

# Notices to Members

## May 2000

### Notices

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**INFORMATIONAL**

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**OATS Limit Order Display Indicator**

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NASD Regulation Reiterates Requirement That Members Correctly Report Order Audit Trail Information

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Operations
- Senior Management
- Training

**KEY TOPICS**

- Limit Order Display
- Order Audit Trail System (OATS)

**Executive Summary**

The purpose of this *Notice* is to reiterate to members one of the requirements of the National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules 6950 through 6957 (Order Audit Trail System (OATS<sup>SM</sup>) Rules). When recording and reporting information on certain customer orders, members must indicate whether or not the customer provided instructions concerning the display or non-display of limit orders. It has come to the attention of NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) staff that several member firms consistently misreport this information to the NASD's OATS.

**Questions/Further Information**

Questions regarding this *Notice* should be addressed to the OATS Support Center at (800) 321-NASD (6273); or the Legal Section of the Market Regulation Department at (301) 590-6410.

**Limit Order Display Indicators**

As outlined in OATS Rule 6954(b), member firms that receive or originate orders in Nasdaq<sup>®</sup> securities must report certain information about these orders to OATS via a New Order Report.<sup>1</sup> One of the data elements required in the New Order Report is the Limit Order Display Indicator (indicator). The indicator provides information to NASD Regulation as to whether the customer provided specific instructions concerning the display/non-display of the limit order. OATS allows two permissible values in the indicator field, "Y" and "N."

**"Y" Indicator**

The "Y" indicator means that a customer **provided**:

- (a) specific instructions not to display a limit order that generally should be displayed under the terms of the Limit Order Display Rule<sup>2</sup>; or
- (b) specific instructions to display a block size order (orders with at least 10,000 shares or with a market value of at least \$200,000) that is not subject to the Limit Order Display Rule.

In both cases, the customer gave instructions regarding the display of an order, therefore the value reported in the indicator field should be "Y."<sup>3</sup>

**"N" Indicator**

The "N" indicator means that a customer **did not provide** specific instructions on:

- (a) not displaying a limit order that generally should be displayed under the terms of the Limit Order Display Rule; or
- (b) displaying a block size order that is not subject to the Limit Order Display Rule.

**Incorrect Use Of The Indicators**

Many firms currently are assigning an incorrect value in the indicator field. This may be caused by setting "Y" as a default or by incorrectly reporting "N" when the customer asks that the order not be displayed.

The NASD Regulation Market Regulation Department uses, among other things, automated surveillance systems to surveil for compliance with the Limit Order Display Rule. When firms incorrectly report the value in the indicator field, it impedes the Market Regulation Department's ability to use OATS data for this purpose. Additionally, these types of errors can cause a significant waste of NASD Regulation's regulatory resources and the firm's resources in responding to unnecessary inquiries.

Please be advised that when Market Regulation's automated systems identify firms as not complying with the Limit Order Display Rule based on incorrectly reported values in the indicator field, the staff may bring a disciplinary action for violation of the OATS Rules. Such violations

will be resolved by imposing appropriate sanctions to address the seriousness of the violation. Intentional misreporting of this information will be resolved through the imposition of sanctions. Member firms are urged to review their systems and procedures to ensure that they are reporting the data appropriately.

### Endnotes

<sup>1</sup>Orders in Nasdaq securities originated in the normal course of market making are exempt from OATS reporting. All other proprietary orders in Nasdaq securities are reportable to OATS.

<sup>2</sup>Securities and Exchange Commission Rule 11Ac1-4. Specialists and OTC Market Makers must display the following: customer limit orders for exchange-traded securities, Nasdaq National Market, and SmallCap<sup>SM</sup> securities. A customer may request that its order not be displayed. Odd-lot orders, all or

none orders, orders that are executed immediately upon receipt, and block size orders (at least 10,000 shares or with a market value of at least \$200,000) need not be displayed.

<sup>3</sup>Values allowed in the Limit Order Display Indicator field are defined in Appendix A, the Data Dictionary, of the OATS Reporting Technical Specifications (Technical Specifications) dated July 29, 1999. The specifications for the Limit Order Display Indicator are found on page A-5 of the Technical Specifications. The Technical Specifications are available via the OATS Web pages located at the NASDR Web Site ([www.nasdr.com](http://www.nasdr.com)) or by calling the OATS Support Desk at (800) 321-NASD (6273).

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**Series 55  
Examination**

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Deadline Extended  
For Series 55 Equity  
Trader Examination To  
October 1, 2000

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Legal & Compliance
- Registration
- Senior Management
- Trading & Market Making
- Training

**KEY TOPICS**

- Series 55 Examination, Equity Trader

**Executive Summary**

The requirement for Nasdaq® and/or over-the-counter equity traders to pass the Series 55 examination by May 1, 2000, has been extended to October 1, 2000.

**Questions/Further Information**

Questions regarding this *Notice* may be directed to Carole Hartzog, Assistant Director, Member Regulation, Testing and Continuing Education, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>), at (301) 590-6696; or Eric Moss, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8982.

**Background**

On January 2, 1998, the Securities and Exchange Commission (SEC) approved amendments to the National Association of Securities Dealers, Inc. (NASD®) rules, creating Rule 1032(f). This rule requires the qualification and registration of representatives who engage in proprietary trading or the execution of transactions on an agency basis in equities, preferred or convertible debt securities effected otherwise than on a securities exchange, or who directly supervise such activities. In order to register as a Limited Representative—Equity Trader, representatives must be registered as General Securities Representatives (Series 7) or as Limited Representatives—Corporate Securities (Series 62), and must pass the Series 55 examination. Rule 1032(f) contains an exemption for representatives whose principal trading activities involve executing orders on behalf of affiliated investment companies registered with the SEC under the Investment Company Act of 1940.

Rule 1032(f) affords an extended qualification period to persons who were performing any of the activities that require registration as a Limited Representative—Equity Trader (outlined above) on or prior to May 1, 1998, and who filed an application to take the Series 55 examination by August 31, 1998. This grace period was scheduled to end on May 1, 2000.

**Extension Granted**

On April 27, 2000, Rule 1032(f) was amended to extend the two-year grace period to October 1, 2000.<sup>1</sup> Representatives will not be permitted to function as equity traders after October 1, 2000 unless they receive passing scores on the Series 55 examination.

Candidates who were granted the two-year grace period and have not yet taken the Series 55 examination will have until October 1, 2000 to pass this examination. Candidates who received the grace period but have failed the Series 55 examination must request on Web CRD<sup>SM</sup> to retake the examination in order to obtain the October 1, 2000 extension.

All candidates who do not qualify for the two-year grace period must pass the Series 55 examination before functioning in a capacity that would require registration, and the normal waiting periods between failed attempts will apply to them. If a firm determines that a candidate with an open Series 55 enrollment does not function as a Nasdaq and/or over-the-counter equity trader as described in NASD Rule 1032(f), the firm must withdraw this examination request on Web CRD by entering a partial Form U-5.

### Endnote

<sup>1</sup>On April 27, 2000, NASD Regulation filed a proposed rule change with the SEC, File No. SR-NASD-00-05, extending the two-year grace period to October 1, 2000. This proposed rule change was effective upon filing pursuant to Section 19(b)(3)(A)(i) of the

Securities Exchange Act of 1934, and paragraph (f)(1) of Rule 19b-4 thereunder, in that the proposed change is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing NASD rule.

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**INFORMATIONAL**

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**Hard To Borrow List**

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**SEC Approves Use Of Hard To Borrow List To Comply With The Affirmative Determination Requirement For Short Sales (Rule 3370)****SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Executive Representatives
- Legal & Compliance
- Operations
- Registered Representatives
- Trading & Market Making

**KEY TOPICS**

- Affirmative Determination
- NASD Rule 3370
- Short Sales

**Executive Summary**

On March 23, 2000, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rule 3370, which is designed to prevent abusive short selling and ensure that short sellers satisfy their settlement obligations.<sup>1</sup> The amendments permit the use of a "Hard to Borrow" list to comply with the affirmative determination requirement for short sales in The Nasdaq Stock Market, Inc. (Nasdaq<sup>®</sup>) National Market (NM) and exchange-listed securities. The amendments become effective on June 9, 2000.

Attachment A includes the text of the amendments to Rule 3370.

**Questions/Further Information**

Questions concerning this *Notice* may be directed to Stephanie M. Dumont, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) at (202) 728-8176; or to the Legal Section, Market Regulation Department, NASD Regulation, at (301) 590-6410.

**Background And Discussion**

NASD Rule 3370 is designed to prevent abusive short selling and ensure that short sellers satisfy their settlement obligations. The rule requires an NASD member or associated person, prior to executing certain short sales, to make an affirmative determination that it will receive delivery of the subject security, or be able to borrow or otherwise provide delivery of the security, by settlement date. The rule also requires that the member or associated person keep a written record that includes the identity of the individual and the firm contact-

ed that offered assurances that the subject security would be delivered by settlement date or be available for borrowing by settlement date.

NASD Rule 3370 currently permits members and associated persons to rely on "blanket" or standing assurances that certain, specified securities will be available for borrowing on settlement date to satisfy their affirmative determination obligations, provided that the information used to generate the "blanket" or standing assurance is less than 24 hours old and the member delivers the security on settlement date.<sup>2</sup>

"Blanket" assurances are commonly referred to as "Easy to Borrow" lists. The rule further provides that if a member relying on a blanket or standing assurance fails to deliver the security on settlement date, the NASD will deem such conduct inconsistent with the terms of the rule, absent mitigating circumstances adequately documented by the member.

A "Hard to Borrow" list includes all securities that are difficult to borrow or unavailable for borrowing. A user of a "Hard to Borrow" list may believe it is reasonable to infer, under appropriate circumstances, that a specific security absent from the list is easy to borrow. In this regard, the amendment to Rule 3370 permits members and associated persons to rely on a "Hard to Borrow" list for any short sales executed in Nasdaq NM or exchange-listed securities, provided that:

- (1) the creator of the list attests in writing that any Nasdaq NM or exchange-listed securities not included on the list are easy to borrow or are available for borrowing; and

(2) any securities restricted pursuant to Uniform Practice Code (UPC) 11830 are included on the list.<sup>3</sup>

Under the amendment, member firms will be able to refer to the “Hard to Borrow” list before executing a short sale in a given security. If that security is not on the list, the member or associated person will be considered to have made the requisite affirmative determination and will be permitted to execute the short sale without taking any further steps to satisfy the affirmative determination rule. Conversely, if the security is on the list, then a member or associated person will not be permitted to execute the short sale without taking additional steps to ensure the security’s availability.

The amendment requires that the creator of a “Hard to Borrow” list attest in writing to the availability of securities not on the list and provide such written statement for each “Hard to Borrow” list created. When the creator of a “Hard to Borrow” list attests in writing, as the amendment requires, that any securities not included on the list are available for borrowing or are easy to borrow, reliance on such “Hard to Borrow” list is substantially similar to reliance on an “Easy to Borrow” list, which is already permitted under NASD Rule 3370. It is the responsibility of the member or associated person using the list to determine that the creator of the list is reliable.

The same requirements that apply to use of “Easy to Borrow” lists also will apply to “Hard to Borrow” lists. In particular, a member or associated person will be permitted to use a “Hard to Borrow” list under the amendment only if the information used to generate the list is less than 24 hours old and the member delivers the security on settlement date. If the member does not deliver the security on settlement date, the NASD will consider such conduct—absent documented mitigating circumstances—inconsistent with the terms of NASD Rule 3370. The member or associated person relying on a “Hard to Borrow” list is obligated to maintain a written record of the determination that the security was available for borrowing, including the identity of the individual and firm that offered the assurance that securities absent from the list were available for borrowing or easy to borrow. Although the rule does not specify the manner in which firms should record and maintain such information, a copy of the “Hard to Borrow” list relied upon may be necessary to demonstrate that the requirements of Rule 3370 were met, including that the information used in generating the list was less than 24 hours old, the creator attested in writing that the securities not on the list were easy to borrow, and that any securities restricted pursuant to UPC 11830 were included on the list.

The amended rule will permit the use of “Hard to Borrow” lists only for Nasdaq NM and exchange-listed securities. For Nasdaq SmallCap and over-the-counter (OTC) equity securities, members can continue to comply with the requirements of Rule 3370 through the use of “Easy to Borrow” lists. The reason for this distinction is that Nasdaq NM and exchange-listed securities are less likely to be subject to short sale abuses than Nasdaq SmallCap and OTC equity securities, which generally are more thinly traded.

### **Effective Date Of Amendments**

The amendments are effective on June 9, 2000.

### **Endnotes**

<sup>1</sup>See Securities Exchange Act Release No. 42571 (Mar. 23, 2000), 65 FR 16993 (Mar. 30, 2000) (File No. SR-NASD-99-37).

<sup>2</sup>See Securities Exchange Act Release No. 36859 (Feb. 20, 1996), 61 FR 7127 (Feb. 26, 1996) (File No. SR-NASD-95-62), approving reliance on “blanket” assurances.

<sup>3</sup>Securities restricted pursuant to UPC 11830 are Nasdaq securities that, as published by the NASD, show an aggregate clearing short position of 10,000 shares or more and that are equal to at least 0.5% of the total shares outstanding of the issue. In practice, securities falling into this category are difficult to borrow.

## ATTACHMENT A

### Text Of Amendments

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

#### Rule 3370. Prompt Receipt and Delivery of Securities

- (a) No change
- (b) No change
  - (1) No change
  - (2) No change
  - (3) No change
  - (4) "Affirmative Determination"
    - (A) No change
    - (B) No change
    - (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 Rule and, therefore, shall be decided by each member. Members may rely on "blanket" or standing assurances (i.e., "Easy to Borrow" lists) that securities will be available for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule. [.] For any short sales executed in Nasdaq National Market (NNM) or national securities exchange-listed (listed) securities, members also may rely on "Hard to Borrow" lists indicating NNM or listed securities that are difficult to borrow or unavailable for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule, provided that: (i) any securities restricted pursuant to UPC 11830 must be included on such a list; and (ii) the creator of the list attests in writing on the document or otherwise that any NNM or listed securities not included on the list are easy to borrow or are available for

borrowing. Members are permitted to use Easy to Borrow or Hard to Borrow lists provided: (i) the information used to generate the list ["blanket" or standing assurance] is less than 24 hours old; and (ii) the member delivers the security on settlement date. Should a member relying on an Easy to Borrow or Hard to Borrow list [blanket or standing assurance] fail to deliver the security on settlement date, the Association shall deem such conduct inconsistent with the terms of this Rule, absent mitigating circumstances adequately documented by the member.

- (5) No change
- (b) No change.
- (c) No change.

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**Audio Tape Order Form \* NASD Regulation, Inc. \* Spring Securities Conference**  
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| <b>CRD Conference</b><br>Recorded in New York City April 13-14, 2000  | <b>Spring Securities Conference</b>   |   |
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Single Tape Session \_\_\_\_\_ × \$12.00 = \$ \_\_\_\_\_  
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 City \_\_\_\_\_ State \_\_\_\_\_ Zip \_\_\_\_\_  
 Day Phone \_\_\_\_\_ Fax \_\_\_\_\_ E-mail \_\_\_\_\_

**For Mail or Fax Orders:** Visa MasterCard AMEX Discover Check (make payable to A.Y.E.R. Associates)

Cardholder Name \_\_\_\_\_ Card Number \_\_\_\_\_  
 Cardholder Signature \_\_\_\_\_ Expiration Date \_\_\_\_\_

**Mail or Fax Completed Order Form and Payment to:** A.Y.E.R. Associates, 6974 Ducketts Lane, Elkridge, MD 21075  
 PHONE 410-796-8940 FAX 410-796-8962

Received \_\_\_\_\_ Auth # & Date \_\_\_\_\_ Shipped \_\_\_\_\_ Up date \_\_\_\_\_

**INFORMATIONAL**

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**Locked/Crossed Markets**

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SEC Approves Changes To Nasdaq Locked/Crossed Markets Rule; **Effective Date: June 5, 2000**

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Institutional
- Legal & Compliance
- Operations
- Senior Management
- Trading & Market Making

**KEY TOPICS**

- Locked/Crossed Markets
- NASD Rule 4613

**Executive Summary**

On February 7, 2000, the Securities and Exchange Commission (SEC) approved changes to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rule 4613(e), which relates to the entering of locking and crossing quotes by Nasdaq<sup>®</sup> market participants (Market Makers and electronic communications networks (ECNs)). The rule change alters market participants' obligations regarding the entry of locking/crossing quotes prior to the opening of the Nasdaq market at 9:30 a.m. Eastern Time (ET), and sets out specific obligations for parties to a lock/cross, which are determined based on the time the locked/crossed market occurs.

Attachment A includes a question and answer section which explains the major points of the rule changes. Attachment B includes the text of the amended rule.

The rule amendments will go into effect on June 5, 2000.

**Questions/Further Information**

Questions regarding this *Notice* should be addressed to John Malitzis, Assistant General Counsel, Office of General Counsel, The Nasdaq Stock Market, Inc. (The Nasdaq Stock Market<sup>®</sup>), at (202) 728-8245; or Thomas Moran, Assistant General Counsel, Office of General Counsel, The Nasdaq Stock Market, at (202) 728-8401; or the Legal Section, Market Regulation Department, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>), at (301) 590-6410.

**Discussion**

To address ongoing concerns with locked/crossed markets on the open, Nasdaq proposed and the SEC approved changes (on

February 7, 2000) to NASD Rule 4613(e). The rule change alters market participants' obligations regarding the entry of locking/crossing quotes prior to the opening of Nasdaq, and sets out specific obligations for parties to a lock/cross. The rule amendments generally allow market participants that enter a locking/crossing quote to send a special message to the party being locked/crossed, and the party being locked/crossed must respond to the message within 30 seconds by trading in full with it or moving its quotation out of the way (*i.e.*, to a price level that resolves the locked/crossed market). As noted below, the **obligations** of the parties to a lock/cross will vary slightly depending on whether the lock/cross occurs prior to or after 9:20 a.m., ET.

**Market Participants' Obligations*****Locks/Crosses Occurring At Or After 9:20 And Before 9:30 a.m., ET***

If a market participant enters a locking/crossing quotation between 9:20:00 a.m. and 9:29:59 a.m. ET, the market participant **must** send to the Market Maker(s) or ECN(s) being locked/crossed a SelectNet<sup>®</sup> message with a "Trade-or-Move" administrative Message (Trade-or-Move Message). (Nasdaq is requiring market participants to append this administrative message to the SelectNet message so that the receiving market participant knows that it owes an obligation to respond to the incoming order.)<sup>1</sup> The Trade-or-Move Message must be sent immediately after entering a locking/crossing quotation, and must be priced at (or better than) the quote of the market participant(s) being locked/crossed. Additionally, the market participant initiating the lock/cross must send

Trade-or-Move Message(s) whose aggregate size is 5,000 shares (*i.e.*, the total number of shares the market participant must send is 5,000 shares). This means that if the market participant is locking/crossing a single Market Maker or a single ECN, it must send one Trade-or-Move Message for 5,000 shares. If the market participant is locking/crossing multiple market participants, it must send each Market Maker or ECN a Trade-or-Move Message and the aggregate size of all of these messages being sent must be 5,000 shares.<sup>2</sup>

#### **Locks/Crosses Prior To 9:20 a.m., ET**

For locks/crosses that occur prior to 9:20 a.m. ET, any party to a lock/cross would have the right, but not the obligation, to send, **beginning at 9:20 a.m.**, a Trade-or-Move Message of any size to any party to the lock/cross. Unlike locks/crosses that occur at or after 9:20 a.m., however, there is no requirement that the market participant initiating the lock/cross send a specific number of shares to those being locked/crossed.

#### **Obligations Regarding "Trade-or-Move Messages"**

A market participant that receives a Trade-or-Move Message between 9:20:00 a.m. and 9:29:59 a.m., must within 30 seconds (of receipt of the message) trade in full with the incoming message or must move its quote to a price level that unlocks/uncrosses the market.

A market participant may partially execute the incoming Trade-or-Move Message, but it then must move its quote out of the way within 30 seconds of receiving the Trade-or-Move Message because it has not executed the full size of the order.

In addition, if the receiving market participant trades in full with the message, the market participant may maintain its quote at the locking/crossing price (*i.e.*, not move) if it wishes to trade more shares. Thereafter, any party to the lock/cross has the right, but not the obligation, to send a subsequent Trade-or-Move Message of any size to any other party to the lock/cross. As always, any party to the lock/cross that receives a Trade-or-Move Message must trade in full or move within 30 seconds.

If a party receives a Trade-or-Move Message and stays at its quote without trading in full, this will be considered a violation of NASD Rule 4613(e). In addition, it could be inconsistent with just and equitable principles of trade for a market participant to send a Trade-or-Move Message when not required to by the rule (*e.g.*, before 9:20 a.m. or after 9:30 a.m.) and/or to send a Trade-or-Move Message that does not meet the requirements of the rule (*e.g.*, at a price that is inferior to the receiving market participant's quote). NASD Regulation will surveil for violations of Rule 4613(e) and will bring disciplinary action when appropriate.

The following are examples of how the rule will work.

**Example 1.** At 9:21 a.m., MMA locks four market participants—MMB, MMC, MMD, and MME—each quoting 1,000 shares. Since the lock has occurred **after 9:20 a.m.**, MMA must send a total of 5,000 shares to these four Market Makers, and must send a Trade-or-Move Message to each party to the lock. Accordingly, MMA sends a Trade-or-Move Message for 1,100 shares to MMB, which declines and moves. MMC receives a 1,500 message, fills it partially (1,000 shares), and as required, moves its quote out of the way. MMD receives a message for 400 shares, and within 30 seconds fills it in full and elects to move down 1/8<sup>th</sup> to unlock the market. MME receives a 2,000 share message, and fills it completely within 30 seconds; MME is permitted to maintain its quote at the lock price (or it may move its quote to unlock the market). MME also may send a Trade-or-Move Message of any size to MMA, which must trade in full or move, or MMA may send another Trade-or-Move Message of any size to MME, which then would have to trade in full or move.

**Example 2.** At 9:18 a.m., MMW and MMX are bidding \$74, and MMY and MMZ enter offer prices of \$73, thus crossing the market. At 9:20 a.m., all four market participants would have the right to send a Trade-or-Move Message of any size to either of the two market participants crossing them. Any party receiving a Trade-or-Move Message after 9:20 would be required to trade in full or move its quote out of the way within 30 seconds.

## ATTACHMENT A

### Questions And Answers

1. When will the rule amendments be implemented?

**A.** The rule amendments will go into effect on June 5, 2000.

2. What is the relationship between the new rule and the rule that currently governs pre-opening locks/crosses, which requires a market participant that enters a locking/crossing quote between 9:25 a.m. and 9:29:59, to take action to unlock/uncross the market within 30 seconds of open?

**A.** The 9:25 Lock/Cross Rule is being rescinded and it will be replaced completely by the new rule described in this *Notice*. As is the case today, if a market participant wishes to enter a quote at or after 9:30 a.m. that locks/crosses the market, the market participant must take reasonable action to avoid locking/crossing the market by, for example, sending a Nasdaq-system order (via SelectNet or Nasdaq National Market<sup>®</sup> Execution System) to the participant(s) that would be locked/crossed. Additionally, if a market participant is party to a lock/cross that is created prior to the open and that is not resolved by 9:30:00 a.m., the parties to the lock/cross still must take reasonable action to resolve the lock/cross when the market opens.

For example, at 9:25:00 a.m., MMA locks MMB at a price of \$20, and consistent with Rule 4613(e), MMA sends MMB a 5,000 share Trade-or-Move Message. At 9:25:20 MMB trades in full with MMA's message, and consistent with Rule 4613(e), MMA opts to stay at \$20 and not unlock the market. Since the lock/cross remains in place at

9:30:00, both parties to the lock/cross must take reasonable action at the open to resolve the locked/crossed markets.

The only exception to this general rule is situations where the Trade-or-Move Message remains "live" when the market opens (*i.e.*, the 30 seconds to respond the Trade-or-Move Message carries over into the market's opening) because the lock/cross was created (and the message was sent) in the last 29 seconds before the market opens. **See** Question 6 below for further explanation.

3. How will Market Makers and ECNs denote that a SelectNet message is a Trade-or-Move Message?

**A.** Nasdaq has added a new "canned" administrative message to SelectNet, which is denoted as "TRD OR MOV." The "TRD OR MOV" administrative message is generated by typing in the text message area of a SelectNet order "TRD OR MOV" or by entering a "6" which will enter the text "TRD OR MOV."

4. If a market participant receives a SelectNet message between 9:20:00 and 9:29:59 a.m. that does not contain the "TRD OR MOV" administrative message, does the recipient owe an obligation to trade or move under NASD Rule 4613(e)?

**A.** No. If the SelectNet message is sent between 9:20:00 and 9:29:59 a.m. and it does not contain the "TRD OR MOV" administrative message, the recipient owes no obligation to it under NASD Rule 4613(e). It would be a violation of Rule 4613(e) for a market participant to initiate a lock/cross during this period without sending a SelectNet message(s) for at least

5,000 shares with the "TRD OR MOV" administrative message.

5. If a Market Maker or ECN sends a Trade-or-Move Message prior to 9:20 a.m., is the recipient required to trade in full or move under Rule 4613(e)?

**A.** No. Under Rule 4613(e), the obligation to trade in full or move only attaches if the message is sent between 9:20:00 a.m. and 9:29:59. Thus, if a Market Maker or ECN receives a Trade-or-Move Message prior to 9:20 a.m., the market participant owes no obligation to the message under Rule 4613(e).

6. If a Market Maker receives a Trade-or-Move Message within the last 30 seconds before the opening (*i.e.*, at or after 9:29:30 a.m.), does the Market Maker still have the obligation to trade or move within 30 seconds?

**A.** Yes. The Market Maker would still have an obligation to trade or move within 30 seconds even if the end of that 30 seconds occurs after the market's open. In this narrow circumstance, the parties to the lock/cross will not have an obligation under Rule 4613(e) to take further action after the 30 seconds has elapsed to resolve the lock/cross that was created prior to the open. Rather, because the Trade-or-Move Message remained "live" when the market opened (*i.e.*, the 30 seconds to respond to the Trade-or-Move Message carried over into the market's opening), the parties to the lock/cross may be deemed to have taken reasonable action to resolve the lock/cross. This, of course, assumes that the parties have fully complied with their obligations under the rule by timely sending Trade-or-Move Messages and properly responding to Trade-or-Move Messages when received.

7. If a market participant receives a Trade-or-Move Message between 9:20:00 a.m. and 9:29:59 a.m. and moves out of the way within 30 seconds, does the member violate the firm quote rule?

**A.** No, assuming the market participant's quote is closed when the order was presented, as is normal practice in the period prior to 9:30:00 a.m.

8. If a market participant receives a Trade-or-Move Message before the opening and the 30 seconds to act falls after the opening, would it be consistent with the firm quote rule if the market participant moved out of the way when the market opened at 9:30:00 a.m.?

**A.** Yes. If a market participant receives a Trade-or-Move Message prior to 9:30:00 a.m. that is at or better than its quoted price and is at or less than its quoted size, it would be consistent with the firm quote rule if after the market opens the market participant declined to trade with the message and moved its quote out of the way. (This assumes that the market participant moves out of the way within 30 seconds of receiving the Trade-or-Move Message.) This is because the market participant was presented with the order prior to the market's open when the market participant's quote was closed.

For example, MMA is bidding \$20 for 1,000 shares when at 9:29:50 it receives from MMB a Trade-or-Move Message to sell 1,000 shares for \$20. It would be consistent with the locked/crossed and firm quote rules if at 9:30:15 MMA moved its bid out of the way without filling MMB's Trade-or-Move Message.

9. If a market participant receives a Trade-or-Move Message between 9:20:00 and 9:29:59 a.m. and does

not fill the order or move out of the way within 30 seconds, does the member violate the firm quote rule?

**A.** It is Nasdaq's and NASD Regulation's view that if a party receives a Trade-or-Move Message and stays at its quote without trading at all or without trading in full, this generally would be considered a violation of NASD Rule 4613(e) regarding locked/crossed markets, and not a violation of the firm quote rule.

10. If a market participant receives a Trade-or-Move Message and in a manner consistent with the rule, moves its quote out of the way, does the market participant have to actually decline the message?

**A.** No. The rule only requires the recipient of a Trade-or-Move Message to move out of the way within 30 seconds of receipt of such message. In these situations, market participants do not have to (and for capacity reasons should not) decline a Trade-or-Move Message.

11. If a Market Maker or ECN enters a locking/crossing quote between 9:20:00 and 9:29:59 a.m., when must the Market Maker or ECN send the Trade-or-Move Message?

**A.** The rule requires the market participant to send the Trade-or-Move Message **immediately** after entering the locking/crossing quote. It would be considered a violation of NASD Rule 4613(e) if a market participant that initiates the lock/cross delays sending a Trade-or-Move Message to the party or parties it is locking/crossing. NASD Regulation will surveil for these types of delays and will take disciplinary action when appropriate.

12. If a Market Maker or ECN enters a locking/crossing quote between 9:20:00 and 9:29:59 a.m., is the Market Maker or ECN required to send a single 5,000-share Trade-or-Move Message or multiple 5,000-share messages?

**A.** The market participant initiating the lock/cross must send a Trade-or-Move Message to each market participant that it will lock or cross. The rule states that the **total size** of all Trade-or-Move Messages must be at least 5,000 shares. This 5,000-share requirement applies to Market Makers and ECNs alike. Accordingly, a Market Maker or ECN may not lock/cross the market in the period between 9:20:00 and 9:29:00 a.m., unless the Market Maker or ECN sends a Trade-or-Move Message for at least an aggregate of 5,000 shares.

For example, if MMA will lock/cross MMC and MMD which are each displaying 1,000 shares in their quotes, MMA must send two Trade-or-Move Messages and the total size of these two messages must be 5,000 shares. While the rule does not specify the size of the individual message that a market participant initiating the lock/cross must send, it must be for at least one normal unit of trading (100 shares).

Additionally, a market participant should (when possible) attempt to match the quote sizes of the market participant(s) being locked/crossed. Thus, if MMA were locking MMC for 2,000 shares, MMD for 2,000 shares, and MME for 100 shares, it would not be consistent with the spirit of the rule for MMA to send MMC and MMD 100 shares each, and MME the remaining 4,800.

13. If a Market Maker or ECN enters a locking/crossing quote between 9:20:00 and 9:29:59 a.m.

and is only locking/crossing one Market Maker or ECN which is displaying less than 5,000 shares, is the market participant initiating the lock/cross still subject to the 5,000-share requirement?

**A.** Yes. The Market Maker or ECN initiating the lock/cross must send the single market participant being locked/crossed a Trade-or-Move Message for 5,000 shares.

**14.** What are an ECN's options for handling an order received between 9:20:00 a.m. and 9:29:59 a.m., that is less than 5,000 shares and that would lock/cross the market if displayed in Nasdaq during that period?

**A.** During the 9:20:00 to 9:29:59 a.m. time period, an ECN may not display in Nasdaq an order for less than 5,000 shares that would lock/cross the market. Instead, the ECN may: (1) attempt to match off the order internally with the order of another subscriber; (2) attempt to fill the order by sending a "regular" SelectNet message to the market participant(s) it would lock/cross; or (3) wait to accumulate at least 5,000 shares and then send the appropriate Trade-or-Move Message(s). When the market opens at 9:30 a.m., the ECN would be obligated to handle the order in a manner consistent with the SEC's Order Handling Rules and NASD rules.

However, in response to concerns that certain agency interest may not be represented in the pre-opening, Nasdaq recently submitted a

proposed rule change to the SEC, which would allow a market participant to lock/cross the market for less than 5,000 shares if it is representing only agency orders. Under the amendment, if between 9:20 a.m. and 9:29 a.m., a market participant receives an agency order that would lock/cross the market, the market participant would be able to lock/cross the market and send a Trade-or-Move Message for the "actual size" of the agency order, instead of 5,000 shares. In essence, agency orders would be "exempt" from the 5,000-share requirement. **Note: This rule change has not been approved by the SEC. We will inform the membership of the progress of this proposed rule change.**

**15.** If a market participant enters a locking/crossing quote before 9:20 a.m. and the market remains locked/crossed after 9:20 a.m., what are that market participant's obligations?

**A.** Prior to 9:20 a.m., the market participant can send any party a "regular" SelectNet message, which the recipient is free to trade with, decline, or ignore. At and after 9:20:00 a.m., if the market is still locked or crossed, any party to a lock/cross has the right, but not the obligation, to send a Trade-or-Move Message to any party to the lock/cross. The message may be of any size (assuming at least one minimum unit of trading). The recipient of a Trade-or-Move Message then is required to trade in full or move out of the way within 30 seconds.

**16.** MMA and MMB lock each other at 9:18 a.m. At 9:25, while MMA and MMB are still locked, MMC joins the locked market. Is MMC obligated to send a Trade-or-Move Message (for a total of 5,000 shares) to the parties it is locking/crossing even though the security was already locked/crossed?

**A.** Yes. A market participant's obligations under Rule 4613(e) are determined by the time it locks/crosses the market or joins an existing locked/crossed market. In the scenario described above, MMC must send a Trade-or-Move Message(s) for a total of 5,000 shares because MMC joined the lock at 9:25 a.m.

**17.** After the SOES/SelectNet integration occurs and the Nasdaq National Market Execution System begins operation, will market participants still use SelectNet to deliver Trade-or-Move Messages during the 9:20 to 9:29:59 a.m. period?

**A.** Yes. Market participants will use the SelectNet system to deliver Trade-or-Move Messages. The automatic execution features of the Nasdaq National Market Execution System will not be available during pre-opening hours, but SelectNet will be available during the pre- and post-market hours as is the case today. Unlike normal market hours, there will be no "over-sized" order requirement for Trade-or-Move and regular SelectNet messages during pre- and post-market hours.<sup>3</sup>

**ATTACHMENT B**

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

**4613. Character of Quotations****(a) - (d) No Changes****(e) Locked and Crossed Markets**

(1) A market maker shall not, except under extraordinary circumstances, enter or maintain quotations in Nasdaq during normal business hours if:

(A) the bid quotation entered is equal to (“lock”) or greater than (“cross”) the asked quotation of another market maker entering quotations in the same security; or

(B) the asked quotation is equal to (“lock”) or less than (“cross”) the bid quotation of another market maker entering quotations in the same security.

[The prohibitions of this rule include the entry of a locking or crossing quotation at or after 9:25:00 a.m. Eastern Time if such quotation continues to lock or cross the market at the market’s opening, and requires a market maker or ECN that enters a locking or crossing quotation at or after 9:25:00 a.m. Eastern Time to take action to avoid the lock or cross at the market’s open or immediately thereafter, but in no case more than 30 seconds after 9:30:00 a.m.]

(C) Obligations Regarding Locked/Crossed Market Conditions Prior to Market Opening

(i) Locked/Crossed Market Prior to 9:20 a.m. — For locks/crosses that occur prior to 9:20 a.m. Eastern Time, a market maker that is a party to a lock/cross because the market maker either has entered a bid(ask) quotation that locks/crosses another market maker’s quotation(s) or has had its quotation(s) locked/crossed by another market maker (“party to a lock/cross”) may, beginning at 9:20 a.m. Eastern Time, send through Nasdaq’s SelectNet system (or its successor system) a Message of any size that is at the receiving market maker’s quoted price (“Trade-or-Move Message”). Any market maker that receives a Trade-or-Move Message at or after 9:20 a.m. Eastern Time, and that is a party to a lock/cross, must within 30 seconds of receiving such Message either: fill the incoming Trade-or-Move Message for the full size of the Message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market.

(ii) Locked/Crossed Market Between 9:20 and 9:29:59 a.m. — If a market maker locks or crosses the market

between 9:20 and 9:29:59 a.m. Eastern Time, the market maker must immediately send through SelectNet to the market maker whose quotes it is locking or crossing a Trade-or-Move Message that is at the receiving market maker’s quoted price and that is for at least 5,000 shares (in instances where there are multiple market makers to a lock/cross, the locking/crossing market maker must send a Message to each party to the lock/cross and the aggregate size of all such Messages must be at least 5,000 shares). A market maker that receives a Trade-or-Move Message during this period and that is a party to a lock/cross, must within 30 seconds of receiving such Message either: fill the incoming Trade-or-Move Message for the full size of the Message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market.

(iii) A market maker that sends a Trade-or-Move Message pursuant to subparagraphs (e)(1)(C)(i) or (e)(1)(C)(ii) of this rule must append to the message a Nasdaq-provided symbol indicating that it is a Trade-or-Move Message.

**(2) - (3) No Changes****Endnotes**

<sup>1</sup>This will allow market participants to distinguish Trade-or-Move Messages (to which it has an obligation to respond under the rule proposed herein) from other pre-opening Messages that a market participant may receive.

<sup>2</sup>Thus, a market participant would be prohibited from locking/crossing the market in the 10-minute period prior to the open unless the actively locking/crossing market participant is willing to trade at least 5,000 shares.

<sup>3</sup>See NASD Rule 4720(c).

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**INFORMATIONAL**

# Nasdaq National Market Execution System

SEC Approves New Systems And Rules Governing Delivery, Negotiation, And Execution Of Orders For Nasdaq National Market Securities; **Effective Date: July 10, 2000**

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Institutional
- Legal & Compliance
- Operations
- Senior Management
- Systems
- Trading & Market Making

**KEY TOPICS**

- Nasdaq National Market Execution System
- SelectNet
- Small Order Execution System
- Trading

## Executive Summary

On January 14, 2000, the Securities and Exchange Commission (SEC) approved rule changes that establish a new platform for the trading of Nasdaq National Market<sup>®</sup> (NNM) securities and amend the rules governing SelectNet<sup>®</sup>. This *Notice to Members* is being issued to alert members to the implementation of these changes.

Nasdaq<sup>®</sup> will establish "The Nasdaq National Market Execution System" (NNMS) as the primary trading platform for NNM securities. NNMS will be based on the architecture of the Small Order Execution System<sup>SM</sup> (SOES<sup>SM</sup>), but will be enhanced in several ways that will be explained later in this *Notice*.

Under the rule changes, SelectNet generally will be used to deliver negotiable orders to Market Makers and Electronic Communication Networks (ECNs) that participate in NNMS. SelectNet orders for NNM securities will no longer be "liability orders."

SmallCap<sup>SM</sup> SOES will continue to operate as it does today. Additionally, market participants will be able to use SelectNet to deliver liability orders in SmallCap issues.

The system changes and applicable rules governing SelectNet and NNMS will take effect on July 10, 2000. Attachment A contains the amended rule language. Attachment B includes a question/answer section dealing with common questions regarding NNMS.

## Questions/Further Information

Questions regarding this *Notice* may be directed to the following:

- For legal issues: the Nasdaq

Office of General Counsel, at (202) 728-8294.

- For technical issues: Peter Martyn or Paul Niche, Nasdaq Product Development, at (212) 858-4322.
- For trading issues: Dan Franks, Nasdaq Market Operations, at (203) 385-6250.
- For market regulation questions: Market Regulation Legal Department, at (301) 590-6410.

## Background

SOES was developed in 1984 to provide a simple and efficient means to execute small agency orders at the inside quote, report trades for public dissemination, and send trades to clearing for comparison and settlement.<sup>1</sup> Trading is done automatically and is negotiation-free. In response to the October 1987 market break, SOES was enhanced in several respects to provide individual investors with guaranteed liquidity and assured access to Market Makers in times of market disruption. In particular, SOES participation was made mandatory for all Market Makers in NNM securities.

SelectNet, approved in January 1988, is an electronic screen-based order routing system that allows market participants to negotiate securities transactions in Nasdaq securities through computer communications, rather than relying on the telephone.<sup>2</sup> SelectNet added communications options and electronic access to Nasdaq's trade reporting, order comparison, and settlement facilities. Unlike SOES, SelectNet offers the opportunity to negotiate for a larger size or a price superior to the current inside quote.

In addition, participants may limit the amount of time an order will be in effect (from 3 to 99 minutes), specify a day order, or indicate whether price or size is negotiable or whether a specific minimum quantity is acceptable. Participants may accept, price-improve, counter, or decline a SelectNet order, consistent with the firm quote requirements of SEC Rule 11Ac1-1 and National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rule 4613(b). Upon agreement to terms, the execution is “locked-in,” reported to the tape, and sent to clearing for comparison and settlement.

SelectNet currently allows subscribers to direct, or “preference,” orders to specified Market Makers or to broadcast orders to all market participants. Although SelectNet is an order delivery service, rather than an order execution service, a preferenced SelectNet order presented to a Market Maker at its displayed quote gives rise to liability under SEC Rule 11Ac1-1 for the Market Maker to execute the transaction at that price and size of its quote.<sup>3</sup>

SelectNet links Nasdaq to ECNs in conjunction with the SEC’s Order Handling Rules,<sup>4</sup> which require a Market Maker to make publicly available any superior prices that the Market Maker quotes privately through an ECN. A Market Maker may comply with this requirement by changing its quote to reflect the superior price or, in the alternative, may deliver better-priced orders to an ECN provided that the ECN disseminates these priced orders to the public quotation system and provides broker/dealers equivalent access to these orders. SelectNet will continue to perform this function in the new trading environment for ECNs that choose not to take

automatic execution against their quotes through NNMS.

While SOES and SelectNet have provided, and continue to provide, valuable services to market participants for the ultimate benefit of investors, the maintenance of two separate execution systems operating independently and simultaneously creates the potential for “dual liability” for Market Makers. Multiple access points to a Market Maker’s quote, through a combination of SOES and SelectNet as well as through a firm’s internal order receipt/execution facilities, can subject Market Makers to unintended double liability for orders that reach their quote at or near the same time through disparate, asynchronous systems. The potential for unexpected order liability reduces Market Maker incentives to commit capital and display larger quote sizes, thereby depriving the Nasdaq market of valuable liquidity. Nasdaq’s new automated execution environment is designed to remedy these problems.

### **Nasdaq’s New Trading Environment**

The SEC has approved modifications to Nasdaq’s negotiation and automatic execution systems to deal with the problem of dual liability. As a general matter, SelectNet, through rule and system changes, will be reestablished as a non-liability, order delivery and negotiation system for NNM securities. The current automatic execution system for small orders from public customers, SOES, will be substantially enhanced for the trading of NNM securities through the following changes:

- (1) increasing the maximum order size for NNM securities to 9,900 shares;
- (2) allowing market participants (including Market Makers) to enter proprietary orders into the new system and to obtain automatic execution for their proprietary and agency orders in NNM securities;
- (3) reducing the current 17-second delay between executions against the same Market Maker to five seconds;
- (4) enabling NNM orders to interact on an automatic basis with Market Makers’ displayed size and reserve size.<sup>5</sup> These rule changes will reduce dual liability, improve the speed of executions, and increase access to the full depth of a security’s trading interest by all market participants; and
- (5) eliminating the “No Decrementation” and preferencing functionality that currently exists in SOES.

### **Changes To SelectNet**

SelectNet will be transformed to an order delivery and negotiation system through rule changes prohibiting the use of SelectNet for the entry of any preferenced orders directed to Market Makers in NNM securities unless such orders are at least 100 shares in excess of the displayed amount of an NNMS Market Maker’s quote to which they are directed (over-sized order requirement). In addition, such orders must also be designated as either:

- (1) an “All-or-None” (AON) order of a size that is at least 100 shares greater than the displayed amount of the NNMS

Market Maker's quote to which the order is directed; or

- (2) a "Minimum Acceptable Quantity" (MAQ) order with an MAQ value of at least 100 shares greater than the displayed amount of the NNMS Market Maker's quote to which the order is directed.

SelectNet will automatically reject preferenced messages that fail to meet these requirements.<sup>6</sup> The over-sized order requirement will also apply to orders directed to ECNs that take automatic execution against their quotes in NNMS. These changes will ensure that Market Makers and ECNs that take automatic execution are not subject to potential dual liability arising under the firm quote rule as the result of receiving orders from different systems. Recipients of over-sized NNM SelectNet orders will have the option to execute or initiate electronic negotiation in response to the message.

ECNs will have the ability to be accessed through the SelectNet linkage, or fully participate in NNMS and be subject to automatic execution through NNMS. Nasdaq currently is working with Unlisted Trading Privilege (UTP) Exchanges to integrate them into the automatic execution functionality of NNMS. If this occurs, UTP Exchanges may be accessed via NNMS, and they may access Nasdaq market participants that take automatic execution via NNMS.

#### ***Nasdaq National Market Execution System (NNMS)***

NNMS will be the Nasdaq market's primary trading and execution medium. NNMS transforms the current operating execution systems for small orders from public customers into a more efficient, automated facility for the

handling of all NNM orders of less than 9,900 shares. NNMS will execute automatically against Market Makers' quotes—displayed and reserve size—as more fully described below.

**Order Entry Parameters.** First, the maximum order size for NNM securities entered into NNMS will be 9,900 shares. Second, NASD members (including Market Makers) will be allowed to use NNMS on a proprietary basis, including being able to obtain automatic execution for orders sent to other NNMS participants, when trading NNM securities. Third, the interval delay between automatic executions against the same Market Maker will be five seconds. Fourth, the system will have a reserve size feature for quotes. NNMS will permit interaction of orders against a Market Maker's "reserve size" after yielding priority to displayed quotes at the same price. Additionally, Market Makers will have the option of having their quotes automatically refreshed from that reserve to a size level of their choosing. If no particular size is designated by the Market Maker, the quote will automatically be refreshed by NNMS at a 1,000-share displayed-size level.<sup>7</sup>

**Reserve Size.** Participants in NNMS will be able to indicate a reserve size amount which will not be displayed in Nasdaq. Rather, reserve size will refresh quotes that have been decremented to zero, and will be accessed automatically if all displayed interest is exhausted. The reserve size feature of NNMS will yield priority to all displayed quotes at the same price level, so that the system will execute against displayed size in time priority and then against the reserve size in time priority. NNMS will require those using the NNMS reserve-size feature to display at

least 1,000 shares in their quotes. Moreover, quotes at the inside of the market that are to be refreshed at the same price level must be refreshed to at least 1,000 shares in order for a Market Maker to continue using reserve size.<sup>8</sup>

Consider the following scenario: three Market Makers, ranked in time priority A, B, and C, are each at the best bid and each displaying 1,000 shares and all with 5,000 shares in reserve, and a 9,000-share market order is entered. The system will handle the order as follows: NNMS would automatically first take out the displayed 3,000 shares, then take out the entire 5,000-share reserve size of Market Maker A (MMA) and 1,000 shares of Market Maker B's (MMB) reserve size in time priority, filling the order. MMB would then have 4,000 shares in reserve size and Market Maker C (MMC) would have 5,000 shares in reserve size.<sup>9</sup> MMA's quote would be completely decremented and drop from the inside market. Since MMB's total displayed and reserve quote would not be completely decremented (4,000-reserve share size remaining) it would retain its time priority and, assuming it remains the best bid, remain at the top of the quote montage with its displayed size refreshed from its remaining reserve size. In order to continue quoting shares in reserve size, MMB would have to have selected a 1,000+ share refresh size. MMC, based on its 5,000-share reserve size remainder, would retain the number two slot in the executive rotation and also have the option of having its displayed quote automatically refreshed from reserve to a size of its choosing. MMC would likewise be subject to a 1,000+ share display refresh minimum to be allowed to continue to quote reserve size. MMA's fully exhausted quote may be automatically

refreshed away from the inside market using Nasdaq's automatic quote update function.

As always, failure to update a fully exhausted quote will result in the system placing the Market Maker's quote in a "closed" state that, if not updated within five minutes, will be cause for suspension of the Market Maker's quote for 20 business days. Market Makers will still have the ability, through Nasdaq's automatic quote update facility, to pre-select a tick value and size, and have Nasdaq refresh their proprietary quote away from the inside market. If a Market Maker's quote is refreshed to a different price or size level, another order will not be delivered to that Market Maker for five seconds after that quote is refreshed at the new price or size level.

**"No Decrementation" Eliminated.** NNMS will not offer the "NO DEC" feature for NNM securities. NO DEC, which currently allows continuous executions against a Market Maker's quote at the same price, is unnecessary in an environment where a Market Maker can manage its quotes by displaying its actual size and refresh its quote at a size it determines.

**Preferencing Eliminated.** Similarly, Nasdaq is also eliminating the existing SOES preferencing feature for NNM securities because it is inconsistent with the processing of orders in time priority. Preferencing in an automatic execution system also reduces Market Maker incentives to aggressively compete for orders by showing the full size and true price of its trading interest.

***ECN And UTP Exchange Participation***

ECNs will have two options for

participation in NNMS, and the manner in which they choose to participate shall be governed by an addendum to the NWII Subscriber Agreement for ECNs. Specifically, ECNs can choose to be Order-Entry ECNs or Full-Participant ECNs.

1) Order-Entry ECNs (OE ECNs) will participate in Nasdaq in substantially the same manner as ECNs do today. That is, market participants would be able to access OE ECN quotes via the SelectNet linkage and to send preferenced SelectNet messages of any size (up to 999,999 shares) to such ECNs. The oversized order requirement for a preferenced SelectNet order would not apply to OE ECNs. OE ECNs that want to access other Market Maker quotes would need to request order-entry capability in NNMS. That is, OE ECNs would enter orders into NNMS for automatic execution against quotes of Market Makers and other ECNs that choose to accept automatic execution against their quotes. OE ECNs can also send preferenced SelectNet orders to NNMS Market Makers subject to the over-sized order restrictions described above.<sup>10</sup>

2) Full-Participant ECNs will agree to provide automatic execution against their quotes for orders entered into NNMS, similar to Market Makers. Like OE ECNs, Full-Participant ECNs will use NNMS to obtain automatic execution of orders they send to NNMS Market Makers or other Full-Participant ECNs. Full-Participant ECNs will use SelectNet to deliver liability orders to OE ECNs.

National securities trading pursuant to grants of UTP will continue to

have access to the full range of SelectNet's capabilities as their primary linkage with Nasdaq. UTP Exchanges will continue to receive, and be obligated to execute, preferenced SelectNet liability orders. Additionally, UTP Exchanges will retain their ability to send SelectNet preferenced liability orders to Market Makers. Thus, a Market Maker will face dual liability on the sporadic occasions when its quote is accessed simultaneously by a UTP Exchange via SelectNet and also by an NNMS Market Maker or Order Entry Firm via NNMS.

As noted above, Nasdaq currently is working with UTP Exchanges to integrate them into the automatic execution functionality of NNMS. If this occurs, UTP Exchanges may be accessed via NNMS, and they may access Nasdaq market participants that take automatic execution via NNMS.

***Nasdaq SmallCap***

For Nasdaq SmallCap securities, the trading rules for automatic execution will not change. Participation in the automatic execution system for SmallCap will remain voluntary, and be available only for the small orders of public customers. Maximum order size limits will remain in effect as well as the prohibition against splitting larger orders to avoid those limits. Restrictions on access by market professionals will likewise be maintained. Lastly, SelectNet in the SmallCap environment will not change. Specifically, the over-sized order requirement will not apply to SmallCap issues. Thus, Market Makers that receive SelectNet orders in SmallCap issues at their quoted price and size will owe an obligation to honor these orders under the SEC's and NASD's firm quote rules.

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### System Examples

The following are some representative examples of how NNMS will operate.

#### **Example 1**

There are three Market Makers at the inside bid displaying the following quotations when an 8,000-share market order to sell is entered into the system:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (AQR) (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMA                | \$20       | 1,000          | 5,000        | 1,000 <sup>11</sup>    | Not being used                                     |
| MMB                | \$20       | 2,000          | 2,000        | 1,000                  | Not being used                                     |
| MMC                | \$20       | 1,000          | 1,500        | 1,000                  | Not being used                                     |
| MMD                | \$19 15/16 | 1,000          | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 1,000 shares       |

Four thousand shares are instantaneously taken from the displayed size of MMA, MMB, and MMC, and 4,000 shares are instantaneously taken from MMA's reserve size, resulting in one execution of 5,000 shares for MMA, one execution of 2,000 shares for MMB, and one execution for 1,000 shares for MMC. (In instances where an order is entered into the system and that order would interact with both a market participant's displayed size and reserve size [consistent with displayed/reserve and price/time priority system rules],<sup>12</sup> the system will execute one transaction—**not** two—against the market participant to minimize transaction costs.) The aforementioned transactions yield the following quotes:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMA                | \$20       | 1,000          | 0            | N/A                    | Not being used                               |
| MMB                | \$20       | 1,000          | 1,000        | 1,000                  | Not being used                               |
| MMC                | \$20       | 1,000          | 500          | 500                    | Not being used                               |
| MMD                | \$19 15/16 | 1,000          | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 1,000 shares |

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Next a 3,500-share market order to sell is entered into the system. (Note that the system will not deliver an order to MMA, MMB, or MMC until five seconds after the previous execution has elapsed.)<sup>13</sup> After five seconds has elapsed, 3,000 shares are executed instantaneously against the displayed size of MMA, MMB, and MMC, and 500 shares are executed instantaneously against the reserve size of MMB. (As noted above, there will only be one execution against MMB for a total of 1,500 shares.) This yields the following quotations:

| Market Participant | Bid Price           | Displayed Size      | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|---------------------|---------------------|--------------|------------------------|--|
| MMB                | \$20                | 500                 | 0            | N/A                    | Not being used                               |
| MMC                | \$20                | 500                 | 0            | N/A                    | Not being used                               |
| MMD                | \$19 15/16          | 1,000               | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 1,000 shares |
| MMA                | <b>closed quote</b> | <b>closed quote</b> | X            | X                      | X  |

Note that MMA is decremented to zero and placed in a closed-quote status. MMA has five minutes in which to re-enter its quotes. If MMA fails to do so, it will be "Timed-out-of-the-Box," and will be withdrawn from market making for 20 days.<sup>14</sup>

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### Example 2

The following quotes are being displayed in Nasdaq when a 1,500-share market order to sell is entered into the system:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMA                | \$20       | 500            | 1,000        | 1,000                  | AQR to 1/16 <sup>th</sup> away, 1,000 shares |
| MMB                | \$19 15/16 | 1,000          | N/A          | N/A                    | Not being used                               |
| MMC                | \$19 15/16 | 1,000          | N/A          | N/A                    | AQR to 1/8 <sup>th</sup> away, 1,000 shares  |
| MMD                | \$19 7/8   | 1,000          | 10,000       | 1,000                  | Not being used                               |

The 1,500-share order is executed instantaneously against MMA's displayed and reserved size, and MMA is refreshed for 1,000 shares, 1/16<sup>th</sup> away from its previous bid, yielding the following quotes:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMB                | \$19 15/16 | 1,000          | N/A          | N/A                    | Not being used                               |
| MMC                | \$19 15/16 | 1,000          | N/A          | N/A                    | AQR to 1/8 <sup>th</sup> away, 1,000 shares  |
| MMA                | \$19 15/16 | 1,000          | N/A          | N/A                    | AQR to 1/16 <sup>th</sup> away, 1,000 shares |
| MMD                | \$19 7/8   | 1,000          | 10,000       | 1,000                  | Not being used                               |

Immediately, a 4,000-share market order to sell is entered into the system, and the following occurs:

- A) 2,000 at \$19 15/16 is executed against MMB's and MMC's displayed size; and
- B) 2,000 shares held in queue momentarily.

Note that 2,000 shares are held in queue and are not immediately delivered to MMA because MMA's quote must be reset to \$19 15/16.<sup>15</sup> After five seconds passes, the remaining 2,000 shares are executed as follows: 1,000 at \$19 15/16 is executed against MMA; a new inside bid is established at \$19 7/8 and 1,000 at \$19 7/8 is executed instantaneously against MMD's displayed size.

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### Example 3

There are three market participants at the inside bid of \$20, displaying the following quotations:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMA                | \$20       | 1,000          | 4,000        | 1,000                  | AQR to 1/16 <sup>th</sup> away, 4,000 shares |
| MMB                | \$20       | 1,000          | 2,000        | 1,000                  | Not being used                               |
| MMC                | \$20       | 1,000          | 4,000        | 1,500                  | N/A  |
| MMD                | \$19 15/16 | 500            | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 500 shares   |

An 8,000-share sell market order is entered into the system, at which time 3,000 shares are instantaneously allocated against the displayed size of MMA, MMB, and MMC; 4,000 are allocated against MMA's reserve; and 1,000 are allocated against MMB's reserve. (As noted above, the system will execute one transaction against MMA for a total of 5,000 shares, and one transaction against MMB for a total of 2,000 shares.) The following quotes will appear in the Nasdaq montage:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMB                | \$20       | 1,000          | 0            | N/A                    | Not being used                               |
| MMC                | \$20       | 1,500          | 2,500        | 1,500                  | N/A  |
| MMD                | \$19 15/16 | 500            | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 500 shares   |
| MMA                | \$19 15/16 | 4,000          | N/A          | N/A                    | AQR to 1/16 <sup>th</sup> away, 4,000 shares |

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**Example 4**

The following market participants are at the inside bid displaying the following quotations, when a 6,500-share sell market order is entered into the system:

| Market Participant | Bid Price  | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|------------|----------------|--------------|------------------------|--|
| MMA                | \$20       | 500            | 0            | 0                      | AQR to 1/16 <sup>th</sup> away, 500 shares   |
| ECN1(OE)           | \$20       | 1,000          | 0            | N/A                    | N/A  |
| MMB                | \$20       | 2,000          | 0            | N/A                    | AQR 1/8 away, 1,000 shares                   |
| ECN2(FP)           | \$20       | 4,000          | 0            | N/A                    | N/A  |
| MMC                | \$19 15/16 | 5,000          | 0            | N/A                    | Not being used                               |

Note that ECN1(OE) represents an ECN that opts to be accessible through SelectNet only, and not subject to automatic execution through the system. ECN2(FP) represents a fully participating ECN that agrees to accept automatic execution against its quotations.

As to the 6,500-share order, the system executes automatically 6,500 shares against the displayed sizes of MMA, MMB, and ECN2(FP), thus filling the entire order. ECN1(OE) does not receive an execution through the system against its 1,000-displayed size because it has opted to accept orders through SelectNet. At this point, ECN1(OE) is alone at the inside, and if after 90 seconds no other Market Maker or fully participating ECN joins ECN1(OE) at the inside (and if ECN1(OE) is not accessed via SelectNet and moves its quote), the system will shut down and return all orders in queue to the appropriate market participant.<sup>16</sup>

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**Example 5**

There are three Market Makers at the inside bid displaying the following quotations when a 9,000-share market order to sell is entered into the system:

| Market Participant | Bid Price | Displayed Size | Reserve Size | Refresh (from Reserve) | Autoquote Refresh (to new price and/or size) |
|--------------------|-----------|----------------|--------------|------------------------|--|
| MMA                | \$20      | 1,000          | 5,000        | 1,500                  | Not being used                               |
| MMB                | \$20      | 2,000          | 1,000        | 1,000                  | Not being used                               |
| MMC                | \$20      | 3,000          | 2,000        | 1,000                  | N/A  |

Here, the system will instantaneously take the displayed size of MMA, MMB, and MMC and 3,000 shares are taken instantaneously from the reserve size of MMA since its reserve size has time priority.

### Endnotes

<sup>1</sup>See Exchange Act Rel. No. 21743 (Feb. 12, 1985).

<sup>2</sup>See Exchange Act Rel. No. 25263 (Jan. 11, 1988). See also, Exchange Act Rel. No. 25690 (May 11, 1988) (order granting permanent approval of SelectNet).

<sup>3</sup>There are two exceptions to the firm quote rule: (1) prior to the receipt of the order, the Market Maker has communicated to its exchange or association a revised quotation size or revised bid or offer; or (2) prior to the receipt of the order, the Market Maker is in the process of effecting a transaction in a security when an order in the same security is presented, and immediately after the completion of such transaction, the Market Maker communicates to its exchange or association a revised quotation size or revised bid or offer. See SEC Rule 11Ac1-1.

<sup>4</sup>SelectNet is also used by UTP Exchanges to access Nasdaq Market Makers. See Exchange Act Rel. No. 34-38191 (Jan. 22, 1997).

<sup>5</sup>Nasdaq recently filed a rule proposal that would permit the separate display of customer orders by Market Makers in

Nasdaq through a Market Maker agency identification symbol ("Agency Quote"). See SR-NASD-99-09.

<sup>6</sup>SelectNet will continue to accept orders of any size (subject to the 999,999-share system limit) for Nasdaq SmallCap securities.

<sup>7</sup>See NASD Rule 4710(g) and proposed Rules 4701(g) and 4710(d)(3).

<sup>8</sup>This restriction will not apply for interim executions against a Market Maker's non-updated quote. For example, should a Market Maker displaying an initial quotation of 1,000 shares with 5,000 shares in reserve be automatically accessed by NNMS for 300 shares in displayed size, that Market Maker will still be allowed to continue to display its remaining 700 shares and keep 5,000 available in reserve size. Should the Market Maker subsequently update either its displayed or reserve sizes, or its quoted price, the Market Maker will be obligated to increase its displayed size to 1,000 shares in order to continue to use the NNMS reserve size feature.

<sup>9</sup>Like Nasdaq's other automatic execution systems, NNMS will impose a \$0.50 per side fee for each execution. To reduce user cost

and facilitate the use of the NNMS reserve size functionality, a simultaneous and instantaneous execution against an NNMS participant's displayed and reserve size will be treated for billing purposes as a single execution.

<sup>10</sup>This would allow ECNs to access Market Makers through two systems, but would limit dual liability that Market Makers currently face since they will only be receiving orders requiring them to execute from NNMS.

<sup>11</sup>Note that under new NASD Rule 4710(b)(2)(A), the refresh size for a market participant using reserve size is a minimum of 1,000 shares.

<sup>12</sup>See NASD Rule 4710(b)(1)(B).

<sup>13</sup>See NASD Rule 4710(b)(5).

<sup>14</sup>See NASD Rule 4710(b)(6).

<sup>15</sup>See NASD Rule 4710(b)(1)(D).

<sup>16</sup>See NASD Rule 4710(b)(10).

**ATTACHMENT A**

(Note: Following is the amended rule language.)

**4611. Registration as a Nasdaq Market Maker**

(a) - (e) No Change

(f) Unless otherwise specified by the Association, each Nasdaq Market Maker that is registered as a Market Maker in a Nasdaq National Market security shall also at all times be registered as a Market Maker in the Nasdaq National Market Execution System (NNMS) with respect to that security and be subject to the NNMS Rules as set forth in the Rule 4700 Series. Participation in the Small Order Execution System (SOES) shall be voluntary for any Nasdaq Market Maker registered to make a market in a Nasdaq SmallCap security.

(g) No Change

\* \* \* \* \*

**4613. Character of Quotations**

(a) Two-Sided Quotations

(1) For each security in which a member is registered as a Market Maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain two-sided quotations in The Nasdaq Stock Market, subject to the procedures for excused withdrawal set forth in Rule 4619.

(2) A registered Market Maker in a security listed on The Nasdaq Stock Market must display a quotation size for at least one normal unit of trading (or a larger

multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered Market Maker may augment its displayed quotation size to display limit orders priced at the Market Maker's quotation.

(b) - (e) No Change

\* \* \* \* \*

**4618. Clearance and Settlement**

(a) A Market Maker shall clear and settle transactions in Nasdaq securities through the facilities of a registered clearing agency that uses a continuous net settlement system. This requirement may be satisfied by direct participation, use of direct clearing services, or by entry into a correspondent clearing arrangement with another member that clears trades through such an agency.

(b) Notwithstanding paragraph (a), transactions in Nasdaq securities may be settled "ex-clearing" provided that both parties to the transaction agree.

(c) All transactions through the Nasdaq National Market Execution System, SOES, and SelectNet services shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

**4619. Withdrawal of Quotations and Passive Market Making**

(a) - (b) No Change

(c) Excused withdrawal status may be granted to a Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member

of such an agency and is withdrawn from participation in the Automated Confirmation Transaction Service, thereby terminating its registration as a Market Maker in Nasdaq issues. Provided however, that if the Association finds that the Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620, the Rules for the Small Order Execution System, as set forth in the Rule 4750 Series, and the Rule 4700 Series governing the Nasdaq's National Market Execution System.

(d) No Change

**4620. Voluntary Termination of Registration**

(a) A Market Maker may voluntarily terminate its registration in a security by withdrawing its quotations from The Nasdaq Stock Market. A Market Maker that voluntarily terminates its registration in a security may not re-register as a Market Maker in that security for twenty (20) business days. Withdrawal from participation as a Market Maker in a Nasdaq National Market security in the Nasdaq National Market Execution System shall constitute termination of registration as a Market Maker in that security for purposes of this Rule; provided, however, that a Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction Service and thereby terminates its registration as a Market Maker in Nasdaq National Market and SmallCap issues may register as a Market Maker at any time after a clearing arrangement has been reestablished and the

Market Maker has complied with ACT participant requirements contained in Rule 6100.

\* \* \* \* \*

#### **4632. Transaction Reporting**

(a) - (d) No Change

(e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) transactions executed through the Computer Assisted Execution System (CAES), the Nasdaq National Market Execution System (NNMS), or the SelectNet service;

(2) - (6) No Change

(f) No Change

\* \* \* \* \*

#### **4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)**

##### **4701. Definitions**

(a) The term "Nasdaq National Market Execution System" or "NNMS" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which enables NNMS participants to execute transactions in active NNMS authorized securities; to have reports of the transactions automatically forwarded to the National Market Trade Reporting System, if required, for dissemination to the public and the industry, and to "lock in" these trades by sending both sides to the applicable clearing corporation(s) designated by NNMS participant(s) for clearance and settlement; and to provide NNMS participants with

sufficient monitoring and updating capability to participate in an automated execution environment.

(b) The term "NNMS participant" shall mean either an NNMS Market Maker or NNMS Order Entry Firm registered as such with the Association for participation in NNMS.

(c) The term "NNMS eligible securities" shall mean designated Nasdaq National Market (NNM) equity securities.

(d) The term "active NNMS securities" shall mean those NNMS eligible securities in which at least one NNMS Market Maker is currently active in NNMS.

(e) The term "NNMS Market Maker" shall mean a member of the Association that is registered as a Nasdaq Market Maker and as a Market Maker for purposes of participation in NNMS with respect to one or more NNMS eligible securities, and is currently active in NNMS and obligated to execute orders for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or ask price.

(f) The term "NNMS Order Entry Firm" shall mean a member of the Association who is registered as an Order Entry Firm for purposes of participation in NNMS which permits the firm to enter orders of limited size for execution against NNMS Market Makers.

(g) The term "automatic refresh size" shall mean the default size to which an NNMS Market Maker's quote will be refreshed pursuant to NASD Rule 4710(b)(2), if the Market Maker does not designate to Nasdaq an alternative refresh size. The maximum order refresh size default size shall be 1,000 shares.

(h) The term "Automated Confirmation Transaction Service" or "ACT" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which compares trade information entered by ACT participants and submits "locked-in" trades to clearing.

(i) The term "Agency Quote" shall mean the quotation that a registered NNMS Market Maker is permitted to display pursuant to the requirements of NASD Rule 4613(b).

\* \* \* \* \*

#### **4705. NNMS Participant Registration**

(a) Participation in NNMS as an NNMS Market Maker requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Market Maker's initial and continuing compliance with the following requirements:

(1) execution of an NNMS participant application agreement with the Association;

(2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which NNMS compared trades may be settled;

(3) registration as a Market Maker in The Nasdaq Stock Market pursuant to the Rule 4600 Series and compliance with all applicable rules and operating procedures of the Association and the Commission;

(4) maintenance of the physical security of the equipment located on the premises of the NNMS Market Maker to prevent the

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unauthorized entry of information into NNMS; and

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(b) Pursuant to Rule 4611(f), participation as an NNMS Market Maker is required for any Nasdaq Market Maker registered to make a market in an NNM security.

(c) Participation in NNMS as an NNMS Order Entry Firm requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Order Entry Firm's initial and continuing compliance with the following requirements:

(1) execution of an NNMS participant application agreement with the Association;

(2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which NNMS compared trades may be settled;

(3) compliance with all applicable rules and operating procedures of the Association and the Commission;

(4) maintenance of the physical security of the equipment located on the premises of the NNMS Order Entry Firm to prevent the unauthorized entry of information into NNMS; and

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Order Entry Firm or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(d) The registration required hereunder will apply solely to the qualification of an NNMS participant to participate in NNMS. Such registration shall not be conditioned upon registration in any particular eligible or active NNMS securities.

(e) Each NNMS participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

\* \* \* \* \*

### **4710. Participant Obligations in NNMS**

#### **(a) Registration**

Upon the effectiveness of registration as an NNMS Market Maker or NNMS Order Entry Firm, the NNMS participant may commence activity within NNMS for exposure to orders or entry of orders, as applicable. The operating hours of NNMS may be established as appropriate by the Association. The extent of participation in Nasdaq by an NNMS Order Entry Firm shall be determined solely by the firm in the exercise of its ability to enter orders into Nasdaq.

#### **(b) Market Makers**

(1) An NNMS Market Maker in an

NNMS Security shall be subject to the following requirements:

(A) For each NNM security in which it is registered as an NNMS Market Maker, the Market Maker must execute individual orders against its quotation including its Agency Quote (if applicable), in an amount equal to or smaller than the combination of the displayed quotation and reserve size of such quotation(s). For purposes of this rule, the term "reserved size" shall mean that an NNMS Market Maker or a customer thereof wishes to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed. To utilize the reserve size function, a minimum of 1,000 shares must initially be displayed in the Market Maker's quote (including the Agency Quote), and the quotation must be refreshed to 1,000 shares consistent with subparagraph (b)(2)(A) of this rule.

(B) Orders entered into NNMS shall be automatically executed against displayed quotations and reserve size, including Agency Quotes (if applicable), in price/time priority. For quotations at the same price level, NNMS will yield priority to all displayed quotations over reserve size, so that the system will execute against displayed quotations in time priority and then against reserve size in time priority.

(C) The size of a displayed quotation will be decremented upon the execution of an NNMS order in an amount

equal to or greater than one normal unit of trading; provided, however, that the execution of an NNMS order that is a mixed lot (i.e., an order that is for more than a normal unit of trading but not a multiple thereof) will only decrement a displayed quotation's size by the number of shares represented by the number of round lots contained in the mixed lot order.

(D) After NNMS has executed an order against a Market Maker's displayed quote and reserve size (if applicable), that Market Maker shall not be required to execute another order at its bid or offer in the same security until a predetermined time period has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as five (5) seconds, but may be modified upon Commission approval and appropriate notification to NNMS participants.

(E) All entries in NNMS shall be made in accordance with the requirements set forth in the NNMS User Guide, as published from time to time by Nasdaq.

**(2) Refresh Functionality**

(A) Reserve Size Refresh — Once an NNMS Market Maker's displayed quotation size on either side of the market in the security has been decremented to zero due to NNMS executions, Nasdaq will refresh the Market Maker's displayed size out of reserve size to a size-level designated by the NNMS Market Maker, or in the

absence of such size-level designation, to the automatic refresh size. If the Market Maker is using the reserve size function for its proprietary quote or Agency Quote, the Market Maker must refresh to a minimum of 1,000 shares, consistent with subparagraph (b)(1)(A) of this rule.

(B) Autoquote Refresh — Once an NNMS Market Maker's displayed quotation size and reserve size on either side of the market in the security has been decremented to zero due to NNMS executions, the NNMS Market Maker may elect to have The Nasdaq Stock Market refresh the Market Maker's quotation as follows:

(i) Nasdaq will refresh the Market Maker's quotation price on the bid or offer side of the market, whichever is decremented to zero, by an interval designated by the NNMS Market Maker; and

(ii) Nasdaq will refresh the Market Maker's displayed size to a level designated by the NNMS Market Maker, or in the absence of such size level designation, to the automatic refresh size.

A Market Maker's Agency Quotation shall not be subject to the functionality described in this subparagraph.

(3) Except as otherwise provided in subparagraph (b)(10) of this rule, at any time a locked or crossed market, as defined in Rule 4613(e), exists for an NNMS security, a Market Maker with a quotation for that security (including an Agency Quote) that is causing the locked or crossed market may have orders

representing shares equal to the size of the bid or offer that is locked or crossed executed by NNMS against the Market Maker's quote (including an Agency Quote) at the quoted price if that price is the best price. During locked or crossed markets, NNMS will execute orders against those Market Makers that are locked or crossed in predetermined time intervals. This period of time initially shall be established as five (5) seconds, but may be modified upon approval by the Commission and appropriate notification to NNMS participants.

(4) For each NNMS security in which a Market Maker is registered, the Market Maker may enter orders into NNMS for its proprietary account as well as on an agency or riskless principal basis.

(5) An NNMS Market Maker may terminate its obligation by keyboard withdrawal (or its equivalent) from NNMS at any time. However, the Market Maker has the specific obligation to monitor its status in NNMS to ensure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the Market Maker.

(6) An NNMS Market Maker will be suspended from NNMS if its bid or offer has been decremented to zero due to NNMS executions and will be permitted a standard grace period, the duration of which will be established and published by the Association, within which to take action to restore a two-sided quotation in the security for at least one normal unit of trading. An NNMS Market Maker that fails

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to reenter a two-sided quotation within the allotted time will be deemed to have withdrawn as a Market Maker ("Timed Out of the Box"). Except as provided below in this subparagraph and in subparagraph (b)(7) of this rule, an NNMS Market Maker that withdraws in an NNM security may not re-register as a Market Maker in that security for twenty (20) business days. The requirements of this subparagraph shall not apply to a Market Maker's Agency Quote.

(A) Notwithstanding the above, a Market Maker can be reinstated if:

(i) the Market Maker makes a request for reinstatement to Nasdaq Market Operations as soon as practicable under the circumstances, but within at least one hour of having been Timed Out of the Box, and immediately thereafter provides written notification of the reinstatement request;

(ii) it was a Primary Market Maker at the time it was Timed Out of the Box;

(iii) the Market Maker's firm would not exceed the following reinstatement limitations:

a. for firms that simultaneously made markets in less than 250 stocks during the previous calendar year, the firm can receive no more than four (4) reinstatements per year;

b. for firms that simultaneously made markets in 250 or more but less than 500 stocks during the previous calendar year, the firm can receive no more

than six (6) reinstatements per year;

c. for firms that simultaneously made markets in 500 or more stocks during the previous calendar year, the firm can receive no more than twelve (12) reinstatements per year; and

(iv) the designated Nasdaq officer makes a determination that the withdrawal was not an attempt by the Market Maker to avoid its obligation to make a continuous two-sided market. In making this determination, the designated Nasdaq officer will consider, among other things:

a. whether the market conditions in the issue included unusual volatility or other unusual activity, and/or the market conditions in other issues in which the Market Maker made a market at the time the firm was Timed Out of the Box;

b. the frequency with which the firm has been Timed Out of the Box in the past;

c. procedures the firm has adopted to avoid being inadvertently Timed Out of the Box; and

d. the length of time before the Market Maker sought reinstatement.

(B) If a Market Maker has exhausted the reinstatement limitations in subparagraph (b)(6)(A)(iii) above, the designated Nasdaq officer may grant a reinstatement request if he or she finds that such reinstatement is necessary for

the protection of investors or the maintenance of fair and orderly markets and determines that the withdrawal was not an attempt by the Market Maker to avoid its obligation to make a continuous two-sided market in instances where:

(i) a member firm experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system) or involving an automated system operated by Nasdaq;

(ii) the Market Maker is a manager or co-manager of a secondary offering from the time the secondary offering is announced until ten (10) days after the offering is complete; or

(iii) absent the reinstatement, the number of Market Makers in a particular issue is equal to two (2) or less or has otherwise declined by 50% or more from the number that existed at the end of the prior calendar quarter, except that if a Market Maker has a regular pattern of being frequently Timed Out of the Box, it may not be reinstated notwithstanding the number of Market Makers in the issue.

(7) Notwithstanding the provisions of subparagraph (6) above: (A) an NNMS Market Maker that obtains an excused withdrawal pursuant to Rule 4619 prior to withdrawing from NNMS may reenter NNMS according to the conditions of its withdrawal;

and (B) an NNMS Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and NNMS for NNM securities, may reenter NNMS after a clearing arrangement has been reestablished and the Market Maker has complied with ACT participant requirements. Provided however, that if the Association finds that the ACT Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused.

(8) The Market Operations Review Committee shall have jurisdiction over proceedings brought by Market Makers seeking review of their removal from NNMS pursuant to subparagraphs (b)(6) or (b)(7) of this rule.

(9) In the event that a malfunction in the NNMS Market Maker's equipment occurs, rendering on-line communications with NNMS inoperable, the NNMS Market Maker is obligated to immediately contact Nasdaq Market Operations by telephone to request withdrawal from NNMS and an excused withdrawal from Nasdaq. Such request must be made pursuant to Rule 4619. If withdrawal is granted, Nasdaq Market Operations personnel will enter the withdrawal notification into NNMS from a supervisory terminal. Such manual intervention, however, will take a certain period of time for completion and the NNMS Market Maker will continue to be obligated for any transaction executed prior to the effectiveness of his withdrawal.

(10) In the event that there are no NNMS Market Makers at the best bid (offer) disseminated by Nasdaq, market orders to sell (buy) entered into NNMS will be held in queue until executable, or until 90 seconds has elapsed, after which such orders will be rejected and returned to their respective Order Entry Firms.

(c) NNMS Order Entry Firms

All entries in NNMS shall be made in accordance with the procedures and requirements set forth in the NNMS User Guide. Orders may be entered in NNMS by the NNMS Order Entry Firm through either its Nasdaq terminal or computer interface. The system will transmit to the firm on the terminal screen and printer, if requested, or through the computer interface, as applicable, an execution report generated immediately following the execution.

(d) Order Entry Parameters

(1) NNMS will only accept market and marketable limit orders for execution and will not accept market or marketable limit orders designated as All-or-None ("AON") orders; provided, however, that NNMS will not accept any limit orders, marketable or unmarketable, prior to 9:30 a.m., Eastern Time. For purposes of this subparagraph, an AON order is an order for an amount of securities equal to the size of the order and no less.

(2) Additionally, NNMS will only accept orders that are unpreferenced, thereby resulting in execution in rotation against NNMS Market Makers, and will not accept preferenced orders.

(3) NNMS will not accept orders that exceed 9,900 shares, and no participant in NNMS shall enter

an order into the system that exceeds 9,900.

(e) Electronic Communication Networks

An Electronic Communications Networks, as defined in SEC Rule 11Ac1-1(a)(8), may participate in NNMS if it complies with NASD Rule 4623 and executes with the Association a Nasdaq Workstation Subscriber Agreement, as amended, for ECNs.

**4711. Clearance and Settlement**

All transactions executed in NNMS shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

**4712. Obligation to Honor System Trades**

If an NNMS participant, or clearing member acting on its behalf, is reported by NNMS to clearing at the close of any trading day, or shown by the activity reports generated by NNMS as constituting a side of a System trade, such NNMS participant, or clearing member acting on its behalf, shall honor such trade on the scheduled settlement date.

**4713. Compliance with Rules and Registration Requirements**

Failure by an NNMS participant to comply with any of the rules or registration requirements applicable to NNMS identified herein shall subject such NNMS participant to censure, fine, suspension or revocation of its registration as an NNMS Market Maker and/or Order Entry Firm or any other fitting penalty under the Rules of the Association.

**4714. Fees Applicable to NNMS**

(a) A fee for orders executed through NNMS shall be assessed, to be allocated as follows: the NNMS Market Maker executing the order shall be assessed \$0.50 per transaction and the NNMS Order Entry Firm or NNMS Market Maker entering the order shall be assessed \$0.50 per order.

(b) For each order entered by an NNMS Order Entry Firm or an NNMS Market Maker that is canceled, the NNMS Order Entry Firm or NNMS Market Maker that cancels such order shall be assessed a fee of \$0.25.

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**4720. SelectNet Service**

(a) Cancellation of a SelectNet Order

No member shall cancel or attempt to cancel an order, whether preferred to a specific Market Maker or electronic communications network, or broadcast to all available members, until a minimum time period of ten (10) seconds has expired after the order to be canceled was entered. Such ten (10) second time period, shall be measured by the Nasdaq processing system processing the SelectNet order.

(b) Prohibition Regarding The Entry of Conditional Orders

No member shall enter an order into SelectNet that is preferred to an electronic communications network covered by Rule 4623 that has any conditions regarding responses to the order, e.g . preferred SelectNet orders sent to electronic communications networks shall not be All-or-None, or subject to minimum execution

size above a normal unit of trading, or deemed non-negotiable.

(c) Prohibition Regarding the Entry of Certain Preferred Orders to Nasdaq National Market Execution System Market Makers

No member may direct a SelectNet preferred order to a Nasdaq National Market Execution System ("NNMS") Market Maker (as defined in NASD Rule 4701) including that Market Maker's Agency Quote (as defined in NASD Rule 4613) unless that order is designated as:

(1) an "All-or-None" order ("AON") and is at least one normal unit of trading (i.e. 100 shares) in excess of the displayed quote to which the preferred order is directed; or

(2) a "Minimum Acceptable Quantity" order ("MAQ"), with a MAQ value of at least one normal unit of trading in excess of the displayed quote to which the preferred order is directed.

The prohibition of this paragraph shall not apply to preferred orders sent by a UTP Specialist to an NNMS Market Maker or to preferred orders sent by an NNMS Market Maker to a UTP Specialist. For purposes of this rule a "UTP Specialist" shall mean a broker/dealer registered as a specialist in Nasdaq securities pursuant to the rules of an exchange that is a signatory to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination Of Quotation and Transaction Information For Exchange-Listed Nasdaq/National Market System Securities Traded On Exchanges On An Unlisted Trading Privilege Basis ("Nasdaq/NMS/UTP Plan").

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**4750. SMALLCAP SMALL ORDER EXECUTION SYSTEM (SOES)****4751. Definitions**

(a) The term "Small Order Execution System" or "SOES" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which enables SOES participants to execute transactions of limited size in active SOES authorized securities (i.e., Nasdaq SmallCap securities); to have reports of the transactions automatically forwarded to Nasdaq for dissemination to the public and the industry, and to "lock in" these trades by sending both sides to the applicable clearing corporation(s) designated by the SOES participant(s) for clearance and settlement; and to provide SOES participants with sufficient monitoring and updating capability to participate in an automated execution environment.

(b) The term "SOES participant" shall mean either a SOES Market Maker or SOES Order Entry Firm registered as such with the Association for participation in SOES.

(c) The term "SOES eligible securities" shall mean all Nasdaq SmallCap securities.

(d) The term "active SOES securities" shall mean those SOES eligible securities in which at least one SOES Market Maker is currently active in SOES.

(e) The term "SOES Market Maker" shall mean a member of the Association that is registered as a Nasdaq Market Maker and as a Market Maker for purposes of participation in SOES with respect to one or more SOES eligible securities, and is currently active in SOES and obligated to execute

orders for the purchase or sale of an active SOES security at the Nasdaq inside bid and/or ask price.

(f) The term "SOES Order Entry Firm" shall mean a member of the Association who is registered as an Order Entry Firm for purposes of participation in SOES which permits the firm to enter orders of limited size for execution against SOES Market Makers.

(g) The term "maximum order size" shall mean the maximum size of individual orders for a security that may be entered into or executed through SOES. The maximum order size for each security shall be published from time to time by the Association. In establishing the maximum order size for each SmallCap security, the Association will give consideration to the average daily non-block volume, bid price, and number of Market Makers for each security. Maximum order size for Nasdaq SmallCap securities shall be 500 shares and may be adjusted on an issue by issue basis, depending upon unique characteristics of the issue as determined by the Association.

(h) The term "agency order" shall mean public customer orders which are executed by the SOES Order Entry Firm on an agency basis. It shall also include, for purposes of these rules, an order entered into SOES on a principal basis by a SOES Order Entry Firm that is not a Market Maker in the SOES security, in SOES or otherwise, where the SOES Order Entry Firm has contemporaneously received an order from a customer and executes the transaction on a riskless principal basis.

(i) The term "Automated Confirmation Transaction Service" or "ACT" shall mean the automated system owned and operated by The

Nasdaq Stock Market, Inc. which compares trade information entered by ACT participants and submits "locked-in" trades to clearing.

#### **4752. SOES Participant Registration**

(a) Participation in SOES as a SOES Market Maker requires current registration as such with the Association. Such registration shall be conditioned upon the SOES Market Maker's initial and continuing compliance with the following requirements:

- (1) execution of a SOES participant application agreement with the Association;
- (2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which SOES compared trades may be settled;
- (3) registration as a Market Maker in The Nasdaq Stock Market pursuant to the Rule 4600 Series and compliance with all applicable rules and operating procedures of the Association and the Commission;
- (4) maintenance of the physical security of the equipment located on the premises of the SOES Market Maker to prevent the unauthorized entry of information into SOES; and
- (5) acceptance and settlement of each SOES trade that SOES identifies as having been effected by such SOES Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified SOES trade by the clearing member on the regularly scheduled settlement date.

(b) Pursuant to Rule 4611(f), participation as a SOES Market Maker shall be voluntary for any Nasdaq Market Maker registered to make a market in a Nasdaq SmallCap security.

(c) Participation in SOES as a SOES Order Entry Firm requires current registration as such with the Association. Such registration shall be conditioned upon the SOES Order Entry Firm's initial and continuing compliance with the following requirements:

- (1) execution of a SOES participant application agreement with the Association;
- (2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which SOES compared trades may be settled;
- (3) compliance with all applicable rules and operating procedures of the Association and the Commission;
- (4) maintenance of the physical security of the equipment located on the premises of the SOES Order Entry Firm to prevent the unauthorized entry of information into SOES; and
- (5) acceptance and settlement of each SOES trade that SOES identifies as having been effected by such SOES Order Entry Firm or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified SOES trade by the clearing member on the regularly scheduled settlement date.

(d) The registration required hereunder will apply solely to the

qualification of a SOES participant to participate in SOES. Such registration shall not be conditioned upon registration in any particular eligible or active SOES securities.

(e) Each SOES participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

### **4753. Participant Obligations in SOES**

#### **(a) Registration**

Upon the effectiveness of registration as a Market Maker or SOES Order Entry Firm, the SOES participant may commence activity within SOES for exposure to orders or entry of orders, as applicable. The operating hours of SOES may be established as appropriate by the Association. A SOES Market Maker may withdraw from and reenter SOES at any time, and without limitations, during the operating hours of SOES. The extent of participation in Nasdaq by a SOES Order Entry Firm shall be determined solely by the firm in the exercise of its ability to enter orders into Nasdaq.

#### **(b) Market Makers**

(1) A SOES Market Maker shall commence participation in SOES by initially contacting the Nasdaq Market Operations Center to obtain authorization for the trading of a particular SOES security and identifying those terminals on which the SOES information is to be displayed and thereafter by an appropriate keyboard entry which obligates the firm, so long as it remains a Market Maker in SOES:

(A) to execute individual preferred SOES orders equal to or smaller than the applicable maximum order size at the best bid or offer as disseminated by Nasdaq in any security for which it is a SOES Market Maker; and

(B) to execute individual unpreferred SOES orders equal to or smaller than the Market Maker's displayed quotation size when the Market Maker's quotation is at the best bid or offer as disseminated by Nasdaq, and, when the Market Maker's quotation is inferior to the best bid or offer as disseminated by Nasdaq, to execute individual unpreferred SOES orders up to the lesser of the Market Maker's displayed quotation size or the smallest quotation size of all the Market Makers whose quotations are at the best bid or offer as disseminated by Nasdaq.

A SOES Market Maker's displayed quotation size will be decremented upon the execution of an unpreferred SOES order equal to or greater than one normal unit of trading; provided, however, that the execution of an unpreferred SOES order that is a mixed lot (i.e., an order that is for more than a normal unit of trading but not a multiple thereof) will only decrement the SOES Market Maker's displayed quotation size by the number of shares represented by the number of round lots contained in the mixed lot order. After SOES has executed an order against a Market Maker, that Market Maker shall not be required to execute another unpreferred order at the same bid or offer in the same security until a predetermined time period has elapsed from the

time the order was executed, as measured by the time of execution in the Nasdaq system, provided the Market Maker has not updated its quotation (bid, offer, or size) within such time period, in which case the Market Maker will become immediately eligible to receive another execution of an unpreferred order. This period of time shall initially be established as 17 seconds, but may be modified upon Commission approval and appropriate notification to SOES participants. All entries in SOES shall be made in accordance with the requirements set forth in the SOES User Guide.

(2) For each security in which the Market Maker is registered, the Market Maker may elect to have The Nasdaq Stock Market refresh its quotation automatically by an interval designated by the Market Maker, once its displayed quotation size on either side of the market in the security has been decremented to zero due to SOES executions. The Nasdaq Stock Market will refresh the Market Maker's quotation on the bid or offer side of the market, whichever is decremented to zero, by the interval designated, and will establish the Market Maker's displayed size to the maximum order size for that security; provided, however, that a Market Maker may elect to have The Nasdaq Stock Market refresh its bid or offer at the same price if the Market Maker's quotation size prior to any decrementation was equal to or greater than the maximum SOES order size for the security.

(3) Except as otherwise provided in subparagraph (10) below, at any time a locked or crossed market, as defined in Rule

4613(e), exists for a SmallCap security, SOES will execute orders against the quotations of SOES Market Makers at the inside price and in an amount equal to or smaller than the Market Maker's displayed quotation size. Those orders will be executed irrespective of any preference indicated by the Order Entry Firm. During locked or crossed markets, SOES will execute orders against those Market Makers that are locked or crossed in predetermined time intervals. This period of time initially shall be established as five (5) seconds, but may be modified upon necessary Commission approval and appropriate notification to SOES participants.

(4) For each security in which a Market Maker is registered, the Market Maker may not enter orders into SOES for its proprietary account, but may enter orders on an agency or riskless principal basis into SOES. As used in this context, "riskless principal" means an order on a principal basis entered into SOES on behalf of a customer by a Market Maker and which otherwise meets the requirements of the term "riskless principal" as used in Rule 4632(d)(3)(B).

(5) The Market Maker may terminate its obligation by keyboard withdrawal (or its equivalent) from SOES at any time. However, the Market Maker has the specific obligation to monitor its status in SOES to ensure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the Market Maker. A Market Maker for which the bid or offer

has been decremented to zero due to SOES executions and that does not reenter a quotation by the close of business on the day its quotation is decremented shall be deemed to have withdrawn as a Market Maker in the security and precluded from re-registering in that security for twenty (20) business days pursuant to NASD Rule 4620.

(6) A Market Maker that fails to reenter a two-sided quotation in a SmallCap security within the allotted time will be deemed to have withdrawn as a Market Maker ("SOESed out of the Box"). Except as provided below in this subparagraph and in subparagraph (7), a Market Maker that withdraws in a SmallCap security may not re-register as a Market Maker in that security for twenty (20) business days.

(A) Notwithstanding the above, a Market Maker can be reinstated if:

(i) the Market Maker makes a request for reinstatement to Market Operations as soon as practicable under the circumstances, but within at least one hour of having been SOESed out of the Box, and immediately thereafter provides written notification of the reinstatement request;

(ii) the Market Maker's firm would not exceed the following reinstatement limitations:

a. for firms that simultaneously made markets in less than 250 stocks during the previous calendar year, the firm can receive no more than four (4) reinstatements per year;

b. for firms that simultaneously made markets in 250 or more but less than 500 stocks during the previous calendar year, the firm can receive no more than six (6) reinstatements per year;

c. for firms that simultaneously made markets in 500 or more stocks during the previous calendar year, the firm can receive no more than twelve (12) reinstatements per year; and

(iii) the designated Nasdaq officer makes a determination that the withdrawal was not an attempt by the Market Maker to avoid its obligation to make a continuous two-sided market. In making this determination, the designated Nasdaq officer will consider, among other things:

a. whether the market conditions in the issue included unusual volatility or other unusual activity, and/or the market conditions in other issues in which the Market Maker made a market at the time of the SOES exposure limit exhaustion;

b. the frequency with which the firm has been SOESed out of the Box in the past;

c. procedures the firm has adopted to avoid being inadvertently SOESed out of the Box; and

d. the length of time before the Market Maker sought reinstatement.

(B) If a Market Maker has exhausted the reinstatement limitations in subparagraph (b)(6)(A)(ii) above, the designated Nasdaq officer may grant a reinstatement request if he or she finds that such reinstatement is necessary for the protection of investors or the maintenance of fair and orderly markets and determines that the withdrawal was not an attempt by the Market Maker to avoid its obligation to make a continuous two-sided market in instances where:

(i) a member firm experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system) or involving an automated system operated by Nasdaq;

(ii) the Market Maker is a manager or co-manager of a secondary offering from the time the secondary offering is announced until ten (10) days after the offering is complete; or

(iii) absent the reinstatement, the number of market makers in a particular issue is equal to two (2) or less or has otherwise declined by 50% or more from the number that existed at the end of the prior calendar quarter, except that if a Market Maker has a regular pattern of being frequently SOESed out of the Box, it may not be reinstated notwithstanding the number of Market Makers in the issue.

(7) Notwithstanding the provisions of subparagraph (6) above: (A) a Market Maker that obtains an excused withdrawal pursuant to Rule 4619 prior to withdrawing from SOES may reenter SOES according to the conditions of its withdrawal; and (B) a Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and SOES, may reenter SOES after a clearing arrangement has been reestablished and the Market Maker has complied with ACT participant requirements. Provided however, that if the Association finds that the Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused.

(8) The Market Operations Review Committee shall have jurisdiction over proceedings brought by Market Makers seeking review of their removal from SOES pursuant to subparagraphs (5), (6), or (7) above.

(9) In the event that a malfunction in the Market Maker's equipment occurs, rendering on-line communications with SOES inoperable, the SOES Market Maker is obligated to immediately contact the Nasdaq Market Operations Center by telephone to request withdrawal from SOES and an excused withdrawal from Nasdaq. Such request must be made pursuant to Rule 4619. If withdrawal is granted, Nasdaq Market Operations personnel will enter the withdrawal notification into SOES from a supervisory terminal. Such manual

intervention, however, will take a certain period of time for completion and the SOES Market Maker will continue to be obligated for any transaction executed prior to the effectiveness of its withdrawal.

(10) In the event that there are no SOES Market Makers at the best bid (offer) disseminated by Nasdaq, market orders to sell (buy) entered into SOES will be held in queue until executable, or until 90 seconds has elapsed, after which such orders will be rejected and returned to their respective Order Entry Firms.

(c) SOES Order Entry Firms

(1) All entries in SOES shall be made in accordance with the procedures and requirements set forth in the SOES User Guide. Orders may be entered in SOES by the SOES Order Entry Firm through either its Nasdaq terminal or computer interface. The system will transmit to the firm on the terminal screen and printer, if requested, or through the computer interface, as applicable, an execution report generated immediately following the execution.

(2) SOES will only accept market and marketable limit orders for execution and will not accept market or marketable limit orders designated as All-or-None ("AON") orders; provided, however, that SOES will not accept any limit orders, marketable or unmarketable, prior to 9:30 a.m., Eastern Time. For purposes of this subparagraph, an AON order is an order for an amount of securities equal to the size of the order and no less. Orders may be preferenced to a specific SOES Market Maker or may be

unpreferred, thereby resulting in execution in rotation against SOES Market Makers. A Market Maker may indicate Order Entry Firms from which it agrees to accept preferred orders. If an order is received by a Market Maker from an Order Entry Firm from which it has not agreed to accept preferencing, the order will be executed at the inside market on an unpreferred basis and will be subject to a period of time between executions for Market Makers to update their quotations.

(3) Only agency orders no larger than the maximum order size, as defined herein, received from public customers may be entered by a SOES Order Entry Firm into SOES for execution against a SOES Market Maker. Agency orders in excess of the maximum order size may not be divided into smaller parts for purposes of meeting the size requirements for orders entered into SOES.

(4) No member or person associated with a member shall utilize SOES for the execution of agency orders in a security in which the member is a Nasdaq

Market Maker but is not a SOES Market Maker.

#### **4754. Clearance and Settlement**

All transactions executed in SOES shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

#### **4755. Obligation to Honor System Trades**

If a SOES participant, or clearing member acting on its behalf, is reported by SOES to clearing at the close of any trading day, or shown by the activity reports generated by SOES as constituting a side of a System trade, such SOES participant, or clearing member acting on its behalf, shall honor such trade on the scheduled settlement date.

#### **4756. Compliance with Rules and Registration Requirements**

Failure by a SOES participant to comply with any of the rules or registration requirements applicable

to SOES identified herein shall subject such SOES participant to censure, fine, suspension or revocation of its registration as a SOES Market Maker and/or Order Entry Firm or any other fitting penalty under the Rules of the Association.

#### **4757. Fees Applicable to SOES**

(a) A fee for orders executed through SOES shall be assessed, to be allocated as follows: the SOES Market Maker executing the order shall be assessed \$0.50 per transaction and the SOES Order Entry Firm or SOES Market Maker entering the order shall be assessed \$0.50 per order.

(b) For each order entered by a SOES Order Entry Firm or a SOES Market Maker that is canceled, the SOES Order Entry Firm or SOES Market Maker that cancels such order shall be assessed a fee of \$0.25.

## ATTACHMENT B

### Questions And Answers

1. When will the rule changes take effect and NNMS begin operation?

**A.** The rule changes and NNMS are scheduled for implementation on July 10, 2000.

### Technical Issues

2. Will there be instructions for setting up the new trading functionality?

**A.** Yes. SelectNet, NNMS, and SOES user guides are being prepared. These user guides will be available to all subscribers describing new features and how to setup NWII. The guides will be published on:  
[www.nasdaqtrader.com](http://www.nasdaqtrader.com).

3. How will market participants enter orders into NNMS?

**A.** Nasdaq will release a new version of NWII which will allow users to enter orders from NWII SOES windows rather than using NWII Harris screens. You can also use automated order-entry and management systems to facilitate trading operations via Application Programming Interface (API) or Computer-to-Computer Interface (CTCI) interfaces.

4. What changes will be required for CTCI and API to accommodate SOES/SelectNet?

**A.** Generally other than larger-sized orders and executions, there are no CTCI format changes for the SOES/SelectNet modifications. An API for SOES was published in November 1999 to allow firms access through the API as well as CTCI. Software producers and in-house systems will have to change

how they access the market to take advantage of the new rules. Testing is currently available for API and CTCI interfaces.

### Pricing

5. Can you explain the fee structures for NNMS and SelectNet?

**A.** The fee structures for NNMS, SelectNet, and SmallCap SOES are designed to benefit market participants that provide liquidity to the market, and charge a fair price to those that access liquidity. To reinforce that policy, the pricing for automatic executions in NNMS and SmallCap SOES will be changed to parallel the current SelectNet pricing structure. Unlike the past, Nasdaq will not charge a fee to a market participant that is executed against by NNMS and SmallCap SOES (*i.e.*, the liquidity provider).

SelectNet trades of all Nasdaq securities will be priced as follows:

- \$.70 per order executed for the first 25,000 liability orders monthly;
- \$.50 per order executed for the next 25,000 liability orders;
- \$.10 per order executed for all remaining liability orders; and
- \$.90 per order executed for all non-liability orders.

NNMS trades of National Market securities and SOES trades of SmallCap securities will be priced as follows:

- \$.50 per order executed for the first 150,000 orders under 2,000 shares monthly;
- \$.30 per order executed for all remaining orders under 2,000 shares;

- \$.90 per order executed for orders over 2,000 shares; and
- free for executions received.

### Trading Issues

6. If I am a market participant that currently does not have access to SOES, how do I obtain order entry capability in NNMS?

**A.** A market participant that does not have access to SOES, but would like access to NNMS should contact Nasdaq Subscriber Services at (800) 777-5606.

7. Is participation in NNMS mandatory for Market Makers?

**A.** Yes. Participation in NNMS (*i.e.*, automatic execution) is mandatory for broker/dealers that are registered as Market Makers in a Nasdaq National Market security, similar to SOES today. Participation in SmallCap SOES will continue to be voluntary. Participation in NNMS is voluntary for UTP Exchanges, ECNs, and alternative trading systems (ATS).

8. How will market participants access Market Maker quotes?

**A.** All registered broker/dealers, ECNs, and ATSS may enter orders into NNMS for automatic execution to access Market Maker quotes. Additionally, a market participant may be able to access ECN and UTP Exchange quotes, based on the method that these participants choose to participate in Nasdaq. Specifically, some ECNs have expressed interest in participating in an automatic-execution environment. If they choose to do so, they will be automatically executed against based upon their displayed and reserve size. Additionally, Nasdaq is also discussing with UTP Exchanges the

possibility that they will accept automatic execution as well. Nasdaq will keep the membership apprised of the result of these discussions.

Any ECN/ATS that notifies Nasdaq that it will accept SOES executions will have a fifth-character identifier of "+" when it begins trading in the automatic-execution environment. Since the implementation of the SEC Order Handling Rules, all ECNs/ATSs have had a fifth-character identifier of "#"; ECNs/ATSs that do not participate in "SuperSOES" will continue to display a "#". A UTP may have a "+" appended as the fifth character if it does not participate in the automatic-execution environment.

**9.** How will market participants access ECNs' quotes when they are at the inside?

**A.** ECNs will have the choice of having their quotes accessed through SelectNet as they do today or through the automatic execution functionality of NNMS. ECNs that choose to accept automatic execution ("Full Participant ECNs" with the "+" indicator) will be accessible through NNMS. Order Entry ECNs (*i.e.*, ECNs that do not accept automatic execution against their quote and continue to display the "#" indicator) will be accessible through a SelectNet liability order.

**10.** Are Market Makers and other broker/dealers permitted to enter proprietary orders into NNMS?

**A.** Yes. Since NNMS will be the only method for sending liability orders to Market Makers and market participants that take automatic execution through NNMS, all Nasdaq market participants may enter proprietary orders in NNMS.

The prohibition on entering proprietary orders as described in *NASD Notice to Members 88-61* will continue to apply in the Nasdaq SmallCap SOES.

**11.** Is there a prohibition on splitting up orders as existed in SOES?

**A.** No. The prohibition against splitting up orders has been removed. Although a market participant may only enter orders of up to 9,900 shares into the NNMS, this is a system constraint. A market participant is not prohibited from entering an order into the NNMS that is greater than 9,900 shares by splitting up the order into multiples of 9,900 shares. For example, if a market participant wished to enter an order for 15,000 shares into the system, the market participant could enter a 9,000 share order and 6,000 share order into the NNMS.

The prohibition on splitting up of orders as described in *NASD Notice to Members 88-61* will continue to apply in the Nasdaq SmallCap SOES.

**12.** Is dual liability being eliminated?

**A.** In most circumstances, yes. Dual liability may result if a market participant receives an order through SelectNet to which it owes liability under the SEC and NASD firm quote rules and immediately thereafter receives an execution against its quote through SOES. Nasdaq is eliminating most instances of dual liability in NNM securities by requiring market participants to send over-sized, conditioned SelectNet messages to Market Makers and any other market participants that participate in the automatic execution functionality of NNMS. Thus, dual liability will be virtually eliminated.

The over-sized, conditioned order requirement does not apply to OptiMark orders and to UTP Exchanges if that UTP Exchange does not take automatic execution via NNMS. Thus, Market Makers may continue to receive liability SelectNet orders from these two entities.

**13.** If a Market Maker receives a SelectNet liability order from a UTP Exchange, is there still the potential for dual liability?

**A.** Yes, depending on the sequence in which the auto-ex notification and the SelectNet liability order are received. If the auto-ex notification is received prior to the SelectNet order, the SelectNet order can be declined. As noted above, however, Nasdaq is working with UTP Exchanges to incorporate them into NNMS auto-ex function. This would eliminate dual liability from UTP Exchange orders.

**14.** Are there any changes affecting SmallCap stocks?

**A.** With the exception of the pricing structure described above, trading of SmallCap securities will not change. Market participants will use SOES and SelectNet as they do today, maximum order sizes will remain as they are today, and order-splitting and the entry of proprietary orders will still be prohibited.

**15.** If there are 10 Market Makers at the inside, how can a market participant trade 20,000 shares, and will there be a delay in execution?

**A.** It would take at least three orders, given the new maximum order size of 9,900. If these are the only orders entered against the 10 Market Makers, you would execute against all 10 Market Makers up to

the total of their displayed and reserve sizes. If these orders are competing with other orders in time sequence, they may get some, all, or none of what is entered, based on the time priority of the orders, and what the 10 Market Makers had as their displayed and reserve size. In addition, there is a five-second interval delay between executions against the same Market Maker at the same price.

**16.** Will firms' obligations regarding the entry of locking/crossing quotes during normal market hours, as set out in NASD Rule 4613(e), change when NNMS is implemented?

**A.** While the obligations under NASD Rule 4613(e) do not change, the mechanism for complying with the rule changes slightly because SelectNet will no longer be used to send liability orders to Market Makers.

More specifically, as Nasdaq and NASD Regulation have stated previously, a market participant must use reasonable means to avoid locking/crossing the market during market hours. "Reasonable means" has been interpreted previously to include sending a preferenced SelectNet order(s) to the firm(s) that would be locked/crossed at the bid or offer price. See *NASD Notice to Members 97-49*. In light of the changes to SelectNet, the market participant will first have to determine how the party (or parties) it will lock/cross is eligible to receive "liability orders" and then send the order(s) to the party (or parties) through the appropriate Nasdaq system or systems — NNMS, SelectNet, or both. For example, if MMA would lock/cross a single or multiple Market Makers, it would be consistent with NASD Rule 4613(e)

for MMA to send orders through NNMS, since the Market Makers are subject to automatic execution. Similarly, if MMA would lock/cross a single or multiple ECNs that do not participate in automatic execution, it would be consistent with NASD Rule 4613(e) for MMA to send a SelectNet preferenced order to the ECN(s) because ECNs are able to receive liability orders only through SelectNet. If MMA would lock/cross a combination of Market Makers and ECNs that do not participate in automatic execution, it would be consistent with NASD Rule 4613(e) for MMA to send orders through both the NNMS and SelectNet systems. It would not be consistent with the NASD Rule 4613(e) for MMA to send a preferenced order through SelectNet if MMA were locking/crossing a Market Maker since the Market Maker would owe no liability to the SelectNet message, nor would it be consistent with NASD Rule 4613(e) for MMA to send an order into NNMS if MMA were locking an ECN that is not subject to automatic execution.

**17.** Does a Market Maker's obligations under the SEC Limit Order Display Rule (SEC Rule 11Ac1-4) change in instances where a Market Maker receives a customer limit order that would lock/crosses the market?

**A.** Similar to Question 16, while the obligations do not change, the mechanism for complying with the obligation varies slightly. Under the SEC Limit Order Display Rule, a Market Maker must display an eligible limit order as soon as practicable, but no later than 30 seconds after receipt under normal market conditions. The Commission has stated, however, that if a limit order that would lock/cross the market is marketable against

another firm's quote, "the Market Maker may attempt to execute the order against that quote prior to displaying the order. For example, a Market Maker may send a SelectNet message to the Market Maker or ECN displaying the existing quote. Although attempting to execute against the quote may result in the display of the customer limit order more than 30 seconds after receipt, the Division believes that such action would not violate the Limit Order Display Rule's immediacy requirement." See Letter from Richard Lindsey, Director, Division of Market Regulation, SEC, to Joseph Hardiman, President, NASD, dated November 22, 1996.

Thus, before displaying a limit order that would lock/cross the market, the Market Maker may attempt to execute the order against the quote that it would lock/cross. As noted in Question 16, since certain market participants are not eligible to receive liability orders through SelectNet, the market participant will first have to determine how the party or parties it will lock/cross is eligible to receive "liability orders" and send the order(s) into the appropriate Nasdaq system or systems — NNMS, SelectNet, or both.

**18.** Will odd-lot processing be included in the new system?

**A.** Yes. In the NNMS, odd lots will be processed against only those Market Makers that are at the inside bid or offer, in round-robin fashion. An odd-lot execution does not decrement a Market Maker's quote. If, however, a Market Maker has reserve size in the system, an odd-lot execution will decrement the reserve size held in Nasdaq. The system cannot decrement displayed quotes in Nasdaq,

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## **NASD Notice to Members 00-30**

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because Nasdaq can only display round lots (*i.e.*, 100 shares or multiples thereof). Since reserve size is not displayed in the Nasdaq

Quotation Montage, but rather is held within the system, it is possible to decrement reserve size by the amount of an odd-lot execution.

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## Notices to Members Bound Volumes

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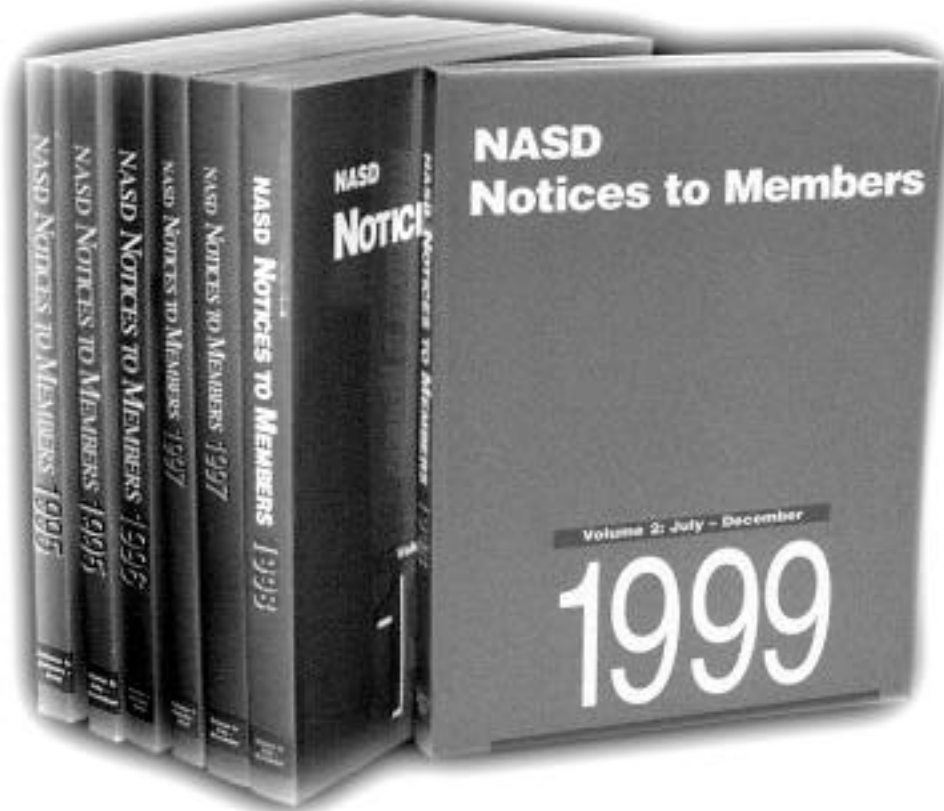
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**NASD**  
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## NASD Notice to Members 00-31

### INFORMATIONAL

## FIPS Changes

Fixed Income Pricing  
System Additions,  
Changes, And Deletions  
As Of March 23, 2000

### SUGGESTED ROUTING

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Corporate Finance
- Legal & Compliance
- Municipal/Government Securities
- Operations
- Senior Management
- Trading & Market Making

### KEY TOPIC

- FIPS

As of March 23, 2000, the following bonds were added to the Fixed Income Pricing System<sup>SM</sup> (FIPS<sup>®</sup>).

| Symbol  | Name                            | Coupon | Maturity |
|---------|---------------------------------|--------|----------|
| ANCG.GB | Anker Coal Group Inc. Ser B     | 14.250 | 09/01/07 |
| CFTR.GB | Conseco Fin'l Tr Inc.           | 8.796  | 04/01/27 |
| CHBS.GA | Charles River Labs Inc.         | 13.500 | 10/01/09 |
| DALY.GB | Dailey Int'l Inc.               | 9.500  | 02/15/08 |
| DHI.GD  | D.R. Horton Inc.                | 10.500 | 04/01/05 |
| DLCA.GB | Dail Call Communications Inc.   | 12.250 | 04/15/04 |
| DVSM.GA | Diva Systems Corp.              | 12.625 | 03/01/08 |
| ECOC.GA | Easco Corp.                     | 10.000 | 03/27/00 |
| EXDS.GC | Exodus Communications Inc.      | 10.750 | 12/15/09 |
| GSTF.GA | GST Equipment Funding Inc.      | 13.250 | 05/01/07 |
| HCHM.GB | Huntsman ICI Chemicals LLC      | 0.000  | 12/31/09 |
| HMTR.GC | Amtran Inc.                     | 10.500 | 08/01/04 |
| INST.GA | Instron Corp.                   | 13.250 | 09/15/09 |
| IRSP.GA | Intersil Corp.                  | 13.250 | 08/15/09 |
| JDN.GA  | JDN Realty Corp.                | 6.800  | 08/01/04 |
| JDN.GB  | JDN Realty Corp.                | 6.950  | 08/01/00 |
| KGEL.GA | Kansas Gas & Electric Co.       | 7.600  | 12/17/03 |
| KGEL.GB | Kansas Gas & Electric Co.       | 6.500  | 08/01/05 |
| KGEL.GC | Kansas Gas & Electric Co.       | 6.200  | 01/15/06 |
| LEN.GA  | Lennar Corp.                    | 7.625  | 03/01/09 |
| LTVP.GA | LTV Corp. New                   | 11.750 | 11/15/09 |
| PBY.GA  | Pep Boys Manny Moe & Jack       | 7.000  | 06/01/05 |
| PBY.GB  | Pep Boys Manny Moe & Jack       | 6.625  | 05/15/03 |
| PGTV.GC | Pegasus Communications Corp.    | 12.500 | 08/01/07 |
| PNSU.GA | Peninsula Gaming LLC Ser B      | 12.250 | 07/01/06 |
| PXD.GC  | Pioneer Natural Resource        | 9.625  | 04/01/10 |
| RPBT.GA | Republic Tech/RTI Capital Corp. | 13.750 | 07/15/09 |
| RYCK.GA | Royster-Clark Inc.              | 10.250 | 04/01/09 |
| TMHL.GA | Team Health Inc. Ser B          | 12.000 | 03/15/09 |
| TNAU.GA | Tenneco Automotive Inc. Ser B   | 11.625 | 10/15/09 |
| USUW.GA | US Unwired Inc.                 | 13.375 | 11/01/09 |
| WCII.GF | Winstar Communications Inc.     | 12.750 | 04/15/10 |
| WCII.GG | Winstar Communications Inc.     | 14.750 | 04/15/10 |
| WCII.GH | Winstar Communications Inc.     | 12.500 | 04/15/08 |
| WR.GA   | Western Resources Inc.          | 6.875  | 08/01/04 |
| WR.GB   | Western Resources Inc.          | 7.125  | 08/01/09 |
| WR.GC   | Western Resources Inc.          | 6.875  | 08/01/04 |

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## NASD Notice to Members 00-31

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As of March 23, 2000, the following bonds were deleted from FIPS.

| Symbol  | Name                            | Coupon | Maturity |
|---------|---------------------------------|--------|----------|
| AEC.GA  | Associated Estates Realty Corp. | 8.375  | 04/15/00 |
| CENU.GA | Cencall Communications Corp.    | 10.125 | 01/15/04 |
| COHO.GA | Coho Energy Inc.                | 8.875  | 10/15/07 |
| DOCI.GA | Decisionone Holdings Corp.      | 11.500 | 08/01/08 |
| EGLE.GA | Eagle Food Ctrs Inc.            | 8.625  | 04/15/00 |
| FALC.GA | Falcon Building Products Inc.   | 9.500  | 06/15/07 |
| FCHM.GA | Freedom Chemicals Inc.          | 10.625 | 10/15/06 |
| FCLT.GA | Facillcom Int Inc.              | 10.500 | 01/15/08 |
| FFSH.GA | Farm Fresh Inc.                 | 12.250 | 10/01/00 |
| FFSH.GB | Farm Fresh Inc.                 | 12.250 | 10/01/00 |
| FLDP.GA | Florida Coast Paper Co.         | 12.750 | 06/01/03 |
| FWTN.GA | FWT Inc.                        | 9.875  | 11/15/07 |
| GGSY.GA | Gross Graphic Sys Inc.          | 12.000 | 10/15/06 |
| JCOM.GA | Jacor Communications Co.        | 9.750  | 12/15/06 |
| JCOM.GB | Jacor Communications Co.        | 8.750  | 06/15/07 |
| JOIN.GB | Jones Intercable Inc.           | 10.500 | 03/01/08 |
| LUGM.GA | Lady Luck Gaming Fin Corp.      | 11.875 | 03/01/01 |
| LUGM.GB | Lady Luck Gaming Fin Corp.      | 11.875 | 03/01/01 |
| NXTL.GB | Nextel Communications Inc.      | 9.750  | 08/15/04 |
| STO.GH  | Stone Container Corp.           | 9.875  | 02/01/01 |
| SVGC.GA | Sovereign Speciality Chem. Inc. | 9.500  | 08/01/07 |
| VCMK.GA | Victory Markets Inc.            | 12.500 | 03/15/00 |
| WR.GA   | Western Resources Inc.          | 6.875  | 08/01/04 |

As of March 23, 2000, changes were made to the symbols of the following FIPS bonds.

| New Symbol | Old Symbol | Name                    | Coupon | Maturity |
|------------|------------|-------------------------|--------|----------|
| CFNI.GA    | CFN.GA     | Contifinancial Corp.    | 8.375  | 08/15/03 |
| CFNI.GB    | CFN.GB     | Contifinancial Corp.    | 8.125  | 04/01/08 |
| CFNI.GC    | CFN.GC     | Contifinancial Corp.    | 7.500  | 03/15/02 |
| PKG.GA     | PKCA.GA    | Packaging Corp. Amer    | 9.625  | 04/01/09 |
| ROIA.GA    | RDIO.GA    | Radio One Inc.          | 7.000  | 05/15/04 |
| TNAU.GA    | TEN.GA     | Tenneco Automotive Inc. | 11.625 | 10/15/09 |

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to FIPS trade-reporting rules should be directed to Patricia Casimates, Market Regulation, NASD Regulation<sup>SM</sup>, at (301) 590-6447.

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

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**INFORMATIONAL**

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**Decimalization**

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**SEC Suspends  
Decimalization Deadline  
And Requests Comment  
On Extended Deadline****SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Operations
- Options
- Registered Representatives
- Senior Management
- Technology
- Trading & Market Making

**KEY TOPICS**

- Decimalization

**Executive Summary**

The Securities and Exchange Commission (SEC or Commission) recently suspended the July 3, 2000 deadline for decimal trading and requests comment on two alternative plans which would revise the securities industry's decimal implementation schedule.

The SEC order announcing the deadline suspension is included with this *Notice*.

**Questions/Further Information**

Questions regarding this *Notice to Members* may be directed to the National Association of Securities Dealers, Inc. (NASD®) Decimalization Program Management Office (DPMO) toll free at: (888) 227-1330 or via e-mail at [decimals@nasd.com](mailto:decimals@nasd.com)

Members should check the NASD Web Site ([www.nasd.com](http://www.nasd.com)) frequently for general information regarding decimalization and the Securities Industry Association (SIA) Web Site ([www.sia.com](http://www.sia.com)) for information on industry preparation testing (view the *Decimalization Testing & Implementation Guide*).

**Decimalization Deadline Extension**

After extensive review and testing of Nasdaq® systems and in light of recent growth in quotation and trade volume, the NASD recently asked the Commission to delay the July 3, 2000 decimals implementation plan. Therefore, the Commission has suspended the original deadline and has proposed the following two alternative schedules for which it is seeking comment:

- 1) trade all exchange-listed securities in decimals by September 4, 2000;
- 2) phase in decimal trading in certain exchange-listed securities on a pilot basis. This pilot program would begin on September 4, 2000, and would initially include a small number of exchange-listed securities and would expand to all listed stocks by March 31, 2001.

Under both alternatives, the NASD would begin trading in decimals by March 31, 2001.

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**INFORMATIONAL**

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**Callable  
Common Stock**

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**NASD Regulation Adopts  
New Rule Interpretation  
To Require Confirmation  
Disclosure Of Callable  
Common Stock****SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Internal Audit
- Legal & Compliance
- Operations
- Senior Management
- Trading & Market Making

**KEY TOPICS**

- Callable Common Stock
- IM-2110-6

**Executive Summary**

On April 24, 2000, NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) adopted a new interpretation of high standards of commercial honor and just and equitable principles of trade, Rule 2110, addressing transactions in callable common stock. Specifically, new Interpretative Material (IM-2110-6) states that a member that provides a confirmation pursuant to Securities and Exchange Commission (SEC) Rule 10b-10 in connection with any transaction in callable common stock shall disclose on such confirmation that the security is callable and that the customer may wish to contact the member for more information regarding the security.

Questions regarding this *Notice* may be directed to Dorothy L. Kennedy, Director, Market Operations, The Nasdaq Stock Market, Inc., at (203) 385-6243; or Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8104.

**Background And Summary**

An issuer's common stock generally continues to trade on a market until the issuer fails to meet the market's listing requirements, combines with another company, or voluntarily delists for another market. Occasionally, common stock will be callable, that is, subject to being called away from a shareholder, either by the issuer or a third party. Typically, the price at which callable common stock is called away from a shareholder is at a premium to the then prevailing market price or pursuant to a schedule of prices announced at the time the common stock is issued.

An investor purchasing callable common stock is subject to unique risks not typically associated with ownership of common stock, even where such stock is called away at a premium. Moreover, the ability of an issuer's common stock to be called away from a shareholder generally will be a material fact to an investor. Accordingly, high standards of commercial honor and just and equitable principles of trade require that any member that provides a written confirmation for a transaction involving callable common stock must disclose on the confirmation that the security is callable and that the customer may contact the member for more information. The staff emphasizes that the disclosure of the call feature on the confirmation in no way relieves a member of its obligation to consider the callable nature of the security when complying with any applicable suitability obligations.

**Text Of IM-2110-6:  
Confirmation Disclosure Of  
Callable Common Stock**

Any member providing a customer confirmation pursuant to SEC Rule 10b-10 in connection with any transaction in callable common stock shall disclose on such confirmation that:

- the security is callable common stock; and
- a customer may contact the member for more information concerning the security.

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# NASD

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# Disciplinary Actions

## Disciplinary Actions Reported For May

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) has taken disciplinary actions against the following firms and individuals for violations of National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). Unless otherwise indicated, suspensions will begin with the opening of business on Monday, May 15, 2000. The information relating to matters contained in this *Notice* is current as of the end of April 25, 2000.

### **Firm Expelled, Individual Sanctioned**

**Lakeside Trading (CRD #39418, Metairie, Louisiana) and Thomas Griswold Russell (CRD #2669033, Registered Principal, Metairie, Louisiana)** were fined \$75,000, jointly and severally. The firm was suspended from association with any NASD member for 30 days for failing to file its audited financial statements and expelled from NASD membership for misuse of funds. Russell was fined an additional \$137,961.95, suspended from association with any NASD member in any capacity for a total of 14 months and 40 business days, barred from association with any NASD member, and ordered to pay restitution totaling \$316,005.48 to a member firm and a public customer. The fines and restitution are due and payable upon Russell's or the firm's re-entry into the securities industry. The sanctions are based on findings that Russell misused customer funds by improperly sharing in the profits in the customer's account. Russell also exercised discretion in the customer's account without a written agreement. The findings also stated that Russell guaranteed a customer against loss in margin

calls, made misrepresentations to his clearing firm, and engaged in unauthorized trading in a customer's account. In addition, the firm, through Russell, failed to file an annual audited statement and failed to file a FOCUS report in a timely manner. Furthermore, the firm and Russell failed to file its Web Site with the NASD before its first use and failed to pre-file its revised Web Sites in a timely manner. Russell failed to ensure the firm's compliance with NASD's advertising rules and distributed misleading advertisements on its Web Sites. Moreover, Russell failed to respond to NASD requests for information. **(NASD Case #C05990018)**

### **Firm Suspended, Individual Sanctioned**

**Kashner Davidson Securities Corp. (CRD #5319, Sarasota, Florida) and Victor Lawrence Kashner (CRD #264714, Registered Principal, Sarasota, Florida)**. The firm was fined \$25,000, suspended from participating in municipal securities transactions for six months, and required to continue to retain an independent consulting firm for 18 months to review and monitor the firm's compliance and written supervisory procedures. Kashner was fined \$50,000, suspended from association with any NASD member in a principal or supervisory capacity for two years, and required to requalify as a general securities principal by taking and passing the Series 24 exam after serving his suspension. In addition, Kashner was required to attend a compliance conference with the NASD within 60 days from the date this decision becomes final. The sanctions were based on findings that the firm effected municipal securities trades without having those trades approved by a

qualified municipal securities principal, and allowed Kashner to approve those trades when he was not qualified as a municipal securities principal. In addition, the firm sold shares of “hot issues” to potentially restricted accounts without inquiring into the beneficial ownership of the purchasers, and the firm and Kashner submitted inaccurate Free-Riding and Withholding questionnaires to the NASD for each of the “hot issues.” Furthermore, the firm placed orders to sell securities on behalf of its customers and accepted “long” sell orders and failed to make the required notations on the order tickets. The firm also effected sell transactions on behalf of its customers without noting on the order ticket whether the sale was long or short and effected principal transactions with its customers where the order tickets reflected the time the order was executed but failed to reflect the time the orders were received. **(NASD Case #C07960095)**

### **Firms Fined, Individuals Sanctioned**

**I. C. Rideau, Lyons & Co., Inc. (CRD #17974, Los Angeles, California), Lamar Andrew Lyons, Sr. (CRD #1788438, Registered Principal, Marina Del Rey, California), and Joyce Ann Green (CRD #1880829, Registered Principal, Pasadena, California)** were fined \$20,000, jointly and severally, and Green was suspended from association with any NASD member in any capacity for 30 days. The sanctions were based on findings that the respondents failed to respond in a complete and timely manner to NASD requests for information. **(NASD Case #C02990034)**

**Peters Securities Co., L.P. (CRD #15970, Chicago, Illinois),**

**Reuben Donnelley Peters (CRD #1329222, Registered Principal, Evanston, Illinois), and John Walter Sobolewski (CRD #1327410, Registered Principal, Woodbridge, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured and fined \$55,000, jointly and severally with Peters. Peters was suspended from acting in the capacities of a general securities principal and/or a financial and operations principal for 30 days and required to requalify by exam as a general securities principal and a financial and operations principal within 90 days of the end of the suspension or cease acting in such capacities until he has requalified. Sobolewski was censured, fined \$15,000, and required to requalify by exam as a financial and operations principal within 90 days of the date that the AWC was accepted by the National Adjudicatory Council (NAC) or cease acting in such capacity until he has requalified.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Peters and Sobolewski, effected securities transactions when it failed to maintain the minimum required net capital. The findings also stated that the firm, acting through Peters, executed transactions at locations but failed to register any of the locations as Offices of Supervisory Jurisdiction (OSJ) and failed to designate an appropriately registered principal in each of the locations. In addition, the firm, acting through Sobolewski, allowed an individual to act in the capacity of a general securities principal when the individual was not appropriately qualified or registered in such capacity. Furthermore, the NASD determined

that the firm, acting through Peters, failed to prepare, maintain, and/or enforce adequate written supervisory procedures regarding the Regulatory Element of the Continuing Education requirement and reviewing the activities and conducting an annual inspection of each OSJ office. **(NASD Case #C8A000023)**

### **Firms And Individuals Fined**

**Brookehill Equities, Inc. (CRD #7966, Westport, Connecticut) and Sarabeth Margolis Wizen (CRD #845499, Registered Representative, Randolph Township, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which they were censured and fined \$15,182, jointly and severally, which included \$2,682 in commissions that the firm received. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Wizen, failed to detect that an individual solicited new account forms and signed her name to the forms as a registered representative, solicited and completed order tickets for transactions with public customers, and generated approximately \$5,364 in commissions before the effective date of her registration. The findings also stated that the firm, acting through Wizen, failed to establish, maintain, and enforce adequate written supervisory procedures reasonably designed to ensure the firm’s compliance with the NASD membership and registration rule. **(NASD Case #C10000032)**

**G. W. Piper & Co., Inc. (CRD #22563, Florham Park, New Jersey), George Warren Piper (CRD #363944, Registered Principal, Ridgewood, New**

**Jersey), and Anthony Vincent Graziano (CRD #1853757, Registered Principal, Florham Park, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm and Piper were censured and fined \$157,500, jointly and severally; the firm and Graziano were fined \$7,500, jointly and severally; and Graziano was fined \$2,500, individually. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Piper, allowed an individual to act as a general securities representative and allowed Graziano to act as a general securities principal while both failed to register in the respective capacities. The findings also stated that the firm, acting through Graziano, failed to evaluate and prioritize its training needs and to implement a written training plan for its Firm Element training requirement. **(NASD Case #C9B000006)**

**Nutmeg Securities, Ltd. (CRD #18975, Westport, Connecticut) and Matthew Kent Rochlin (CRD #1629493, Registered Principal, Westport, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm and Rochlin were censured; fined \$5,000, jointly and severally; and required to pay \$18,816.28, plus interest, in restitution to public customers, jointly and severally. The firm was also individually fined \$3,000. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm inaccurately reported Nasdaq SmallCap<sup>SM</sup> transactions to the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) as cross transactions when they

should have been reported as sell or buy transactions. The findings also stated that the firm failed to identify aggregated transaction reports in a Nasdaq SmallCap security to ACT using the required “.B” modifier, failed to report transactions to ACT, failed to designate a transaction as late, and reported transactions late using the required “.SLD” modifier. The firm also failed to designate as late to ACT transactions in Nasdaq National Market<sup>®</sup> (NNM) securities and Consolidated Quotation System and reported transactions late using the required “.SLD” modifier. In addition, the firm, acting through Rochlin, charged excessive markups to retail customers based on its contemporaneous cost in principal transactions in a Nasdaq SmallCap security resulting in a gross dollar profit to the firm of \$18,816.28. Moreover, the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules relating to trade reporting and recordkeeping. **(NASD Case #C11000006)**

#### **Firms Fined**

**D.E. Frey & Company, Inc. (CRD #23595, Denver, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report settlements of customer complaints and arbitration awards to the NASD as required. **(NASD Case #C3A000011)**

**Investment Services Capital Corp. (CRD #31271, Suffern, New York)** submitted a Letter of

Acceptance, Waiver, and Consent pursuant to which the firm was censured and fined \$12,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short-sale transactions in certain securities, all of which were NNM securities, at or below the inside bid when the current inside bid was below the preceding inside bid in each of the securities, and executed short-sale transactions in certain securities and failed to maintain a written record of the affirmative determinations made for such orders. The findings also stated that the firm executed long-sale transactions and incorrectly reported each of these transactions to ACT with a short-sale indicator, and failed to maintain brokerage order memoranda for transactions. The firm also failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with the applicable NASD rules. **(NASD Case #CMS000049)**

**LCP Capital Corporation (CRD #14469, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured, fined \$17,500, and required to pay \$406.25, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to use reasonable diligence to ascertain the best inter-dealer market by failing to buy or sell in such market so that the resultant price to the customer was as favorable as possible under prevailing market conditions and by failing to execute customer orders fully and promptly. The findings also stated that the firm failed to establish, maintain, and enforce written supervisory

procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding trading and market making. **(NASD Case #CMS000056)**

**Miller Tabak Hirsch & Co. (CRD #10384, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured, fined \$12,500, and fined an additional \$5,000 jointly and severally with an individual. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it entered orders into the Small Order Execution System<sup>SM</sup> (SOES<sup>SM</sup>) on the same side of the market in securities, and in each instance, the order, based on a single investment decision, was larger than the maximum order size for SOES, and was broken up into small parts and entered into SOES exceeding the SOES maximum order size for that security if aggregated. The findings also stated that the firm entered orders for trades from its proprietary account as SOES orders for execution against a SOES Market Maker, and executed securities transactions for the accounts of its customers but failed to make and keep current a memorandum of each order received. In addition, the firm failed to establish or maintain adequate written supervisory procedures regarding its trading and market-making activities. **(NASD Case #C8A000021)**

**RBC Dominion Securities Corporation (CRD #6579, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures relating to trade reporting. Without admitting or denying the allegations, the firm

consented to the described sanctions and to the entry of findings that it reported transactions in NNM securities, Nasdaq SmallCap securities, and OTC equity securities to ACT late and without the appropriate .SLD modifier. The findings also stated that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding trade reporting. **(NASD Case #CMS000052)**

**Standard & Poor's Securities, Inc. (CRD #5248, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to ensure that individuals actively engaged in the firm's securities business, or in its management, were properly registered with the NASD. **(NASD Case #C10000036)**

**Starr Securities, Inc. (CRD #13336, New York, New York)** submitted a Letter of Acceptance, Waiver and Consent pursuant to which the firm was censured, fined \$11,000, and required to submit revised written supervisory procedures concerning transaction reporting to the NASD within 60 days of acceptance of this AWC by the NAC. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it reported transactions in NNM securities late to ACT and failed to designate transactions as late and incorrectly designated NNM securities transactions as ".T" to ACT. The findings also stated that the firm incorrectly reported to ACT whether it executed trades as

principal or agent in transactions. In addition, the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding transaction reporting. **(NASD Case #CMS000053)**

### **Individuals Barred Or Suspended**

**Alberto Enrique Argomaniz (CRD #2518033, Registered Representative, Miami, Florida)** was fined \$62,500 and barred from association with any NASD member in any capacity. The sanctions were based on findings that Argomaniz forged a public customer's endorsement to an insurance premium refund check and converted the \$7,500 proceeds to his own use and benefit. **(NASD Case #C07990013)**

**James Edward Bassano (CRD #2736206, Registered Representative, North Bellmore, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Bassano deliberately opened accounts and executed purchases of stock for public customers without their knowledge or consent. **(NASD Case #C02990053)**

**Frank Paul Bavaro (CRD #1504493, Registered Principal, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$5,000, suspended from association with any NASD member in any capacity for 10 days, and required to requalify as a general securities principal. Without admitting or denying the allegations, Bavaro consented to the described sanctions and to the entry of

findings that he changed a trading desk time clock to an earlier date, placed the new time stamp on an internal order ticket that reflected the cancellation of an order to buy a New York Stock Exchange (NYSE)-listed security on the earlier date. Bavaro sent the ticket to NYSE Market Surveillance as evidence of the canceled trade. **(NASD Case #C1000055)**

**Anyta Leigh Boroski (CRD #2983888, Registered Representative, Westerville, Ohio)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Boroski failed to respond to NASD requests for information. **(NASD Case #C8B990035)**

**William Thomas Breese (CRD #2542710, Registered Representative, Midlothian, Illinois)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Breese converted funds totaling nearly \$300,000 from public customers for his own use and benefit. Breese also failed to respond to NASD requests for information. **(NASD Case #C8A990039)**

**Michael William Burke (CRD #1793662, Registered Representative, Mount Joy, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Burke consented to the described sanction and to the entry of findings that he provided fictitious account statements to a public customer to deceive him about the existence and value of investments. The findings also stated that Burke failed to respond to NASD requests

to provide documents. **(NASD Case #C9A000013)**

**Joseph Giulio Chiulli (CRD #1149276, Registered Principal, Lynbrook, New York)** was censured, suspended from association with any NASD member in any capacity for one year, and required to requalify by exam before acting in any capacity requiring registration. The Securities and Exchange Commission (SEC) affirmed the sanctions following appeal of a December 1998 NAC decision. The sanctions were based on findings that Chiulli failed to preserve his member firm's books and records and failed to respond to NASD requests for information. **(NASD Case #C07970006)**

**Kelly Marie Denti (CRD #2279001, Registered Representative, Flemington, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Denti consented to the described sanction and to the entry of findings that she failed to disclose withdrawal penalties and surrender charges to public customers in connection with the sale of mutual funds and variable annuities. **(NASD Case #C10000051)**

**Gale Reich Donovan (CRD #70260, Registered Representative, New York, New York)** was fined \$39,000; suspended from association with any NASD member in any capacity for two years and 30 business days; required to pay \$4,488, plus interest, in restitution to a public customer for unsuitable recommendations; and barred from association with any NASD member in any capacity. The fines shall be

due and payable prior to Donovan's re-entry in the securities industry. The sanctions were based on findings that Donovan engaged in unsuitable and excessive trading in the accounts of a public customer and effected discretionary trades without the customer's prior written authorization. The findings also stated that Donovan acted as a general securities representative at a member firm without being registered with the NASD. In addition, Donovan failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C10990142)**

**Alan Jay Eisenman (CRD #1532934, Registered Representative, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$25,000 and suspended from association with any NASD member in any capacity for seven business days. Without admitting or denying the allegations, Eisenman consented to the described sanctions and to the entry of findings that, acting in his capacity as a registered representative, he caused to be entered two non-bona fide orders in an NYSE-listed security in his personal account at the close of the market to determine how orders would be treated and at what price they would be executed. The NASD found that at the time of placing the orders, Eisenman held a short position of contracts of call options in the security and such orders were executed and reported, causing the Pacific Stock Exchange-listed calls to move to the strike price. **(NASD Case #CMS000033)**

**Renato Carbonel Fernandez (CRD #2647861, Registered Representative, San Jose, California), Marie Soriano Delacruz (CRD #2547419,**

**Registered Representative, San Jose, California), and Alma Guiang Pontillas (CRD #283333, Registered Representative, San Jose, California)** submitted Offers of Settlement pursuant to which they were each fined \$10,000 and suspended from association with any NASD member in any capacity for three months. Payment of the fines shall be a prerequisite for consideration of any application for reentry by the respondents. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that, in connection with an individual's attempt to reach a higher level of sales of variable life insurance at the member firm, Fernandez, Delacruz, and Pontillas signed as writing agent and/or witness attesting to information concerning applications for variable life insurance policies. The NASD determined that in fact, Fernandez, Delacruz, and Pontillas were neither the agent nor a witness, and had no idea as to whether the information on the application was correct, but were merely provided the applications for their signatures. **(NASD Case #C01990022)**

**Richmond Talbot Fisher (CRD #2994893, Registered Principal, Riverside, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$7,500 and suspended from association with any NASD member in a principal capacity for 10 business days. Without admitting or denying the allegations, Fisher consented to the described sanctions and to the entry of findings that he functioned as the president and chief operating officer of his firm and was active in the management of the firm's securities business, including the supervision of employees and the conduct of business, without being

registered in the capacity of a general securities principal. **(NASD Case #C10000038)**

**Bruce Thomas Gmahle, Jr. (CRD #2044839, Registered Representative, Point Pleasant Beach, New Jersey)** submitted an Offer of Settlement pursuant to which he was fined \$10,858, which includes the disgorgement of \$858 of commissions earned, and barred from association with any NASD member in any capacity with the right to reapply after two years. The fine, including disgorgement, shall be due and payable prior to reassociation with a member firm following the bar or prior to any application requesting relief from a statutory disqualification. Without admitting or denying the allegations, Gmahle consented to the described sanctions and to the entry of findings that he executed transactions in the accounts of public customers without their prior knowledge, authorization, or consent. **(NASD Case #C10990211)**

**Jennifer Lynn Gonzalez (CRD #2461482, Registered Principal, Houston, Texas)** submitted an Offer of Settlement pursuant to which she was suspended from association with any NASD member as a general securities principal for two years and barred from association with any NASD member as a financial and operations principal. Without admitting or denying the allegations, Gonzalez consented to the described sanctions and to the entry of findings that she failed to ensure the preparation and maintenance of accurate books and records for her member firm. The findings also stated that she allowed her firm to engage in a securities business when she knew, or should have known, that her firm's net capital was below the

required minimum and failed to provide appropriate notification. Gonzalez also failed to ensure the accurate preparation of FOCUS Part II filings for her firm. In addition, Gonzalez failed to ensure that unaudited financial statements in a private placement memorandum and financial information in a stock purchase agreement were not false and misleading. **(NASD Case #C05990026)**

**Jonathan David Gottfried (CRD #2647864, Registered Representative, Malverne, New York)** submitted an Offer of Settlement pursuant to which he was fined \$2,500 and suspended from association with any NASD member in any capacity, including clerical and administrative, for 15 business days. Without admitting or denying the allegations, Gottfried consented to the described sanctions and to the entry of findings that he failed to disclose a settled customer complaint on a Form U-4. **(NASD Case #C10990214)**

**Michael John David Halladay (CRD #2275159, Registered Representative, Belvidere, Illinois)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Halladay participated in private securities transactions without providing prior written notification to his member firm. Halladay also failed to respond to NASD requests for information. **(NASD Case #C8A990006)**

**James Han (CRD #2710091, Registered Principal, Bayside, New York)** submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the

allegations, Han consented to the described sanction and to the entry of findings that he effected the unauthorized transfer of funds totaling \$6,600 from the day-trading account of a public customer to his own personal account maintained at his member firm, without the knowledge or consent of the customer. The findings also stated that Han transferred securities transactions from the day-trading account of another customer to his own personal account without the knowledge or consent of the customer. In addition, Han failed to respond to NASD requests for information. **(NASD Case #C05000005)**

**Boggie Hanczaruk-Harlow (CRD #2381253, Registered Principal, Woodbridge, Illinois)** was barred from association with any NASD member in any capacity and ordered to pay \$43,000 in restitution to a public customer. The sanctions were based on findings that he participated in private securities transactions that resulted in a customer loss of \$43,000, without prior written notice to, and approval of, his member firm. Hanczaruk-Harlow also failed to respond to NASD requests for information. **(NASD Case #C8A990041)**

**Steven Gerald Ives (CRD #2197745, Registered Representative, St. Paul, Minnesota)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Ives failed to respond to NASD requests for information. **(NASD Case #C04990046)**

**Garry Scott Ivey (CRD #801743, Registered Representative, Atlanta, Georgia)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was

fined \$7,500, and suspended from association with any NASD member in any capacity for 30 business days. The fine shall be due and payable either prior to reassociation with a member firm following the suspension or prior to any application requesting relief from a statutory disqualification. Without admitting or denying the allegations, Ivey consented to the described sanctions and to the entry of findings that he exercised discretionary power in accounts held by a public customer without obtaining prior written authorization from the customer and without having the accounts accepted as discretionary accounts by his member firm. **(NASD Case #C07000018)**

**Robert Joseph Kernweis (CRD #1392867, Registered Representative, Burbank, California)** and **William Pohn Willis (CRD #836417, Registered Principal, Rancho Palos Verdes, California)**. Kernweis was fined \$294,063, which shall be due and payable at such time as he seeks to reenter the securities industry, and barred from association with any NASD member in any capacity. Willis was fined \$10,000, suspended from association with any NASD member in any supervisory capacity for 30 days and required to requalify by exam as a principal by taking and passing the Series 24 exam. The sanctions were based on findings that Kernweis engaged in trading in the account of a public customer that was not suitable based on the size, nature, and frequency of the recommended transactions, and engaged in excessive trading in the customer's account. Willis, as manager, had the authority and the obligation to prevent the unsuitable and excessive trading in the customer's account, and failed to take appropriate action to supervise

the firm. **(NASD Case #C02980024)**

**Joseph Jerry Lacertosa (CRD #2556113, Registered Representative, Pompano, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Lacertosa failed to respond to NASD requests for information. **(NASD Case #C10990160)**

**Patrick Joseph Larkin (CRD #2597308, Registered Representative, Sarasota, Florida)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$35,000, suspended from association with any NASD member in any capacity for one year, and ordered to disgorge \$22,812.66 in commissions. Without admitting or denying the allegations, Larkin consented to the described sanctions and to the entry of findings that he sold promissory notes to public customers without providing prior written notice of his participation in such sales to his member firm. **(NASD Case #C07000022)**

**Albert Douglas Lassak (CRD #1633765, Registered Representative, West Palm Beach, Florida)** was fined \$50,000 and suspended from association with any NASD member in all capacities for two years for making unsuitable recommendations. Lassak was also fined \$10,000 and suspended from association with any NASD member in all capacities for 30 business days for improperly exercising discretion in a customer's account. In addition, Lassak was barred from association with any NASD member in all capacities for failure to respond. The sanctions were based on findings that Lassak

made unsuitable recommendations in a public customer's account and improperly used discretion in the customer's account. Lassak also failed to respond to NASD requests for information. **(NASD Case #C07990062)**

**Edwin Leslie Lawrence, Jr. (CRD #2282684, Registered Representative, Dix Hills, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Lawrence made baseless and improper price predictions, guarantees, and misrepresentations to public customers about speculative stocks. The findings also stated that Lawrence engaged in unauthorized trading in the accounts of customers and failed to execute sell orders for customers. **(NASD Case #CAF980031)**

**Gary Vincent Leone (CRD #1092745, Registered Principal, Sarasota, Florida)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$25,000, suspended from association with any NASD member in any capacity for 90 days, and ordered to disgorge \$4,141 in commissions. Without admitting or denying the allegations, Leone consented to the described sanctions and to the entry of findings that he sold promissory notes to public customers without providing prior written notice of his participation in such sales to his member firm. **(NASD Case #C07000021)**

**Paul Patrick McGlynn (CRD #2496302, Registered Principal, Middle Village, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that McGlynn failed to respond to NASD requests for information and to

appear for on-the-record interviews. **(NASD Case #C10990151)**

**Leonard Alan Neuhaus (CRD #1871294, Registered Principal, Roslyn Heights, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$6,400 and suspended from association with any NASD member in any supervisory capacity for 10 business days. Without admitting or denying the allegations, Neuhaus consented to the described sanctions and to the entry of findings that a member firm, acting through Neuhaus, caused the sale of units of a public offering to a general securities representative who, at the time of the sale, was a prohibited recipient of the hot issue. The findings also stated that the firm, acting through Neuhaus, failed to prepare, maintain, and enforce adequate written supervisory procedures in connection with the NASD's Free-Riding and Withholding Interpretation. **(NASD Case #C10000034)**

**William James O'Brien (CRD #350577, Registered Representative, Hawthorn Woods, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was barred from association with any NASD member in any capacity and ordered to pay \$60,000, plus interest, in restitution to public customers. The restitution is due and payable prior to any application or request for relief from any statutory disqualification. Without admitting or denying the allegations, O'Brien consented to the described sanctions and to the entry of findings that he sold \$60,000 in promissory notes to public customers, and failed to provide written notice to, or receive written authorization from, his member firm of his participation in the private securities transactions. The

findings also stated that O'Brien misrepresented to the customers that their funds would be used to purchase property which would then be sold and the proceeds of the sale would be used to repay the customers when, in fact, the funds were used for his own benefit. The NASD determined that as a result of this misrepresentation, O'Brien received checks totaling \$60,000 payable to him, negotiated and cashed the checks, and used the funds for purposes other than the customers' benefit. O'Brien also filed a Form U-4 with the NASD that failed to disclose a bankruptcy petition filed in Illinois. **(NASD Case #C8A000016)**

**Valerie Remon Patterson (CRD #2350853, Registered Principal, Lanham, Maryland)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Patterson consented to the described sanction and to the entry of findings that she received \$1,194 from individuals recruited to represent affiliates of her member firm and deposited the funds in her personal bank account instead of remitting them as required. **(NASD Case #C9A000011)**

**Donna Lorine Post (CRD #1271324, Registered Representative, Mentone, California)** was barred from association with any NASD member in any capacity and ordered to reimburse her former member firm \$165,182.73, plus interest, for restitution paid by the firm to her customers. The sanctions were based on findings that Post received approximately \$203,000 from public customers for the purpose of purchasing various investments, failed and neglected to execute the purchase of the

requested investments on the customers' behalf, and instead misappropriated these funds to her own use and benefit, without the customers' knowledge or consent. **(NASD Case #C02990026)**

**John Joseph Puglisi (CRD #1537482, Registered Representative, New York, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Puglisi failed to respond to NASD requests for information. **(NASD Case #C10990069)**

**Renato Gonzales Quiazon (CRD #2139458, Registered Representative, Union City, California)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Quiazon failed to respond to NASD requests for information. **(NASD Case #C01990018)**

**Nelson E. Ramosdiaz, Sr. (CRD #2359612, Registered Representative, Aguas Buenas, Puerto Rico)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Ramosdiaz failed to respond to NASD requests for information. **(NASD Case #C07990054)**

**Ricky Cecil Reed (CRD #1092905, Registered Representative, Watertown, 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 15 months. Without admitting or denying the allegations, Reed consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or written approval

from, his member firm. Reed received \$19,378.43 in commissions as a result of the transactions.

Reed's suspension began with the opening of business on April 24, 2000, and will conclude at the close of business on July 23, 2001. **(NASD Case #C11000004)**

**Merlin Blaine Riley, III (CRD #1318026, Registered Principal, Dana Point, California)** submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for one year. Without admitting or denying the allegations, Riley consented to the described sanction and to the entry of findings that he executed transactions in various securities in the accounts of public customers without their authorization and executed purchase and sale transactions for the account of a public customer pursuant to oral discretionary authority but without the requisite written authority from the customer nor the permission of his member firm. **(NASD Case #C02990050)**

**Paul Anthony Romero (CRD #2817671, Registered Representative, Littleton, Colorado)** was barred from association with any NASD member in any capacity and ordered to reimburse his member firm \$4,694.48, plus interest, for restitution the firm paid to a public customer. The sanctions were based on findings that Romero recommended that the customer purchase a life insurance policy. The customer completed the application and paid the initial premium of \$4,600 to purchase the policy. The findings further stated that the customer decided not to complete the purchase of the policy whereupon the firm canceled the application and issued the

customer a \$4,600 refund check. Romero intercepted the check, forged the customer's signature, endorsed the check over to himself, and converted the \$4,600 to his own use. **(NASD Case #C3A990058)**

**Bernard San Juan Rondez (CRD #2791324, Registered Representative, Marina, California)** was barred from association with any NASD member in any capacity. The NAC imposed the sanctions following appeal of an Office of Hearing Officers decision. The sanction was based on findings that Rondez failed to respond to NASD requests for information. **(NASD Case #C01990002)**

**Don Anthony Rouzan (CRD #2933209, Registered Principal, New Orleans, Louisiana)** submitted an Offer of Settlement pursuant to which he was suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Rouzan consented to the described sanction and to the entry of findings that he induced the sale of and effected transactions in securities by means of manipulative, deceptive, or other fraudulent devices or contrivances. Rouzan delivered an investment contract to a purchaser that contained fraudulent information regarding the uses to be made of invested funds and the risks of the investments. The findings also stated that Rouzan engaged in private securities transactions without prior written notice to, and approval from, his member firm. **(NASD Case #C05000006)**

**Brian Michael Rowland (CRD #1558510, Registered Representative, Bartlett, Illinois) and Nelida Vazquez-Rowland (CRD #1410094, Registered**

**Principal, Bartlett, Illinois)** submitted an Offer of Settlement pursuant to which Rowland was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine shall be due and payable either prior to reassociation with a member firm following the two year suspension or prior to any application or request from relief from any statutory disqualification. Vazquez-Rowland was barred from association with any NASD member firm. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they engaged in private securities transactions and failed and neglected to give written notice to, or receive written approval from, their member firm prior to engaging in such activities. **(NASD Case #C8A990065)**

**Philip Rubinovich (CRD #2615385, Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was suspended from association with any NASD member in any capacity for 90 business days and required to requalify in all capacities. Without admitting or denying the allegations, Rubinovich consented to the described sanctions and to the entry of findings that he sold a private placement to a public customer and failed to disclose this activity to his member firm. Rubinovich received \$5,000 in compensation for the sale of the private placement. **(NASD Case #C10000041)**

**Edward Thomas Rush (CRD #812872, Registered Representative, Hampton Bays, New York)** was fined \$48,096.89, suspended from association with any NASD member in any capacity

for 50 days, and barred from association with any NASD member in any capacity. The fine shall be due and payable prior to re-entry in the securities industry. The sanctions were based on findings that Rush made unsuitable recommendations to public customers in regard to short term trading in mutual funds and did so to reap commissions. The findings also stated that Rush exercised discretion in the accounts of public customers without written authorization from the customers and prior written acceptance of the accounts as discretionary from his member firm. In addition, Rush failed to respond to NASD requests for information. **(NASD Case #C05990043)**

**Thomas Edward Smith (CRD #2225515, Registered Representative, Bay City, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was fined \$25,000 and barred from association with any NASD member in any capacity. Payment of the fine shall be a prerequisite for consideration of any application for association with a member firm. Without admitting or denying the allegations, Smith consented to the described sanctions and to the entry of findings that he participated in private securities transactions and failed to provide written notice to, or receive written authorization from, his member firm of his participation in such transactions. The findings also stated that Smith executed transactions involving equity securities for the accounts of public customers when he was not properly qualified and registered in an appropriate capacity. **(NASD Case #C8A000017)**

**Louis Joseph Sorrentino (CRD #2192207, Registered Representative, Marlboro, New**

**Jersey)** submitted an Offer of Settlement pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sorrentino consented to the described sanction and to the entry of findings that he failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C10000010)**

**Eddy Ralph St. Louis (CRD #2358608, Registered Principal, Brooklyn, New York)** was barred from association with any NASD member in any capacity and ordered to pay \$1,300, plus interest, in restitution to a public customer. The sanctions were based on findings that St. Louis received \$2,000 from a public customer for investment in a company he controlled and, instead, converted the money to his own use and benefit without authorization from the customer. **(NASD Case #C10990196)**

**Cartha Lawrence Stroud, Jr. (CRD #1939827, Registered Representative, Arlington, Texas)** submitted a Letter of Acceptance, Waiver, and Consent pursuant to which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Stroud consented to the described sanction and to the entry of findings that he converted two laptop computers from his member firm. **(NASD Case #C06000009)**

**Blaine Stanley Tarnecki (CRD #1042264, Registered Representative, Port Charlotte, Florida)** was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 days for participation in an outside business activity, and fined

\$10,000 and suspended from association with any NASD member in any capacity for six months for failure to respond. The fines shall be payable prior to Tarnecki's reentry into the securities industry. The sanctions were based on findings that Tarnecki participated in an outside business activity without providing prior notice to his firm, and failed to respond in a timely manner to NASD requests for information. **(NASD Case #C07990050)**

**Michael John Tindall (CRD #2630450, Registered Representative, Novi, Michigan)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine shall not be due and payable until Tindall seeks to re-enter the securities industry. The sanctions were based on findings that Tindall forged public customers' signatures on various forms he submitted in connection with their applications for variable appreciable life insurance policies, without their knowledge or consent. **(NASD Case #C8A990061)**

**Roberto Gonzalez Villasenor, Jr. (CRD # 1031313, Registered Representative, New York, New York)** submitted an Offer of Settlement pursuant to which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine shall be due and payable prior to reassociation with a member firm following the suspension or prior to any application requesting relief from a statutory disqualification. Without admitting or denying the allegations, Villasenor consented to the described sanctions and to the entry of findings that he failed to provide his member firm with written or oral notice of his participation in outside business

activities. **(NASD Case #C10000005)**

**Andrew Neal Weber (CRD #2364164, Registered Representative, Rockville Centre, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Weber failed to respond to NASD requests for information. **(NASD Case #C10990166)**

**Horner Steven Williams (CRD #1884779, Registered Representative, Red Bank, New Jersey)** was fined \$25,000 and suspended from association with any NASD member in any capacity for two years. The fine is due and payable when Williams seeks to re-enter the securities industry. The sanctions were based on findings that Williams failed to respond timely and completely to NASD requests for information. **(NASD Case #C9B990033)**

**Andrew Richard Zimmer (CRD #1493072, Registered Representative, Stamford, Connecticut)** was barred from association with any NASD member in any capacity and ordered to pay \$10,000, plus interest, in restitution to a member firm. The sanctions were based on findings that Zimmer engaged in outside business activities without providing prompt written notification to his member firm. The findings also stated that Zimmer fraudulently induced a public customer to send him \$10,000 as an advance against fee, withheld repayment of the advance, and converted the funds to his own use and benefit. In addition, Zimmer failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C10990191)**

## Decisions Issued

The following decisions have been issued by the District Business Conduct Committee or the Office of Hearing Officers and have been appealed to or called for review by the NAC as of April 14, 2000. The findings and sanctions imposed in the decision may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notices to Members*.

**Averell Golub (CRD #2083375, Registered Representative, Brooklyn, New York)** was fined \$50,175 and suspended from association with any NASD member in any capacity for one year. The fine is due and payable upon Golub's re-entry into the securities industry. The sanctions were based on findings that Golub made material misrepresentations and omitted material facts to solicit public customers to purchase a security.

Golub has appealed this case to the NAC and it has been called for review by the NAC. The sanctions are not in effect pending consideration of the review. **(NASD Case #C10990024)**

**Robert Tretiak (CRD #1416058, Registered Principal, Las Vegas, Nevada)** was fined \$10,000, suspended from association with any NASD member in any capacity for two years, and barred from association with any NASD member in any principal capacity for disseminating a false and misleading prospectus. In addition, Tretiak was fined \$15,000 and suspended from association with any NASD member in any capacity for six months for failing to require return of investor funds, and for causing his member firm to enter into an improper escrow

agreement. The sanctions were based on findings that Tretiak participated in an initial public offering of securities on a contingency basis to raise funds to acquire a parcel of land and provided a prospectus to public investors that was materially false and misleading in that it contained out of date and erroneous information and failed to disclose significant changes in the IPO's financial circumstances. The findings also stated that Tretiak failed to return investor funds when terms of the contingency were not met and failed to transmit investor funds promptly to a properly established escrow account.

Tretiak has appealed this action to the NAC and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C02990042)**

**Robert Tretiak (CRD #1416058, Registered Principal, Las Vegas, Nevada)** was fined \$10,000, and suspended from association with any NASD member in any capacity until the arbitration award is satisfied (by payment or fully paid settlement), plus 30 additional business days. The NASD further ordered that the fine be increased by \$100 per day if the arbitration award is not satisfied within 30 days of the date this decision became final, until such time as the award is satisfied. The sanctions were based on findings that Tretiak failed to pay a \$52,360 arbitration award.

Tretiak has appealed this action to the NAC and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C02980085)**

## Complaints Filed

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

**Frank Anthony Cardia, Jr. (CRD #2808582, Registered Representative, Bogota, New Jersey)** was named as a respondent in an NASD complaint alleging that he and another individual caused their member firm to fail to maintain accurate books and records, and the individual permitted Cardia to use his account executive number to enter transactions in a customer's account when the transactions were solicited by and executed at the direction of Cardia. The complaint also alleges that in soliciting the purchase of shares in an initial public offering, Cardia recklessly informed the customer he would have to commit to buying shares in the aftermarket, and failed to execute a customer's sell limit offer. Furthermore, the complaint alleges that Cardia failed to respond truthfully to an NASD request for information and provided false and/or misleading testimony during an NASD on-the-record interview. **(NASD Case #C9B000007)**

**Paul Edward Carney (CRD #1943974, Registered Representative, Vernon Hills, Illinois)** was named as a respondent in an NASD complaint alleging that he concealed losses in

a public customer's accounts by preparing and delivering false statements concerning the accounts and engaged in transactions in the customer's account without the customer's knowledge or consent and in the absence of written or oral authorization to exercise discretion in the account. The complaint also alleges that Carney refused to answer questions by the NASD staff during an on-the-record interview. **(NASD Case #C8A000024)**

**Scott Mark Crane (CRD #1530938, Registered Principal, Boca Raton, Florida)** and **Robert Ian Siegel (CRD #1627931, Registered Representative, Boca Raton, Florida)** were named as respondents in an NASD complaint alleging that they executed unauthorized transactions in the accounts of a public customer. **(NASD Case #C07000023)**

**William Michael Cutrone (CRD #2542314, Registered Representative, Woodbury, New York)** was named as a respondent in an NASD complaint alleging that he misled public customers into investing in securities through misleading statements and omissions by making price predictions about speculative securities without an adequate, accurate, or reasonable basis in fact, omitted negative information about a security being recommended, and failed to make any disclosure about risk in purchasing the security. The complaint also alleges that Cutrone executed unauthorized trades in the accounts of public customers, prevented customers from selling stocks, or failed to disclose that he would refuse or discourage the sale of stocks. The complaint also alleges that Cutrone induced the purchase or sale of securities by means of manipulative, deceptive, and other fraudulent

devices and contrivances. The complaint further alleges that Cutrone failed to respond to NASD requests for information and documents. **(NASD Case #CAF000009)**

**Amir Leif Ecker (CRD #1253824, Registered Representative, Media, Pennsylvania)** was named as a respondent in an NASD complaint alleging that he excessively traded in the account of a public customer and purchased an unsuitable concentration of speculative securities in the account. The complaint also alleges that Ecker exercised discretion in the customer's account without prior written authorization from the customer and prior written acceptance of the account as discretionary by his member firm. **(NASD Case #C9A000007)**

**Andrew James Finnegan (CRD #1398403, Registered Representative, Philadelphia, Pennsylvania)** was named as a respondent in an NASD complaint alleging that he received \$5,625 from public customers to purchase stock in a company, failed to execute the purchases, and, instead, converted the funds to his own use and benefit without the customers' knowledge or consent. The complaint also alleges that Finnegan failed to respond to NASD requests for information and documentation. **(NASD Case #C9A000015)**

**George Michael Goritz (CRD #226024, Registered Representative, New York, New York)** was named as a respondent in an NASD complaint alleging that he engaged in private securities transactions without prior written notice to, or written approval from, his member firm. The complaint also alleges that Goritz distributed an offering memoranda in connection with the sale of limited

partnership interests that contained a material misstatement in regard to Goritz's investment banking experience. **(NASD Case #C10000037)**

**Christopher Lee Miano (CRD #2847056, Registered Representative, Deerfield Beach, Florida)** was named as a respondent in an NASD complaint alleging that he effected, or caused to be effected, unauthorized transactions in the accounts of public customers and misrepresented to a customer that he had purchased and sold shares and warrants. The complaint also alleges that Miano altered or created trade confirmations to reflect the false transactions. In addition, the complaint also alleges that Miano failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C07000025)**

**Adnan Ali Mirza (CRD #2953565, Registered Representative, Lomita, California)** was named as a respondent in an NASD complaint alleging that he acted in a principal capacity of a member firm when he was never registered with the NASD to act in any such capacity. The complaint also alleges that Mirza received funds totaling \$226,262 from public customers for investment purposes and used the funds for some purpose other than the benefit of the customers. The complaint further alleges that Mirza failed to respond to NASD requests for information. **(NASD Case #C02000009)**

**Quentin Thomas Quintana (CRD #2317118, Registered Representative, Brooklyn, New York)** was named as a respondent in an NASD complaint alleging that he executed the purchase of shares or warrants in the joint accounts of public customers without their prior

knowledge, authorization, and consent. The complaint also alleges that Quintana failed to execute a customer's order to sell shares of stock and sent the customer a false or misleading confirmation letter advising him that the shares had been sold. **(NASD Case #C10000046)**

**Michael Anthony Scaramellino (CRD #2497751, Registered Representative, Boca Raton, Florida)** was named as a respondent in an NASD complaint alleging that he made intentional or reckless material misrepresentations to public customers to induce them to purchase shares of stock and effected an unauthorized purchase of stock in the account of a public customer. **(NASD Case #C07000024)**

**Michael Robert Schiller (CRD #1531515, Registered Representative, New York, New York)** was named as a respondent in an NASD complaint alleging that he received an \$8,109.34 check to purchase a variable annuity for public customers, failed to execute the purchase, and, instead, converted the funds to his own use and purpose without the customers' knowledge or consent. **(NASD Case #C10000039)**

**Simon Piers Thurlow (CRD #2697252, Registered Representative, Scarsdale, New York)** was named as a respondent in an NASD complaint alleging that he guaranteed a public customer against loss with the sale of shares of stock. The complaint also alleges that Thurlow failed to provide written notice to, or receive written approval from, his member firm prior to engaging in a private securities transaction and failed to provide prompt written notice of outside business activities to his

firm. In addition, Thurlow impeded an NASD investigation by guaranteeing a customer against loss prior to the customer submitting a signed affidavit in regard to Thurlow's activities. **(NASD Case #C1000045)**

**Joseph Stanley Williams (CRD #1455909, Registered Representative, College Park, Georgia)** was named as a respondent in an NASD complaint alleging that he made misrepresentations and omissions to public customers concerning the future price, nature, and financial condition of a speculative company and its common stock, and made unsuitable recommendations to the customers to use margin for the purchase of the stock. The complaint also alleges that Williams failed to respond to NASD requests for information. **(NASD Case #C07990032)**

### **Firms Suspended**

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of NASD Rule 8210 and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

**BSR Securities, Inc.**, Boca Raton, Florida (April 12, 2000)

**Canterbury Securities Corporation**, Chicago, Illinois (April 12, 2000)

**Chadbourn Securities, Inc.**, Jacksonville, Florida (April 12, 2000)

**Continuum Capital Inc.**, New York, New York (April 12, 2000)

**Kensington, Bentley & Barnes, Inc.**, Dallas, Texas (April 17, 2000)

**Pegasus Capital Investments LC**, Greensboro, North Carolina (April 12, 2000)

**Sterling Capital Group Limited**, Westport, Connecticut (April 17, 2000)

**Whitestone Capital Markets, L.P.**, New York, New York (April 12, 2000)

### **Firms Canceled**

The following firms were canceled from membership in the NASD for failure to comply with formal written requests to submit financial information to the NASD. The actions were based on the provisions of NASD Rule 8210 and Article VII, Section 2 of the NASD By-Laws. The date the cancellation commenced is listed after the entry.

**Murphy & Lopes & Co., Inc.**, New Bedford, Massachusetts (April 7, 2000)

**MZB Select Management, L.L.C.**, New York, New York (April 7, 2000)

**RBG Investments, Inc.**, Chicago, Illinois (April 7, 2000)

**TAP Capital, Inc.**, Plano, Texas (April 7, 2000)

### **Suspension Lifted**

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

**Bright Cove Securities, Inc.**, Virginia Beach, Virginia (March 24, 2000)

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

**Balbirer, Mark S.**, Sunrise, Florida  
(March 31, 2000)

**Biondo, Anthony V.**, Valley Stream, New York  
(March 31, 2000)

**DeForrest, Jeffrey M.**, Medway, Massachusetts (March 31, 2000)

**Gunn, James R.**, Ada, Michigan  
(March 31, 2000)

**Higgins, Bryan**, Long Island City, New York (March 31, 2000)

**Stricklin, Kevin H.**, Warwick, Rhode Island (March 31, 2000)

### **Seven Brokerage Firms Settle NASD Regulation Charges Of Yield Burning**

NASD Regulation announced that it has censured seven brokerage firms for engaging in the practice of yield burning. Additionally, NASD Regulation ordered them to pay a total of \$21.4 million to the U.S. Treasury, under an agreement with the Internal Revenue Service and the United States Attorney for the Southern District of New York, and to pay disgorgement directly to 38 municipal issuers. In settling the charges, the seven firms named in these actions, A.G. Edwards & Sons, Inc.; CS First Boston Corporation; J.C. Bradford & Co.; U.S. Bancorp Piper Jaffray, Inc.; Raymond James & Associates, Inc.; Southwest Securities, Inc.; and Wheat, First Securities, Inc., neither

admitted nor denied NASD Regulation's findings.

NASD Regulation found that each firm had violated the NASD rule governing just and equitable principals of trade that requires members to observe high standards of commercial honor, as well as federal securities laws, by selling U.S. Treasury securities to municipalities at prices not reasonably related to the current wholesale market prices for those securities. NASD Regulation found that the excessive markups jeopardized the tax-exempt status of those municipalities' refunding bonds and diverted money from the U.S. Treasury to the firms in certain transactions and reduced the savings available to the municipalities from the refundings in other transactions.

In a falling interest rate environment, state and local governments often seek to reduce their borrowing costs by paying off outstanding bonds through the issuance of new bonds at lower interest rates. When the old bonds cannot be paid off until a future call date, the municipality can still take advantage of lower interest rates through an "advance refunding." In an advance refunding, the proceeds of the bond issuance are invested in U.S. Treasury securities, which are placed in an escrow account to pay the principal and interest obligations on the old bonds. Brokerage firms sell U.S. Treasury securities to municipalities for these escrow accounts. To prevent abuse of the benefit the federal government gives municipal issuers by not taxing interest on their bonds, federal law limits the yield an issuer can earn on Treasury securities bought for advance refundings. The practice known as "yield burning" occurs when a brokerage firm charges

excessive markups on the sale of U.S. Treasury securities to municipalities for refundings to reduce the yield on those securities so they do not violate the yield restrictions. If yield burning occurs, holders of the new refunding bonds can be required to pay federal income tax on the bond interest they receive.

The cases are the result of extensive NASD Regulation examinations conducted over a three-year period coordinated with the Securities and Exchange Commission, which announced similar settlements with an additional 10 firms. The examinations were conducted by NASD Regulation Offices in New Orleans, Dallas, and New York, and with the Department of Enforcement. The disciplinary actions were filed by the District Office in New Orleans.

Each firm was censured and ordered to make payments to the U.S. Treasury, under an agreement with the Internal Revenue Service and the United States Attorney for the Southern District of New York, and to pay disgorgement directly to 38 municipal issuers, if required as a part of the settlement.

### **NASD Regulation Charges Millennium Securities and Execs with Fraudulent Trading Activity Following IPO**

NASD Regulation announced that it has filed a complaint charging Millennium Securities Corporation, New York, New York, its Chief Executive Officer, Richard A. Sitomer; and its President, Todd M. Rome with the unlawful distribution and fraudulent after-market trading of an initial public offering (IPO) of common stock and warrants in December of 1996. NASD

Regulation alleges that the firm and individuals made over \$5 million in illegal profits as a result of their violations of the federal securities laws and NASD rules.

As co-underwriter of the IPO, Millennium sold about 52 percent of its allocation of Translation Group, Ltd.'s common stock and about 80 percent of its allocation of warrants to a select group of Sitomer's and Rome's retail customers. Within 90 seconds of the commencement of aftermarket trading, the complaint alleges that Sitomer and Rome repurchased all of the IPO common stock and warrants that had been sold to these customers. As a result of these repurchases, Millennium amassed a substantial inventory position of shares and warrants – nearly all the trading activity of Translation Group securities at that time. Thereafter, the firm actively participated in increasing the quotes in the common stock and warrants, sharply driving up their price.

NASD Regulation's complaint states that within 13 minutes of repurchasing the stock and warrants, Millennium began selling them to retail investors at a significantly higher price. To encourage the sale of these securities, the complaint also alleges that Millennium paid the sales force greater than average compensation. The NASD

investigation found that Millennium made a profit of approximately \$5 million from this activity, 40 percent more than the total net proceeds of the IPO.

The complaint also asserts that Millennium, Sitomer and Rome, committed fraud by failing to disclose material facts to customers relating to the sale of Translation securities in the immediate aftermarket. Sitomer and Rome did not tell customers the source and amount of the securities being distributed; or that new buyers would pay significantly more than what Millennium had paid to re-acquire the same securities. Customers also were not told that the sales force received higher than normal compensation.

Translation Group Ltd. was not charged in the complaint, and there are no allegations that it engaged in any wrongdoing.

The issuance of a disciplinary complaint represents the initiation of a formal proceeding by the NASD in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, the respondents should be contacted before drawing any conclusion regarding the allegations in the complaint.

## **NASD Regulation Censures And Fines E\*TRADE Securities**

NASD Regulation announced that it has censured and fined E\*TRADE Securities, Inc., of Menlo Park, CA, \$20,000 for failing to promptly respond to NASD Regulation requests for information relating to customer complaints.

In a three-month period, from April 1999 to June 1999, NASD Regulation made 17 separate requests for information relating to customer complaints that it had received about the firm, and in each instance E\*TRADE failed to provide further information or respond in a timely fashion.

One result of E\*TRADE's tremendous account growth, 550 percent from third quarter 1997 to third quarter 1999, according to the firm, has been the challenge of handling the needs and requests of such a large number of customers.

"Prompt response to regulators' inquiries about customer complaints has to be front and center for all firms," said Barry R. Goldsmith, Executive Vice President of Enforcement at NASD Regulation. "Brokerage firms need to devote the resources that are necessary to handle all aspects of their securities business."

In settling this matter, E\*TRADE neither admitted nor denied NASD Regulation's allegations.

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