NASD Regulatory & Compliance

ALERT

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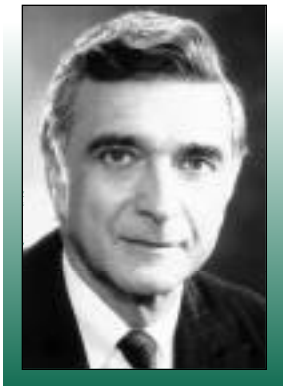

Frank G. Zarb Named NASD CEO

On January 28, 1997, the Board of Governors of the National Association of Securities Dealers, Inc. (NASD®) elected Frank G. Zarb as the organization's new President and Chief Executive Officer. He assumed his new duties on February 24, 1997.

Mr. Zarb succeeds Joseph R. Hardiman who retired January 31, 1997, after nearly 10 years of service to the NASD as its President and Chief Executive Officer.

Mr. Zarb joined the NASD from Alexander & Alexander Services Inc., where he was Chairman, President, and Chief Executive Officer. The firm was recently acquired by Aon Corporation, an insurance services holding company.

Mr. Zarb was chosen by a Search Committee chaired by Daniel P. Tully, NASD Chairman and Chairman and Chief Executive Officer of Merrill Lynch & Co., Inc. "The NASD Board of Governors believes that with his proven leadership abilities and vast experience in both the private and public sectors, Frank is the ideal person to lead the NASD in its next phase of growth and development," said Mr. Tully. "Frank is a person of great character and vision who is committed to making our securi-

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NASD Increases Availability Of Disciplinary Complaints And Decisions

With recent approval by the Securities and Exchange Commission (SEC), the NASD amended the Interpretation on the Release of Disciplinary Information (Rule), IM-8310-2, to provide complete copies of disciplinary complaints and decisions upon request, provided appropriate disclosures accompany the information.

All released complaints will note that the issuance of a complaint does not represent a decision as to any of the allegations contained in the complaint. Similarly, all disciplinary decisions that are released prior to the expiration of the time period during which they can be called for review by the NASD or appealed within the NASD or to the SEC will disclose that the findings and/or sanctions may be increased, decreased, modified, or reversed before the decision is final.

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ties markets the fairest and most efficient in the world, with the highest standards of self-regulation, for the benefit of all who participate in them."

The CEO post is the senior leadership position for the NASD and has ultimate responsibility for all facets of the organization, including the self-regulatory responsibilities vested in it under the 1934 Securities Exchange Act and the market operations it conducts under the umbrella of The Nasdaq Stock Market℠. As the NASD's top executive, the CEO, together with the Board of Governors, is responsible for setting the overall strategic direction and policy agendas of the total enterprise. In addition, the CEO is also the principal representative of the organization to all its constituents and as such serves as its chief spokesperson.

"I am truly looking forward to the challenges and opportunities for the NASD as we move forward," said Mr. Zarb. "This organization is a leader in the world marketplace and is now poised to meet the new demands of the 21st century."

"Frank Zarb is an excellent choice to succeed me," said Mr. Hardiman. "His knowledge of and commitment to fair and efficient markets and to effective self-regulation for the broker/dealer industry, coupled with his experience in running major financial services firms, make him the right choice to run this vital institution at this time."

Prior to joining Alexander & Alexander Services Inc., in 1994, Mr. Zarb was Vice Chairman, Group Chief Executive of The Travelers Inc. Previously, from 1988 to 1993, he was Chairman, President, and Chief Executive Officer of Smith Barney and from 1977 to 1988 he was a General Partner of Lazard Freres & Co.

In 1974, Mr. Zarb was appointed by President Ford as Administrator of the Federal Energy Administration (the Energy Czar), a post he held until 1977 when he returned to the private sector. He also served as the Executive Director of the cabinet level Energy Resources Council and as the Associate Director of the Office of Management and Budget and Assistant Secretary of the Department of Labor.

Prior to his years of government service, Mr. Zarb held a variety of senior executive posts with a number of large, New York-based securities firms including CBWL Hayden Stone and Goodbody & Company. ❐

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Also, the amendments change existing rule language that appears to prevent releasing information that must be reported on Form BD or Form U-4, if these forms are not submitted. The Rule now specifies that this information will be released, regardless of whether it was reported to the NASD on these forms.

These changes significantly increase the availability of disciplinary information to the general public. While the NASD has maintained a policy of providing complete copies of disciplinary decisions upon request since 1994, this was not the practice for complaints.

Questions concerning this policy may be directed to Suzanne E. Rothwell, Associate General Counsel, NASD Regulation, Inc., at (202) 728-8247. ❒

Regulation

NASD Regulation Invites Public Comment On Rule Proposals

In November 1996, NASD Regulation, Inc. (NASD Regulation[SM]) announced immediate plans to boost the voice of investors in its rulemaking process. In addition to its current practice of notifying NASD members of pending rule proposals, NASD Regulation now posts a public notice on its World Wide Web site (www.nasdr.com), seeking comments from key investor, consumer, and seniors' organizations. NASD Regulation also will hold periodic forums for individual investors to present their views.

"We are here to serve investors, so it's logical that we want to hear from them about our proposed rules," said NASD Regulation President Mary Schapiro. "We will seek comment on current proposals, and then use public forums to gauge the views of investors about issues that may be addressed in future rulemaking. Our goal is to bring about a more open rulemaking process that incorporates the input of an array of constituencies, investors foremost among them."

The investor forums, according to Schapiro, will not be pegged to any existing NASD Regulation rule proposals. Instead, the public comment sessions will focus on topics either known to be of interest to investors or the subject of possible future NASD Regulation rulemaking.

"We want to hear directly from investors and we don't want to go through a cumbersome, bureaucratic process to do it," Schapiro said. "I look at this as a real opportunity to begin a dialogue with investors about topics that may not yet be part of the formal rulemaking process. By listening to the public's views at an early stage, NASD Regulation will be able to do its business in a way that is more sensitive and responsive to the public's concerns."

In the past, NASD proposals were only subject to public input during the notice and comment period after publication by the SEC, a step required by federal statute. In practical terms, public comment occurred rarely, and only after the NASD had filed a formal proposal with the SEC.

The new approach will involve public notice at a much earlier stage, at the same time that the proposal and its objectives are explained to NASD members. At that point, NASD Regulation will issue a news release, post the proposal on its Web site, and solicit comment from the general public.

"The federal laws put in place in 1934 did not contemplate much in the way of feedback from individual investors about pending proposals," said Michael Jones, Vice President, NASD Individual Investor Services. "Even though it is not legally required to do so, NASD Regulation will voluntarily make proposals known to the public at an earlier stage than is now the case. The hope is that this will result in rulemaking that does the best possible job of reflecting the priorities of investors and those representing them."

NASD Regulation maintains a site on the World Wide Web at http://www.nasdr.com that can be accessed free of charge by anyone. Investor, consumer, and seniors' groups interested in being part of the rulemaking input process should speak directly with NASD Individual Investor Services Vice President Michael Jones at (202) 728-6964.

An announcement about the date and location for the first NASD Regulation Investor Forum is expected during the first few months of 1997. ❒

Tougher NASD Telemarketing Rules Take Effect

On December 11, 1996, the SEC approved an NASD proposal that toughens its telemarketing rules and provides more protection to the general public. Prior to these changes, NASD Regulation's ability to take action against members that use deceptive or abusive telemarketing practices was limited. Although Federal Communications Commission (FCC) and Federal Trade Commission (FTC) regulations governing residential telephone solicitations apply to broker/dealers that market their products and services in this manner, NASD Regulation lacked direct authority to enforce those rules.

As a first step in protecting customers from abusive practices, the NASD adopted a cold-call requirement under Rule 3100 in June 1995. Rule 3100(g) requires members to maintain a centralized "do-not-call" list of individuals who do not wish to receive telephone solicitations from firms or their associated persons. In July 1996, the NASD published *Notice to Members 96-44* reminding members that abusive telemarketing conduct will result in disciplinary action under Rule 2110, the NASD's fundamental rule of ethical practice. Rule 2110 requires members to observe high standards of commercial honor and just and equitable principles of trade.

In its *Notice*, the NASD also issued a formal interpretation of the Rule specifically stating that members and their associated persons "shall not engage in communications with customers that constitute threats, intimidation, the use of profane or obscene language, or calling a person repeatedly on the telephone to annoy, abuse, or harass the called party."

At the same time, the NASD determined to amend its rules to provide additional protection to customers. Newly approved Rule 2211 imposes time-of-day restrictions on outbound telephone calls and requires prompt disclosures about the caller. In addition, amendments to Rule 3110 require written authorization from the customer to use demand drafts to pay for securities transactions.

Time-Of-Day Restrictions

Rule 2211(a) prohibits outbound calls soliciting the purchase of securities or related services to residences at any time other than between 8 a.m. and 9 p.m. local time at the called person's location, without prior consent. Certain calls to existing customers are exempt.

Disclosure Requirements

Rule 2211(b) requires callers to disclose promptly and in a clear and conspicuous manner the following information:

- the identity of the caller and the member firm,
- the telephone number or address at which the caller may be contacted,
- that the purpose of the call is to solicit the purchase of securities or related services.

Exemptions

Rule 2211(c) exempts calls to certain existing customers from the time-of-day and disclosure requirements. Generally these are customers for whom the member carries an account. However, the Rule provides the exemption only if, within the preceding 12 months, the customer has effected a securities transaction in, or made a deposit to, an account assigned to the caller; or if, at any time in the past, the customer has transacted business in an account assigned to the caller and the account has earned interest or dividend income during the preceding 12 months.

Demand Draft Authorization And Recordkeeping

A "demand draft" is a way for broker/dealers (as potential payees) to obtain funds from a customer's bank account without that person's signature on a negotiable instrument. The customer provides the potential payee with bank account identification information that permits the payee to create a piece of paper that will be processed like a check and includes the words "signature on file" or "signature preapproved" where the customer's signature normally would appear. The amendments to Rule 3110(g) require express written authorization from the customer for firms to use demand drafts and that firms maintain this authorization for three years.

Members may refer to *Notice to Members 96-44*, July 1996, for additional details. The proposed changes were published for comment by the SEC in the July 30, 1996, *Federal Register*. Questions concerning these requirements may be directed to your local NASD Regulation District Office. ❐

NASD Creates Two New Exams: Equity Trading And Government Securities

The NASD Board of Governors has approved the creation of two new qualification exams for securities industry personnel. The new exams, one for corporate securities traders and the other for government securities broker/dealers, join the existing battery of tests that NASD Regulation administers to qualify registered representatives and principals to conduct a securities business.

Once the exams are approved by the SEC, every corporate securities trader, those already in the industry as well as those new to the industry, must take the new Series 55 exam, the Equity Trader Exam. The new exam will assure that traders have a more consistent understanding of securities industry rules and practices, especially in light of the rapid regulatory and structural changes in the marketplace.

The Series 55 exam will be given as a supplement to other already required testing. Traders must continue to take the Series 7 exam, which qualifies an individual as a general securities representative, or the Series 62 exam, which qualifies an individual as a limited representative handling only corporate securities and not municipals, options, investment companies (except for money market funds), variable contracts, or direct participation programs. After the SEC approves the Series 55 exam, existing traders will granted a period of two years to pass it.

The proposed new exam for government securities representatives, the Series 72 exam, was developed following Congressional approval of the Government Securities Act Amendments of 1993. Previously, the NASD lacked the authority to require a qualification examination for broker/dealers engaged solely in the solicitation and sale of government securities.

Following SEC approval, any individual, who is either new to the securities industry or who has been in the business for less than two years, and sells government securities must take either the new Series 72 or the existing Series 7 exam prior to selling government securities.

The new exams will upgrade significantly the qualification standards necessary for registered representatives who focus on sales or trading in these areas. According to NASD Regulation President Mary L. Schapiro, "Adding these exams will help educate the thousands of registered representatives and principals who specialize in trading corporate equities and selling government securities at a time when the market for them, and their complexity, is growing."

Both tests, each of which will have about 100 questions, will be available at 150 NASD-approved testing centers across the country. ❐

NASD Regulation Bars Nine Registered Representatives Suspected Of Using An Impostor To Take Qualification Examination

NASD Regulation censured and barred nine individuals suspected of paying an impostor to take a qualification examination on their behalf. Each individual was fined $25,000 for cheating on the examination and fined another $25,000 if they failed to respond to NASD Regulation requests for information. In addition, these individuals were required to disgorge all commissions earned while they functioned in a registered capacity.

The disciplinary action is a continuation of an earlier investigation, which resulted in the barring and fining of 12 registered representatives for similar violations.

"Industry rules require that securities professionals who deal with the public pass certain examinations designed to test their knowledge of the securities markets and regulations. These examinations are an important feature of the investor protection framework. In a business built on trust and confidence, there is no room for any person who would cheat on the exam," said Mary L. Schapiro, President of NASD Regulation.

Continuing Education Council Issues Status Update

The Securities Industry/Regulatory Council (Council) on Continuing Education issued a status report in October 1996, its second update since the inception of the Securities Industry Continuing Education Program (Program) on July 1, 1995. The first status report was issued by the Council in March 1995 (see *NASD Special Notice to Members 95-13*).

The Program is a mandatory two-part program adopted by the securities industry to help brokerage firms and their associated professionals stay current on industry rules and regulations, products, and other market-related subjects.

The Program requires all persons who are registered 10 years or less and those who have been the subject of a serious disciplinary action (regardless of how long they have been registered) to participate in periodic computer-based training sessions (the Regulatory Element) and requires broker/dealers to provide their employees with a formal, ongoing education process (the Firm Element).

The Council, which is comprised of 13 industry and six self-regulatory representatives, coordinates the administration and future development of the Program. According to the status report, more than 100,000 Regulatory Element training sessions were administered from July 1, 1995 through September 30, 1996, mainly in the United States.

The Council also reported that it hosted several focus groups of industry firms for a first-hand update on how firms were complying with the Firm Element. Based on that input, the Firm Element Committee revised the *Guidelines For Firm Element Training* and issued new guidelines with the status report.

Also issued with the status report were a revised question-and-answer section on the Regulatory and Firm Elements and the *Content Outline For The Regulatory Element*, although there were no changes to the Content Outline at that time.

The complete *Status Report On The Securities Industry Continuing Education Program* was published in *Notice to Members 96-69*, in October 1996. Questions concerning the status report may be directed to John Linnehan, Member Regulation, at (301) 208-2932. ❒

NASD Regulation Fines Citicorp Securities

In 1996, NASD Regulation censured and fined Citicorp Securities, Inc. $25,000, and ordered it to disgorge $300,000 for violating NASD Regulation's Continuing Education Requirements.

In an investigation conducted by its New York District Office, NASD Regulation found that for certain periods between November 1995 and May 1996, Citicorp failed to ensure that 19 employees completed the Regulatory Element of NASD Regulation's Continuing Education Requirements within the prescribed time period. As a result of their failure to comply with these requirements, the individuals' registrations were deemed inactive. Nevertheless, these individuals continued to function in capacities which required registration.

"In light of the increased complexity of the demands made upon securities professionals who deal with the public, it is essential that brokers maintain maximum standards of competency and professionalism," NASD Regulation President Mary L. Schapiro said. "This case demonstrates how important it is for the membership to ensure that its registered persons fully comply with the mandates of the Continuing Education Requirements."

The settlement requires Citicorp to disgorge $300,000 to NASD Regulation, the amount it improperly paid the 19 individuals during the periods in which their registrations were inactive.

"NASD Regulation is committed to closely monitoring members' compliance with these essential rules and assisting members in achieving full compliance. We will continue to pursue disciplinary actions against those members, large or small, who fail to comply," Schapiro said.

Compliance Questions & Answers

The Compliance Department frequently receives inquiries from members. To better inform members on matters of common interest, the Compliance Department provides this question-and-answer feature through the *Regulatory & Compliance Alert*.

Q. Are Martin Luther King, Jr. Day, Columbus Day, and Veterans' Day, as observed by the U.S. banking community, considered business days for receiving customer payments under Regulation T (Reg T) of the Federal Reserve Board ?

A. Yes. These holidays are considered business days for receiving payments under Reg T and are counted as business days when determining the "Reg T date" of a trade. However, these holidays are not considered to be settlement dates under Reg T, because many of the nation's banking institutions are closed (even though the securities markets are open for trading). The specific trade dates, settlement dates, and Reg T dates surrounding a specific holiday are published in an NASD *Notice to Members* prior to each approaching holiday.

Q. How may a broker/dealer operating pursuant to the (k)(2)(ii) exemptive provision of SEC Rule 15c3-3 utilize a "deposit account"?

A. A broker/dealer introducing accounts to a clearing firm on a fully disclosed basis will often have the ability to deposit funds directly into a bank account that is under the ultimate control/ownership of the clearing firm. Often these accounts are established under the name "Deposit Account of 'Clearing Member'". Customer funds are deposited directly into the account by the introducing firm and then are accessed by the clearing firm. In addition, the same account may be used by the introducing broker/dealer to issue checks or drafts to customers on the clearing firm's behalf. This account must meet the following conditions: 1) the bank account must be in the name of the clearing firm; and 2) there must be a written contract between the carrying broker/dealer and the introducing firm specifying that the introducing firm is acting as agent for the carrying broker/dealer.

Q. Can a broker/dealer maintain a (k)(2)(i) account at a credit union?

A. No. A Special Account for the Exclusive Benefit of Customers established pursuant to SEC Rule 15c3-3 (k)(2)(i) may be maintained only at a financial institution that meets the definition of a bank pursuant to Section 3(a)(6) of the Securities Exchange Act of 1934. Since a credit union does not meet that definition, it is not an acceptable location for a (k)(2)(i) account.

Q. If the repayment of a matured temporary subordinated loan would cause a firm to have less than 120% of its required minimum net capital, would the firm be required to make such repayment?

A. Pursuant to the language contained in the subordinated loan contract and SEC Rule 15c3-1, Appendix D (b)(8)(i), a temporary subordinated loan is not treated any differently from any other subordinated loan. If repayment of a subordinated loan would cause a firm's net capital to fall below 120% of its required net capital, then the payment obligation of the firm is suspended and the subordinated loan does not mature.

The subordination agreement, however, may include language to the effect that if the payment obligation is suspended for six months, the firm is required to commence a rapid and orderly complete liquidation of its business. If such liquidation is required, the subordinated loan matures on the date on which the liquidation commences. Appendix D (b)(8)(i) should be reviewed for other net capital situations that also cause suspension of the prepayment obligation.

Q. On the scheduled maturity date of an approved subordinated loan, a firm has sufficient net capital to repay the loan, but nevertheless does not repay it. If the firm's net capital then declines so that it is no longer sufficient to permit repayment of an approved subordinated loan (pursuant to SEC Rule 15c3-1, Appendix D (b)(8)), may the firm repay the matured loan?

A. Once an approved subordinated loan matures, it no longer receives favorable treatment under the net capital rule. From the time that the loan matured and was not repaid, it became another (i.e., not subordinated) liability, which the firm may not add back to net worth in computing net capital.

Repayment of the matured loan is not prohibited by Appendix D of SEC Rule 15c3-1. Although Appendix D(b)(8) prohibits an approved subordinated loan from maturing in certain circumstances (for example, the loan will not mature on the scheduled maturity date if repaying the loan would leave the firm with less than 120% of its required minimum net capital), in the situation described above, the firm had sufficient capital on the scheduled date of maturity, and the loan did mature.

Q. What are the net capital implications for a firm that has a broker/dealer receivable on its balance sheet related to syndicate activity?

A. Concessions receivable are non-allowable assets unless there is a related offsetting payable that meets the conditions set forth in *Notices to Members 84-48* and *85-5* and noted on pages 9 and 10 of the *NASD Guide to Rule Interpretations* (May 1996). Syndicate fees receivable and other receivables

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related to the syndicate also are non-allowable assets (SEC Rule 15c3-1(c)(2)(iv)(E)).

Q. What percentage should be applied in computing the open contractual commitment (OCC) charge for an initial public offering (IPO) of cumulative, nonconvertible preferred stock?

A. Pursuant to SEC Rule 15c3-1(c)(2)(viii), the OCC charge is based on the percentages specified in SEC Rule 15c3-1(c)(2)(vi), with the exception of those securities covered in paragraph J of SEC Rule 15c3-1(c)(2)(vi) that are not listed on a national securities exchange or the Nasdaq National Market, and of option positions subject to SEC Rule 15c3-1, Appendix A.

Therefore, pursuant to paragraph H of SEC Rule 15c3-1(c)(2)(vi), the OCC charge for an IPO of cumulative, nonconvertible preferred stock is 10%, providing the security ranks ahead of all other classes of stock of the same issuer, is rated in one of the four highest categories by at least two nationally recognized statistical rating organizations, and the payment of dividends is not in arrears. If the issue does not meet all of the above conditions, the charge would be 30%, pursuant to subparagraph (c)(2)(viii).

Q. How should a member firm properly compute the haircut on a "risk arbitrage" position?

A. If a member purchases stock in a company that is expected to be acquired and simultaneously sells stock in the company that is expected to do the acquiring, this is described as having a "risk arbitrage" position. A "risk arbitrage" relationship does not receive any special treatment under the net capital rule. The member should haircut each side as a separate position, using the appropriate paragraphs of SEC Rule 15c3-1(c)(2)(vi). ❐

SEC Takes Action To Curb Problems With Regulation S Practices

Regulation S, which was adopted by the SEC in 1990, provides two safe harbors from the registration requirements of the Securities Act of 1933 ('33 Act) for offers or sales of securities that legitimately occur outside the United States (U.S.). One safe harbor is available to the issuers, underwriters, and other market participants involved in the initial distribution process; the other applies to resales by persons not involved in the distribution process.

In an Interpretive Release dated June 27, 1995, the SEC noted a number of troubling practices that have developed since the adoption of Regulation S (see SEC Release No. 33-7190 in the July 10, 1995, *Federal Register*). Specifically, the SEC mentioned instances during the restricted period in which market participants parked securities with offshore affiliates, engaged in short selling and other hedging transactions, and pledged the securities as collateral in margin or other accounts. According to the SEC, these activities indicate that ownership of the securities never left the U.S. market; that a substantial portion of the economic risk remained in, or returned to, the U.S. market; and that the securities were placed offshore only temporarily to evade registration requirements.

After soliciting and reviewing comments on proposed changes, the SEC determined to require that U.S. companies report information about sales made in reliance upon Regulation S on Form 8-K within 15 days of their occurrence.

Effective November 18, 1996, companies must disclose the title and amount of securities sold, the date of the transaction, the name of the underwriter or placement agent, the consideration received, the persons or classes of persons to whom the securities were sold, and the terms of conversion or exercise for convertible or exchangeable securities, warrants, and options.

In a companion action, the SEC sought to reduce companies' reliance on Regulation S offerings by streamlining the process for registered offerings. These changes reduce the instances in which an issuer must include audited financial statements of significant businesses acquired, or likely to be acquired, when filing registration statements.

On February 28, 1997, the SEC proposed additional amendments to Regulation S, also designed to stop abusive practices. The proposals affect offshore sales of equity securities of U.S. issuers and foreign issuers where the principal market for the securities is in the U.S.

The Regulation S proposals would:

- classify these equity securities placed offshore under Regulation S as "restricted securities" within the meaning of Rule 144;

- align the Regulation S restricted period for these equity securities with the Rule 144 holding periods by lengthening from 40 days (currently applicable to reporting issuers) or one year (currently applicable to non-reporting issuers) to two years the period during which persons relying

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Alex. Brown Fined For Regulation S Violations

In the fall of 1996, NASD Regulation fined Alex. Brown & Sons $100,000 and one of the firm's registered representatives $50,000 in the sale of Regulation S securities in six companies by one of the firm's customers.

Without admitting or denying the findings, Alex. Brown and the registered representative, agreed to disgorge a total of $150,000 in commissions for the sales, and both the firm and the representative were also censured. In addition, Alex. Brown was cited for not having adequate supervisory procedures in place.

This sanction marks the first time NASD Regulation has taken disciplinary action in connection with the sale of Regulation S securities. Regulation S describes the circumstances in which an offering of securities is not required to be registered with the SEC because it is deemed to occur outside the U.S. To qualify for this "safe harbor," the securities of the six companies in question could not be sold, directly or indirectly, to any U.S. company or citizen prior to the expiration of a 40-day restricted period after the offshore offering.

"This settlement makes it clear that all NASD member firms are responsible for educating their staffs about the need to prevent abuses associated with Regulation S offerings," said NASD Regulation Chief Operating Officer, Elisse B. Walter. "In order to ensure that every investor is treated fairly, all of our members must establish and follow adequate supervisory procedures."

A lengthy investigation by NASD Regulation's Market Regulation Department found that for almost a year (from July 1993 through April 1994) an Alex. Brown customer purchased shares in six Regulation S offerings and then sold them back into the U.S. markets (through accounts maintained at Alex. Brown) prior to the expiration of the 40-day restricted period.

NASD Regulation determined that 117 sales transactions were executed in the six securities through several offshore accounts maintained at Alex. Brown by the customer. Two of the securities were traded on the Nasdaq National Market, and four of them on the Nasdaq SmallCap Market.

NASD Regulation found that the representative, or his sales assistant, executed the 117 transactions without making an "affirmative determination," or accurately marking order tickets as "long" or "short," as required by NASD Rules. In addition, NASD Regulation found that Alex. Brown failed to establish, maintain, and enforce a supervisory system designed to achieve compliance with the NASD Rules.

As part of its agreement with NASD Regulation, Alex. Brown must put in place the necessary supervisory and educational procedures to prevent similar violations in the future, and the representative must requalify as a general securities representative by taking the Series 7 examination again.

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on the Regulation S safe harbor may not sell these equity securities to U.S. persons (unless pursuant to registration or an exemption);

- impose certification, legending, and other requirements now only applicable to sales of equity securities by non-reporting issuers;
- require purchasers of these securities to agree not to engage in hedging transactions with regard to such securities unless such transactions are in compliance with the '33 Act;
- prohibit the use of promissory notes as payment for these securities; and
- make clear that offshore resales under Rule 901 or 904 of equity securities of these issuers that are "restricted securities," as defined in Rule 144, will not affect the restricted status of those securities.

In addition, the SEC issued three companion releases to help alleviate concerns that the more restrictive Regulation S procedures will cut off access to capital on a cost-effective basis for smaller companies.

Interested members should review SEC Releases No. 33-7355 and 34-37801 in the October 18, 1996, *Federal Register*, and Releases No. 33-7392, 33-7390, 33-7391, and 33-7393 in the February 28, 1997, *Federal Register*, which contain detailed discussions of these changes and proposals.

For questions concerning Regulation S, please call your local SEC office or the SEC Division of Corporation Finance at (202) 942-2800. ❐

NASD Regulation Elects New Board Members

NASD Regulation has announced the election of a new Chairman and Vice Chairman of the Board. The annual election of the new Chairman and Vice Chairman occurred during NASD Regulation's November Board meeting. The NASD Regulation Board also elected a new Chairman and Vice Chairman of the National Business Conduct Committee.

The newly elected individuals took office following NASD Regulation's January 1997 Board meeting.

Todd A. Robinson will be Chairman of the NASD Regulation Board of Directors. Mr. Robinson is currently Chairman and CEO of Linsco/Private Ledger Corp. He became CEO of Linsco Financial Group, Inc., in 1985 and merged it with Linsco/Private Ledger Corp. in 1989. He was Chairman of the NASD Business Conduct Committee for District 11, and a member of the NASD Continuing Education Task Force. He is also a member of the Securities Industry Association's Independent Contractor Firms Committee and Government Relations Committee. He holds a B.A. from Bates College.

Robert R. Glauber will be Vice Chairman of the NASD Regulation Board of Directors. Mr. Glauber is Adjunct Lecturer at the Center for Business and Government of the Kennedy School, Harvard University, which he joined after serving as Under Secretary of the U.S. Treasury for Finance in the Bush Administration from 1989 to 1992. Prior to joining Treasury, Mr. Glauber was a Professor of Finance at the Harvard Business School. In 1987, he served as Executive Director of the Task Force (Brady Commission) appointed by President Reagan to study the October 1987 stock market break. He joined Harvard Business School's Finance Faculty in 1964, specializing in corporate finance and investment banking. During 1975-76 and 1981, he was a member of the faculty at Harvard's International Senior Managers Program in Vevey, Switzerland. He received a B.A. from Harvard College and Doctorate from Harvard Business School.

Richard F. Brueckner will be Chairman of the National Business Conduct Committee. Mr. Brueckner is Managing Director of Donaldson, Lufkin and Jenrette's (DLJ) Financial Services Group and its Pershing Division. He joined DLJ in 1978 and has previously served as Treasurer of DLJ Securities Corporation and Chief Financial Officer of Pershing. Mr. Brueckner has been a member of the Executive Committee at Pershing since 1980 and is currently responsible for Institutional and International Marketing, Corporate Communications, and Pershing's individual brokerage services including its PC Financial Network business. He currently serves as Trustee for the Frontier Trust Company in Fargo, as Trustee and Chairman of the Securities Industry Foundation for Economic Education, and as a Trustee of the SIA New York District Economic Education Foundation. He is also Chairman of the SIA Clearing Firms and Membership Committees and of their New York District. Mr. Brueckner graduated from Muhlenberg College with a B.A. in Economics. He is also a CPA.

Ellyn L. Brown will be Vice Chairman of the National Business Conduct Committee. Ms. Brown practices securities and financial services law in Baltimore, Maryland. She taught securities and business law at the University of Maryland School of Law prior to returning to the private sector in 1994. From 1987 to September 1992, Ms. Brown was the Securities Commissioner for the State of Maryland. She holds an undergraduate degree from Vasser College, a master's degree from The John Hopkins University, and a law degree from the University of Maryland.

Questions concerning this story may be directed to Michael W. Robinson, NASD Media Relations, at (202) 728-8304. ❒

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where you can get practical compliance advice and hear about the latest developments in regulatory matters.

Watch your mail for a conference brochure and registration materials this month!
Also, if you are interested in attending, we encourage you to make hotel reservations early at our special conference rate by contacting the J.W. Marriott Hotel at (800) 228-9290 and mentioning "NASD Conference."

For more details call the NASD at (202) 728-6900.

Customer Complaint Reporting Rule Update

In October 1995, the NASD adopted Rule 3070 to strengthen NASD efforts in conducting intense sales-practice examinations of member firms that employ registered persons who may pose heightened risks to public investors due to past misconduct related to abusive sales and trading practices (profiled registered representatives). The Rule requires members to report the occurrence of 10 specified events and to file quarterly statistical information about written customer complaints.

The information reported by members under Rule 3070 provides important regulatory information that helps identify problem members, branch offices, and registered representatives. This information is integrated with an automated system that draws on the Central Registration Depository (CRD) and other internal regulatory systems to analyze the current registered representative population, giving NASD Regulation the capacity to identify more precisely those individuals who may pose risks to public investors, and thus, should be subject to closer than normal regulatory scrutiny, as well as heightened supervision by their employing firms.

Since adoption of the Rule, NASD Regulation has responded to numerous questions regarding its application to specified circumstances. Reprinted from NASD *Notice to Members 96-85* are select questions. Additional questions may be directed to Daniel M. Sibears, Member Regulation, at (202) 728-6911, or David A. Spotts, Office of General Counsel, at (202) 728-8014.

Questions And Answers

Q. *Under the customer complaint reporting section of the Customer Complaint System User Manual (Chapter Four, Page 29), what date should be provided when the software prompt asks for the date of the complaint letter? Should the member report the receipt date or the date of the written customer complaint letter?*

A. The complaint date is the date the complaint letter is first received by the member. The member should maintain a systematic method (e.g., date stamping) for recording the dates that customer complaints are first received by the member.

Q. *Once a customer complaint quarterly filing or specified event filing is submitted to NASD Regulation within the required time frames, is the member under any obligation to update or amend the earlier filing? For example, the member may subsequently learn through an internal investigation that, in the member's opinion, the earlier submitted customer complaint is without merit.*

A. No. A member should not update or modify an earlier submission to NASD Regulation unless the member learns that there was an error in the information previously submitted. Even if the member learns that the information in a customer complaint is later filed without action, a member is not permitted to delete or modify this earlier customer complaint submission.

Q. *If a member receives a customer complaint letter regarding an associated person's conduct that includes more than one allegation, security, or damage amount, what information is the member required to submit to NASD Regulation?*

A. The member is obligated to send one report for each customer complaint letter received. Even though the complaint may include more than one allegation, security, or damage amount, the member should report the most egregious problem code alleged (e.g., fraud, misrepresentation, unauthorized transaction), the security associated with the most egregious problem code, and the highest alleged damage amount.

Q. *If more than one associated person is named in a customer complaint (i.e., an associated person and a branch manager or two associated persons), what information is the member required to submit to NASD Regulation?*

A. A member is obligated to report a customer complaint filing for each person named in a customer complaint. Thus, if two associated persons are named by the complaint, the member should report two separate customer complaint filings to NASD Regulation.

Q. *If a member receives a customer complaint on October 1, 1995, and receives a second written complaint from the same customer after October 1, 1995, regarding the same matter that includes new allegations regarding the member or an associated person, must the member consider the second letter a new customer complaint under the Rule?*

A. Yes. Both letters would be subject to the Rule and should be submitted to NASD Regulation in the member's quarterly filing. The second letter involves a new grievance by the customer against an associated person or member, and the substance of the new allegations must be reported.

Q. *Are insurance affiliated broker/dealers (IABD), or broker/dealers who also maintain insurance operations in the same corporate entity, required to include in their quarterly customer complaint statistical reports customer complaints involving persons who are both registered representatives and insurance agents who receive customer complaints regarding the sale of*

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insurance-related non-securities products (e.g., fixed insurance products)?

A. No. Subsection (c) of the Rule defines "customer" as any person other than a broker/dealer with whom the member has engaged, or has sought to engage, in securities activities, therefore, it was intended to exclude non-securities products.

All affected members must report all customer complaints involving securities products that involve persons who are both registered representatives and insurance agents, but should not report complaints that relate to non-securities activities (such as fixed insurance products) from the member's quarterly customer complaint submission.

Q. As a follow-up to the preceding question, are there any circumstances under which a member must report a customer complaint involving the sale of an insurance-related non-securities product?

A. Yes. Subsection (a)(2) of the Rule requires a member to report to NASD Regulation a specified event filing within 10 business days when a member or associated person "is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery." Therefore, affected members must report certain customer complaint information, including information relating to the sale of insurance-related non-securities products.

Q. If a mutual fund distributor broker/dealer receives a customer complaint regarding an alleged sales practice problem of another selling broker/dealer (or associated person of such other broker/dealer), is the mutual fund distributor broker/dealer required to file the complaint with NASD Regulation?

A. No. Since the customer complaint involves the sales practices of another member broker/dealer, the mutual fund broker/dealer is not obligated to file the report for the other member firm. The mutual fund broker/dealer should promptly provide the customer complaint to the selling broker/dealer and retain a copy of the original customer complaint in its records. While not required by the Rule, the distributor broker/dealer is encouraged to provide a copy of the complaint to the local NASD Regulation District Office.

Q. When NASD Regulation receives a customer complaint directly from a customer and the member firm has not received the complaint or a copy, upon notification and receipt of the complaint by the member from NASD Regulation, is the member obligated to report the complaint through the customer complaint reporting system?

A. Yes. Although NASD Regulation is already investigating the customer complaint, the member is still required to report the complaint in its quarterly filing or specified event filing.

Q. If a member receives a customer complaint alleging theft, misappropriation of funds or securities, or forgery and files the appropriate specified event filing under section (a)(2) with NASD Regulation within 10 business days, is the member also required to submit a quarterly customer complaint filing with NASD Regulation regarding the same event?

A. Yes. Although a member timely files its specified event filing number 2, the member is also obligated to submit a separate report of the customer complaint in its next quarterly statistical filing. ❒

NASD Regulation Toll-Free Numbers

(800) 208-2098 ***Reports of Anti-Competitive Market-Maker Behavior***

Use this number to report market makers who:

- harass other market makers for narrowing the displayed quotations in The Nasdaq Stock Market;
- harass other market makers for quoting in size not greater than the minimum quantities of securities they are required to trade under NASD Rules; or
- otherwise engage in anti-competitive conduct.

Market Regulation will investigate all reports of the above-described harassment; coordination between or among market makers of quotes, trades and trade reports; or concerted discrimination and concerted refusals to deal by market makers.

(800) 925-8156 ***Resolution of Backing-Away Complaints on a Real-Time Basis***

Market Regulation accepts real-time reports (within five minutes of the suspected backing-away incident) by members of market makers that fail to honor their quotations. These complaints will be addressed immediately during the trading day so that valid complaints may be satisfied with a contemporaneous trade execution. NASD Regulation also continues to accept and investigate backing-away complaints received off-line.

Compliance Short Takes

NASD Begins Collecting SEC Transaction Fees

As of January 1, 1997, the NASD began collecting a congressionally approved fee for the SEC. The Omnibus Consolidated Appropriations Act for Fiscal Year 1997 authorizes the SEC to collect a fee of 1/300th of one percent on the aggregate dollar amount of sales transacted by or through any member other than on a securities exchange for securities subject to last-sale reporting.

The new fee applies to all domestic and foreign securities listed on The Nasdaq Stock Market℠, with the exception of convertible debt. In addition, it applies to all domestic OTC equity securities, ADRs, and Canadian securities. The fee does not apply to securities in FIPS or PORTAL, nor to transactions in non-Canadian foreign securities.

For transactions between two NASD members, the charge will apply to the member on the sell side. For transactions between a member and a customer, the charge will apply to the member.

On December 3, 1996, the NASD published a *Special Notice to Members 96-81* that details how the new fee will be administered and collected. In that *Notice*, members were advised to notify their customers about the SEC fee as soon as practicable.

Questions regarding the SEC fee may be directed to Andrew S. Margolin, Senior Attorney, The Nasdaq Stock Market, at (202) 728-8869, or James Shelton, Billing Manager, NASD, at (301) 590-6757.

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SEC Approves SOES Rule Change For Locked And Crossed Markets

The SEC recently approved an amendment to NASD Rule 4730 to provide that, during locked and crossed markets, SOES will execute orders in five-second intervals against a market maker whose quotation is locked or crossed at the best price, regardless of whether the market maker entered the quotation locking or crossing the market.

This change was effective on January 8, 1997. Questions concerning the amendment may be directed to Andrew S. Margolin, Senior Attorney, The Nasdaq Stock Market, at (202) 728-8869.

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NASD Regulation Receives Approval For Change To Use Of Investment Company Rankings In Advertising And Sales Literature

On March 5, 1997, the SEC approved an amendment to NASD IM-2210-3, Use of Rankings in Investment Companies Advertisements and Sales Literature. The Rule requires members to use one-, five-, and ten-year periods if these time periods are published by the ranking entity. The Rule amendment allows firms to use short-, medium-, and long-term performance figures in place of the required one-, five-, and ten-year rankings when the ranking entity does not publish rankings for the required time periods, but only when these required rankings are not available. The amendment also replaces the phrase "in the category" with the phrase "relating to the same investment category" to clarify that rankings for the prescribed time periods must be for the same investment category or sub-category as the total return ranking that is used with the prescribed ranking.

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SEC Approves Amendment To NASD Mutual Fund Quotation Service

In December 1996, the SEC approved a change to the NASD's Mutual Fund Quotation Service (Service) that collects and disseminates mutual fund prices. The change to NASD Rule 6800 affects the Service's Supplemental List (List), which contains data for more than 450 mutual funds and is distributed to more than 280,000 Nasdaq Level 1 terminals. Formerly, the Rule required that funds must have 300 shareholders at the time of initial application to be quoted on the List.

The amended Rule replaces the shareholder requirement with two alternative standards:

1) the fund must have net assets of $10 million or more at the time of application, or
2) the fund must be in operation for two full years, regardless of net assets.

This change will allow approximately 1,400 small mutual funds and money market funds to be included in the Service.

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SEC Grants Temporary Approval Of Certain SelectNet Orders

Effective January 21, 1997, until July 1, 1997, the SEC has granted temporary approval of rule changes concerning preferenced SelectNet℠ orders. During this period, members are prohibited from canceling or attempting to cancel a broadcast or preferenced order entered into SelectNet until a minimum of 10 seconds has elapsed, and from entering a conditional order when the order is preferenced to an electronic communications network.

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SEC Proposes Amendments To Its Books And Records Rules

In late October 1996, the SEC proposed amendments to Rules 17a-3 and 17a-4 that clarify, modify, and expand record-keeping requirements for purchase and sale documents, customer records, associated person records, customer complaints, and certain other documents. In addition, the proposed amendments would require broker/dealers to keep certain types of books and records in their local offices. Proposed in response to concerns by the North American Securities Administrators Association (NASAA), these amendments will obligate broker/dealers to make and retain additional records valuable to state regulators during examination and enforcement proceedings.

Proposed Changes To SEC Rule 17a-3 And Related Retention Requirements Under Rule 17a-4

Blotters And Memoranda

A proposed change to Rule 17a-3(a)(1) would require broker/dealers to make records of purchases and sales of securities for customer accounts accessible in the appropriate local office. Under Rule 17a-3(a)(6), a proposed amendment would require broker/dealers to indicate on each sales/purchase memorandum which associated person entered the order and whether the order was solicited or unsolicited.

Associated Person Records

Proposed amendments would add new Rule 17a-3(a)(20) requiring broker/dealers to maintain several additional records for each associated person. These new records include registration and licensing materials, contracts or agreements between the associated persons and the broker/dealer, compensation arrangements, customer complaint information, and client trading records. Under proposed amendments to Rule 17a-4, these records would be retained for three years following the associated person's termination of employment.

In addition, proposed Rule 17a-3(a)(21) would require broker/dealers to maintain a list identifying each of their associated persons and designating the local office where each associated person conducts the greatest portion of his or her business. In conjunction with proposed Rule 17a-4(l)(1), this change also will require all records concerning an associated person to be stored where the associated person conducts most of his or her business. Proposed changes to Rule 17a-4(a) would establish a six-year retention period for these records.

Account Forms

Proposed Rule 17a-3(a)(16) creates a new requirement for broker/dealers to maintain an account form for each customer account. *The new requirements would apply to new and existing customer accounts*.

The information required for the account form would include basic identification and background information about a customer, the customer's investment objective(s), and the approximate percentage of investment capital that the customer would like to allocate to speculative investments. In addition, the associated person responsible for each account and a principal of the broker/dealer must sign or initial each account form to indicate approval of the contents.

The proposal also would require broker/dealers to send the material contents of a new or changed customer account form to the customer for confirmation. To minimize burdens and allow maximum flexibility for broker/dealers who send communications to their customers from a central location, the proposed Rule will permit broker/dealers to send a customer an alternate document which contains the material contents of the account form, rather than a copy of the account form itself.

As a customer's financial situation and investment preferences will vary over time, proposed Rule 17a-3(a)(16) also includes a requirement for broker/dealers to update this information on an annual basis. Under proposed changes to Rule 17a-4, all records required under Rule 17a-3(a)(16) need to be kept for a period of at least six years after the customer's account is closed.

In its release, the SEC noted it will be difficult for broker/dealers to prepare the required account forms for existing customers immediately upon adoption of the new Rule. Therefore, the SEC is proposing a one-year grace period for broker/dealers to comply with the requirements for *existing* customer accounts.

Complaints

The proposed amendments add a new subsection(a)(17) to Rule 17a-3 requiring broker/dealers to maintain files of written materials relating to customer complaints, already a requirement for members under NASD Rule 3110. In addition, proposed Rule 17a-3(a)(17) will require broker/dealers to make and keep written memoranda of oral customer complaints alleging certain types of fraud and theft. The language of the proposed Rule, however, expressly specifies that the requirement to prepare a written memorandum of certain oral complaints does not convert the complaint into a reportable event for purposes of Form U-4 or other reporting requirements.

In addition, proposed Rule 17a-3(a)(17) would require broker/dealers to include

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SEC Proposes Amendments, from page 14

a routine notice in account statements telling customers to put their complaints in writing to establish an independent record of the complaint. Under proposed amendments to Rule 17a-4, broker/dealers must keep the complaint records for six years.

Other Records

Proposed Rule 17a-3(a)(18) would require broker/dealers to indicate for each commission, override, and other compensation transaction (including any bonus) the following information: (1) the person or persons receiving the compensation, (2) the customer account number, (3) the date the transaction occurred, (4) the amount of compensation, and (5) the name of the security involved. Proposed changes to Rule 17a-4 would establish a three-year retention requirement for these records. To the extent that compensation is based on factors other than remuneration per trade, such as a total production system or bonus system, the broker/dealer must be able to demonstrate and to document, upon request, how compensation was earned.

Proposed Rule 17a-3(a)(19) would require that broker/dealers develop activity reports for management that identify exceptional numerical occurrences, such as frequent trading in customer accounts, unusually high commissions, or an unusually high number of trade corrections or canceled transactions. Under Rule 17a-4 proposed amendments, broker/dealers must keep these records for three years.

Individual broker/dealers may determine for themselves the systems and criteria used to generate these activity reports, as long as the system and its parameters are reasonably designed to monitor levels of activity in accounts that may warrant further review and analysis by management. Members should note that they do not need to retain actual copies of these reports if the member electronically stores the data necessary to create or recreate promptly the required reports upon request by regulatory authorities.

Additional Proposed Changes To SEC Rule 17a-4

New Records

In addition to the amendments that establish retention requirements for the new records proposed under Rule 17a-3, the SEC is adding several other new items under Rule 17a-4. These include copies of advertisements and marketing materials, information relating to underwritten or recommended securities, registrations and licenses, audit and examination reports, and manuals relating to compliance, supervision, and procedures.

One change specifically would require broker/dealers to keep all Forms BD, BDW, amendments to these forms, licenses and other documentation showing registrations, and organizational documents for the life of the firm.

Retention Periods

Currently, Rules 17a-4(a) and 17a-4(b) require broker/dealers to retain specified records for a period of six and three years, respectively. However, paragraph (a) stipulates that the records must be kept in an "easily accessible place" for the first two years, while paragraph (b) states that records must be kept in an "accessible place." Proposed changes will modify both paragraphs (a) and (b) to require retention of records *in an easily accessible place for the entire retention period, not just for the first two years*.

Definition Of The Term "Promptly"

To expedite the production of records during regulatory investigations, the SEC is proposing amendments to Rule 17a-4(j) to define the term "promptly." As proposed, the definition will require that requested records must be produced immediately when the records are located in the office where the request is made and within three business days if the requested records are located off-site.

On January 17, 1997, the SEC announced that it is extending, until March 31, 1997, the comment period for the proposed changes to Rules 17a-3 and 17a-4. Comments regarding the proposal should be submitted, in triplicate, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Stop 6-9, Washington, DC 20549, or electronically to the following e-mail address; *rule-comments@sec.gov.* All comment letters should refer to File No. S7-27-96.

Designation Of A Books And Records Principal

Proposed Rule 17a-4(k) will require each broker/dealer to designate a principal for purposes of the books and records rules, with responsibilities that would include approval of documents, such as outgoing correspondence and marketing materials.

Local Office Requirements

Proposed Rule 17a-4(l) would adopt a new requirement that broker/dealers make available certain records in their local offices. These records would

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SEC Amendments, from page 15

include blotters of the local office's activities, order tickets and memoranda, complaint and correspondence files, associated person records, and customer account forms.

To accommodate centralized electronic record storage systems used by some broker/dealers and to minimize the overall burden of the local office requirements, proposed Rule 17a-4(l) specifies that the ability to display the necessary records electronically in a local office and immediately produce printed copies will satisfy the requirements of the Rule. The proposed Rule also limits the local office record availability period to three years, and allows single-agent offices to comply if the required records are made available in certain other offices of the broker/dealer.

Members are urged to review the SEC release discussing these changes in its entirety. The release appeared in the October 28, 1996, *Federal Register*, and was reprinted in *NASD Special Notice to Members 96-80*, dated November 27, 1996.

Questions regarding this Notice may be directed to Samuel Luque, Jr., Compliance Department, at (202) 728-8472, or Susan DeMando, Compliance Department, at (202) 728-8411. ❒

SEC Adopts Regulation M

Effective March 4, 1997, the SEC adopted Regulation M (Reg M) to govern the activities of underwriters, issuers, selling security holders, and others in connection with securities offerings. Reg M replaces Rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21 (trading practice rules) under the Securities Exchange Act of 1934 (Exchange Act), which are now rescinded. Like the previously effective trading practice rules, Reg M seeks to prevent the manipulation of the price of a security in the open market during the time period when that security, or a security that determines its value, is the subject of a subsequent distribution.

Reg M consists of Rules 100 through 105. Rule 100 contains the definitions that will facilitate an understanding of the operational rules, Rules 101 through 105.

Rules 101 and 102, which replace SEC Rule 10b-6, prohibit certain activities during a "restricted period" that usually commences either one or five business days prior to the pricing of the offering and continues until the distribution is complete. Rule 101 applies to broker/dealers and their affiliated purchasers, while Rule 102 applies to issuers or selling security holders and their affiliated purchasers.

Generally, Rule 102 will apply to an NASD member will only when the firm is acting as an affiliated purchaser of an issuer or selling security holder, and not a distribution participant.

Rule 103 replaces SEC Rule 10b-6A. It outlines the terms and conditions by which a broker/dealer functioning as a market maker in a covered security can continue to participate in open-market transactions while also functioning as a distribution participant. (These transactions would otherwise be prohibited under Rule 101.)

Rule 103's restricted period is one or five business days in length. However, the Rule allows the distribution participant to function as a "passive" market maker under certain conditions. Generally, a passive market maker: 1) can not "lead" the market for a covered security by initiating a high bid; and 2) is limited in the amount of volume that it can generate in a covered security. A passive market maker can enter a bid that is higher than the independent high bid only when the broker/dealer is displaying a customer limit order in compliance with the SEC's Order Execution Rules. In addition, the normal volume limitation does not apply to transactions executed due to the display of a customer's limit order.

Like Rule 103, Rule 104 allows certain transactions to take place that would otherwise violate Rule 101. Rule 104 prescribes the circumstances under which "stabilizing" may occur, i.e., when the syndicate manager may enter a bid or effect a purchase in a security subject to a distribution to keep the market price from falling below the public offering price of the securities being distributed. Rule 104 replaces SEC Rule 10b-7.

Members should note that, effective April 1, 1997, the SEC is amending Rule 17a-2 to require that managing underwriters keep records of their stabilizing activity for any offering registered under the Securities Act of 1933, conducted pursuant to Regulation A thereunder, or where the aggregate proceeds exceed $5 million. SEC Rule 17a-2 details the specific records that must be kept and establishes a three-year retention period.

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Municipal Securities Roundup

NASD members engaged in a municipal securities business should be aware of recent developments emanating from the Municipal Securities Rulemaking Board (MSRB) that may affect the way they conduct their municipal business.

Rule G-14 Transaction Reporting Requirements

On November 29, 1996, the SEC approved amendments to MSRB Rule G-14, Reports of Sales and Purchases, to require broker/dealers to take steps during 1997 so as to be prepared on January 1, 1998, to report retail and institutional customer transaction information under the MSRB's Transaction Reporting Program. Previously, broker/ dealers were reporting only information about inter-dealer transactions.

The changes, which will enhance price transparency in the municipal securities market, also will provide a central, computerized audit trail of municipal transactions for regulatory purposes.

The new Rule amendments require broker/dealers to:

- Obtain an executing broker symbol from Nasdaq Subscriber Services at (800) 777-5606 within 30 days of SEC approval of the Rule. The NASD assigns executing broker symbols to all broker/dealers, including bank dealers that are not members of the NASD. When calling the NASD for an executing broker symbol, broker/dealers should state that they need the symbol for use in reporting transactions in municipal securities to the MSRB.
- Provide the MSRB, on or before July 1, 1997, with the name and telephone number of a person(s) responsible for testing the firm's capabilities to report customer transaction information.
- Test capabilities to report customer transaction information between July and December 1997, on a schedule to be announced by the MSRB. Brokers/dealers with electronic linkages to NSCC will be able to report customer trades using the same linkages. Brokers/dealers with low volumes of trades will be able to use PCs to report directly to the MSRB.
- Report to the MSRB, beginning January 1, 1998, each day's municipal securities transactions with customers.

Rule G-12(h) On Close-Outs

On January 13, 1997, the SEC approved an amendment to MSRB Rule G-12(h) effective immediately that allows broker/dealers to use a facsimile transmission to satisfy the Rule's requirement that written notices of close-outs must be sent "return receipt requested," provided the sender receives an acknowledgment that the notice was transmitted successfully.

Prior to the change, certified mail, registered mail, messenger services, and the Depository Trust Company's Participant Exchange Service system were the permissible means used to comply with the Rule. Members should note that, prior to sending written notice, they must notify the appropriate parties by telephone of their intended action under the Rule.

MSRB Telemarketing Rules Approved

New MSRB Rule G-39 on telemarketing was approved by the SEC in December 1996. The Rule stipulates the time period during which broker/dealers can make telephone solicitations and the information they must disclose to the person being called. Without the prior consent of the called person, the Rule limits calls to residences between the times of 8 a.m. and 9 p.m., local time, at the called person's location. Also, the Rule requires disclosure of the caller's identity, firm, the telephone number or address at which the caller may be contacted, and that the purpose of the call is to solicit the purchase of municipal securities or related services. The Rule, however, does provide some exemptions when dealing with existing customers.

In addition, the SEC approved amendments to Rules G-8 and G-9 that require firms to create and maintain a centralized "do-not-call" list of persons who do not wish to receive telephone solicitations. The MSRB requirements are similar to NASD Rules (see story on page 4).

Revisions To Rule G-37 Definitions Are Approved

On November 6, 1996, the SEC approved amendments to Rule G-37 on political contributions and prohibitions that include revisions to the definitions of "municipal finance professional" and "executive officer."

The amendments to Rule G-37(g)(iv)(E) exempt executive or management committee members from the definition of municipal finance professional (and the applicable recording and reporting requirements) if these are the only individuals in the firm that would otherwise meet the definition in the Rule.

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Clarification Of Rules G-36 And G-32 For Submitting Final Official Statements

MSRB Rule G-36 requires a broker/dealer acting as a managing or sole underwriter in a primary offering of municipal securities to deliver official statements, advance refunding documents (ARDs) Forms G-36(OS) and G-36(ARD) to the MSRB within a specified time frame. Broker/dealers are reminded that there is a distinction for offerings that are subject to SEC Rule 15c2-12.

For negotiated sales, the "final agreement date" is the date on which the bond purchase is executed. For competitive sales, the final agreement date is the date of award.

Enforcement of Rule G-36 remains a priority for NASD Regulation in 1997. Special reviews are being conducted to determine members' compliance with the Rule's filing requirements. In addition, on-site routine examinations of members' municipal securities activities include a close review for its Rule G-36 practices. These examinations are resulting in numerous formal disciplinary actions because of findings that members have either been late in making required filings of official statements or refunding documents, or have failed to make them altogether.

In addition, certain members are not sending the documents to the MSRB by a method that, " . . . provides a record of sending . . . " as required by the Rule. Accordingly, it is imperative that members ensure that their policies and procedures are sufficient to meet their obligations to make timely filings of required documents under Rule G-36, and maintain the appropriate records of delivery as specified in Rule G-8. NASD Regulation will continue to review for compliance in this area, and failure to comply with the Rule will subject the member to disciplinary action.

In addition to Rule G-36, NASD Regulation is also focusing its examination efforts on MSRB Rule G-32, which among other things, requires members to deliver, by settlement date, a final official statement to customers purchasing any new issue municipal securities.

Members should review their internal procedures to ensure that the documents and information required to be furnished to customers purchasing new municipal issues are complied with, and done so within the time period specified in Rule G-32. NASD Regulation will be paying particular attention to members' compliance with this important rule during its examinations.

Municipal Securities, from page 17

Similarly, the definition of executive officer in Rule G-37(g)(v) is revised to provide that, if no associated person of the firm meets the definition of municipal finance professional, the broker/dealer would be deemed to have no executive officers and thus the recording and reporting requirements for executive officers would not be applicable.

In addition to the above, the amendments to the Rule revise the definition of "official of an issuer" to remove the incorrect reference to an elective office for those who are appointed by an elected official, and the definition of "municipal securities business" to clarify that it includes financial advisory services when the broker/dealer is chosen as a financial adviser on a negotiated basis. It is irrelevant whether the financial advisory services provided by the broker/dealer are with respect to a negotiated or competitive issue.

A related change to Rule G-8 requires broker/dealers to keep copies of Forms G-37/G-38 that they file with the MSRB and the certified or registered mail receipt or other record that shows the forms were sent on a timely basis.

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"Ask The Analyst"

This "Ask the Analyst" features answers to questions of general interest raised during the Advertising Regulation Seminars held in Washington, D.C. and San Diego during October 1996. The seminars addressed a variety of topics, including electronic communications, mutual funds, variable products, and recent disciplinary actions. If you have any questions or comments about this column, or suggestions for topics to be covered in future "Ask The Analyst" columns, please contact the Advertising Regulation Department, at (202) 728-8330.

Electronic Communications And Stocks/Research Reports

Q. Can we transmit research reports electronically?

A. Yes. Research reports transmitted electronically to a group of customers or prospects are considered sales literature. Alternatively, you may also post research reports on the Internet or a commercial on-line site as a form of advertising; in this case, you must assure that the report remains current throughout the time it is posted on an Internet or other on-line site. For example, it would be misleading to continue posting a report that recommends purchasing a stock if your firm is no longer recommending that security. Please note, a registered principal must approve research reports prior to use and in writing, regardless of how your firm distributes them.

Electronic Communications And Filing Requirements

Q. If an Internet or commercial on-line site that has already been filed with and reviewed by the Advertising Regulation Department is updated or otherwise modified, where material information is not added, deleted, or otherwise affected but, the "look and feel" of the site is entirely different, does the site need to be reviewed by the NASD Regulation staff again?

A. An entirely new "look and feel" of a site may equal a material change and thus require a second filing with the Advertising Regulation Department. The NASD Regulation staff evaluates the entire presentation including text, graphics, audio (if applicable), and the location of text.

For example, assume you have already filed with and received clearance from NASD Regulation staff to use a web site which discusses specific mutual funds including their objectives, minimum investment amount, and how to obtain prospectuses. After receiving the staff's comment letter, you add graphics such as the pot of gold at the end of a rainbow or $1,000 bills falling from a money tree. These changes would modify the presentation materially—in this case by implying that the funds will be successful. Accordingly, you would be required to re-submit the modified Internet site for review and comment.

Similarly, changing the placement or relative prominence of disclosures or other material information in a previously reviewed site may also require resubmission. However, if the change in "look and feel" is non-material such as a modification of font style, color, or spacing of sections, you would not have to resubmit the site. (Please also refer to "Ask The Analyst About Electronic Communications" in the April 1996, *Regulatory & Compliance Alert*.)

Q. Do weekly "newsbriefs" that are continually added to an Internet home page need to be filed with the Advertising Regulation Department?

A. Content dictates whether a newsbrief must be filed. Newsbriefs providing information regarding, or commentary relating to the desirability of owning, registered investment companies, collateralized mortgage obligations, public direct participation programs, options, or government securities is subject to the filing requirements. In particular, please note that collateralized mortgage obligation and options material must be submitted 10 days prior to first use (see NASD Conduct Rules 2210(c) and 2220(c)).

You would not need to submit newsbriefs about other types of securities or those that merely provide updates on the stock and bond markets or economic conditions, unless your firm has never submitted advertising to NASD Regulation or is within its first year of submitting advertising. If your firm has never submitted material to NASD Regulation or is within its first year of submitting, you must file all advertising, including Internet material, 10 days prior to first use pursuant to NASD Conduct Rule 2210(c)(3)(A).

Q. My firm has already submitted the script and storyboards for a television commercial to the Advertising Regulation Department and received a "no objection" comment letter. Do I need to file a final form of the commercial? And if so, what do I need to send?

A. Because of the material impact sound and graphics can have on the content of a commercial, the Advertising

Regulation Department staff request that you send a video tape (VHS format) of the final commercial. The staff will review the final form of the commercial and contact you if it raises regulatory concerns. This final review is free of charge, assuming you already submitted the commercial in paper form.

Electronic Communications And Broker/Dealer Names

Q. Can registered representatives include their individual E-mail addresses on business cards that include their NASD member firm name?

A. Yes, provided your firm permits its registered personnel to use E-mail in the conduct of their securities business. In addition, the card must disclose the address and telephone number of the registered location that supervises the representative's securities business.

Broker/Dealer Names

Q. Is letterhead used for correspondence considered advertising or sales literature?

A. The NASD Conduct Rules apply the same standards for use and disclosure of member names to letterhead as to advertising and sales literature, regardless of how the letterhead may be used. The specific standard, Conduct Rule 2210(f) requires, among other things, that the NASD member name be clearly and prominently disclosed and that no confusion be created as to who offers securities when a member and a non-member entity are named in the same communication.

Mutual Funds

Q. With respect to rankings, can I use a ranking that is more current than the most recent calendar quarter end?

A. Yes. More current rankings are acceptable; calendar quarter information is merely the minimum requirement. Please see NASD Conduct Rule IM-2210-3, "Use of Rankings in Investment Company Advertisements and Sales Literature," for more details.

Mutual Funds And Filing Requirements

Q. How does NASD Regulation define generic sales literature and advertising, and when is such material required to be filed?

A. Generic material may provide discussions of investment company securities as a means of investing so long as no specific security is named, described, or offered. You must file generic communications concerning registered investment companies (i.e., mutual funds, variable annuities, unit investment trusts) with the Advertising Regulation Department within 10 days of first use as required by Rule 2210 (c)(1). The Rule exempts from this requirement communications that do no more than list types of securities available from the member (e.g., "We offer the following products: stocks, bonds, mutual funds and variable annuities").

Variable Products

Q. Our variable annuity contract includes several underlying funds that have performance records pre-dating their inclusion in the contract. In advertising, is it permissible to include variable annuity rankings based on performance that pre-dates the fund's inclusion in the variable annuity?

A. Yes. However, the performance upon which the ranking is based must reflect the current costs of the variable annuity (i.e., the mortality and expense risk charge, any administrative charges and/or contract charges, etc.). Additionally, the presentation must not imply that the entire variable annuity product has been ranked. Rather, it must be clear that the ranking pertains only to the specific underlying fund's performance.

Q. May we discuss tax-deferral in our variable life insurance brochures?

A. You may include fair and balanced discussions of the tax-deferral benefits of variable life insurance that do not obscure the life insurance features of the product.

Hypothetical tax-deferral illustrations showing a tax-deferred investment versus a taxable investment may be inappropriate, or even misleading, in variable life communications because they can overemphasize the investment aspects of the policy, or the potential performance of the sub-accounts. In addition, these types of illustrations may fail to reflect the significant costs associated with variable life insurance. The illustrations and accompanying discussion must permit the investor to evaluate how long it takes the benefit of tax deferral to offset the costs of the policy.

Q. Can member firms submit advertising or sales literature relating to fixed annuities to the Advertising Regulation Department?

A. NASD Regulation does not provide comment on material pertaining strictly to fixed annuities. However, material containing discussions of fixed annuities as part of an overall presentation of investment company securities (such as a variable annuity) should be filed in its entirety with the Advertising Regulation Department to facilitate a thorough review. ❐

NASD Chooses Independent Consultant

The NASD has selected Frederick M. Werblow as an independent consultant to oversee the terms of its August 1995 settlement agreement with the Securities and Exchange Commission (SEC). Werblow will review and report periodically over the next three years to the NASD's Audit Committee on the progress of its undertakings. In turn, the Audit Committee will report the consultant's findings to the NASD Board of Governors and the SEC.

Werblow, a certified public accountant and a retired partner of Price Waterhouse LLP, has extensive experience working with investment companies, their directors/trustees, and the investment management industry. In addition, he previously served as an independent consultant on other SEC settlements.

Werblow will be assisted in his work by Daniel K. Webb, a partner in the law firm of Winston & Strawn, who will serve as counsel to the independent consultant, and Robert E. Butler, Partner in charge of Regulatory Consulting at Price Waterhouse LLP. ❒

NASD Regulation Test Centers Transition To Sylvan Learning Systems

In July 1996, NASD Regulation contracted with Sylvan Learning Systems, Inc. (Sylvan) to manage and operate its test center network. The transition of the predecessor PROCTOR® Certification and Training Centers into the Sylvan Network began mid-November 1996 and is continuing into 1997.

The transition to Sylvan presents significant benefits for NASD members. The network of test center sites will increase to 125 sites by March 1, 1997, and to 250 by March 1, 1998. Also, the new sites will offer extended hours including evening and weekend appointments.

Sylvan's National Registration Center (NRC) offers improved access for appointment scheduling. In addition to scheduling an appointment at the local center, the appointment may be scheduled through the NRC from 8 a.m. until 8 p.m., Eastern Time (ET), Monday through Friday, and from 8 a.m. until 4 p.m., ET, on Saturday.

The transition to the Sylvan Network will not affect the registration procedures for examinations and the Regulatory Element of Continuing Education. Enrollments will still be processed through NASD Regulation's Central Registration Depository (CRD℠) system.

The appearance of the computerized sessions also will not change. NASD Regulation will continue to use the PROCTOR presentation software to deliver the sessions in the Sylvan Network. In addition, candidates still must comply with the same policies and the Rules of Conduct agreement, show identification, and be fingerprinted at the delivery location.

Since the transition schedule varies by site and has numerous dependencies, candidates are urged to contact their local PROCTOR Certification and Training Center or Sylvan's National Registration Center to obtain the most current information regarding appointment scheduling. Once the transition is complete, a list of locations with addresses and telephone numbers will be published in a future *NASD Notice to Members*.

Questions regarding computer-based testing and training may be directed to a member's Quality & Service Team at:

Team 1 . . . . . .(301) 921-9499
Team 2 . . . . . .(301) 921-9444
Team 3 . . . . . .(301) 921-9445
Team 4 . . . . . .(301) 921-6664
Team 5 . . . . . .(301) 921-6665

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NASD Regulation Expels Stratton Oakmont, Bars Principals

In December 1996, NASD Regulation announced the expulsion of the New York-based firm Stratton Oakmont from the securities industry. The announcement was made following a decision by the NASD Regulation National Business Conduct Committee (NBCC) of an appeal by Stratton Oakmont of an April 1996 decision by the New York District Business Conduct Committee (DBCC).

Stratton Oakmont was charged with excessive and fraudulent markups in the sale of an initial public offering (IPO) and with failure to establish, maintain, and enforce an adequate supervisory system during the period and activity noted.

The NBCC decision also barred Stratton Oakmont President Daniel M. Porush and head trader Steven P. Sanders. In its decision, the NBCC increased Sanders' original penalty from a one-year suspension to a bar and affirmed the bar for Porush. Porush was also fined $250,000 and censured, while Sanders was fined $25,000 and censured.

Stratton Oakmont was ordered by the NBCC to pay $416,528 in restitution to customers, fined $500,000, and censured.

In its ruling, the NBCC stated: "Stratton Oakmont, through Sanders, intentionally structured and participated in an IPO with a view toward retaining a high percentage market share for the purpose of economic gain." It also said that "the firm and Sanders engaged in abusive pricing" and actions that "discouraged the sales force from allowing customers to sell their securities back to Stratton Oakmont, thus reducing the firm's risk and enhancing its ability to dictate prices arbitrarily."

The NBCC also found that Porush did not satisfy his responsibility to establish supervisory procedures as the firm's President and supervisor of the firm's retail sales force and trading and compliance operations. The NBCC added "we do not accept Porush's defense that he was a mere figurehead as President." According to the NBCC decision, Porush also was the salesperson with the largest individual allocation in the underwriting, had access to real-time pricing information, and as a result "had an obligation to assure that the retail products marketed by his sales force were in compliance with all relevant legal requirements, including those prohibiting excessive pricing."

The NBCC found further that "The firm must be, and hereby is, expelled from membership due to the number and gravity of the violations which we have sustained, and the number and gravity of the firm's relevant prior disciplinary incidents. We find that this history establishes a coherent pattern of willful disregard for regulatory requirements and regulatory authority, as well as a failure of lesser steps to remediate the firm's conduct."

The 23-page decision also noted that the bars of both Porush and Sanders were necessary because: "[They] continue to deny responsibility and exhibit no remorse for [their] misconduct, and, but for the bar, would continue to pose an on-going risk to the investing public."

The SEC and a number of state securities regulators around the nation have also sanctioned Stratton Oakmont. In early 1994, the SEC settled an enforcement action against Stratton Oakmont and Porush, after alleging that the firm engaged in securities fraud through its "boiler room" sales operation. By late 1994, the SEC had charged Stratton Oakmont with violating the settlement agreement and obtained a permanent injunction against the firm requiring future compliance. Numerous states have taken action against Stratton Oakmont.

Questions concerning this action may be directed to Michael W. Robinson, NASD Media Relations, at (202) 728-8304. ❒

Regulation M, from page 16

Rule 105 replaces SEC Rule 10b-21 and prohibits certain short sales from being covered with securities obtained from an underwriter, broker, or dealer that is participating in an offering. Rule 105 covers only those short sales effected during the five-business-day period prior to the offering's pricing.

Members are urged to review SEC Release No. 34-38067 adopting Reg M. It was published in the January 3, 1997, *Federal Register*. Members should also review NASD *Notice to Members 97-10* that discusses amendments to NASD Rules to facilitate compliance with Reg M.

Questions about Reg M may be directed to Samuel Luque, Associate Director, Compliance, at (202) 728-8472, or Susan DeMando, District Coordinator, Compliance, at (202) 728-8411. ❒

NASD Regulation Fines Stephens Inc.

In December 1996, NASD Regulation fined Stephens Inc. $225,000 and censured the firm for not adequately supervising its employees that were selling mutual funds to the public. The mutual funds were sold mainly by NationsSecurities through the branch offices of NationsBank located throughout the southeast.

Without admitting or denying the findings, Stephens agreed to a settlement requiring the firm to hire an independent auditor to review the firm's supervisory policies and procedures, and then to implement the changes recommended by the consultant. Further, the consultant will conduct a mandatory training program in the new supervisory system for appropriate senior personnel and supervisors.

"Putting an end to abuses in the sales of mutual funds is a high priority at NASD Regulation," said NASD Regulation President Mary L. Schapiro. "With more investors putting their savings in mutual funds than ever before, it's our job as a regulator to ensure that they are treated fairly."

The settlement with Stephens was reached following an investigation of Stephens by the NASD Regulation District 5 office in New Orleans. NASD Regulation also found that a Stephens broker failed to properly perform his duties as supervisor of Stephens' employees who were involved in the promotion and distribution of the mutual funds. The broker, who also neither admitted nor denied the findings, was fined $10,000, censured, and required to participate in the new supervisory training program referenced above.

Questions concerning this action may be directed to Michael W. Robinson, NASD Media Relations, at (202) 728-8304 or Warren A. Butler, Jr., NASD Regulation, Vice President and District Director, at (504) 522-6527. ❒

NASD Disciplinary Actions

The September, October, and November 1996 disciplinary actions are available by accessing the appropriate monthly edition of the *NASD Notice to Members* also available on this Web site.

NASD Regulatory & Compliance Alert Information

Regarding Any Items In This Publication
If you have further questions or comments, please contact either the individual listed at the conclusion of an item or Susan Lang, Senior Writer/Editor, NASD Regulatory & Compliance Alert, 1735 K Street, NW, Washington, DC 20006-1500, (202) 728-6969.

Regarding NASD Disciplinary Actions & Histories
If you are a member of the media, please contact NASD Media Relations at (202) 728-8884. To investigate the disciplinary history of any NASD-licensed representative or principal, call our toll-free NASD Disciplinary Hot Line at (800) 289-9999.

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