

# NASD NOTICE TO MEMBERS 94-80

## SEC Approves NASD Proposal Requiring Members To Annotate Their Affirmative Determinations As To Stock Availability Made In Connection With Short Sales

### Suggested Routing

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

### Executive Summary

On September 12, 1994, the Securities and Exchange Commission (SEC) approved an NASD rule change that amends the Prompt Receipt and Delivery of Securities Interpretation (Interpretation) issued by the NASD Board of Governors under Article III, Section 1 of the NASD Rules of Fair Practice. Specifically, the Interpretation, as amended, requires members to annotate their affirmative determinations as to stock availability that are required to be made when effecting short sales for their own proprietary account or the account of a customer. **The rule change will become effective November 30, 1994.**

### Background And Description

Under the Interpretation, members are required to make certain affirmative determinations as to stock availability when effecting sale transactions. Specifically, for long sales by customers, members must make an affirmative determination that the customer owns the security and will deliver it in good deliverable form within 5 business days of execution of the order. For customer short sales, the Interpretation requires members to make 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. Similarly, for short sales effected in a member's proprietary account, a member must make an affirmative determination that it can borrow the securities or otherwise provide for delivery of the securities by settlement date.

While members must make affirmative determinations as to stock availability when effecting long sales and short sales, the Interpretation present-

ly only requires members to annotate their affirmative determinations made in connection with long sales.<sup>1</sup> Accordingly, to enhance member firm compliance with the affirmative determination requirements already imposed by the Interpretation in connection with short sales and to enable the NASD to more effectively examine for compliance with the affirmative determination requirements, the NASD proposed, and the SEC approved, an amendment to the Interpretation that requires members to annotate their affirmative determinations as to stock availability that are required to be made when effecting short sales for their own proprietary account or the account of a customer. Thus, with this rule change, members will be required to annotate activities that they are already performing in connection with the execution of short sales.<sup>2</sup>

In particular, the Interpretation, as amended, will require members to

<sup>1</sup> Specifically, Section (b)(4) of the Interpretation requires that a member or person associated with a member "must make a 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."

<sup>2</sup> The NASD notes, however, that the rule change does not modify any exemptions from the affirmative determination requirements that are presently in the Interpretation. Specifically, transactions in corporate debt securities, bona fide market making transactions by members in securities in which they are registered as Nasdaq<sup>®</sup> market makers, bona fide market-maker transactions in non-Nasdaq securities in which the market maker publishes two-sided quotations in an independent quotation medium, and proprietary transactions by members that result in fully hedged or arbitrated positions, are still exempt from the affirmative determination requirements for short sales.

annotate, on the trade ticket or on some other record maintained for that purpose by the member firm, the following information:

1. if a customer assures delivery, the member must annotate that conversation noting the present location of the securities; whether the securities are in good deliverable form; and whether they will be delivered to the firm within time for settlement; or
2. if the member locates the stock, the member must annotate the identity of the individual and firm contacted who offered assurance that the shares would be delivered or were available for borrowing by settlement date; and the number of shares needed to cover the short sale.

The manner by which a member or person associated with a member annotates compliance with the "affirmative determination" requirements for short sales (for example, marking the order ticket, recording inquiries in a log, etc.) is not specified by this Interpretation and, therefore, shall be decided by each member. However, an affirmative determination and annotation of that affirmative determination must be made for each and every transaction because a "blanket" or standing assurance that securities are available for borrowing is not acceptable to satisfy the affirmative determination requirement.

Accordingly, with this rule change, the NASD has made clear its long-standing policy that firms cannot rely on daily fax sheets of "borrowable stocks" to satisfy their affirmative determination requirements under the Interpretation. The annotation requirement will preclude this practice as members will have to annotate the name of the person contacted and number of shares for each short sale. Requiring annotation of affirmative determinations in connection with short sales also will enhance the

NASD's ability to examine for compliance with various other NASD short-sale rules including those in Article III, Section 21 of the Rules of Fair Practice (recordkeeping) and in the Uniform Practice Code, Section 71 (mandatory delivery requirements for certain restricted securities). Further, the annotation requirement will assist in examining for compliance with the NASD's recently adopted short-sale rule.

Questions regarding this Notice should be directed to NASD Market Surveillance, at (301) 590-6080, or Thomas R. Gira, Assistant General Counsel, at (202) 728-8957.

### **Text Of Amendments To The Prompt Receipt And Delivery Of Securities Interpretation Issued By The NASD Board Of Governors Under Article III, Section 1 Of The NASD Rules Of Fair Practice**

(Note: New text is underlined; deleted text is bracketed.)

### **••• 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 or person associated with a member to violate the provisions of the following interpretation thereof:

(a) **Purchases:** No member or person associated with a 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) No change.

(B) No change

(C) The member or person associated with a 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) No change.

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

(A) **Customer 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 or person associated with a member makes an affirmative determination that the member [it] will receive delivery of the security from the customer or that the member [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.

(B) **Proprietary short sales.** No member or person associated with a member shall effect a "short" sale for its own account in any security unless the member or person associated with a member makes an affirmative determination that the member [it] can borrow the securities or otherwise provide for delivery of the securities by settlement date. This

requirement will not apply to transactions in corporate debt securities, to bona fide market making transactions by a member in securities in which it is registered as a NASDAQ market maker, to bona fide market maker transactions in non-NASDAQ securities in which the market maker publishes a two-sided quotation in an independent quotation medium, or to transactions which result in fully hedged or arbitrated positions.

### (3) Public Offering

No change.

### (4) "Affirmative Determination"

(A) To satisfy the requirements for an "affirmative determination" contained in subsection (b)(1)(C) above for long sales, the member or person associated with a member must make a notation on the order ticket at the time [he takes] the order is taken which reflects [his] the conversation

with the customer as to the present location of the securities in question, whether they are in good deliverable form and [his] the customer's ability to deliver them to the member within five (5) business days.

(B) To satisfy the requirement for an "affirmative determination" contained in subsection (b)(2) above for customer and proprietary short sales, the member or person associated with a member must keep a written record which includes:

(i) if a customer assures delivery, the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member within five (5) business days; or

(ii) if the member or person associated with a member locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that

were available for borrowing by settlement date and the number of shares needed to cover the short sale.

(C) The manner by which a member or person associated with a member annotates compliance with the "affirmative determination" requirement contained in subsection (b)(2) above (e.g., marking the order ticket, recording inquiries in a log, etc.) is not specified by this Interpretation and, therefore, shall be decided by each member. However, an affirmative determination and annotation of that affirmative determination must be made for each and every transaction since a "blanket" or standing assurance that securities are available for borrowing is not acceptable to satisfy the affirmative determination requirement.

### (5) "Bona Fide Fully Hedged" and "Bona Fide Fully Arbitrated"

No change.

# NASD NOTICE TO MEMBERS 94-81

## SEC Approves NASD Proposal To Require CQS Market-Maker Participation In ITS/CAES And CAES

### Suggested Routing

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

### Executive Summary

On June 29, 1994, the Securities and Exchange Commission (SEC) approved several proposed rule changes by the NASD concerning trading in exchange-listed securities by NASD Consolidated Quotation System (CQS) market makers.<sup>1</sup> Specifically, the following rules will be effective on October 31, 1994:

- All CQS market makers in Rule 19c-3 securities<sup>2</sup> must register as ITS/CAES market makers;<sup>3</sup>
- All CQS market makers in non-Rule 19c-3 securities must register as Computer Assisted Execution System (CAES) market makers;<sup>4</sup>
- All CQS market makers must input a minimum size of 500 shares in their quotations;<sup>5</sup>
- All CQS market makers must abide by the excess spread parameters for CQS securities in Part V of Schedule D to the NASD By-Laws; and
- All CQS market makers will be permitted to enter principal orders into CAES.

The NASD and The Nasdaq Stock Market, Inc., believe these changes will enhance the quality and liquidity of the markets provided by CQS market makers in exchange-listed securities, improve opportunities for customers to receive automated executions of their orders in the third market, and make ITS a more effective market link mechanism in exchange-listed securities. The text of the amendments follows the discussion below.

### Background And Description

In an effort to enhance the quality of the markets provided by CQS market makers in exchange-listed securities, promote competition among exchange

markets and markets provided by CQS market makers, and facilitate better order interaction among ITS Participant Markets, the NASD proposed various amendments to Schedules D and G and the Rules of Practice and Procedure for ITS/CAES. Following is a more detailed explanation of the specific rule changes approved by the SEC.<sup>6</sup>

<sup>1</sup> The third market is the market for exchange-listed securities away from exchange markets.

<sup>2</sup> SEC Rule 19c-3 prohibits the application of off-board trading restrictions to securities that: (1) were not traded on an exchange before April 26, 1979; or (2) were traded on an exchange on April 26, 1979, but ceased to be traded on an exchange for any period of time thereafter. The Intermarket Trading System (ITS) Plan limits the securities eligible for trading through the ITS/CAES linkage to Rule 19c-3 securities.

<sup>3</sup> ITS/CAES is the NASD's link to ITS that enables ITS/CAES market makers in Rule 19c-3 securities to direct agency and principal orders to and receive orders from the floors of participating ITS exchanges. Only CQS market makers registered as ITS/CAES market makers with the NASD are eligible to participate in the ITS/CAES link.

<sup>4</sup> CAES is an automated system regulated by the NASD and operated by The Nasdaq Stock Market, Inc., that allows NASD members to direct agency orders (and principal orders with this rule change) in exchange-listed securities to CAES for automated execution in the third market. CAES market makers are CQS market makers that have registered as CAES market makers.

<sup>5</sup> The NASD's new rule with respect to minimum quotation sizes in CQS securities provides that "CQS market makers shall be required to input a minimum quotation size of 200 or 500 shares in each reported security (as established and published from time to time by the Association) depending on trading characteristics of the security . . ." In this connection, the NASD has determined to require a minimum quotation size of 500 shares for all CQS market-maker quotations.

<sup>6</sup> See Securities Exchange Act Release No. 34280 (June 29, 1994), 59 FR 34880

## 1. Mandatory Inclusion Of CQS Market Makers In Rule 19c-3 Securities In ITS/CAES

One of the most significant amendments approved by the SEC is the requirement that all CQS market makers in Rule 19c-3 securities must register as ITS/CAES market makers, thereby subjecting all CQS market makers in these securities to the obligations and protections afforded participants in the ITS Plan. This rule change is designed to eliminate confusion by exchange participants and others concerning the accessibility of quotations disseminated by CQS market makers. Currently, the quotes of all CQS market makers in exchange-listed securities are consolidated into a composite third-market quote and disseminated to vendors and to the floors of competing exchanges on CQS. The quotes of CQS market makers that are not ITS-linked are included in the consolidated quote, but are not accessible through the facilities of ITS or ITS/CAES to other ITS Participants or ITS/CAES market makers. ITS has its own display of quotations, available only to ITS Participants, and this dual system of quotation information is sometimes confusing. Specifically, when other market centers send ITS commitments to the NASD in response to non-ITS/CAES market-maker quotes seen through CQS, the commitments expire unexecuted and the other market centers may believe that an ITS/CAES market maker has backed away from its quotes. With this rule change, there will be no confusion as to the accessibility of CQS market makers' quotes in Rule 19c-3 securities through ITS.

In addition, by requiring all CQS market makers in Rule 19c-3 securities to participate in ITS, the rule change facilitates better interaction between CQS market makers and the exchanges. Currently, other ITS

Participant Markets cannot execute transactions through ITS with CQS market makers that are not ITS/CAES market makers, even though these market makers may be quoting superior prices. Conversely, non-ITS-linked CQS market makers cannot access, through ITS, superior quotes displayed by the exchanges. With this rule change, orders received by all CQS market makers in Rule 19c-3 securities will be able to interact, through ITS, with orders placed on the exchanges, thus promoting the best execution of investors' orders.

Non-ITS-linked CQS market makers also are presently not bound by the ITS Plan or operating procedures. The ITS Plan contains provisions regarding treatment of trade-through occurrences, block trades, pre-opening procedures, and resolution of obvious errors and intermarket disputes. The new rule will eliminate the current disparate regulatory treatment between those CQS market makers bound by the ITS Plan and those not bound by the Plan. **In addition, pursuant to Section (b)(2) of the NASD's ITS/CAES Rules, members are reminded that they must execute an ITS/CAES Market Maker Application Agreement at least two days before the date they intend to be registered as an ITS/CAES market maker in a CQS security.**

Members are reminded, however, that if they effect and report a transaction in a CQS security that is included within the ITS/CAES linkage after 9:30 a.m. Eastern Time, but before any ITS/CAES market maker in that security has commenced quoting or trading the issue, then all ITS/CAES market makers in that security may be precluded from participating in the ITS pre-opening procedure for that security on that trading day.

## 2. Mandatory Participation In CAES For Non-Rule 19c-3 Securities/Permitting Principal Transactions Through CAES

The SEC approved the requirement that all CQS market makers in non-Rule 19c-3 securities must register as CAES market makers. Mandatory participation in CAES will enhance the liquidity provided through CAES and permit CAES to be a more efficient mechanism for trading exchange-listed securities in the third market. In addition, with mandatory CAES participation, the NASD believes it is appropriate for CAES market makers to be able to access each other through CAES, reducing reliance on telephone contact. Accordingly, the SEC also approved an NASD proposal to modify CAES to permit market-maker-to-market-maker executions within the system.

## 3. Minimum Quotation Sizes For CQS Market Makers

All CQS market makers, regardless of whether they are ITS/CAES market makers or CAES market makers, are now required to input a minimum size of 500 shares in their quotations. The minimum quotation size for an individual CQS security may be lowered from 500 shares to 200 shares from time to time by the NASD depending on unique circumstances, however.<sup>7</sup> The minimum quotation size for each CQS issue will be displayed to the left of the issue's name in the bid/ask quotation display on the Nasdaq Workstation®.

## 4. Excess Spread Parameters To CQS Market Makers

All CQS market makers will be required to adhere to the excess spread parameters established in Part VI, Section 2 of Schedule D to the NASD By-Laws. Specifically, the

<sup>7</sup> See *infra* note 5.

maximum permissible spread for a dealer's quote in a CQS security will be equal to 125 percent of the average of the narrowest three dealer spreads in that issue, provided that the maximum allowable spread will never be less than 1/4 a point. In determining the maximum allowable spread, quotations of exchange participants will be included in the calculation.

Questions regarding this rule change should be directed to Glen Shipway, Senior Vice President, Nasdaq Market Operations, at (203) 385-6250, or Thomas R. Gira, Assistant General Counsel, at (202) 728-8957. Questions concerning the ITS/CAES Market Maker Application Agreement should be directed to Market Data Services at (301) 948-6162.

### **Text Of Amendments To Schedules D And G To The NASD By-Laws And The Rules Of Practice And Procedure For ITS/CAES**

(Note: New text is underlined; deleted text is bracketed.)

### **Schedule D, Part VII Consolidated Quotation Service (CQS)**

#### **Sec. 1 Registration as a CQS Market Maker**

(a) through (d) No change.

(e) All CQS market makers registered in reported securities shall be registered as market makers in the Computer Assisted Execution System (CAES); all CQS market makers registered in reported securi-

ties that are eligible for inclusion in the Intermarket Trading System/Computer Assisted Execution System (ITS/CAES) shall be registered as market makers in ITS/CAES and shall be subject to the Rules of Practice and Procedure for the ITS/CAES System Automated Interface.

#### **Sec. 2 Obligations of CQS Market Makers**

(a) Pursuant to SEC Rule 11Ac1-1, a CQS market maker's quotation in reported securities are required to be firm for the size displayed or, if no size is displayed, for a normal unit of trading. If a market maker displays quotations in a reported security on both a national securities exchange and the NASD's CQS [and the Nasdaq] System, the market maker shall maintain identical quotations in each system [service].

(b) CQS market makers shall be required to input a minimum quotation size of 200 or 500 shares in each reported security (as established and published from time to time by the Association) depending on trading characteristics of the security, and shall be subject to the excess spread parameters established for Nasdaq market makers in Part VI, Schedule D of the NASD By-Laws.

### **Schedule G**

#### **Reporting Transactions In Listed Securities**

This Schedule has been adopted pursuant to Article VII, Section 1(a)(6)

of the Corporation's By-Laws and shall apply to all over-the-counter transactions in listed securities that are required to be reported to the Consolidated Tape ("eligible securities") as provided in the Plan filed by the Association pursuant to Rule 11Aa3-1 under the Securities Exchange Act of 1934 ("Plan"). Section (2) of this Schedule shall not apply to transactions executed through CAES (Computer Assisted Execution System) or ITS/CAES (Intermarket Trading System/Computer Assisted Execution System) by market makers registered as CQS market makers.

### **Rules Of Practice And Procedure For The ITS/CAES Automated Interface**

(a) Definitions

(1) No change.

(2) The term "ITS/CAES Market Maker" shall mean a member of the Corporation that is registered as a market maker with the Corporation for the purposes of participation in ITS through CAES with respect to one or more specified ITS securities in which he is then actively registered. Registration as an ITS/CAES market maker is mandatory for all registered CQS market makers in securities eligible for inclusion in the ITS/CAES linkage.

# NASD NOTICE TO MEMBERS 94-82

**NASD Solicits Comment  
On Proposed Amendment  
To The Corporate  
Financing Rule Relating  
To Rights Of First Refusal;  
Comment Period  
Expires November 30,  
1994**

## Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
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## Executive Summary

The NASD is requesting comment on an amendment to its Corporate Financing Rule (the Rule) relating to rights of first refusal granted to underwriters and related persons in connection with the distribution of public offerings. The amendment would continue to permit the use of rights of first refusal, but would prohibit an underwriter from receiving a right of first refusal to underwrite or participate in future offerings of the issuer that has a duration of longer than three years, has more than one opportunity to waive or terminate the right in consideration of any payment or fee, and is paid other than in cash. The amendment would also require that a right of first refusal have a compensation value of the lesser of one percent of the offering proceeds or the dollar amount contractually agreed to for waiver or termination of the right. Finally, the amendment would prohibit any payment or fee to waive or terminate a right of first refusal that has a value in excess of the greater of one percent of the original offering (or an amount in excess of one percent if additional compensation is available under the compensation guideline of the original offering) or 5 percent of the underwriting discount or commission paid in connection with the future offering. The text of the amendment follows this Notice.

## Background

The NASD developed its policy on the valuation of rights of first refusal in the early 1970s. Rights of first refusal are typically negotiated in connection with an issuer's initial public offering and grant the underwriter a right to underwrite or participate in any future public offerings, private placements, or other financings by the issuer for a certain period of years. The NASD values rights of

first refusal as a non-cash item of compensation at one percent of the offering proceeds and currently limits the duration of the right to 5 years.<sup>1</sup> To the extent that an underwriting agreement includes a provision specifying a dollar amount for the waiver or termination of a right of first refusal, it has been the policy of the NASD Corporate Financing Department (the Department) to value the right of first refusal on the basis of the specified dollar amount in place of the one percent valuation.

The NASD believes that members should be permitted to negotiate to waive or terminate a right of first refusal in the event that the issuer wishes to use a different underwriter to subsequently raise additional capital through a public or private offering of its securities, provided that amounts negotiated are limited to an amount that has some relation to the size of the subsequent offering in which the member is not participating. Because use of rights of first refusal is primarily confined to certain underwriters of companies that are generally small and without significant operative history, the NASD has found that issuers negotiating with an underwriter for the first time in connection with an initial public offering often may not fully comprehend that they have agreed to extend their relationship with the underwriter for as many as five years, nor be in a position to influence the terms of the right. In addition, the NASD has observed that certain underwriters routinely negotiate to receive rights of first refusal at the time of an initial public offering and later negotiate to waive or terminate their rights, apparently without any original

<sup>1</sup> See, Corporate Financing Rule at Article III, Section 44 of the Rules of Fair Practice (Corporate Financing Rule), Section (c)(3)(A)(ix) and Section (c)(6)(B)(v). *NASD Manual*, paragraph 2200D at pages 2206 and 2209.

intent to actually underwrite any subsequent offering of securities by the issuer.

The NASD is concerned that underwriters not be permitted to avoid underwriting compensation limits by negotiating to waive or terminate a right of first refusal with no limitation whatsoever on the amount of compensation they might negotiate to receive. The NASD is also concerned that an issuer may find it difficult to negotiate appropriate underwriting compensation with a new underwriter, where the issuer has determined to sever its relationship with its former underwriter and the former underwriter requires a substantial payment to waive or terminate its right of first refusal. Finally, the NASD believes that the policy on rights of first refusal should also protect investors, who ultimately incur the cost when an issuer compensates an underwriter for waiving or terminating a right of first refusal.

### **NASD Proposal**

The NASD is proposing to amend Section (c)(3)(A)(ix) and Section (c)(6)(B)(v) of the Rule to modify its current provisions regulating the receipt of a right of first refusal. The amendment is intended to preserve rights of first refusal as a valuable item of compensation to an underwriter, while protecting issuers from excessive payments to waive or terminate a right of first refusal granted to a former underwriter.

The amendment would prohibit an underwriter from receiving a right of first refusal that has a duration of longer than three years from the effective date of the offering. The NASD has concluded that a 5-year right is "overreaching" and determined a 3-year period more appropriate. The amendment would also prohibit a right of first refusal that

grants the underwriter more than one opportunity to waive or terminate the right in consideration of any payment or fee. The NASD believes that only one payment should be received by a member for waiving a right of first refusal and that such a payment indicates that the originally negotiated relationship between the issuer and the member has been severed.

With respect to valuation of a right of first refusal in connection with the offering where the right is granted, the amendment would require that a right of first refusal have a compensation value of the lesser of one percent of the offering proceeds or the dollar amount contractually agreed to for waiver or termination of the right.

With respect to the amount of the fee permitted to be paid to a former underwriter in connection with the waiver or termination of a right of first refusal, the NASD has determined to continue to permit such payments, subject to limitations, and to not include the fee paid in connection with its review of the subsequent offering of securities. The amendment would permit the former underwriter to receive a payment or fee to waive or terminate a right of first refusal, so long as the payment or fee does not exceed the greater of one percent of the original offering (or an amount in excess of one percent if additional compensation is available under the compensation guideline of the original offering),<sup>2</sup> or 5 percent of the underwriting discount or commission paid in connection with the future offering (including any allotment option that is exercised). The payment or fee would be permitted regardless of whether it is negotiated at the time of or subsequent to the original public offering. The NASD believes that it is appropriate that the former underwriter be permitted to negotiate a fee that is at least equal to the original valuation of the right of first refusal. With respect to the 5

percent alternative limitation, the NASD recognizes that a right of first refusal is intended to benefit the former underwriter that assumed the risk of distributing the issuer's initial public offering by allowing that underwriter to participate in the issuer's subsequent offering of securities, which is usually considerably larger. The NASD believes, therefore, that it is appropriate to permit the former underwriter to receive a fee based on the new underwriter's commission in the event that the issuer wishes to sever its relationship with the former underwriter.<sup>3</sup>

Finally, the amendment would require that any payment or fee for terminating or waiving a right of first refusal can only be in cash, not in securities or rights to acquire securities.

The NASD recognizes that a right of first refusal may be entered into between an issuer and an underwriter in connection with a private placement that occurs before a public offering, with the result that the underwriting agreement in connection with the public offering will not include this arrangement. The NASD recognizes that in most cases, the right of first refusal only relates to the right of the underwriter to distribute the subsequent public offering. In

<sup>2</sup> It is anticipated that the former underwriter will contact the Department when it is negotiating a waiver or termination of a right of first refusal to obtain information on whether additional compensation is available under the compensation guideline of the original offering.

<sup>3</sup> For example, where the offering proceeds of the original offering were \$10 million and the new offering was to be \$150 million, with a discount of 6 percent or \$9 million, the member could negotiate a fee for waiver or termination of the right of first refusal of up to \$450,000 (5 percent of \$6 million, or \$450,000, which is greater than 1 percent of \$10 million, or \$100,000).



certain cases, however, the right may have a longer duration. Although private placements are not subject to the Rule, the underwriting arrangements entered into in connection with the distribution of the private placement are subject to review by the Department at the time it reviews a subsequent public offering that is subject to the Rule. Under the Rule, any compensation or securities received by the underwriter and related persons may be considered in connection with a public offering if received within the 12 months immediately preceding the filing of the public offering. The Department, therefore, intends to review any right of first refusal granted in connection with a private offering that occurs within the previous 12 months to determine if it should be considered compensation received in connection with the public offering. If the right is found to be in connection with the public offering, the terms of the right will be required to be in compliance with the Rule's limitations on rights of first refusal.

### Request For Comments

The NASD encourages all members and other interested parties to comment on the proposed amendment to the Rule on rights of first refusal. Comments should be forwarded to: Joan C. Conley, Office of the Secretary, NASD, 1735 K Street, N.W., Washington, D.C. 20006-1506. Comments should be received by November 30, 1994.

Questions concerning this Notice may be directed to Richard J. Fortwengler or Paul M. Mathews, Corporate Financing Department, (301) 208-2700. Comments received on or before November 30, 1994, will be considered before final action by the Corporate Financing Committee and the NASD Board on the proposed amendment. If approved by the

Committee and the Board, the amendment will be filed with the Securities and Exchange Commission (SEC). It is anticipated that the SEC will also publish the proposed amendment before acting on it. SEC approval of the amendment is required before it can become effective.

### Text Of Proposed Amendment To The Corporate Financing Rule, Article III, Section 44 Of The Rules Of Fair Practice

[**Note:** New text is underlined; deleted text is bracketed.]

#### (3) Items of Compensation

(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to paragraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the offering, as determined pursuant to paragraph (c)(4) below shall be included:

(i) through (viii) No change.

(ix) any right of first refusal provided to the underwriter and related persons to underwrite or participate in future public offerings, private placements or other financings [by the issuer], which will have a compensation value of the lesser of one percent of the offering proceeds or that dollar amount contractually agreed to by the issuer and underwriter to waive or terminate the right of first refusal;

(x) through (xiii) No change.

(3)(B), (4) and (5) No change.

(6) Unreasonable Terms and Arrangements

(A) No change.

(B) Without limiting the foregoing, the following terms and arrangements, when proposed in connection with the distribution of a public offering of securities, shall be unfair and unreasonable:

(i) through (iv) No change.

(v) any right of first refusal provided to the underwriter and related persons [regarding] to underwrite and participate in future public offerings, private placements or other financings which:

(1) has a duration of more than [five (5)] three (3) years from the effective date of the offering; or

(2) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee;

(vi) any payment or fee to waive or terminate a right of first refusal regarding future public offerings, private placements or other financings provided to the underwriter and related persons which:

(1) has a value in excess of the greater of one (1) percent of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of one percent if additional compensation is available under the compensation guideline of the original offering) or five (5) percent of the underwriting discount or commission paid in connection with the future financing (including any over-allotment option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering; or

(2) is not paid in cash.

[(vi)] (vii) Text unchanged.

[(vii)] (viii) Text unchanged.

[(viii)] (ix) Text unchanged.

[(ix)] (x) Text unchanged.

[(x)] (xi) Text unchanged.

[(xi)] (xii) Text unchanged.

[(xii)] (xiii) Text unchanged.

# NASD NOTICE TO MEMBERS 94-83

## NASD Provides Additional Guidance Concerning The Operation Of The NASD Short-Sale Rule

### Suggested Routing

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

On August 25, 1994, the NASD issued *Special Notice to Members 94-68* (Special Notice) dealing with the NASD's recently approved short-sale rule (Rule). In that Special Notice, the NASD set forth a description of the Rule, provided answers to questions concerning the operation of the Rule, and included the final text of the short-sale rule. In addition, the NASD separately issued ACT Notice 94-1 describing new rules applicable to the reporting of short sales through The Nasdaq Stock Market, Inc., Automated Confirmation Transaction (ACT<sup>SM</sup>) service. Since the Special Notice was issued and the Rule became effective on September 6, the NASD has received additional questions concerning the operation of the Rule. Accordingly, this Notice provides answers to these and other questions in an attempt to enhance member-firm compliance with the Rule. As with the Special Notice dealing with the Rule, the NASD hopes this Notice is helpful to the membership in understanding the new obligations that apply to them as a result of the Rule. The NASD also recognizes that additional assistance may be needed to respond to specific areas of concern to the membership. Inquiries should be directed to the staff members listed after the "Questions And Answers" section below.

### Questions And Answers

**Question #1:** To determine whether a short sale is a "legal" short sale (that is, a non-exempt short sale effected at a price 1/16th above the bid on a down bid), should members refer to the "gross" price at which the short sale is reported to and disseminated by the NASD exclusive of any markdown or should the reference price be the "net" price inclusive of any markdown?

**Answer:** The reported price general-

ly is the "benchmark" price to determine whether a non-exempt short sale is a legal short sale when there is a down bid, not the "net" price incorporating any markdown. For example, if the market is 10 - 10 1/4 and the 10 bid is a down bid, a transaction reported at 10 1/16 would be a legal short sale, even if there were a markdown of 1/16 on the sale. However, if a firm were to modify its practices in dealing with a customer or group of customers after implementation of the Rule such that it commenced charging markdowns or commenced charging larger markdowns so that it could effect and report short sales for its customers at higher "gross" prices while trading at virtually the same "net" price, then the NASD would deem such conduct to be a violation of the short-sale rule and Interpretation C thereto.

For example, the NASD understands that members often trade on a "net" basis with large, institutional clients. If a member were to deviate from this practice by charging such customers a markdown when they are effecting short sales, the NASD would presume that the member is assessing the markdown to facilitate the customer's short-sale transaction. Moreover, if a member were to assess a markdown on a short sale by a customer who had previously traded with the firm exclusively on a "net" basis and, thereafter, immediately sell the stock at the bid, the NASD's presumption that the short sale was effected in violation of the Rule would be even stronger.

**Question #2:** Is it a violation of the Rule to effect a short sale at a price below the bid when the bid is an "up" bid?

**Answer:** No. The Rule only constrains the execution of short sales when there is a down bid. However, depending on the circumstances, the NASD may deem such activity to be

a manipulative act or practice inconsistent with just and equitable principles of trade and a violation of the SEC's anti-fraud rule. The NASD also notes that members should be aware that the execution of a short sale for a customer at a price below the best inside bid may raise concerns that the member did not adequately discharge its best execution obligation with respect to that order. Nevertheless, the NASD acknowledges that it is conceivable that large, institutional-size sell orders may receive best execution even if they are effected at prices below the inside bid.

**Question #3:** When executing a customer's limit order to sell short, does compliance with the NASD's Limit Order Protection Interpretation supersede compliance with the Rule?

**Answer:** If a customer's limit order to sell short is activated by a member's sale transaction, the customer's short-sale order still must be effected in compliance with the Rule. For example, assuming the market for XYZ is 10 - 10 1/4 and the 10 bid is a down bid, if a market maker were to execute a customer's market order to buy XYZ at 10 1/4 while holding a customer's limit order to sell XYZ short at 10, the market maker would not be able to immediately execute the limit order. While the market maker's execution of the market order would activate execution of the limit order under the NASD Limit Order Protection Interpretation, the Rule would preclude the market maker from executing the limit order at 10 because the 10 bid in XYZ is a down bid. If the inside bid for XYZ were to decline to 9 7/8, however, then the limit order could be executed in the event of a subsequent sale by the market maker at the offer because the short sale would be effected at a price at least a 1/16th above the inside bid.

Members should not confuse the answer to this question with the answer to Question #10 in the Special Notice. Question #10 in the Special Notice addressed the situation where a market maker would be selling short on a down bid to fill a customer's limit order to buy at the bid. In that case, the NASD concluded that the market maker's obligation to comply with the Limit Order Protection Interpretation superseded the member's obligation to comply with the Rule.

**Question #4:** If a qualified market maker receives an order to sell 20,000 shares of XYZ short when the market for XYZ is 10 - 10 1/4 on a down bid, would it be a violation of the Rule if the market maker were to sell 20,000 shares of XYZ at the 10 bid and subsequent lower bids in reliance on its exemption from the Rule and then turn around and buy the 20,000 shares from its customer at 1/16th of a point above the new, lower "down" bid?

**Answer:** Yes. The NASD would view the market maker's short sales as an impermissible use of the market-maker exemption and an attempt to avoid application of the Rule to its customer's short sale.

**Question #5:** If a qualified market maker effects short sales in anticipation of selling pressure in a stock or in anticipation of a general decline in the market, are the short sales exempt from the Rule?

**Answer:** If a qualified market maker reasonably believes that the price of a stock is going to decline because of specific news about the stock, a general decline in market prices, or otherwise, then the qualified market maker can effect short sales at down bids in an attempt to "liquify" itself to facilitate customer selling interest in the stock. However, as noted in Question #6 above, if a market

maker were to effect short sales at down bids after having received a customer's short-sale order, the NASD would view such short sales as an impermissible use of the market-maker exemption. In the event a qualified market maker receives a customer order to sell short during a declining market or while the market maker has a reasonable belief that the price of the stock is declining, it will involve a facts-and-circumstances analysis to determine whether the market makers' short sales are attributable to the facilitation of the customer's short-sale order or the result of bona fide market-making activity.

**Question #6:** Are sale transactions that are "short against the box"<sup>1</sup> subject to the Rule?

**Answer:** Yes. Section 48(l)(1) of the NASD Rules of Fair Practice provides that the term short sale means "any 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." Accordingly, if a customer intends to satisfy its settlement obligation for a sale transaction with borrowed stock, then that sale transaction is subject to the Rule, regardless of whether the customer has a long position in the stock.

**Question #7:** If a member facilitates a customer transaction in a standardized equity or stock index option, is it eligible for an exemption from the rule to effect hedging short-sale transactions?

**Answer:** With respect to the facilitation of customer transactions in standardized equity options, a member is eligible for an exemption from the

<sup>1</sup> A sale transaction that is "short against the box" is one where an investor owns the stock sold but intends to deliver borrowed stock to satisfy its settlement obligation.

Rule for short sales made in connection with hedging activities associated with the facilitation of such transactions, provided the short sales hedge, and in fact serve to hedge, an existing offsetting standardized options position or an offsetting options position that was created in a transaction(s) contemporaneous with the short sale and provided the member is a qualified market maker in the stock underlying the option.<sup>2</sup>

With respect to the facilitation of customer transactions in standardized index options, a member is eligible for an exemption from the Rule for short sales made in connection with hedging activities associated with the facilitation of such transactions, provided the short sales hedge, and in fact serve to hedge, the corresponding stock index options position and the underlying stock index option is a qualified stock index under Section 48(h)(2)(d) of the NASD Rules of Fair Practice.<sup>3</sup> Members do not have to be a qualified market maker in each of the Nasdaq National Market<sup>®</sup> stocks underlying a qualified stock index to be eligible for the exemption from the Rule for hedging short-sale transactions.

In sum, Nasdaq market makers are afforded treatment comparable to that afforded "qualified options market makers" under the rule when hedging standardized options positions with short sales. In addition, as noted above, this interpretation only applies to Nasdaq market makers hedging customer facilitation transactions in standardized options.

**Question #8:** If a member is a registered market maker in a convertible bond or holds itself out as a market maker in a convertible bond, is it eligible for an exemption from the rule if it effects short sales in the underlying security to hedge transactions in the convertible bonds?

**Answer:** If a member establishes a convertible bond position during the course of bona fide market-making activity and the member is a qualified market maker in the stock underlying the bond, the member can effect short sales in the underlying security to hedge such bond positions. Members are directed to Questions 33 - 39 of the Special Notice for guidance on when short sales in the corresponding stock are deemed to be hedges of bona fide market making transactions in the related convertible bond and when they are considered arbitrage transactions unrelated to normal market-making activity.

**Question #9:** Are there any circumstances under which a qualified market maker would ever have to mark an ACT report "short sale" or "sell short exempt?"

**Answer:** Yes. Even though a qualified market maker does not have to append a short-sale indicator to its ACT Report when it is selling short, when a qualified market maker is buying from a customer who is selling short, the market maker must indicate in its ACT Report that the sale was a short sale. In addition, if a customer of a qualified market maker is effecting a short sale that is exempt from the Rule, the market maker must indicate on its ACT Report that the sale was "sell short exempt." For example, if the customer is an options market maker effecting a hedging short-sale transaction in reliance on the options market-maker exemption to the Rule, the market maker would have to mark its ACT Report "sell short exempt." Similarly, if a customer of a qualified market maker effected a short sale in reliance on the "special arbitrage exemption" afforded investors in Section 48(c)(6) of the Rule (or any other exemption afforded investors), then the market maker would have to mark its ACT Report "sell short exempt."

Members are directed to ACT Notice 94-1 for further guidance on how to mark their ACT Reports to reflect short sales.

**Question #10:** Do non-qualified market makers have to append a "sell short" designator to their ACT Reports when effecting short sales?

**Answer:** Yes. A "sell short" designator is required for all proprietary short sales by members who are not qualified market makers. In addition, as noted in Question #9 above, if a customer of a market maker is selling short or selling short in reliance on an exemption from the Rule, the market maker must indicate on its ACT Report that the sale was a short sale or an exempt short sale.

**Question #11:** If a member has an arrangement with a customer whereby it will buy stock from a customer at a higher price to accommodate a short sale by the customer at a price a 1/16th above the bid on a down bid (short-sale accommodation differential) in return for the ability to recoup the short-sale accommodation differential when selling that stock to the customer in the future,

<sup>2</sup> Consistent with Section 48(h)(2)(a)(i) of the NASD Rules of Fair Practice, the phrase contemporaneously established includes transactions occurring simultaneously with the short sale as well as transactions occurring within the same brief period of time.

<sup>3</sup> Section 48(h)(2)(d) provides that "a 'qualified stock index' shall mean any stock index that includes one or more Nasdaq National Market securities, provided that more than 10% of the weight of the index is accounted for by Nasdaq National Market securities and provided further that the qualification of an index as a qualified stock index shall be reviewed as of the end of each calendar quarter, and the index shall cease to qualify if the value of the index represented by one or more Nasdaq National Market securities is less than 8% at the end of any subsequent calendar quarter."

would such an arrangement violate the Rule?

**Answer:** Short sales effected pursuant to an arrangement involving any price modifications, rebates, discounts, or other remuneration that is designed to circumvent application of the Rule would be in violation of the Rule.

**Question #12:** If a non-qualified market maker has a short position of 10,000 shares in XYZ and it purchases 1,000 shares of XYZ, is it "long" the 1,000 shares of XYZ it just purchased?

**Answer:** No. Members must net out long positions and short positions in the same stock to determine if they are net long or short. In this case, the purchase of the 1,000 shares of XYZ merely lowered the market maker's net short position in XYZ to 9,000 shares from 10,000 shares. Any subsequent resale of the 1,000 shares would be considered a short sale and subject to the Rule.

**Question #13:** If a non-qualified market maker effects a short sale because of a SOES<sup>SM</sup> transaction, does the market maker have to report that sale as a short sale?

**Answer:** No. Because SOES automatically executed the short sale for the market maker and reported the transaction, the market maker has no reporting obligation with respect to the short sale.

**Question #14:** After a merger or acquisition involving an exchange of stock has been publicly announced and not yet consummated or terminated, the Rule provides that a market maker may register and begin entering quotations in either or both of the two affected securities and immediately become a qualified market maker in either or both of the issues. The Rule also provides that if the market maker withdraws on an unexcused basis from any stock in which it has so registered within 20 days of so registering, the market maker will not be eligible for immediate designation as a qualified market maker for any merger or acquisition announced within three months subsequent to such unexcused withdrawal. If a merger or acquisition is consummated or terminated within 20 days of a market maker's registration in either or both of the effected securities, may the market maker withdraw from either or both of the securities before the balance of the 20 days has elapsed without being subject to the "three month" waiting provision?

**Answer:** Yes. If the merger or acquisition is consummated or terminated before the 20-day period elapses, the market maker may withdraw from either or both of the stocks upon such termination or consummation of the merger or acquisition and not be subject to the three-month waiting period.

**Question #15:** If a non-market maker effects a short-sale transaction with a market maker, can the member use the "browse/accept" feature of ACT to compare the trade for clearance and settlement purposes?

**Answer:** Yes. The member can use the "browse/accept" feature, provided the member updates the ACT Report to append a "short sale" or "short sale exempt" indicator with the symbols "S" or "X", respectively. This answer is a clarification of the answer to Question #31 in the Special Notice. In the answer to Question #31, the NASD stated that members would be "unable to use the ACT 'browse/accept' feature to compare trades in ACT for clearance and settlement purposes." This statement was incorrect, as members can use the "browse/accept" feature so long as they mark their ACT Reports appropriately during the acceptance process. If the member were to use the "browse/accept" feature without marking the ACT Report to appropriately reflect the short sale, however, it would be a violation of the ACT Rules.

Questions regarding this Notice should be directed to NASD Market Surveillance, at (301) 590-6080; Glen Shipway, Senior Vice President, Nasdaq Market Operations, at (203) 385-6250; or Thomas R. Gira, Assistant General Counsel, at (202) 728-8957.

# NASD NOTICE TO MEMBERS 94-84

## Broker/Dealer And Agent Renewals For 1994-95

### Suggested Routing

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

### Executive Summary

The 1994-95 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, New York Stock Exchange (NYSE), American Stock Exchange (ASE), Chicago Board Options Exchange (CBOE), 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 instruction materials to be sent with the November invoice package to ensure continued eligibility to do business in the states, effective January 1, 1995.

### Initial Renewal Invoices

On or around November 11, 1994, initial renewal invoices will be mailed to all member firms. The invoices will include fees for NASD personnel assessments, NASD branch-office fees, NYSE, ASE, CBOE, 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 16, 1994.**

NASD personnel assessments for 1995, which will be \$10 per person, will be based on the number of registered personnel with an approved NASD license as of December 31, 1994. NASD branch-office assessments, which have increased from \$50 to \$75 per branch pending a filing with the Securities and Exchange Commission, will be based on the number of active branches as of December 31, 1994.

Agent renewal fees for NYSE, ASE,

CBOE, 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. NYSE, ASE, CBOE, 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 NYSE-, ASE-, CBOE-, 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 in the form of a check made payable to the National Association of Securities Dealers, Inc., or by bank wire transfer. The check should be drawn on the member firm's account, with the firm's Central Registration Depository (CRD) 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. 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 deadline, which is December 16, 1994, could mean a loss of the eligibility to do business in the states, effective January 1, 1995.

### Filing Form U-5

Members may avoid paying unneces-

sary renewal fees by filing Form U-5s for agents terminating in one or more jurisdiction affiliations. Due to the positive feedback received by NASD member firms that used post-dated Form U-5s for renewals, the NASD will again accept post-dated agent termination notices on Form U-5s. From November 1 to December 16, 1994, the NASD will accept and process Form U-5s (partial and full terminations) with **post-dated dates of termination**. Under this procedure, if the Form U-5 indicates a December 31, 1994, termination date, 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 Form U-5s are filed by the renewal deadline date of December 16, 1994. Also, **post-dated Form U-5s cannot be processed if the date of termination indicated is after December 31, 1994.**

Members should exercise care when submitting post-dated Form U-5s. 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 use electronic filings to submit all Form U-5s and Page 1s of Form U-4s. 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 1994. 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 6th year, allows firms requesting terminations (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 seven jurisdictions that are *not* participating in Phase II:

- Alabama
- Michigan
- Puerto Rico
- American Stock Exchange
- Chicago Board Options 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 1994 is December 16, 1994. 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 Form U-5s.

### Removing Open Registrations

For the 8th year, the initial invoice

package will include in a roster of firm agents whose NASD registration is 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 help reconcile personnel registrations before year end. Firms may terminate obsolete state registrations by submitting Form U-5s or reinstate the NASD licenses by filing Page 1s of Form U-4s. No roster will be included if a firm does not have agents in this category.

### Final Adjusted Invoices

On or about January 17, 1995, 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, 1994. 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, NYSE, ASE, CBOE, 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 two months 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 1995 issue of *Notices 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 registra-

tion process. This breakdown will aid firms in their internal research and allocation of fees.

Questions concerning this Notice may be directed to your firm's assigned Quality and Service Team or the NASD's Member Services Phone Center at (301) 590-6500.

# NASD NOTICE TO MEMBERS 94-85

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Veterans' Day, Friday, November 11, 1994, and Thanksgiving Day, Thursday, November 24, 1994. On Friday, November 11, The Nasdaq Stock Market<sup>SM</sup> 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 24, in observance of Thanksgiving Day.

	<u>Trade Date</u>	<u>Settlement Date</u>	<u>Reg. T Date*</u>
	Nov. 2	Nov. 9	Nov. 11
	3	10	14
	4	14	15
Veterans' Day And Thanksgiving Day: Trade Date-Settlement Date Schedule	7	15	16
	8	16	17
	9	17	18
Suggested Routing	10	18	21
<input type="checkbox"/> Senior Management	11	18	22
<input type="checkbox"/> Advertising	14	21	23
<input type="checkbox"/> Corporate Finance	15	22	25
<input type="checkbox"/> Government Securities	16	23	28
<input type="checkbox"/> Institutional	16	23	28
<input type="checkbox"/> Internal Audit	17	25	29
<input checked="" type="checkbox"/> Legal & Compliance	17	25	29
<input type="checkbox"/> Municipal	18	28	30
<input type="checkbox"/> Mutual Fund	21	29	Dec. 1
<input checked="" type="checkbox"/> Operations	21	29	Dec. 1
<input type="checkbox"/> Options	22	30	2
<input type="checkbox"/> Registration	23	Dec. 1	5
<input type="checkbox"/> Research	23	Dec. 1	5
<input type="checkbox"/> Syndicate	24	Markets Closed	—
<input checked="" type="checkbox"/> Systems	25	2	6
<input checked="" type="checkbox"/> Trading	25	2	6
<input type="checkbox"/> Training			

\*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 "Reg. T Date."

**Note:** November 11, 1994, 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 18. 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.

Brokers, dealers, and municipal securities dealers should use these settlement dates to clear and settle 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 (203) 375-9609.

# NASD NOTICE TO MEMBERS 94-86

## NASD 1995 Holiday Schedule

### Suggested Routing

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

The NASD will observe the following holiday schedule for 1995:

January 2	New Year's Day (observance)
February 20	President's Day
April 14	Good Friday
May 29	Memorial Day
July 4	Independence Day
September 4	Labor Day
November 23	Thanksgiving Day
December 25	Christmas Day

Questions regarding this holiday schedule may be directed to  
NASD Human Resources, at (301) 590-6821.

# NASD NOTICE TO MEMBERS 94-87

Nasdaq National Market  
Additions, Changes, And  
Deletions As Of  
September 29, 1994

## Suggested Routing

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

As of September 29, 1994, the following 49 issues joined the Nasdaq National Market, bringing the total number of issues to 3,725:

Symbol	Company	Entry Date	SOES Execution Level
BDTC	Bio-Dental Technologies Corporation	8/30/94	200
FCNB	FCNB Corp.	8/30/94	200
CCIL	Cellular Communications International, Inc.	8/31/94	500
FFFD	First Federal Savings Bank of Fort Dodge	8/31/94	200
IDMC	IDM Environmental Corp.	8/31/94	200
IDMCW	IDM Environmental Corp. (Cl A Wts exp 4/21/99)	8/31/94	200
WAVX	Wave Systems Corp.	8/31/94	500
CGMV	Cedar Group, Inc.	9/1/94	200
SBSE	SBS Engineering, Inc.	9/6/94	200
CBNJ	Carnegie Bancorp	9/8/94	200
CBNJW	Carnegie Bancorp (Wts exp 8/9/97)	9/8/94	200
INCL	InControl, Inc.	9/9/94	500
DARL	Darling International Inc.	9/12/94	200
PNTGF	Petromet Resources Limited	9/12/94	200
AQUX	Aquagenix, Inc.	9/13/94	500
AQUXW	Aquagenix, Inc. (Wts exp 9/12/99)	9/13/94	500
EGFC	Eagle Financial Corp.	9/13/94	200
MIHOW	Miles Homes, Inc. (Wts exp 4/1/97)	9/13/94	200
COHU	Cohu, Inc.	9/14/94	200
CBTC	CBT Corporation	9/15/94	200
DRMD	Duramed Pharmaceuticals, Inc.	9/16/94	200
MMRI	Macheezmo Mouse Restaurants, Inc.	9/16/94	200
ARIA	ARIAD Pharmaceuticals, Inc.	9/19/94	500
ARIAW	ARIAD Pharmaceuticals, Inc. (Wts 5/20/99)	9/19/94	500
CLNPV	Callon Petroleum Company (WI)	9/19/94	200
DRTK	GTS Duratek Inc.	9/19/94	200
NDCOO	Noble Drilling Corporation (\$1.5 Conv Pfd)	9/19/94	200
CMCAF	Comcast UK Cable Partners Limited	9/20/94	200
ERCC	Energy Research Corporation	9/21/94	200
IGCA	Innovative Gaming Corporation of America	9/21/94	200
PBBUF	Pacific Basin Bulk Shipping Limited (Uts exp 9/30/99)	9/21/94	1000
OSKY	Mahaska Investment Company	9/22/94	200
PSCM	Professional Sports Care Management, Inc.	9/22/94	500

Symbol	Company	Entry Date	SOES Execution Level
TLIWV	Telios Pharmaceuticals, Inc. (Wts 9/29/96)(WI)	9/22/94	200
BOBJY	Business Objects S.A. (ADS)	9/23/94	200
CEXP	Corporate Express, Inc.	9/23/94	200
FMAC	First Merchants Acceptance Corporation	9/23/94	500
NKPR	Innkeepers USA Trust	9/23/94	200
WELC	Welcome Home, Inc.	9/23/94	200
ASHE	Aasche Transportation Services, Inc.	9/26/94	200
AFLX	ADFlex Solutions, Inc.	9/27/94	200
ACSA	Affiliated Computer Services, Inc. (Cl A)	9/27/94	200
ARANY	Aran Energy plc (ADR)	9/27/94	200
BSST	Baby Superstore, Inc.	9/27/94	500
BFCX	Benson Financial Corporation	9/27/94	200
DOSKR	Doskocil Companies Incorporated (Rts exp 10/19/94)	9/27/94	200
ERNS	Ernst Home Center, Inc.	9/27/94	200
IPCI	IPC Information Systems, Inc.	9/27/94	200
EBMA	E & B Marine, Inc.	9/28/94	200

### Nasdaq National Market Symbol And/Or Name Changes

The following changes to the list of Nasdaq National Market securities occurred since August 29, 1994:

New/Old Symbol	New/Old Security	Date of Change
PSRC/PNJI	PrimeSource Corporation/Phillips & Jacobs, Inc.	9/2/94
GENE/CRIC	Genome Therapeutics Corp./Collaborative Research, Inc.	9/6/94
OXIS/DDIX	OXIS International, Inc./DDI Pharmaceuticals, Inc.	9/8/94
RPAPF/RPAPF	REPAP Enterprises Corp. (Com Stk)/ REPAP Enterprises Corp. (Sub Vtg Shs)	9/9/94
SEMCF/ISEAF	Semi-Tech Corp. (Vtg Cl A)/International Semi-Tech Microelectronics, Inc. (Vtg Cl A)	9/22/94
TWMC/TWMC	Trans World Entertainment Corp./Trans World Music Corp.	9/22/94

### Nasdaq National Market Deletions

Symbol	Security	Date
GAFA	Gates/FA Distributing, Inc.	8/30/94
ALDC	Aldus Corporation	9/1/94
PION	Pioneer Financial Corporation	9/1/94
SMAC	SuperMac Technology, Inc.	9/1/94
DFCO	Destron Fearing Corporation	9/2/94
HHOT	H & H Oil Tool Co., Inc.	9/2/94
MAXMW	Maxim Group Inc. (The) (Wts exp 9/30/98)	9/2/94
MMDI	Momentum Corporation	9/2/94
CDIC	Cardinal Health, Inc.	9/7/94
AMRS	American Residential Holding Corporation	9/9/94

Symbol	Security	Date
SPHX	SPHINX Pharmaceuticals Corporation	9/12/94
CRES	Crestmont Financial Corp.	9/14/94
NNCXF	Newbridge Networks Corporation	9/14/94
SERV	Serving Software, Inc.	9/14/94
GNBC	Glendale Bancorporation	9/15/94
KNFL	Kenfil Inc.	9/15/94
MCTIE	Micro Component Technology, Inc.	9/15/94
REST	Restor Industries, Inc.	9/15/94
SCRIP	Scripps Howard Broadcasting Company	9/15/94
SPRC	Sports & Recreation, Inc.	9/15/94
SHRO	Sports Heroes, Inc.	9/15/94
SHROW	Sports Heroes, Inc. (Wts exp 11/20/95)	9/15/94
FSVBW	Franklin Bank, National Association (Wts exp 9/15/94)	9/16/94
INFD	Infodata Systems, Inc.	9/16/94
ARIAZ	ARIAD Pharmaceuticals, Inc. (Uts)	9/19/94
CCLPZ	Callon Consolidated Partners, L.P. (Uts)	9/19/94
MCAWA	McCaw Cellular Communications, Inc. (Cl A)	9/20/94
MEDQ	Medquist, Inc.	9/20/94
ASKI	Ask Group, Inc. (The)	9/21/94
BDRM	Body Drama, Inc.	9/23/94
NTAWF	Nam Tai Electronics, Inc. (Wts exp 9/29/96)	9/23/94

Questions regarding this Notice should be directed to Mark A. Esposito, Supervisor, Market Listing Qualifications, at (202) 728-8002. Questions pertaining to trade reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301) 590-6436.

# NASD NOTICE TO MEMBERS 94-88

Fixed Income Pricing  
System Additions,  
Changes, And Deletions  
As Of September 30,  
1994

## Suggested Routing

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

As of September 30, 1994, the following bonds were added to the Fixed Income Pricing System (FIPS<sup>SM</sup>). These bonds are **not** subject to mandatory quotation:

Symbol	Name	Coupon	Maturity
PLTT.GA	Plitt Theatres Inc.	10.875	6/15/04
DMTR.GA	Domtar Inc.	11.250	9/15/17
SBO.GA	Showboat Inc.	13.000	8/1/09
RPWI.GB	Repap Wis. Inc.	9.250	2/1/02
KSRE.GA	Kearny Str. Real Estate	9.560	7/15/03
TIPK.GA	Tiphook Fin. Corp.	7.125	5/1/98
TIPK.GB	Tiphook Fin. Corp.	10.750	11/1/02
CBLV.GB	Cablevision Inds Corp.	9.250	4/1/08
TLXC.GA	Telex Communications	12.000	7/15/04
LRHI.GA	Laroche Inds Inc	13.000	8/15/04
NTK.GC	Nortek Inc.	9.875	3/1/04
TIPK.GC	Tiphook Fin. Corp.	8.000	3/15/00
CVC.GD	Cablevision Sys Corp.	14.000	11/15/03
BLY.GC	Ballys PI PI FDG Inc.	9.250	3/15/04
CONA. GD	Container Corp. Amer.	14.000	12/1/01
BLG.GB	Bally Grand Inc.	10.375	12/15/03

As of September 30, 1994, the following changes to the list of FIPS symbols occurred:

New/Old Symbol	Name	Coupon	Maturity
DTC.GB/DMTR.GA	Domtar Inc.	11.250	9/15/17

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to trade-reporting rules should be directed to Bernard Thompson, Assistant Director, NASD Market Surveillance, at (301)590-6436.



# BOARD BRIEFS

## Actions Taken By The Board Of Governors In September

**President's Report**—The NASD and The Nasdaq Stock Market<sup>SM</sup> are continuing to enjoy higher than anticipated revenues while their expenses have remained relatively stable throughout the year. Key factors contributing to the favorable performance on the revenue side are new Nasdaq listings, listings of additional shares, trading volume, growth in subscriber terminal populations, and higher than expected industry qualification and registration activity.

Nasdaq's cumulative share volume registered 49.4 billion shares at the end of August, surpassing the record-setting pace of 41.7 billion shares set this time last year. The year-to-date average daily volume of 294.1 million shares is 18 percent ahead of 1993's volume of 248 million shares. As of August, Nasdaq market value was nearly 10 percent higher and Nasdaq dollar volume was over 15 percent higher than in August 1993. New records have already been established in several categories including: number of companies—4,849; number of issues—5,705; active market makers—510; and total market-maker positions—62,110.

Nasdaq's ongoing record of operating efficiency is excellent—with a better than 99.9 percent systems uptime rate. Because glitches are so rare, when they occur, they become front-page financial news as evidenced by Nasdaq's short-term outages in mid-summer. One outage was a combination of communications software and unrelated hardware problems and the other a malfunction in the uninterrupted power supply system following a utility company power disruption. In both cases, operations were switched to Nasdaq's back-up facility in Rockville, which operated as it was designed. Nasdaq has addressed the causes of these outages and the systems have since operated without incident.

Internationally, Nasdaq in recent months has stepped up its consulting activities. Members of the General Counsel's Office recently helped draft the charter and rules for a Russian self-regulatory organization. As a result, 15 Russian CEOs representing the founding members of a new dealer's association signed the Charter of the Professional Association of Participants of the Securities Markets, the first of five or six such regional associations that will ultimately join together under the auspices of a national association.

Nasdaq is also helping KPMG Peat Marwick promote Russia's first screen-based stock market. The PORTAL<sup>SM</sup> Market of The Nasdaq Stock Market, Inc., is being considered as the model for such a trading system. Separately, discussions are continuing on the possibility of developing a Nasdaq-like market for emerging growth companies in Europe.

In Asia, Nasdaq has bid on a contract to support an Agency for International Development project in India. The Financial Institutions Reform and Expansion (FIRE) Project will be a four-year effort to help the Indian government reform and modernize its capital markets by inducing greater investor participation, increasing trading activity through market restructuring, and introducing a range of new and innovative investment products.

**Regulation**—Faster dissemination of certain sanctions will result from Board action on the public release of disciplinary action. The proposal, to be filed with the SEC for approval, calls for the immediate notification of the membership and press of any sanctions that involve an expulsion, a revocation, and/or a bar. The current requirement, which would still apply to all other sanctions, allows a delay of 30 days after the NASD renders its final decision.

Concern about the effect on debt-market structure of disparate regulatory treatment of listed and OTC debt securities prompted the SEC to request comments on its efforts to equalize such treatment. Currently, listed debt, unlike OTC debt, must be registered under the Securities Exchange Act of 1934 (Act). Such registration subjects listed debt to regulatory provisions, such as restrictions on borrowing, periodic reporting by the issuer, and proxy rules. The SEC's proposal exempts listed debt securities from the borrowing restrictions and proxy rules. At the same time, it would subject private-equity companies with OTC-traded debt securities to the periodic reporting requirements of the Act. The Board approved filing a comment letter supporting the SEC proposal.

Citing possible conflict between underwriting compensation limits and a right of first refusal granted to an underwriter, the NASD Board has approved for member comment a proposal on these rights of first refusal. Such provisions which are often part of initial public offering arrangements can come back to haunt an issuer during a secondary offering, especially if the cost to the issuer of waiving or terminating the right is excessive. Under the proposal, any right of first refusal would:

- Be limited to three years.
- Have its compensation value capped.
- Limit the underwriter's waiver or termination fee.
- Terminate the right once payment is made.

- Limit underwriter's termination payment to cash only.

The Board approved filing with the SEC a measure to exempt from filing under the Corporate Financing Rule offerings of Modified Guaranteed Annuity Contracts and Modified Guaranteed Life Insurance Policies. These products are deferred annuity contracts or life insurance policies with values that are guaranteed if held for specified periods of time. In addition, the non-forfeiture values are based on a market-value adjustment formula for withdrawals made before the end of any specified period.

Reacting to Congressional and SEC inquiries as to evaluation-and-reporting practices surrounding limited partnerships, the NASD Board has approved publication for member comment of proposals to address some of these concerns. Essentially, the changes would require members when including limited partnership activity on customer account statements to segregate direct participation program (DPP) securities in a separate location. If the DPP securities are listed without a price and there is no active secondary market in the securities, a member would have to include a statement that accurate pricing information is not available. If the securities are listed with a price, the member would:

- Not be able to aggregate the value of DPP securities with that of any other securities.
- Not be able to include the value of DPP securities in any customer account net worth calculation.
- Have to include the methodology

used for the valuation of the DPP securities.

- Have to include a statement that DPP securities are illiquid securities and the price listed may not be realizable if the customer seeks to liquidate them.

**Market Services**—Acting on recommendations of an industry task force, the NASD Board approved for public comment a proposal to require a firm accepting investors' limit orders from another firm to handle those orders as follows:

- For orders of 1,000 shares or less, to execute those customers' orders when trading the stock for the firm's own account at prices equal to or better than the limit-order price.
- For an investor order in excess of 1,000 shares, to execute that order when trading the stock for the firm's own account at a price better than the limit-order price.

The proposal provides for a one-year assessment period to determine the market and economic impact of the changes as a basis for possible future actions.

To accommodate the transition to the T+3 settlement cycle mandated by SEC Rule 15c6-1, the NASD Board has approved a series of amendments to its rules. The changes would revise the parts of those rules that are either geared to a T+5 settlement cycle or reliant on time frames constructed around the T+5 cycle. The measures must now be filed with the SEC for final approval.

# NASD DISCIPLINARY ACTIONS

## Disciplinary Actions Reported For October

The NASD<sup>®</sup> has taken disciplinary actions against the following firms and individuals for violations of the NASD Rules of Fair Practice; securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board. Unless otherwise indicated, suspensions will begin with the opening of business on Monday, October 17, 1994. The information relating to matters contained in this Notice is current as of the fifth of this month. Information received subsequent to the fifth is not reflected in this edition.

### Firms Suspended, Individuals Sanctioned

**Franklin-Lord, Inc., (Scottsdale, Arizona) and John E. Cathcart (Registered Principal, Scottsdale, Arizona).** The firm was fined \$20,000 and suspended from NASD membership for five days. Cathcart was fined \$20,000, suspended from association with any NASD member in any capacity for 30 days, and ordered to requalify by examination as a general securities representative and a general securities principal. The National Business Conduct Committee (NBCC) imposed the sanctions following appeal of a Denver District Business Conduct Committee (DBCC) decision. The sanctions were based on findings that the firm, acting through Cathcart, filed seven inaccurate Uniform Applications for Broker Dealer Registration (Form BD) with the NASD and failed to abide with the terms of its restriction agreement with the NASD. In addition, the firm, acting through Cathcart, effected municipal securities transactions prior to paying the required registration fee to the MSRB and without having a qualified municipal securities principal.

This action has been appealed to the Securities and Exchange

Commission (SEC) and the sanctions are not in effect pending consideration of the appeal.

**Ratliff Securities, Inc., (Phoenix, Arizona) and John D. Ratliff, Sr., (Registered Principal, Phoenix, Arizona)** submitted an Offer of Settlement pursuant to which they were fined \$5,000, jointly and severally, and Ratliff was required to requalify by examination as a direct participation programs principal or cease to function in that capacity until he successfully requalifies. In addition, the firm was suspended from NASD membership and Ratliff was suspended from association with any NASD member in any capacity until they pay the aforementioned fine. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Ratliff, disbursed the proceeds received from a contingency offering before meeting the stated contingency.

### Firms Fined, Individuals Sanctioned

**Toluca Pacific Securities Corp. (Burbank, California) and Peter J. H. Blowitz (Registered Principal, Studio City, California)** submitted an Offer of Settlement pursuant to which they were fined \$10,000, jointly and severally, and ordered to pay \$14,747.44 in restitution to customers. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Blowitz, engaged in sales to public customers of stock in the secondary market at unfair prices. The NASD found that the firm and Blowitz engaged in this activity in contravention of the Board of Governors Interpretation with respect to the NASD Mark-Up Policy in that such sales resulted in markups

ranging from 10.28 to 39.11 percent.

## Firms And Individuals Fined

**Devon Resources Financial Corporation (Tulsa, Oklahoma), Catherine W. Yox (Registered Principal, Tulsa, Oklahoma), W. Jeffrey A. Haver (Registered Representative, Ontario, Canada), and James M.C. Haver (Registered Principal, Tulsa, Oklahoma)** submitted an Offer of Settlement pursuant to which they were fined \$15,000, jointly and severally. In addition, the firm agrees to engage a public accounting firm acceptable to the NASD to perform an analysis of the firm's operational and accounting procedures and agrees to institute the recommendations in the audit within 60 days of its issuance. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Yox, J. Haver, and W. Haver, collected \$228,455.81 from 16 subscribers in connection with a joint venture offer, without issuing an adequate private placement memorandum or similar disclosure document.

The NASD also found that the firm, acting through Yox, failed to have an annual audit performed by an independent accountant. Furthermore, the findings stated that the firm, acting through Yox and J. Haver, engaged in a securities business while failing to maintain its required minimum net capital. In addition, the NASD found that the firm, acting through Yox, failed to compute accurately its net capital.

## Firms Fined

**Masters Financial Group, Inc., (Little Rock, Arkansas)** 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 conducted a securities business while failing to maintain its required minimum net capital.

**Shearson Lehman Brothers, Inc., n/k/a Lehman Brothers Inc. (New York, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to supervise adequately and properly an account executive of the firm.

## Individuals Barred Or Suspended

**Bonnie Jean Baker (Registered Representative, Bellevue, Washington)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The sanctions were based on findings that Baker failed to amend her Uniform Application for Securities Industry Registration or Transfer (Form U-4) to disclose a criminal conviction and failed to disclose this information on a Form U-4 when applying for association with another member firm.

**David Blake Bansmer (Registered Representative, Spokane, Washington)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$75,000, barred from association with any NASD member in any capacity, and required to pay \$193,000 in restitution to a customer. Without admitting or denying the allegations, Bansmer consented to the described sanctions and to the entry of findings that he received from a public customer \$50,000 to fund a joint trading account or otherwise to purchase securities on his

behalf. According to the findings, the funds were used by Bansmer and the \$50,000 has not been returned to the customer.

The findings also stated that Bansmer received \$143,000 from the same customer and represented that in return for the use of these funds he would provide the customer with one-half the trading profits in the account (\$10,000) and that the \$143,000 would be returned. The NASD determined that the \$143,000 was used by Bansmer to repay a loan he had taken out with another individual and was never returned to the customer. In addition, the NASD determined that Bansmer opened a securities account at another member firm but failed to notify his firm in writing of his association with the other firm.

**Donna J. Beatty (Registered Representative, Dayton, Ohio)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which she was fined \$5,000, barred from association with any NASD member in any capacity, and required to provide proof that restitution was paid. Without admitting or denying the allegations, Beatty consented to the described sanctions and to the entry of findings that she misappropriated insurance customers' funds totaling \$601.

**William M. Binder (Registered Principal, Deerfield Beach, Florida)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 days. Without admitting or denying the allegations, Binder consented to the described sanctions and to the entry of findings that he caused customers to purchase common stock and warrants in a security at unfair prices when he knew he would receive a large per-

centage of the total purchase price.

**Craig R. Brown (Registered Representative, Manchester, Connecticut)** was fined \$25,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Brown recommended and caused the execution of unsuitable transactions in the account of a public customer. In addition, Brown engaged in private securities transactions outside the regular course or scope of his association with a member firm without giving prior written notification to the firm.

**William H. Cantrell (Registered Representative, Shreveport, Louisiana)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$15,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cantrell consented to the described sanctions and to the entry of findings that he offered to sell unregistered securities in violation of Section 5 of the Securities Act of 1933. In addition, the findings stated that Cantrell engaged in private securities transactions without prior written notice to and approval from his member firm. The NASD also determined that Cantrell, while registered with a member firm, failed to notify the firm of his status as president of another company.

**Stephen Carella (Registered Representative, Bayside, New York)** submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Carella consented to the described sanctions and to the entry of findings that, without the knowledge, authorization, or consent of public customers, Carella caused their account address-

es to be changed to a fictitious address and executed purchase and sale transactions in their accounts.

**Newcomb D. Cole, Jr., (Registered Representative, Melrose, Massachusetts)** was fined \$15,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Cole misused customer funds totaling \$5,500 intended for investment purposes. In addition, Cole failed to respond to NASD requests for information.

**Carlo D'Alelio (Registered Representative, Magnolia, Massachusetts)** 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, D'Alelio consented to the described sanctions and to the entry of findings that he misappropriated for his own use and benefit public customer funds totaling \$24,925 intended for securities investment. In connection with the above activity, the NASD found that D'Alelio engaged in business activities outside the scope of his relationship with his member firm without providing prior written notice to the firm.

**Christopher Regan DeVany (Registered Representative, Wayland, Massachusetts)** 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, DeVany consented to the described sanctions and to the entry of findings that he falsified a medical examination form on behalf of a potential client in an effort to secure a traditional life insurance policy for the client without the client's desire or request for the policy.

**Mark Allen Elliott (Registered Representative, Independence, Missouri)** was fined \$7,500 and suspended from association with any NASD member in any capacity for two years. The SEC affirmed the sanctions following appeal of a June 1993 NBCC decision. The sanctions were based on findings that Elliott failed to respond to NASD requests for information concerning a customer complaint.

**Edward C. Farni, II, (Registered Principal, Excelsior, Minnesota)** 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. Without admitting or denying the allegations, Farni consented to the described sanctions and to the entry of findings that he made written representations to a public customer concerning the purchase of securities in which he made price predictions, without having a reasonable basis.

**Steven J. Finklestein (Registered Principal, Fort Lee, 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 capacity for five days. Without admitting or denying the allegations, Finklestein consented to the described sanctions and to the entry of findings that he caused customers to purchase common stock and warrants in a security at unfair prices while knowing that he would receive compensation on a large percentage of the total purchase price.

**Paul T. Fiorini (Registered Principal, Linden, New Jersey)** 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 deny-

ing the allegations, Fiorini consented to the described sanctions and to the entry of findings that he caused customers to purchase common stock and warrants in a security at unfair prices when he knew he would receive a large percentage of the total purchase price. The findings also stated that Fiorini failed to assure that his member firm established and enforced written supervisory procedures that would have enabled the firm to supervise properly the activities of its associated persons. In addition, the NASD found that Fiorini failed to supervise properly the activities of certain principals and registered representatives of his member firm.

**Randy Richard Franks (Registered Representative, Cypress, Texas)** was fined \$100,000, barred from association with any NASD member in any capacity, and required to pay \$78,045 in restitution to public customers or his member firm. The sanctions were based on findings that Franks received seven checks totaling \$78,045 from public customers for investment purposes. Without the knowledge, consent, or authorization of the customers, Franks endorsed and deposited the checks in bank accounts he controlled and personally used, thereby converting said funds to his own personal use and benefit. In addition, Franks failed to respond to NASD requests for information.

**Julia Gail Frisino (Registered Representative, Gilmer, Texas)** was fined \$50,000, barred from association with any NASD member in any capacity, and required to pay \$5,291 in restitution to public customers or her member firm. The sanctions were based on findings that Frisino received from public customers checks totaling \$5,921 for insurance premium payments, endorsed the checks, and converted the funds to her own personal use and benefit. In

addition, Frisino failed to respond to NASD requests for information.

**Thomas J. Gavin (Registered Representative, Orange Beach, Alabama)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Gavin shared in the losses in the account of public customers when he submitted a personal check to the branch office cashier and caused the check to be deposited into the account of the customers. In addition, Gavin failed to respond to NASD requests for information.

**Ricky Lee Grady (Registered Representative, Jackson, Tennessee)** was fined \$15,000, barred from association with any NASD member in any capacity, and required to pay \$3,000 in restitution to his former member firm. The sanctions were based on findings that Grady signed the names of two public customers to checks issued to them by his member firm, deposited the checks into his personal bank account, thereby converting the funds to his own use and benefit without the customers' knowledge or consent.

**Gary D. Hamby (Registered Representative, Loudon, Tennessee)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$105,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hamby consented to the described sanctions and to the entry of findings that he received from public customers checks totaling \$21,544.72 to be deposited into separate annuity accounts. The NASD found that Hamby failed to deposit the funds and, instead, endorsed the checks and deposited the funds into his personal credit union account, thereby converting the funds to his own use and bene-

fit without the knowledge or consent of the customers.

In addition, the findings stated that Hamby submitted a completed application along with a cashier's check in the amount of \$1,513.30 to purchase a variable life insurance policy on behalf of a public customer. Hamby then signed the customer's name to the application without the knowledge or consent of the customer and received \$2,360.75 in commissions to which he was not entitled.

**Roger D. Hanna (Registered Representative, Girard, Ohio)** submitted an Offer of Settlement pursuant to which he was fined \$3,000, suspended from association with any NASD member in any capacity for five business days, and required to retake and pass the Series 6 examination. If Hanna does not requalify within 90 days, he will remain suspended until he passes the exam. Without admitting or denying the allegations, Hanna consented to the described sanctions and to the entry of findings that he participated in the sale of securities to four public customers without having provided written notice to or written authorization from his member firm.

**William D. Harrison (Registered Representative, Delaware, Ohio)** submitted an Offer of Settlement pursuant to which he was fined \$2,500, suspended from association with any NASD member in any capacity for one business day, and required to retake and pass the general securities representative's examination. Without admitting or denying the allegations, Harrison consented to the described sanctions and to the entry of findings that he mishandled customers' funds totaling \$18,987.94 when he deposited the funds in an account he controlled.

**Allen Dewayne Hawkins (Registered Representative, Rancho Palos Verdes, California)**

was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The NBCC imposed the sanctions following review of a Los Angeles DBCC decision. The sanctions were based on findings that Hawkins executed unauthorized transactions in the accounts of public customers. In addition, Hawkins used the proceeds of an authorized sale of stock to purchase another security when he was instructed to distribute the funds to the customers.

**David C. Kovacic (Registered Representative, Jeannette, Pennsylvania)** 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, Kovacic consented to the described sanctions and to the entry of findings that he failed to transmit promptly to his member firm mutual fund subscriptions and payments he received from public customers. In addition, the NASD found that Kovacic failed to respond to NASD requests for information.

**John J. Margiotta (Registered Principal, New York, New York)** 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 five days. Without admitting or denying the allegations, Margiotta consented to the described sanctions and to the entry of findings that he caused customers to purchase common stock and warrants in a security at unfair prices while knowing that he would receive compensation on a large percentage of the total purchase price.

**Kevin P. McCoy (Registered Representative, Waterford, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined

\$40,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, McCoy consented to the described sanctions and to the entry of findings that he misappropriated for his own use and benefit policyholders' funds totaling \$25,145. In addition, the NASD found that McCoy forged customers' signatures on checks representing disbursements of accumulated dividends for seven life insurance policies without the knowledge or consent of the customers.

**Zebedee McLaurin, V. (Registered Representative, Chicago, Illinois)** was barred from association with any NASD member in any capacity. The sanction was based on findings that McLaurin purchased for the accounts of public customers securities without the customers' knowledge or consent and in the absence of written or oral authorization to exercise discretion in said accounts. In addition, McLaurin purchased and sold shares of stock for a fictitious account.

**Stuart J.D. Mills (Registered Principal, Englewood, Colorado)** was fined \$10,000 and suspended from association with any NASD member in any capacity for one year. In addition, Mills must requalify by examination before acting in any capacity with any member firm. The SEC affirmed the sanctions following appeal of a May 1993 NBCC decision. The sanctions were based on findings that Mills either solicited, or otherwise caused customer orders to be received and processed for purchases of securities, at unfair and unreasonable prices with gross commissions ranging from 23.08 to 40 percent of the total price paid by customers. Moreover, Mills failed to disclose to his customers that these prices were unfair and unreasonable.

**Herbert B. Moriarty, III, (Registered Representative,**

**Memphis, Tennessee)** submitted an Offer of Settlement pursuant to which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 6 months. Without admitting or denying the allegations, Moriarty consented to the described sanctions and to the entry of findings that he signed the names of four public customers to three requests for account transfer without the knowledge or consent of the customers.

**David J. Nava (Associated Person, La Jolla, California)** was fined \$10,000 and barred from association with any NASD member in any capacity. The NBCC affirmed the sanctions following appeal of a Los Angeles DBCC decision. The sanctions were based on findings that Nava submitted to two member firms and to the NASD Uniform Applications for Securities Industry Registration (Form U-4) wherein he gave a false response to a question regarding his disciplinary history.

**John P. Pala (Registered Representative, Poland, Ohio)** 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, Pala consented to the described sanctions and to the entry of findings that he received from an insurance customer payments of \$125 each designated for semi-annual premiums on an auto insurance policy and, instead, he retained and converted the funds to his own use.

**Jeffrey Michael Pieper (Registered Representative, Tigard, Oregon)** submitted an Offer of Settlement pursuant to which he was fined \$10,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Pieper consented to the

described sanctions and to the entry of findings that he signed a customer's name on a company proceeds check made payable to the customer in the amount of \$2,026.56 and deposited the check into his own bank account.

**Richard Earl Scholl (Associated Person, Dallas, Texas)** was fined \$20,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that without the benefit of registration with the NASD Scholl solicited customers to purchase partnership interests. In addition, Scholl failed to respond to NASD requests for information.

**Howard B. Schwartz (Registered Principal, Dix Hills, New York)** 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 5 days. Without admitting or denying the allegations, Schwartz consented to the described sanctions and to the entry of findings that he caused customers to purchase common stock and warrants in a security at unfair prices while knowing that he would receive compensation on a large percentage of the total purchase price. Schwartz's suspension will commence October 24, 1994.

**Manuel R. Silva (Registered Representative, Assonet, Massachusetts)** 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, Silva consented to the described sanctions and to the entry of findings that he withheld and misappropriated to his own use and benefit insurance customer funds totaling \$4,288 intended for insurance premium payments on seven policies.

**Thomas M. Sipsy (Registered Representative, Salem, New Hampshire)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$35,000 and barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sipsy consented to the described sanctions and to the entry of findings that he withheld and misappropriated to his own use and benefit funds totaling \$29,276. These funds represented checks generated subsequent to the submission of forged insurance loan and dividend disbursement requests made by Sipsy.

**Fred C. Smith (Registered Representative, Tupelo, Mississippi)** submitted an Offer of Settlement pursuant to which he was fined \$150,000, barred from association with any NASD member in any capacity, and required to pay \$124,700 in restitution to the appropriate parties. Without admitting or denying the allegations, Smith consented to the described sanctions and to the entry of findings that he obtained customer funds totaling \$141,700 for the purpose of investing in securities, deposited a portion of these funds into his own bank account, and otherwise converted the funds to his own use and benefit without the knowledge or consent of the customers. The findings also stated that in connection with the above, Smith provided public customers and individuals with false monthly account statements reflecting fictitious stock transactions. Furthermore, the NASD found that Smith provided letters to individuals wherein he guaranteed them against losses in their investment portfolios. In addition, the NASD determined that Smith engaged in sales of securities to public customers and failed and neglected to become properly registered with the NASD as a general securities representative prior to

engaging in such acts. Also, the findings stated that Smith failed to respond to NASD requests for information.

**Jon Clayton Stanley (Registered Representative, Honolulu, Hawaii)** was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. The NBCC affirmed the sanctions following appeal of a San Francisco DBCC decision. The sanctions were based on findings that Stanley engaged in private securities transactions without giving prior written notice to his member firm.

**James A. Vitale (Registered Representative, Coraopolis, Pennsylvania)** submitted an Offer of Settlement 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, Vitale consented to the described sanctions and to the entry of findings that he collected from insurance customers \$5,877.75 in premiums that he failed to remit to his member firm. Vitale also failed to respond to NASD requests for information.

**Caron George von Carlowitz (Registered Representative, Concord, Ohio)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which he was fined \$90,000, barred from association with any NASD member in any capacity, and required to pay restitution to his member firm. Without admitting or denying the allegations, von Carlowitz consented to the described sanctions and to the entry of findings that he misappropriated and converted \$17,891 from 10 insurance customers of his member firm.

**John V. Ziedins (Registered Representative, Norwood, Massachusetts)** 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, Ziedins consented to the described sanctions and to the entry of findings that he submitted 17 fictitious life insurance policies to his member that generated approximately \$3,785 in commissions.

### **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 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 requests for information, the listing also includes the date the suspension concluded.

**CMS Financial Group, Inc.**, Hinsdale, Illinois (September 13, 1994)

**Eurocapital Partners, Inc.**, Laguna Hills, California (August 26, 1994)

**J.M. Securities, Inc.**, Rowlett, Texas (September 13, 1994)

**Worthington & Dunn Securities**, Dallas, Texas (September 13, 1994)

### **Suspension Lifted**

The NASD has lifted suspension from membership on the date shown for the following firm, because it has complied with formal written requests to submit financial information.

**PCA Capital Corporation**, Boston, Massachusetts (August 18, 1994)

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

**James P. Brennan, Sr.**, Prosper, Texas

**James D. Chase**, Williamsburg, Virginia

**Daniel E. Cloonan**, Pittsburgh, Pennsylvania

**Richard L. Hansen**, Battle Creek, Michigan

**Charles F. Tummino**, Rogue River, Oregon

### **Individual Whose Registration Was Cancelled/Suspended Pursuant To Article VI Section 2 Of The NASD Code Of Procedure For Failure To Pay An Arbitration Award**

**Michael O' Neill**, Ocean, New Jersey

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