employer-member under a fictitious business name and traded options in the account for his own use and benefit. Potter opened the nominee account after his employer-member had ordered him to cease trading options in his personal account.

**Jay Brian Stephens (Registered Representative, Dalton, GA)** was fined \$10,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Stephens accepted a check from a customer in the amount of \$2,378 for the purchase of a security and, instead of remitting it to his employer-member for its intended purpose, deposited the check in his own bank account. Stephens also failed to respond to the NASD's requests for information made pursuant to Article IV, Section 5 of the NASD Rules of Fair Practice.

**Matthew Macrae Witherbee (Associated Person, Bridgeport, CT)** submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for one (1) year. Without admitting or denying the allegations, Witherbee consented to the described sanction and findings that, while taking the Series 52 Examination, he had in his

possession handwritten notes pertaining to the subject matter of the examination.

**INDIVIDUALS FINED**

**Joseph P. Berry (Registered Representative, Simsbury, CT)** submitted an Offer of Settlement pursuant to which he was fined \$20,000. Without admitting or denying the allegation, Berry consented to the described sanction and finding that he engaged in private securities transactions outside the scope of his employment without prior written notification to his employer in contravention of the Board of Governors Interpretation with respect to Private Securities Transactions, then in effect.

**Randall Robert Heiner (Registered Principal, Minneapolis, MN)** and **William Boyd Olson (Registered Principal, Minneapolis, MN)** were fined \$10,000, jointly and severally. Without admitting or denying the allegations, Heiner and Olson consented to the described sanction and findings that they permitted their firm to effect securities transactions while failing to maintain minimum required net capital and, at various times, failed to record an accurate computation of aggregate indebtedness and net capital. On one occasion, the respondents failed to maintain sufficient funds on deposit in the Special Reserve Account and on six occasions failed to compute accurately the amount required to be on deposit. Heiner and Olson also failed to comply with certain business limitations imposed on their employer-member by the District Surveillance Committee pursuant to Section 38 of the NASD Rules of Fair Practice. The limitations required the firm to maintain 200 percent of its otherwise required minimum net capital. Heiner also purchased four different securities from his employer-member at prices substantially less than the prevailing market price and sold three of the securities back to the firm at prices at or in excess of the prevailing market prices resulting in a profit of \$18,454.

**INDIVIDUALS WHOSE REGISTRATIONS WERE REVOKED FOR FAILURE TO PAY FINES AND COSTS IN CONNECTION WITH VIOLATIONS**

Gary J. Chapman, Dothan, AL  
 William H. Clark, Murray, UT  
 Richard P. Fike, Bellevue, WA  
 Constantine C. Gavrel, Houston, TX

Joseph Harvest, Miami, FL  
 Paul B. Hoffer, La Costa, CA  
 George R. Holder, Fort Worth, TX  
 Robert M. Lannon, Marietta, GA  
 John W. McIntyre, Lakewood, CO  
 Howard B. Scott, Las Vegas, NV  
 Roswell P. Watkins, Madison, NJ

**NASD EXPELS K.A. KNAPP & CO., INC., AND BARS KIRK A. KNAPP**

The NASD has expelled K.A. Knapp & Co., Inc., of Grand Rapids, Michigan, and has barred Kirk A. Knapp, the firm's President, from association with any NASD member in any capacity. In addition, the firm was fined \$150,000. Kirk Knapp was fined \$250,000 and prohibited, with certain exceptions, from maintaining any proprietary interest in any member of the NASD.

The sanctions were imposed by the NASD Board of Governors, following the appeal of an action taken by the District Business Conduct Committee for District 8 in Chicago.

The NASD found that, in connection with an initial public offering and the after-market trading of the new issue, the firm and Knapp falsely reported to the issuer that they had sold the 14,600,000 shares for which they had acted as selling agent, when, in fact, the firm sold only 11,665,000 shares, or 2,935,000 shares less than what was reported. The firm opened a secondary market in the shares on NASDAQ at a premium, bid for and purchased shares for its own account, and induced public customers to purchase shares at a premium. The firm and Knapp were found to have consistently charged a premium which was arbitrary and unrelated to any independent market demand and to have effected transactions at prices which were arbitrary and unreasonable.

The firm and Knapp also refused to close the underwriting of the security unless \$60,000 was paid by the issuer to Knapp, in addition to the disclosed selling agent compensation set forth in the prospectus. When added to the disclosed selling compensation, the total underwriting compensation amounted to 16.25 percent of the gross offering proceeds, which was unfair and unreasonable under the Board of Governors' Interpretation with respect to Corporate Financing. It was also found that the true selling expenses of the offering were never disclosed to the NASD, notwithstanding the requirement for such disclosure.

In connection with this offering, the firm and Knapp also were found to have guaranteed a customer against loss. The simultaneous sale and repurchase from this customer for extended settlement were found not only to be a guarantee against loss, but a transaction which was made to appear as a loan to the firm.

A false free-riding and withholding questionnaire detailing their participation in this issue was submitted to the NASD by the firm and Knapp. The questionnaire failed to disclose that a purchaser of 2,395,000 shares was a Registered Principal of another NASD member firm and concealed the fact that one customer was a controlled account of Knapp and therefore restricted from purchasing the security. The firm and Knapp also reported erroneous volume figures to NASDAQ with respect to the secondary trading of the security, and granted an arbitrary and unreasonable profit of 56 percent to the principal of the other firm on his sale of the 2,395,000 shares.

The NASD further found that Kirk A. Knapp, while barred as a General Securities Principal, remained as President and a member of the Board of K.A. Knapp & Co., Inc., and acted, from time to time, in the capacity of a Registered Principal by exercising, and/or attempting to exercise, managerial control over the affairs of the firm. K.A. Knapp & Co., Inc., was found to have failed to take adequate steps to ensure that Knapp would not violate the terms of his bar.

In addition to these activities, the firm and Knapp committed numerous violations of the Securities and Exchange Commission's financial responsibility rules, including the Customer Protection Rule, by making erroneous computations of the customer reserve account requirement, resulting in deficiencies for certain months; failing to maintain certain books and records currently and accurately; inaccurately computing the firm's net capital at various times; filing inaccurate Focus Part I and II Reports for certain periods. Knapp was also found to have written personal checks to the firm totaling at least \$620,000, when he knew that he had insufficient funds in his account to cover the checks. In addition, the firm and Knapp failed to amend the firm's Form BD to reflect the fact that a formal complaint had been issued against it by the NASD.

K.A. Knapp & Co., Inc., further permitted options transactions to be effected without having a

Registered Options Principal, notwithstanding the fact that the firm was notified by the NASD of this obligation, and the firm failed to evidence delivery of options disclosure documents to certain customers opening options accounts. In addition, municipal securities transactions were effected without the firm having an appropriately qualified Municipal Securities Principal.

In connection with another offering, the firm failed to make a *bona fide* public distribution of shares which traded at a premium in the secondary market, in that the firm received 2,000 shares for public distribution and withheld these shares in a firm account in contravention of the Board of Governors Interpretation with respect to Free-Riding and Withholding.

Kirk A. Knapp has appealed this action to the Securities and Exchange Commission. The sanctions, however, are effective pending the consideration of the appeal.

#### **NASD EXPELS TIDD LACKEY & COMPANY, INC., FOR VIOLATIONS OF NASD'S ANTI-FRAUD RULES**

The NASD has expelled Tidd Lackey & Company, Inc., of Chico, California for violations of the NASD's anti-fraud rules. It barred four associates of the firm, David M. Lackey, John T. Lackey, David J. Haehn, and Jen Ming Gee, from association with any NASD member in any capacity. The firm and four individuals were also censured and jointly and severally fined \$450,000.

The sanctions were imposed by the NASD Board of Governors, following the appeal of an action taken by the District Business Conduct Committee for District 2N in San Francisco.

The NASD found that Tidd Lackey, David Lackey, John Lackey, Haehn, and Gee, in connection with their recommendation of certain new issues, induced customers to purchase securities by using high-pressure sales tactics, making false and misleading statements and omitting to disclose material facts. All respondents were found responsible for such misconduct and for violation of NASD rules, including Article III, Section 18 of the NASD Rules of Fair Practice, which prohibits the use of any manipulative, deceptive, or other fraudulent device in the purchase or sale of any security.

In recommending certain securities, the respondents intentionally made misleading

representations concerning the timing and magnitude of stock price increases, the firm's control over stock prices, and the riskless nature of the recommended investments. The respondents also guaranteed returns to customers, and failed to advise customers of the business and operating histories of the companies issuing such securities.

In connection with a new-issue underwriting, the firm, acting through David and John Lackey, sold a total of 72,444 units to 44 investors prior to the effective date of the registration statement filed with the Securities and Exchange Commission. In addition, the issuer received a limited qualification from the California Department of Corporations, based upon the condition that no sales would be made to investors who did not meet certain net worth or net worth plus income criteria. The firm and David and John Lackey sold at least 44,041 units to at least 52 investors who did not meet these limited qualification terms. In two other new-issue offerings, they also sold 214,600 shares of one to at least 75 California residents, and 1,291,900 of the other to at least 50 residents, when these securities were not qualified for sale in the state of California.

### NASD BARS, SUSPENDS, AND FINES TWO INDIVIDUALS

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

Without admitting or denying the allegations of the Complaint, Aslanian and Laff, in their Offers of Settlement, consented to certain findings made and sanctions imposed by the NASD Market Surveillance Committee. The Committee found that Aslanian violated Article III, Sections 1, 5, 15(b), and 18 of the NASD Rules of Fair Practice, as alleged in the Complaint. Section 18 is the NASD's anti-fraud provision, which prohibits the use of any manipulative, deceptive, or other fraudulent device in the purchase or sale of any security. Laff was found to have violated Article III, Sections 1 and 27 of the NASD Rules of Fair Practice, as alleged in the Complaint.

Pursuant to his Offer, Aslanian was barred

from association with any NASD member in any capacity with the right to reapply for such association after five years, fined \$100,000, and censured. Under Laff's Offer of Settlement, he was suspended for two years from association with any NASD member in any supervisory capacity, fined \$15,000, and censured.

The Complaint alleged price manipulation by Aslanian and Haas of Cliff Engle common stock (CLIF) and Cliff Engle warrants (CLIFW), and fraud in the offer and sale of CLIF and CLIFW. The Complaint also alleged the publication and circulation by Aslanian and Haas of non-*bona fide* quotations in nine other securities, namely, T.S. Industries, Inc., common stock (TNDS), Fountain Power Boat Industries, Inc., common stock (FPBT), Fountain Power Boat Industries, Inc., warrants (FPBTW), Big O Tires, Inc., common stock (BIGO), Flores de New Mexico common stock (FLWR), Satellite Auction units (SATLU), Satellite Auction common stock (SATL), Satellite Auction warrants (SATLW), Eagle Entertainment common stock (EEGL), as well as CLIF and CLIFW. Finally, the Complaint focused on allegedly inadequate supervision by Laff.

Specifically, the Complaint alleged that between October 1, 1987, and October 21, 1987, Aslanian and Haas manipulated the price of CLIF and CLIFW in that Aslanian, acting for Haas, placed increasingly higher quotations in the NASDAQ System for CLIF and CLIFW, and purchased CLIF and CLIFW at higher prices in the face of Haas' existing long inventory positions. Through this allegedly manipulative conduct, the prices of CLIF and CLIFW reached their all-time high prices of \$14 each, on October 20, 1987, and October 21, 1987, respectively.

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

Regarding Laff, the Complaint alleged that

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

In its decision, the Market Surveillance Committee found that Haas underwrote the Cliff Engle initial public offering with another broker-dealer. It further found that from October 1, 1987, to October 20, 1987, a period encompassing the market break of October 19, 1987, the inside bid price of CLIF in the NASDAQ market increased 60 percent, from \$8.75 to \$14. Similarly, the inside bid price of CLIFW moved from \$6.25 to \$14 between October 1, 1987, and October 21, 1987, representing a 124 percent increase. Haas was responsible for the quotations that created the \$14 prices.

When considering total trading time during the period of the alleged manipulation, the Committee found that Haas was responsible for the dramatic price rise, with nearly 62 percent of the inside bid upticks in the common stock and approximately 95 percent of the inside bid upticks in the warrants. Haas' pricing leadership was even more pronounced, according to the Committee, in that the firm represented the sole high bid over 58 percent of the time in the common stock and nearly 70 percent of the time in the warrants. The Committee also noted that Haas often upticked Haas' own inside bid in both securities while showing a long inventory position in both CLIF and CLIFW, with no apparent reason for wanting to accumulate additional inventory, particularly in light of the negligible interest shown by customers in the Cliff Engle securities. Specifically, the Committee found that there was virtually no retail demand at Haas for these securities. Throughout the review period, Haas sold CLIF to only eight retail customers and sold CLIFW to 13 retail accounts, with certain purchasers of CLIF claiming that the transactions represented unauthorized purchases by Aslanian.

Also viewed by the Committee as hallmarks of fraud were sales to retail customers below the existing inside bid (evidencing the lack of retail demand and the fraudulent nature of Haas'

quotes), and the immediate drop in the price of the Cliff Engle securities upon Haas' withdrawal as a market maker on October 28, 1987. Specifically, when Haas withdrew as a market maker in CLIF and CLIFW, all other market makers withdrew shortly thereafter, causing the price of the common stock to drop from \$12 to zero within 15 minutes and the warrants to decline from \$13.125 to zero within 30 minutes of Haas' withdrawal. No market makers existed in either CLIF or CLIFW from October 28, 1987, until October 30, 1987, in the common stock, and until November 6, 1987, in the warrants. Thereafter, the price of CLIF stabilized in the \$1 to \$2 range and CLIFW was quoted at \$.375.

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

Given the fact that Haas is in bankruptcy and being liquidated, and that appropriate action has been taken against Aslanian and Laff, the individuals responsible for the violative activities, the allegations contained in the Complaint against Haas were dismissed.

The NASD investigation, which was conducted by its Anti-Fraud Section, is part of the NASD's stepped-up enforcement efforts in the area of securities fraud and price manipulation. In addition to carrying out its own investigations, the NASD routinely cooperates with other self-regulatory organizations, the SEC, and governmental law enforcement agencies. In this regard, the NASD cooperated with the Office of the United States Attorney for the Southern District of New York in its investigation, which resulted in the filing on January 5, 1989, of criminal charges relating to securities fraud against Aslanian. The NASD intends to continue cooperating with federal and state authorities as part of its efforts to vigorously enforce the securities laws, particularly with regard to fraud and other serious sale practices abuses.

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

# For Your Information

National Association of Securities Dealers, Inc.

February 1989

## Series 7 Test Date and Site Changes in February

### February Series 7 Date Change

Because of the national holiday that falls on the third weekend, the February Series 7 exam session will be conducted February 11, 1989, at all locations except:

Atlanta, GA                      Minneapolis, MN  
 Little Rock, AR                San Francisco, CA

The locations listed above will administer the exam February 18, 1989.

### Atlanta Test Site for February

The February 18, 1989, Series 7 exam in Atlanta will be held at the following location:

Ramada Inn  
 I-85 & Shallowford Road  
 Atlanta, GA

Signs will be posted in the lobby to direct candidates to the exam.

### Memphis Test Site for February

The February 11, 1989, Series 7 exam in Memphis will be held at:

Holiday Inn  
 Overton Square  
 1837 Union Avenue  
 Memphis, TN

Signs will be posted in the lobby to direct candidates to the exam.

For information on exams, locations, or dates, contact the Information Services Department at (301) 590-6500.

## Correction to Notice to Members 89-9 Re: Thanksgiving Day Trade-Settlement Schedule

Veterans Day, November 10, 1989 was incorrectly identified as a holiday in the previous issue. November 10 is considered a business/settlement date since the nation's banking institutions **will not** be closed in observance of Veterans Day. The corrected November holiday schedule follows.

### Thanksgiving Day: Trade Date Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Thursday, November 23, 1989, Thanksgiving Day. "Regular way" transactions made on the preceding business day will be subject to the settlement date schedule listed below.

Trade Date	Settlement Date	Regulation T Date*
November 13	20	22
14	21	24
15	22	27
16	24	28
17	27	29
20	28	30
21	29	December 1
22	30	4
23	Markets Closed	—
24	December 1	5

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

Questions regarding the application of these settlement dates to a particular situation may be directed to the NASD Uniform Practice Department at (212) 858-4341.

\* 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 seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Regulation T Date."

**Correction to Notice 89-6 Re: State Participation in CRD Form BD and BDW Processing**

The last issue incorrectly listed the state of Arkansas as a CRD Phase II participant. The state of Arkansas will not accept the Form BD amendments and Forms BDW filed with CRD in place of an original filing made directly to the state office.

Fees will not be collected through CRD. The initial BD registration fee is the same at \$300.

Questions regarding CRD participation should be directed to NASD Information Services at (301) 590-6500.

# Notice To Members

National Association of Securities Dealers, Inc.

February 17, 1989 — Supplement

**Number 89-20****Suggested Routing:\*** Senior Management Corporate Finance Government Securities Institutional Internal Audit Legal & Compliance Municipal Mutual Fund Operations Options Registration Research Syndicate Systems Trading Training

\*These are suggested departments only. Others may be appropriate for your firm.

**IMPORTANT MAIL VOTE**

**Subject: Proposed Amendments to Article III, Sections 1-28 of the  
NASD Rules of Fair Practice — Last Voting Date: March 20, 1989**

**EXECUTIVE SUMMARY**

NASD members are invited to vote on extensive amendments to Article III, Sections 1 through 28 of the NASD Rules of Fair Practice that include a number of new sections. The amendments have been approved by the NASD Board of Governors and now require membership approval. Prior to becoming effective, the amendments must be filed with, and approved by, the Securities and Exchange Commission.

The proposed amendments include five entirely new sections to be added to Article III of the Rules of Fair Practice. The proposed new sections are identified in this notice by the letter designations Sections [A] through [E]. If approved by the membership and the SEC, the new sections will entirely replace certain current NASD Board of Governors' Interpretations.

The amendments to existing Sections 1 through 28 include proposals to delete several

sections in their entirety, primarily because they duplicate existing standards already covered under SEC regulations.

Many of the remaining sections contain proposed language revisions that clarify standards and requirements or respond to members' comments. There are extensive changes in Section 4 to incorporate the "NASD Mark-Up Policy" (sometimes referred to as the "Five Percent Policy"), which currently is a Board of Governors' Interpretation under Section 4, as well as to Section 25 to incorporate existing statutory changes and SEC rulings affecting the latter section. Members are not being asked to vote on the existing sections in which no changes are being proposed, and the texts of these sections are reproduced in this notice solely for information.

The texts of the proposed amendments follow.

**BACKGROUND**

During the past several years, the NASD Ad Hoc Committee on Rule and By-Law Amendments (Committee) has been reviewing the NASD's By-

Laws, rules, interpretations, policies, and resolutions and making recommendations. The Committee's initial review covered the NASD By-Laws and Code of Procedure that, following adoption by

the NASD Board of Governors, were approved by the Securities and Exchange Commission (SEC) and have been in effect since early 1985.<sup>1</sup>

The proposed amendments to Article III, Sections 1 through 28 of the NASD Rules of Fair Practice contained in this notice represent a further step in the Committee's review and have been approved by the NASD Board of Governors. The amendments are primarily designed to conform the current provisions to statutory changes made over the years, to clarify their applications, to codify certain Board of Governors' Interpretations and policies into new rules, and generally to make the provisions more current and workable.

### THE PROPOSED AMENDMENTS

The proposed amendments represent a revision of the proposals as previously published for comment in *Notice to Members 86-9* (February 7, 1986). The NASD received 14 written comments, which were reviewed and considered by the Board of Governors and the Committee. The Board of Governors and the Committee believe that a number of these comments raised valid concerns about the application of the amendments to several substantive areas of NASD regulation. Therefore, the Board of Governors and the Committee revised the proposed amendments to reflect these concerns.

The proposed amendments are limited to Sections 1 through 28 of Article III of the NASD Rules of Fair Practice and certain interpretations and other published material thereunder. Although the Board of Governors and the Committee reviewed all the Rules of Fair Practice, Sections 1 through 28 have been specifically selected for revision because they have been in existence for many years without any overall Board of Governors' review. Almost all these sections date from the NASD's inception, and some were adopted shortly thereafter.<sup>2</sup>

Any future changes to the balance of the Rules of Fair Practice, when and if they appear necessary, will be submitted separately for membership vote.<sup>3</sup> The proposed amendments fall into two broad categories: (1) several entirely new sections; and (2) proposed amendments to, or deletions of, certain existing sections.

### NEW SECTIONS REPLACING CURRENT BOARD INTERPRETATIONS

The proposed amendments include five

entirely new sections to be added to Article III of the Rules of Fair Practice. The proposed new sections are identified in this notice and on the ballot by the letter designations Sections [A] through [E]. If approved by the membership and the SEC, the new sections will entirely replace certain current NASD Board of Governors' Interpretations.

The new sections are intended to incorporate and codify four current, long-standing, and important Interpretations of the Board of Governors, which now appear in the NASD Manual under Section 1 of Article III of the Rules of Fair Practice.<sup>4</sup> They include the Interpretations under Section 1 entitled "Execution of Retail Transactions in the Over-the-Counter Market," "Prompt Receipt and Delivery of Securities," "Forwarding of Proxy and Other Materials," and "Free-Riding and Withholding."<sup>5</sup>

New Sections [A] through [E] to Article III represent both a codification and a revision to the language of the existing Board Interpretations. The Board of Governors and the Committee believe the language changes made in the Interpretations clarify the applicable standards and requirements. Substantive changes have been kept to a minimum, and most are in response to members' comments. The Board of Governors and the Committee believe that the new sections are long overdue and should result in a major improvement in communicating — to persons entering the securities industry as well as to persons now in the industry — the basic ethical standards to which they may look for guidance and the standards they must meet to remain in compliance with NASD rules.

### CHANGES IN CURRENT SECTIONS

The amendments to existing Sections 1 through 28 include proposals to delete several sections in their entirety, primarily because they duplicate existing standards that are already covered under SEC regulations. Many of the remaining sections contain proposed language revisions that primarily clarify standards and requirements or respond to members' comments. There are extensive changes in Section 4 to incorporate the "NASD Mark-Up Policy," sometimes referred to as the "Five Percent Policy," into the section, which currently is a Board of Governors' Interpretation under Section 4, as well as to Section 25 to incorporate existing statutory changes and SEC

rulings affecting this section.<sup>6</sup>

### MATTERS NOT COVERED BY THE AMENDMENTS

Several Board of Governors' Interpretations, Resolutions, and similar material now appearing in the NASD Manual under Sections I through 28 of Article III are not included in the attached proposed amendments because they constitute a relatively small volume of published material, compared with the extensive texts of the Board of Governors' Interpretations being codified into new sections of the Rules of Fair Practice. For a variety of reasons, the Board of Governors and the Committee believe that this material does not lend itself easily to codification as new Rules of Fair Practice.

After considering previous comments by members, the Board of Governors decided to withhold any action to modify or rescind these Interpretations and other materials, pending further study and review.<sup>7</sup> The materials not codified in the proposed amendments, therefore, will continue to be effective and binding on members and persons associated with members.

### REQUEST FOR VOTE

The attached texts of the proposed amendments are published in the sequence in which they

now appear in the NASD Manual. Each proposed amendment also contains paragraph and page references to indicate where the existing material can be found in the Manual and the item number on the ballot, if applicable.

Proposed new Sections [A] through [E] to Article III will replace the Board of Governors' Interpretations under Section 1 of Article III. The new sections, however, will be given numerical identifiers prior to publication in the NASD Manual.

An explanation and description of each amendment immediately follows the text of the proposed amendment.

These amendments are important and merit members' immediate attention. The Board of Governors believes these amendments to the Rules of Fair Practice are necessary and appropriate and recommends that members vote their approval. Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to The Corporation Trust Company. Ballots must be postmarked **no later than March 20, 1989.**

Questions concerning this notice may be directed to Dennis C. Hensley, NASD Vice President and Deputy General Counsel, at (202) 728-8294, or John F. Mylod, Jr., NASD Assistant General Counsel, at (202) 728-8288.

<sup>1</sup> Securities Exchange Act of 1934, Release Nos. 21843 (March 12, 1985) and 21838 (March 12, 1985); and NASD *Notice to Members* 85-27 (April 15, 1985).

<sup>2</sup> Sections 1 through 25 of Article III of the NASD Rules of Fair Practice were part of the NASD's original registration statement approved when the SEC granted the NASD's application for registration as a national securities association. In the Matter of National Association of Securities Dealers, Inc., 5 S.E.C. 627 (1939). Sections 26-28 were adopted shortly after such date.

<sup>3</sup> The proposed amendments do not cover Sections 29 *et seq.* of Article III of the Rules of Fair Practice. These provisions are comparatively new sections and, therefore, are more current in their scope and purpose. The proposed amendments also do not cover Articles I, II, IV, V, and VI of the Rules of Fair Practice, which cover matters other than basic ethical standards of conduct, e.g., definitions and procedural matters.

<sup>4</sup> The Board Interpretations relating to Section 1 and covered by this notice now appear at ¶2151.03-2151.06 (pp. 2037-2047-3), NASD Manual (CCH). The Board Interpretation relating to Section 4 now appears at ¶2154 (pp. 2054-2058), NASD Manual (CCH).

<sup>5</sup> The one Board Interpretation under Section 1 not

covered by the amendments is entitled "Review of Corporate Financing." This interpretation already has been codified into a new section of the Rules of Fair Practice and approved by a separate membership vote. A filing has been made and is pending approval before the SEC. NASD *Notice to Members* 83-24 (May 19, 1983); SR-NASD-83-27 (December 27, 1983).

<sup>6</sup> Current Section 25 now appears at ¶2175 (p. 2101) NASD Manual (CCH).

<sup>7</sup> These Interpretations and similar material were included in the original amendments circulated for comment in NASD *Notice to Members* 86-9 (February 7, 1986). Some commenters expressed concern over the statement that the Committee and Board of Governors were considering deleting some of these materials or placing them in an "omnibus notice" to be sent separately to all members.

The commenters believed that these provisions establish important guidelines and standards that members should have readily available. In light of these comments, the Board of Governors and the Committee are continuing to study various ways of dealing with these materials, including a possible new manual of interpretations to be furnished to members, which could contain interpretations issued by both the NASD and the SEC.

## NASD RULES OF FAIR PRACTICE

(Note: New language is underlined, and deleted language is bracketed.)

### CURRENT TEXT

NASD Manual, ¶ 2151, p. 2014

#### No Vote Required

#### Business Conduct of Members

Sec. 1. A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

### EXPLANATION

No change is being proposed to this section.

This is the broadest and most fundamental section of the NASD Rules of Fair Practice and the source of a great deal of the existing precedent that has evolved in NASD disciplinary actions. The section contains a long-accepted principle that expresses the basic statement of standards of ethical business conduct in the investment banking and securities businesses. Therefore, it would be unwise and without justification to amend the language.

The section also restates the requirements of the statute under which the NASD has been granted its self-regulatory authority.

### CURRENT TEXT

#### Items 1 and 2 on ballot

NASD Manual, ¶ 2151.03, pp. 2037 — 2037-3

[... Interpretation of the Board of Governors]

[Execution of Retail Transactions in the Over-The-Counter Market]

### [Background]

[.03 The Board of Governors, under its obligation to "remove impediments to and perfect the mechanism of a free and open market," has made a review of practices in the over-the-counter market that can affect the price of shares paid by public customers in retail transactions. This review has brought to light certain practices by members that may deny customers the benefit of the diversity and competition that may exist in the inter-dealer market.]

[To make members more fully aware of their obligations in this area and to more expressly define the standards of fair practice pertaining, the Board of Governors has issued the following Interpretation:]

### [Interpretation]

[A. In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Failure to exercise such diligence shall constitute conduct inconsistent with just and equitable principles of trade in violation of Article III, Section 1 of the Rules of Fair Practice.]

[Comment: Among the factors that will be considered by the Business Conduct Committees in applying the standard of "reasonable diligence" in this area are:]

- [(1) The character of the market for the security — e.g., price, volatility, relative liquidity, and pressure on available communications;]
- [(2) the size and type of transaction;]
- [(3) the number of primary markets checked;]
- [(4) location and accessibility to the customer's broker-dealer of primary markets and quotations sources.]

[B. In any transaction for or with a customer, no member or person associated with a member shall interject a third party between the member and the best available market except in cases where the member can demonstrate that to his knowledge at the time of the transaction the total cost or proceeds of the transaction, as confirmed to the member acting for or with the customer, was better than the prevailing inter-dealer market for the security. Failure to comply with the provisions of this paragraph shall constitute conduct inconsistent with just and equitable principles of trade in violation of Article III, Section 1 of the Rules of Fair Practice.]

[Comment: Under this standard the member's obligations to his customers are generally not fulfilled when he channels transactions through another broker-dealer or some person in a similar position, unless he can show that by so doing he reduced the costs of the transactions to the customer.]

[The Board of Governors realizes that there are occasions when a member cannot execute directly with a market maker but must employ a broker's broker or some other means in order to insure an execution advantageous to the customer. Some examples are where a customer's order is "crossed" with another retail firm that has a

corresponding order on the other side, or where the identity of the retail firm, if known, would likely cause undue price movements adversely affecting the cost or proceeds to the customer. In such situations, the burden of showing the circumstances is on the retail firm.]

[A simple failure to maintain or adequately staff an over-the-counter order room or other department assigned to execute customers' orders cannot be considered justification for executing away from the best available market; nor can channeling orders through a third party as described above as reciprocation for service or business operate to relieve a member of his obligations. However, this interpretation would not prohibit the channeling of customers' orders through a broker's broker or other third party pursuant to established correspondent relationships under which executions are confirmed directly to the member acting as agent for the customer, such as where the third party gives up the name of the retail firm, so long as the cost of such service is not borne by the customer.]

[A member through which a retail order is channeled, as described above, and which knowingly is a party to an arrangement whereby the initiating member has not fulfilled his obligations under this interpretation, will also be deemed to have engaged in conduct inconsistent with just and equitable principles of trade.]

[C. The obligations described in paragraphs A and B above exist not only where the member acts as agent for the account of his customer but also where retail transactions are executed as principal and contemporaneously offset. Such obligations do not relate to the reasonableness of commission rates, markups or markdowns that are governed by Article III, Section 4 of the Rules of Fair Practice.]

[D. In any transaction for or with a customer pertaining to the execution of an order in a non-NASDAQ security (as defined in Schedule H to the By-Laws) a member or person associated with a member shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.]

**PROPOSED NEW SECTION [A] OF THE NASD RULES OF FAIR PRACTICE**

**Item 1 on ballot**  
Obligations in Effecting Customer Transactions In the Over-the-Counter Market  
Sec. [A].

**General**

(a) A member and persons associated with a member, when effecting any agency or contemporaneous principal transaction, for or with a customer in the over-the-counter market, shall (1) use reasonable diligence to ascertain the best inter-dealer market for the security and (2) where the purchase or sale takes place in the inter-dealer market, shall use reasonable diligence to effect the transaction at a price to the customer, net of commissions charged or mark-ups or mark-downs applied by the member, which is as favorable as possible under existing market conditions. For purposes of this section, the term "contemporaneous principal transaction" shall mean any transaction by a member which is not a market maker in the security in which, after receiving a customer's order or indication of interest, the member purchases or sells the security in the inter-dealer market to offset a contemporaneous purchase or sale by such customer. For purposes of this section, the term "inter-dealer market" shall include the market on a national securities exchange if the security is traded in both the over-the-counter and exchange markets.

Due Diligence

(b) For purposes of determining whether the standard of "due diligence" has been satisfied, the following factors, as well as any other relevant factors and circumstances, shall be taken into consideration:

(1) The characteristics of the market for the security, including, but not limited to, price, volatility, depth, and liquidity;

(2) The pressure on communication systems available to the member;

(3) The size and kind of order;

(4) The total amount of the transaction;

(5) The type of security;

(6) The accessibility to the customer's broker-dealer of market makers and quotations sources; and

(7) The number of market makers checked.

(c) In any transaction for or with a customer pertaining to the execution of an order in a non-NASDAQ security (as defined in Schedule H to the By-Laws), a member or person associated with a member shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

**EXPLANATION**

This new section will codify the language that now appears in the NASD Manual as an Interpretation of the Board of Governors — "Execution

of Retail Transactions in the Over-the-Counter Market" — under Article III, Section I of the Rules of Fair Practice (Best Execution Interpretation). The new section will replace paragraphs A and C of the Best Execution Interpretation, which will be rescinded by the Board of Governors upon effectiveness of the new section. The new section is designated Section [A] and will be given a permanent section number and placement within Article III prior to effectiveness. The basic duty of "best execution" appears in current paragraph A, which has been codified as subsections (a) and (b) of new Section [A]; and the basic prohibition against "interpositioning," which is currently contained in paragraph B, has been codified as new Section [B] discussed below separately. The language defining the scope of the Best Execution Interpretation in current paragraph C has been incorporated into both new sections. The existing Interpretation of the Board of Governors was adopted in 1968 in response to a recommendation in the 1964 SEC Special Study of Securities Markets. The language of paragraph D relating to the execution of transactions in non-NASDAQ securities was added to the Interpretation effective September 1, 1988, and is proposed to be incorporated into new Section [A]. The Board of Governors believes that the Best Execution Interpretation is included with those existing interpretations and policies of the Board that establish basic standards of conduct and, therefore, merits codification and adoption as a new rule of fair practice. The new section appears on the ballot as Item 1.

**Subsection (a):**

The proposed recodification of the "best execution" part of the Interpretation clarifies the types of customer transactions covered. They are limited to agency and contemporaneous principal, i.e., so-called riskless principal transactions.

The rule contains a definition of "contemporaneous principal transaction." It appears that the original intent of the Interpretation was to cover principal trades that are the functional equivalent of agency transactions. The new definition covers only situations where, after a member has received a customer order, an offsetting purchase or sale is effected by the member.

The new definition parallels the language of SEC Rule 10b-10(a)(8), which requires disclosure of markups in confirmations for contemporaneous principal trades when the broker-dealer has the

customer's order in hand and then effects the offsetting transaction. The NASD rule, however, also covers situations where the customer has indicated an interest in buying or selling a security but the member does not record the order to prevent evasion of the best-execution duty.

The proposed rule continues and clarifies the existing language that confines the Best Execution Interpretation's coverage to transactions where the offsetting trade is effected only in the inter-dealer market. The primary concern expressed in the Interpretation was for transactions effected by retail firms with wholesale firms. The current language in the Best Execution Interpretation states that the firm's duty is to ascertain the best inter-dealer market and ". . . buy or sell in such market. . . ." The quoted phrase, however, is being deleted because it might imply an obligation to execute in the inter-dealer market. This is contrary to industry practice and presumably was never intended. There are many situations where effecting transactions outside the inter-dealer market is permissible. It is not uncommon for members to cross transactions with other customers' orders to buy or sell securities on behalf of customers from or to banks, other institutions, or even the issuer on some occasions. The substituted language is designed to clarify this point.

The revised language is not intended to impose a duty to ascertain the market outside the inter-dealer market since this would go beyond the apparent scope of the Interpretation. If, however, a member knows of a better market elsewhere and, without any justification, fails to execute the customer's order in such market, the member's conduct could be considered by an NASD District Business Conduct Committee or, if appropriate, the Market Surveillance Committee, to be inconsistent with high standards of commercial honor, in violation of the broad provisions of Article III, Section I of the Rules of Fair Practice.

By including the firm's duty to ascertain the market (in new Subsection (a)(1) above) and to obtain the most favorable price (in new Subsection (a)(2)), the rule clarifies that both duties are satisfied if the member uses reasonable diligence. The last sentence of existing paragraph C of the Interpretation has been rewritten to clarify that retail commissions and markups are to be evaluated separately from whether the duty of best execution has been satisfied.

This proposed new rule of fair practice is identical to that proposed for comment in *Notice to Members 86-9*, except for the added language to clarify that the "inter-dealer market" includes the "exchange markets" in dually traded securities. Also, a change in the title of the section reflects that the section protects both individual and institutional customers.

**Subsection (b):**

The "due diligence" factors to be considered are especially important because of the broad scope of the best-execution obligation. In Subsection (b)(1), the word "depth" has been added. The concepts of depth and liquidity are different. "Depth," meaning the ability of the market to rapidly absorb or supply a large block of securities, may not exist, even though the market may be liquid, due to the existence of several market makers willing to buy and sell a normal unit of trading.

The existing "pressure on available communications" has been repositioned to new Subsection (b)(2) since it appears to relate more to a particular member's situation rather than being a characteristic of the market for the security. In Subsection (b)(3), the word "order" has been substituted for "transaction" because "not held" orders, limit orders, all-or-none orders, and other types of orders require different handling.

The amount of the transaction is of obvious relevance and, although implicit under the existing language, is emphasized by placing it separately in new Subsection (b)(4).

The "type of security" is a factor not mentioned in the existing language. It has been added under Subsection (b)(5) because the market often differs depending on the type of security.

The word "primary" is deleted in Subsections (b)(6) and (b)(7) because it seems unwarranted to impose on members a duty to know which, if any, firms are the primary market makers in any given security. The requirement in Subsection (b)(7) could be satisfied by checking a NASDAQ Level 3 terminal.

**Subsection (c):**

This subsection is the identical language currently contained in paragraph D of the Interpretation with respect to the duty of members executing transactions in non-NASDAQ securities to obtain quotations from at least three dealers (or fewer if there are less than three dealers in the security) to

determine the best inter-dealer market. The purpose and application of the provision, which became effective September 1, 1988, and certain other related requirements contained or to be contained shortly in other NASD rules and schedules, were previously announced in *NASD Notices to Members 88-40* (June 1988) and *88-54* (July 1988).

**PROPOSED NEW SECTION [B] OF THE NASD RULES OF FAIR PRACTICE**

**Item 2 on ballot**

**Interpositioning Prohibition**

**Sec. [B].**

**General**

(a) No member or person associated with a member in any agency or contemporaneous principal transaction for or with a customer in the over-the-counter market shall interpose another broker-dealer or any other conduit between the member and the best available market for the security, unless the member can demonstrate that to his knowledge at the time of the transaction the total price paid, or amount received by the customer, as confirmed or billed to the member having the customer by the interposed person, net of commissions paid to the member by the customer, or mark-ups or mark-downs applied by the member, was better than or equal to the prevailing inter-dealer market for the security.

**Exemptions**

(b) The prohibitions of subsection (a) shall not be applicable to: (1) "principal disclosed" clearing arrangements under which transactions are effected by the clearing member for the introducing member and the market maker or other third member confirms the transaction directly with the clearing member, or (2) other relationships between members under which a correspondent intermediary member transmits the order to a market maker or other third member and the market maker confirms the transaction directly with the initiating member rather than with the intermediary member ("give-up" transactions), so long as the cost of such service is not borne by the customer.

**Obligations of Interposed Members**

(c) No member shall permit an order to be channeled through it as described in subsection (a) of this section when it knowingly is a party to an arrangement whereby the initiating member has not fulfilled its obligations under this section.

**Definitions**

(d)(1) As used in subsection (a), the term "best available market" shall mean the best inter-dealer market for the security, unless the member has actual knowledge of any market outside the inter-dealer market that is better than such inter-dealer market.

(2) As used in subsection (a), the term "contemporaneous principal transaction" shall have the same meaning as that used in Section [A] of the Rules of Fair Practice.

**EXPLANATION**

New Section [B] will replace paragraphs B and C of the Best Execution Interpretation, which together constitute the "interpositioning" part of the Interpretation, which will be rescinded on adoption of the new section. The new section has been temporarily designated Section [B] of Article III of the Rules of Fair Practice and will be given a permanent section number and placement within Article III prior to effectiveness. The new section appears on the ballot as Item 2.

Except as noted below, proposed new Section [B] retains the language originally proposed for comment. The new section is a rewording of existing paragraph B of the Best Execution Interpretation and the language found under the heading "Comment." The added language "in any agency or contemporaneous principal transaction for or with a customer in the over-the-counter market," which appears in Subsection (a) of new Section [B], is intended to clarify that the restriction against interpositioning applies to both types of transactions. It also parallels the language of proposed Section [A] that establishes a general best-execution standard.

The existing Best Execution Interpretation covers any interposed third party. This provision allows the NASD to bring disciplinary actions when the interposed account is the personal account of the member's trader or other persons associated with a member. Subsection (a) of the proposed rule substitutes the words "any other conduit" for the current "third party" language because this appears more consistent with the concept of interpositioning. The use of the term "conduit" is, thus, intended to clarify that the prohibitions of Section [B] apply when the proposed intermediary is simply a channel between the member and the market in which the transaction is executed.

A major change from the language of proposed Section [B] as published for comment relates to the scope of the interpositioning prohibition. Under both the existing Interpretation and the originally proposed new section, a member is prohibited from interposing someone between the customer and the best available market unless it can be demonstrated that the price paid or received by the customer was "better than" the prevailing inter-dealer price. One commenter stated that if a customer is not prejudiced because the price received or paid is the same as the prevailing inter-dealer price, it is unnecessary to limit the ability of the member to act in the best interest of the customer. It was further pointed out that if a member deems it advantageous for legitimate business reasons to buy or sell a security from a non-market maker and the customer receives a price equal to the inter-dealer price, the customer cannot be prejudiced. Therefore, Subsection (a) of new Section [B] prohibits interpositioning unless the member can demonstrate that the price paid or received by the customer was "better than or equal to" the prevailing inter-dealer price. A further change in new Section [B] is elimination of the word "retail" before "customer" to clarify that the protections of the section apply to institutional as well as individual customers.

The words "cost or proceeds" in the Best Execution Interpretation have been deleted and new language added to clarify that the amount paid or received by the customer is the amount the member paid or received from the interposed party without any adjustment for commissions paid by the customer to the member or markups or markdowns applied by the member in the transaction with the customer. The phrase "as confirmed to the member" is expanded because, where the interposed person is not a broker-dealer, the member would not necessarily receive a receipt or bill labeled a "confirmation."

Proposed Subsection (b) is entirely new and replaces the last sentence of the third paragraph under the heading "Comment" in paragraph B of the Best Execution Interpretation. New Subsection (b) would explicitly exempt (1) principal disclosed clearing arrangements and (2) other correspondent arrangements involving "give ups" of the name of the member initiating the transaction through another member.

Proposed Subsection (c) is a revision of the

fourth paragraph under the heading "Comment" in the Best Execution Interpretation. The language clarifies the responsibility of the interposed member and is considered appropriate considering that one of the traditional motives for interpositioning is to reward the interposed firm for business or services.

Subsection (d) contains a definition of the phrase "best available market." Without a definition in the current Best Execution Interpretation, the phrase appears to place an uncertain standard on members, which could be unfair if members are required to become aware of the existence of some little-known or obscure market, such as a single investor willing to buy the security whose interest is not advertised in conventional quotations media. As a result of member comment, however, the definition originally proposed has been revised slightly to more closely parallel the general duty of best execution in proposed new Section [A].

### CURRENT TEXT

#### Item 3 on ballot

NASD Manual, ¶ 2151.04, p. 2037-4 — 2037-5

[. . . Interpretation of the Board of Governors]

#### **[Prompt Receipt and Delivery of Securities]**

[04. It shall be deemed a violation of Article III, Section 1 of the Rules of Fair Practice of the Association for a member to violate the provisions of the following Interpretation thereof:]

[(a) Purchases: No member may accept a customer's purchase order for any security unless it has first ascertained that the customer placing the order or its agent agrees to receive securities against payment in an amount equal to any execution, even though such an execution may represent the purchase of only a part of a larger order.]

[(b) Sales:]

#### **[(1) Long Sales]**

[No member or person associated with a member shall accept a long sale order from any customer in any security unless:]

[(A) The member has possession of the security;]

[(B) The customer is long in his account with the member;]

[(C) The member makes an affirmative determination that the customer owns the security and will deliver it in good deliverable form within five (5) business days of the execution of the

order; or]

[(D) The security is on deposit in good deliverable form with a member of the Association, a member of a national securities exchange, a broker-dealer registered with the Securities and Exchange Commission, or any organization subject to state or federal banking regulations and that instructions have been forwarded to that depository to deliver the securities against payment.]

#### **[(2) "Short" Sales]**

[No member or person associated with a member shall accept a "short" sale order for any customer in any security unless the member makes an affirmative determination that it will receive delivery of the security from the customer or that it can borrow the security on behalf of the customer for delivery by settlement date. This requirement shall not apply, however, to transactions in corporate debt securities.]

#### **[(3) Public Offering]**

[In the case of a public offering of securities, paragraph 1 hereof shall not apply during the period from the commencement of the public offering until seven (7) business days following the date of settlement between the underwriter and the issuer of the securities; provided, however, that the member believes in good faith that the customer has purchased the securities.]

#### **[(4) "Affirmative Determination"]**

[(C) To satisfy the requirements for an "affirmative determination" contained in Subsection (1)(C) above, the member or person associated with a member must make notation on the order ticket at the time he takes the order which reflects his conversation with the customer as to the present location of the securities in question, whether they are in good deliverable form and his ability to deliver them to the member within five (5) business days.]

### PROPOSED NEW SECTION [C] OF THE NASD RULES OF FAIR PRACTICE

#### Item 3 on ballot

#### **Prompt Receipt and Delivery of Securities**

#### **Sec. [C]**

**(a) Purchases. No member or person associated with a member shall accept a customer's purchase order for any security for more than a single unit of trading unless it has first ascertained that the customer placing the order or its agent agrees to receive securities against payment in an amount equal to any execution, even though such an execution may represent the purchase of only a part of a larger order.**

**(b) Sales**

**(1) Long Sales**

No member or person associated with a member shall execute a long sale order from any customer in any security unless:

(A) The member has possession of the security;

(B) The customer is long in his account with the member;

(C) The member makes an affirmative determination that the customer owns the security and will deliver it in good deliverable form within five (5) business days of the execution of the order;  
or

(D) The security is on deposit in good deliverable form with a member of the Association, a member of a national securities exchange, a broker-dealer registered with the Securities and Exchange Commission, or any organization subject to state or federal banking regulations and that instructions have been forwarded to that depository to deliver the securities against payment.

**(2) "Short" Sales**

No member or person associated with a member shall accept a "short" sale order for any customer in any security unless the member makes an affirmative determination that it will receive delivery of the security from the customer or that it can borrow the security on behalf of the customer for delivery by settlement date. This requirement shall not apply, however, to transactions in corporate debt securities.

**(3) Public Offering**

In the case of a public offering of securities, paragraph (1) hereof shall not apply during the period from the commencement of the public offering until seven (7) business days following the date of settlement between the underwriter and the issuer of the securities; provided, however, that the member believes in good faith that the customer has purchased the securities.

**(4) "Affirmative Determination" and Notation on Order Ticket**

To satisfy the requirements for an "affirmative determination" contained in subsection (1)(C) above, the member or person associated with a member must make a notation on the order ticket at the time he takes the order which reflects the conversation with the customer as to the present loca-

tion of the securities in question, whether they are in good deliverable form, and his ability to deliver them to the member within five (5) business days. If subsections (1)(B) or (1)(D) above are applicable, the order ticket must contain a notation reflecting the requirements of these subsections.

**EXPLANATION**

As originally proposed, new Section [C] would have codified the language that now appears in the NASD Manual as an Interpretation of the Board of Governors — "Prompt Receipt and Delivery of Securities" — under Article III, Section 1 of the Rules of Fair Practice (Prompt Receipt Interpretation) and would have included a new provision to cover short sales. However, on October 15, 1986, the short-sale provision became effective as an amendment to the existing Prompt Receipt Interpretation. Proposed new Section [C] converts the Interpretation as amended into rule form with certain changes explained below.

Subsection (a) of new Section [C] incorporates the current provision in the Prompt Receipt Interpretation requiring that the customer placing a purchase order agree to accept a partial delivery, but modifies the existing language to make the requirement applicable only to purchase orders for more than a single unit of trading. The Board of Governors believes that it is unfair to require a customer who places an order for less than a unit of trading to accept a partial delivery.

The other change is in Subsection (b)(4) of new Section [C], which would expand the existing order-ticket-notation requirement when the selling customer has possession of the securities to also require an appropriate order-ticket notation when the securities are long in the customer's account or in the possession of another member or bank. The new section appears as Item 3 on the ballot.

The NASD has filed a proposed rule change with the SEC to amend the current language of Subsection (b)(2) to impose the same requirement on short sales by members effecting short sales for their own accounts. See rule filing SR-NASD-89-5 and *Notice to Members* 88-47 (July 1988) publishing the proposal for comment. The rule filing has not been approved by the SEC. If SR-NASD 89-5 is approved by the SEC, the amendment proposed herein will be made to the Interpretation as amended by that rule change.