

**RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS,  
EMPLOYEES, AND OTHERS' EMPLOYEES**

**TABLE OF CONTENTS**

3000.	RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS' EMPLOYEES
	3010. Supervision
	3020. Fidelity Bonds
	3030. Outside Business Activities of an Associated Person
	3040. Private Securities Transactions of an Associated Person
	3050. Transactions for or by Associated Persons
	3060. Influencing or Rewarding Employees of Others
	3070. Reporting Requirements
	3080. Disclosure to Associated Persons When Signing Form U-4
3100.	BOOKS AND RECORDS, AND FINANCIAL CONDITION
	3110. Books and Records
	IM-3110. Customer Account Information
	3120. Use of Information Obtained in Fiduciary Capacity
	3130. Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties
	IM-3130. Restrictions on a Member's Activity
3200.	SETTLEMENTS
	3210. Securities "Failed to Receive" and "Failed to Deliver"
	3220. Adjustment of Open Orders
3300.	TRADING
	3310. Publication of Transactions and Quotations
	IM-3310. Manipulative and Deceptive Quotations
	3320. Offers at Stated Prices
	3330. Payment Designed to Influence Market Prices, Other than Paid Advertising
	3340. Prohibition on Transactions During Trading Halts
	3350. Short Sale Rule
	IM-3350. Short Sale Rule
	3360. Short-Interest Reporting
	3370. Prompt Receipt and Delivery of Securities
3400.	COMPUTER SYSTEMS
	3410. Mandatory Decimal Pricing Testing

### **3000. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS' EMPLOYEES**

#### **3010. Supervision**

##### **(a) Supervisory System**

Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Nasdaq Rules. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by paragraphs (b) and (c) of this Rule.

(2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required.

(3) The designation as an office of supervisory jurisdiction (OSJ) of each location that meets the definition contained in paragraph (g) of this Rule. Each member shall also designate such other OSJs as it determines to be necessary in order to supervise its registered representatives and associated persons in accordance with the standards set forth in this Rule, taking into consideration the following factors:

(A) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;

(B) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;

(C) whether the location is geographically distant from another OSJ of the firm;

(D) whether the member's registered persons are geographically dispersed; and

(E) whether the securities activities at such location are diverse and/or complex.

(4) The designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.

(5) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.

(6) Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities.

(7) The participation of each registered representative, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the member at which compliance matters relevant to the activities of the representative(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative's(') place of business.

(8) Each member shall designate and specifically identify to Nasdaq one or more principals who shall review the supervisory system, procedures, and inspections implemented by the member as required by this Rule and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations, and with Nasdaq Rules.

**(b) Written Procedures**

(1) Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Nasdaq Rules.

**(2) Tape recording of conversations**

(i) Each member that either is notified by Nasdaq or otherwise has actual knowledge that it meets one of the criteria in paragraph (b)(2)(viii) relating to the employment history of its registered persons at a Disciplined Firm as defined in paragraph (b)(2)(x) shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

(ii) The member must establish the supervisory procedures required by this paragraph within 30 days of receiving notice from Nasdaq or obtaining actual knowledge that it is subject to the provisions of this paragraph.

(iii) The procedures required by this paragraph shall include tape-recording all telephone conversations between the member's registered persons and both existing and potential customers.

(iv) The member shall establish reasonable procedures for reviewing the tape recordings made pursuant to the requirements of this paragraph to ensure compliance with applicable securities laws and regulations and applicable rules of Nasdaq. The procedures must be appropriate for the member's business, size, structure, and customers.

(v) All tape recordings made pursuant to the requirements of this paragraph shall be retained for a period of not less than three years from the date the tape was created, the first two years in an easily accessible place. Each member shall catalog the retained tapes by registered person and date.

(vi) Such procedures shall be maintained for a period of two years from the date that the member establishes the procedures required by the provisions of this paragraph.

(vii) By the 30th day of the month following the end of each calendar quarter, each member firm subject to the requirements of this paragraph shall submit to Nasdaq a report on the member's supervision of the telemarketing activities of its registered persons.

(viii) The following members shall be required to adopt special supervisory procedures over the telemarketing activities of their registered persons:

- A firm with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been employed by one or more Disciplined Firms within the last three years;
- A firm with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been employed by one or more Disciplined Firms within the last three years;
- A firm with at least twenty registered persons, where 20% or more of its registered persons have been employed by one or more Disciplined Firms within the last three years.

(ix) For purposes of this Rule, the term "registered person" means any person registered with Nasdaq as a representative, principal, or assistant representative pursuant to the Rule 1020, 1030, and 1040, Series..

(x) For purposes of this Rule, the term "disciplined firm" means a member that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer.

(xi) Pursuant to the Rule 9600 Series, Nasdaq may exempt any member unconditionally or on specified terms and conditions from the requirements of this paragraph upon a satisfactory showing that the member's supervisory procedures ensure compliance with applicable securities laws and regulations and applicable rules of Nasdaq.

(3) The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the Nasdaq Rules. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(4) A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the Nasdaq Rules, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

**(c) Internal Inspections**

Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with the Nasdaq Rules. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected according to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location. Each member shall retain a written record of the dates upon which each review and inspection is conducted.

**(d) Review of Transactions and Correspondence****(1) Supervision of Registered Representatives.**

Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to Nasdaq upon request.

**(2) Review of correspondence.**

Each member shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business, including procedures to review incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence; documentation of such education and training; and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

**(3) Retention of correspondence.**

Each member shall retain correspondence of registered representatives relating to its investment banking or securities business in accordance with Rule 3110 ("Books and Records"). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records and the retained records shall be readily available to Nasdaq, upon request.

**(e) Qualifications Investigated**

Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with Nasdaq. Where an applicant for registration has previously been registered with Nasdaq, the member shall obtain from the Central Registration Depository or from the applicant a copy of the Uniform Termination Notice of Securities Industry Registration (Form U-5) filed with Nasdaq by such person's most recent previous Nasdaq member employer, together with any amendments thereto that may have been

filed pursuant to Article V, Section 3 of Nasdaq's By-Laws. The member shall obtain the Form U-5 as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to Nasdaq that it has made reasonable efforts to comply with the requirement. A member receiving a Form U-5 pursuant to this Rule shall review the Form U-5 and any amendments thereto and shall take such action as may be deemed appropriate.

**(f) Applicant's Responsibility**

Any applicant for registration who receives a request for a copy of his or her Form U-5 from a member pursuant to this Rule shall provide such copy to the member within two (2) business days of the request if the Form U-5 has been provided to such person by his or her former employer. If a former employer has failed to provide the Form U-5 to the applicant for registration, such person shall promptly request the Form U-5, and shall provide it to the requesting member within two (2) business days of receipt thereof. The applicant shall promptly provide any subsequent amendments to a Form U-5 he or she receives to the requesting member.

**(g) Definitions**

(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

- (A) order execution and/or market making;
- (B) structuring of public offerings or private placements;
- (C) maintaining custody of customers' funds and/or securities;
- (D) final acceptance (approval) of new accounts on behalf of the member;
- (E) review and endorsement of customer orders, pursuant to paragraph (d) above;
- (F) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Rule 2210(b)(1); or
- (G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(2) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding:

- (A) any location identified in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly

supervised;

(B) any location referred to in a member advertisement, as this term is defined in Rule 2210, by its local telephone number and/or local post office box provided that such reference may not contain the address of the non-branch location and, further, that such reference also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised; or

(C) any location identified by address in a member's sales literature, as this term is defined in Rule 2210, provided that the sales literature also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised.

(D) any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the convenience of customers, so long as each customer is provided with the address and telephone number of the branch office or OSJ of the firm from which the person conducting business at the non-branch location is directly supervised.

(3) A member may substitute a central office address and telephone number for the supervisory branch office or OSJ locations referred to in paragraph (g)(2) above provided it can demonstrate to Nasdaq that it has in place a significant and geographically dispersed supervisory system appropriate to its business and that any investor complaint received at the central site is provided to and resolved in conjunction with the office or offices with responsibility over the non-branch business location involved in the complaint.

Selected NASD Notices to Members: 86-65, 88-84, 89-34, 89-57, 92-18, 96-82, 98-11, 99-03; 98-52.

**Selected SEC Decisions:**

Juan Carlos Schidlowski, SEC Rel. No. 34-23347 (1986).

Wedbush Securities, Inc. (f/k/a Wedbush Noble, Cooke, Inc.), SEC Rel. No. 34-25504 (1988).

Seco Securities, Inc. and Stanley Richards, SEC Rel. No. 34-26054 (1988).

**3020. Fidelity Bonds**

Each member required to join the Securities Investor Protection Corporation who has employees and who is a member in good standing of another self-regulatory organization shall follow the applicable fidelity bond rule of the self-regulatory organization to which it is designated by the Commission for financial responsibility pursuant to Section 17 of the Act and SEC Rule 17d-1 thereunder.

**3030. Outside Business Activities of an Associated Person**

No person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member. Such notice shall be in the form required by the member. Activities subject to the requirements of Rule 3040 shall be exempted from this requirement.

Selected NASD Notices to Members: 88-45, 88-86, 89-39, 90-37, 94-44, 94-93, 96-33.

### **3040. Private Securities Transactions of an Associated Person**

#### **(a) Applicability**

No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this Rule.

#### **(b) Written Notice**

Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

#### **(c) Transactions for Compensation**

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice pursuant to paragraph (b) shall advise the associated person in writing stating whether the member:

- (A) approves the person's participation in the proposed transaction; or
- (B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to paragraph (c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to paragraph (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

#### **(d) Transactions Not for Compensation**

In the case of a transaction or a series of related transactions in which an associated

person has not and will not receive any selling compensation, a member which has received notice pursuant to paragraph (b) shall provide the associated person prompt written acknowledgment of said notice and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction.

**(e) Definitions**

For purposes of this Rule, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in IM-2110-1, Free-Riding and Withholding), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

(2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Selected NASD Notices to Members: 85-54, 85-84, 94-44, 96-33.

Selected SEC Decisions

Allen S. Klosowski and Jack D. Prosen, SEC Rel. No. 34-25467 (1988).  
Zester Herbert Hatfield, SEC Rel. No. 34-25488 (1988).

**3050. Transactions for or by Associated Persons**

**(a) Determine Adverse Interest**

A member ("executing member") who knowingly executes a transaction for the purchase or sale of a security for the account of a person associated with another member ("employer member"), or for any account over which such associated person has discretionary authority, shall use reasonable diligence to determine that the execution of such transaction will not adversely affect the interests of the employer member.

**(b) Obligations of Executing Member**

Where an executing member knows that a person associated with an employer member has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member, the executing member shall:

(1) notify the employer member in writing, prior to the execution of a transaction

for such account, of the executing member's intention to open or maintain such an account;

(2) upon written request by the employer member, transmit duplicate copies of confirmations, statements, or other information with respect to such account; and

(3) notify the person associated with the employer member of the executing member's intention to provide the notice and information required by subparagraphs (1) and (2).

**(c) Obligations of Associated Persons Concerning an Account with a Member**

A person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member, in writing, of his or her association with the other member; provided, however, that if the account was established prior to the association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming so associated.

**(d) Obligations of Associated Persons Concerning an Account with an Investment Adviser, Bank, or Other Financial Institution**

A person associated with a member who opens a securities account or places an order for the purchase or sale of securities with a domestic or foreign investment adviser, bank, or other financial institution, except a member, shall:

(1) notify his or her employer member in writing, prior to the execution of any initial transactions, of the intention to open the account or place the order; and

(2) upon written request by the employer member, request in writing and assure that the investment adviser, bank, or other financial institution provides the employer member with duplicate copies of confirmations, statements, or other information concerning the account or order;

provided, however, that if an account subject to this paragraph (d) was established prior to a person's association with a member, the person shall comply with this paragraph promptly after becoming so associated.

(e) Paragraphs (c) and (d) shall apply only to an account or order in which an associated person has a financial interest or with respect to which such person has discretionary authority.

**(f) Exemption for Transactions in Investment Company Shares and Unit Investment Trusts**

The provisions of this Rule shall not be applicable to transactions in unit investment trusts and variable contracts or redeemable securities of companies registered

under the Investment Company Act of 1940, as amended, or to accounts which are limited to transactions in such securities.

Selected NASD Notices to Members: 83-17, 87-2, 91-27.

### **3060. Influencing or Rewarding Employees of Others**

(a) No member or person associated with a member shall, directly or indirectly, give or permit to be given anything of value, including gratuities, in excess of one hundred dollars per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity. A gift of any kind is considered a gratuity.

(b) This Rule shall not apply to contracts of employment with or to compensation for services rendered by persons enumerated in paragraph (a) provided that there is in existence prior to the time of employment or before the services are rendered, a written agreement between the member and the person who is to be employed to perform such services. Such agreement shall include the nature of the proposed employment, the amount of the proposed compensation, and the written consent of such person's employer or principal.

(c) A separate record of all payments or gratuities in any amount known to the member, the employment agreement referred to in paragraph (b) and any employment compensation paid as a result thereof shall be retained by the member for the period specified by SEC Rule 17a-4.

Selected SEC Decisions

Albert P. Fosha, SEC Rel. No. 34-22815 (1986).

### **3070. Reporting Requirements**

(a) Each member shall promptly report to Nasdaq whenever such member or person associated with the member:

(1) has been found to have violated any provision of any securities law or regulation, any rule or standards of conduct of any governmental agency, self-regulatory organization, or financial business or professional organization, or engaged in conduct which is inconsistent with just and equitable principles of trade; and the member knows or should have known that any of the aforementioned events have occurred;

(2) is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery;

(3) is named as a defendant or respondent in any proceeding brought by a regulatory or self-regulatory body alleging the violation of any provision of the Act, or of any other federal or state securities, insurance, or commodities statute, or of any rule or regulation thereunder, or of any provision of the By-laws, rules or similar governing instruments of any securities, insurance or commodities regulatory or self-regulatory

organization;

(4) is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry regulatory or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member of any such self-regulatory organization;

(5) is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any criminal offense (other than traffic violations);

(6) is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company which was suspended, expelled or had its registration denied or revoked by any agency, jurisdiction or organization or is associated in such a capacity with a bank, trust company or other financial institution which was convicted of or pleaded no contest to, any felony or misdemeanor;

(7) is a defendant or respondent in any securities or commodities-related civil litigation or arbitration which has been disposed of by judgment, award or settlement for an amount exceeding \$15,000. However, when the member is the defendant or respondent, then the reporting to Nasdaq shall be required only when such judgment, award, or settlement is for an amount exceeding \$25,000;

(8) is the subject of any claim for damages by a customer, broker, or dealer which is settled for an amount exceeding \$15,000. However, when the claim for damages is against a member, then the reporting to Nasdaq shall be required only when such claim is settled for an amount exceeding \$25,000;

(9) is associated in any business or financial activity with any person who is subject to a "statutory disqualification" as that term is defined in the Act, and the member knows or should have known of the association. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification;

(10) is the subject of any disciplinary action taken by the member against any person associated with the member involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or otherwise disciplined in any manner which would have significant limitation on the individual's activities on a temporary or permanent basis.

(b) Each person associated with a member shall promptly report to the member the existence of any of the conditions set forth in paragraph (a) of this Rule.

(c) Each member shall report to Nasdaq statistical and summary information regarding customer complaints in such detail as Nasdaq shall specify by the 15th day of the month

following the calendar quarter in which customer complaints are received by the member. For the purposes of this paragraph, "customer" includes any person other than a broker or dealer with whom the member has engaged, or has sought to engage, in securities activities, and "complaint" includes any written grievance by a customer involving the member or person associated with a member.

(d) Nothing contained in paragraphs (a), (b) and (c) of this Rule shall eliminate, reduce, or otherwise abrogate the responsibilities of a member or person associated with a member to promptly file with full disclosure, required amendments to Form BD, Forms U-4 and U-5, or other required filings, and to respond to Nasdaq with respect to any customer complaint, examination, or inquiry.

(e) Any member subject to substantially similar reporting requirements of another self-regulatory organization of which it is a member is exempt from the provisions of this Rule.

Selected NASD Notices to Members: 95-81.

### **3080. Disclosure to Associated Persons When Signing Form U-4**

A member shall provide an associated person with the following written statement whenever the associated person is asked to sign a new or amended Form U-4.

The Form U-4 contains a predispute arbitration clause. It is in item 5 on page 4 of the Form U-4. You should read that clause now. Before signing the Form U-4, you should understand the following:

(1) You are agreeing to arbitrate any dispute, claim or controversy that may arise between you and your firm, or a customer, or any other person, that is required to be arbitrated under the rules of the self-regulatory organizations with which you are registering. This means you are giving up the right to sue a member, customer, or another associated person in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(2) A claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute is not required to be arbitrated under Nasdaq rules. Such a claim may be arbitrated at the Nasdaq only if the parties have agreed to arbitrate it, either before or after the dispute arose. The rules of other arbitration forums may be different.

(3) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

(4) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(5) The arbitrators do not have to explain the reason(s) for their award.

(6) The panel of arbitrators may include arbitrators who were or are affiliated with the securities industry, or public arbitrators, as provided by the rules of the arbitration forum in which a claim is filed.

(7) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

Selected NASD Notice to Members: 99-96.

## **3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION**

### **3110. Books and Records**

#### **(a) Requirements**

Each member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Nasdaq Rules and as prescribed by SEC Rule 17a-3. The record keeping format, medium, and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934.

#### **(b) Marking of Customer Order Tickets**

(1) A person associated with a member shall indicate on the memorandum for the sale of any security whether the order is "long" or "short," except that this requirement shall not apply to transactions in debt securities. An order may be marked "long" if (A) the customer's account is long the security involved or (B) the customer owns the security and agrees to deliver the security as soon as possible without undue inconvenience or expense.

(2) A person associated with a member shall indicate on the memorandum for each transaction in a Bulletin Board security, pursuant to the Rule 6500 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD Regulation has access to historical quotation information.

#### **(c) Customer Account Information**

Each member shall maintain accounts opened after January 1, 1991 as follows:

(1) for each account, each member shall maintain the following information:

(A) customer's name and residence;

(B) whether customer is of legal age;

(C) signature of the registered representative introducing the account and signature of the member or partner, officer, or manager who accepts the account; and

(D) if the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity;

(2) for each account other than an institutional account, and accounts in which investments are limited to transactions in open-end investment company shares that are not recommended by the member or its associated persons, each member shall also make reasonable efforts to obtain, prior to the settlement of the initial transaction in the account, the following information to the extent it is applicable to the account:

- (A) customer's tax identification or Social Security number;
- (B) occupation of customer and name and address of employer; and
- (C) whether customer is an associated person of another member; and

(3) for discretionary accounts, in addition to compliance with subparagraphs (1) and (2) above, and Rule 2510(b) of these Rules, the member shall:

- (A) obtain the signature of each person authorized to exercise discretion in the account;
- (B) record the date such discretion is granted; and
- (C) in connection with exempted securities other than municipals, record the age or approximate age of the customer.

(4) For purposes of this Rule and Rule 2310 the term "institutional account" shall mean the account of:

- (A) a bank, savings and loan association, insurance company, or registered investment company;
- (B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or
- (C) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.

**(d) Agreements to Be Obtained**

For all customer accounts opened after January 1, 2001, each member shall obtain from the customer, within fifteen (15) days of approval of the customer's account, a written agreement that the account shall be handled in accordance with all Nasdaq Rules.

**IM-3110. Customer Account Information**

(a) Members should be aware that, any transaction which involves a Bulletin Board equity security trading for less than five dollars per share may be subject to the provisions of SEC Rules 15g-1 through 15g-9, and those rules should be reviewed to determine if an executed customer suitability agreement is required.

(b) Additional information is required to be obtained prior to making recommendations to customers (see Rule 2310) and in connection with discretionary accounts (see Rule 2510).

(c) [Reserved]

**(d) Record of Written Complaints**

Each member shall keep and preserve in each office of supervisory jurisdiction, as defined in Rule 3010, either a separate file of all written complaints of customers and action taken by the member, if any, or a separate record of such complaints and a clear reference to the files containing the correspondence connected with such complaint as maintained in such office.

**(e) "Complaint" Defined**

A "complaint" shall be deemed to mean any written statement of a customer or any person acting on behalf of a customer alleging a grievance involving the activities of those persons under the control of the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.

**(f) Requirements When Using Predispute Arbitration Agreements With Customers**

(1) Any predispute arbitration clause shall be highlighted and shall be immediately preceded by the following disclosure language (printed in outline form as set forth herein) which shall also be highlighted:

(A) Arbitration is final and binding on the parties.

(B) The parties are waiving their right to seek remedies in court, including the right to jury trial.

(C) Pre-arbitration discovery is generally more limited than and different from court proceedings.

(D) The arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited.

(E) The panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry.

(2) Immediately preceding the signature line, there shall be a statement which

shall be highlighted that the agreement contains a predispute arbitration clause. The statement shall also indicate at what page and paragraph the arbitration clause is located.

(3) A copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(4) No agreement shall include any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award.

(5) The requirements of subparagraphs (1) through (4) shall apply only to new agreements signed by an existing or new customer of a member after September 7, 1989.

(6) All agreements shall include a statement that "No person shall bring a putative or certified class action to arbitration, nor seek to enforce any pre-dispute arbitration agreement against any person who has initiated in court a putative class action; or who is a member of a putative class who has not opted out of the class with respect to any claims encompassed by the putative class action until: (i) the class certification is denied; or (ii) the class is decertified; or (iii) the customer is excluded from the class by the court. Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein."

(7) The requirements of subparagraph (6) shall apply only to new agreements signed by an existing or new customer of a member after October 28, 1993.

**(g) Telemarketing Requirements**

(1) Each member shall make and maintain a centralized do-not-call list of persons who do not wish to receive telephone solicitations from such member or its associated persons.

(2) No member or person associated with a member shall obtain from a customer or submit for payment a check, draft, or other form of negotiable paper drawn on a customer's checking, savings, share, or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument.

(3) Each member shall maintain the authorization required by subparagraph (2) for a period of three years. This provision shall not, however, require maintenance of copies of negotiable instruments signed by customers.

**(h) Order Audit Trail System Record keeping Requirements**

(1) Each member that is a Reporting Member, as that term is defined in Rule 6951(n), shall record and maintain, with respect to each order, as that term is defined in

Rule 6951(j), for such security that is received or executed at its trading department:

(A) an identification of each registered person who receives the order directly from a customer;

(B) an identification of each registered person who executes the order;  
and

(C) when an order is originated by the member and transmitted manually to another department, an identification of the department that originated the order.

(2) Each Reporting Member shall maintain and preserve records of the information required to be recorded under paragraph (h)(1) of this Rule for the period of time and accessibility specified in SEC Rule 17a-4(b).

(3) The records required to be maintained and preserved under paragraph (h)(1) of this Rule may be immediately produced or reproduced on "micrographic media" as defined in SEC Rule 17a-4(f)(1)(i) or by means of "electronic storage media" as defined in SEC Rule 17a-4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and be maintained and preserved for the required time in that form.

Selected NASD Notices to Members: 86-29, 86-69, 87-15, 88-40, 88-83, 89-58, 90-52, 91-46, 92-65, 95-16, 95-54, 95-85, 96-82, 98-11, 98-33, 98-47, 98-73.

*Cross References - Rule 2860(b)(17), Options, Maintenance of Records*  
*- Rule 8210, Reports and Inspection of Books for Purpose of Investigating Complaints*  
*- Rule 8220, Suspension of Members for Failure to Furnish Information Duly Requested*  
*- IM-2310-2, Fair Dealing with Customers*

#### **Selected SEC Decisions:**

Failure to maintain records

Marshall and Mever, Inc., Comark Securities, Inc. and Gary J. Lundgren, SEC Rel. No. 34-23013 (1986).  
 Cal Caulfield and Co., Inc. and Calvin L. Caulfield, SEC Rel. No. 34-23050 (1986).  
 Mark James Hankoff, SEC Rel. No. 34-24390 (1987).

#### **3120. Use of Information Obtained in Fiduciary Capacity**

A member who in the capacity of paying agent, transfer agent, trustee, or in any other similar capacity, has received information as to the ownership of securities, shall under no circumstances make use of such information for the purpose of soliciting purchases, sales or exchanges except at the request and on behalf of the issuer.

*Cross Reference - Rule 2330, Customers' Securities or Funds*

#### **3130. Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties**

(a) Application--For the purposes of this Rule, the term "member" shall be limited to any member of Nasdaq who is not designated to another self-regulatory organization by the Commission for financial responsibility pursuant to Section 17 of the Act and SEC Rule 17d-1 thereunder. Further, the term shall not be applicable to any member who is subject to paragraphs (a)(2)(iv), (a)(2)(v) or (a)(2)(vi) of SEC Rule 15c3-1, or is otherwise exempt from the provisions of said rule.

(b) A member, when so directed by Nasdaq, shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist, or have existed, for more than 15 consecutive business days:

(A) A firm's net capital is less than 150 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be prescribed by Nasdaq;

(B) If subject to the aggregate indebtedness requirement under SEC Rule 15c3-1, a firm's aggregate indebtedness is more than 1,000 per centum of its net capital;

(C) If, in lieu of paragraph (b)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than 5 percent of the aggregate debit items thereunder; or

(D) The deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in subparagraph (A), (B) or (C).

(2) Nasdaq restricts the member for any other financial or operational reason.

(c) A member, when so directed by Nasdaq, shall forthwith reduce its business:

(1) to a point enabling its available capital to comply with the standards set forth in paragraph (b)(1)(A), (B) or (C) of this Rule if any of the following conditions continue to exist, or have existed, for more than fifteen (15) consecutive business days:

(A) A firm's net capital is less than 125 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be proscribed by Nasdaq;

(B) If subject to the aggregate indebtedness requirement under SEC Rule 15c3-1, a firm's aggregate indebtedness is more than 1,200 per centum of its net

capital;

(C) If, in lieu of paragraph (c)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers, under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than 4 percent of the aggregate debit items thereunder; or

(D) If the deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in paragraph (c)(1)(A), (B) or (C) of this Rule.

(2) As required by Nasdaq when it restricts a member for any other financial or operational reason.

Selected NASD Notices to Members: 84-21, 85-89.

### **IM-3130. Restrictions on a Member's Activity**

(a) This explanation outlines and discusses some of the financial and operational deficiencies which could initiate action under Rule 3130. Paragraphs (b)(2) and (c)(2) of Rule 3130 and recognize that there are various unstated financial and operational reasons for which Nasdaq may impose restrictions on a member so as to prohibit its expansion or to require a reduction in overall level of business. These provisions are deemed necessary in order to provide for the variety of situations and practices which do arise and which, if allowed to persist, could result in increased exposure to customers and to broker/dealers.

(b) In the opinion of the Board of Directors, it would be impractical and unwise to attempt to identify and list all of the situations and practices which might lead to the imposition of restrictions or the types of remedial actions Nasdaq may direct be taken because they are numerous and cannot be totally identified or specified with any degree of precision. The Board believes, however, that it would be helpful to members' understanding to list some of the other bases upon which Nasdaq may conclude that a member is in or approaching financial difficulty.

(c) For purposes of paragraphs (b)(2) and (c)(2) of Rule 3130, a member may be considered to be in or approaching financial or operational difficulty in conducting its operations and therefore subject to restrictions if it is determined by Nasdaq that any of the parameters specified therein are exceeded or one or more of the following conditions exist:

(1) The member has experienced a reduction in excess net capital of 25% in the preceding two months or 30% or more in the three-month period immediately preceding such computation.

(2) The member has experienced a substantial change in the manner in which it processes its business which, in the view of Nasdaq, increases the potential risk of loss to customers and members.

(3) The member's books and records are not maintained in accordance with the provisions of SEC Rules 17a-3 and 17a-4.

(4) The member is not in compliance, or is unable to demonstrate compliance, with applicable net capital requirements.

(5) The member is not in compliance, or is unable to demonstrate compliance, with SEC Rule 15c3-3 (Customer Protection--Reserves and Custody of Securities).

(6) The member is unable to clear and settle transactions promptly.

(7) The member's overall business operations are in such a condition, given the nature and kind of its business that, notwithstanding the absence of any of the conditions enumerated in subparagraphs (1) through (6), a determination of financial or operational difficulty should be made; or

(8) The member is registered as a Futures Commission Merchant and its net capital is less than 7% of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder.

(e) If Nasdaq determines that any of the conditions specified in paragraphs (c) or (d) of this explanation exist, it may require that the member take appropriate action by effecting one or more of the following actions until such time as Nasdaq determines they are no longer required:

(1) Promptly pay all free credit balances to customers.

(2) Promptly effect delivery to customers of all fully-paid securities in the member's possession or control.

(3) Introduce all or a portion of its business to another member on a fully-disclosed basis.

(4) Reduce the size or modify the composition of its inventory.

(5) Postpone the opening of new branch offices or require the closing of one or more existing branch offices.

(6) Promptly cease making unsecured loans, advances or other similar receivables, and, as necessary, collect all such loans, advances or receivables where practicable.

(7) Accept no new customer accounts.

(8) Undertake an immediate audit by an independent public accountant at the member's expense.

(9) Restrict the payment of salaries or other sums to partners, officers, directors, shareholders, or associated persons of the member.

(10) Effect liquidating transactions only.

(11) Accept unsolicited customer orders only.

(12) File special financial and operating reports; and/or

(13) Be subject to such other restrictions or take such other action as Nasdaq deems appropriate under the circumstances in the public interest and for the protection of members.

### **3200. SETTLEMENTS**

*Cross References -*

- Rule 4618, Clearance and Settlement

- Rule 11000 Series, Uniform Practice Code

### **3210. Securities "Failed to Receive" and "Failed to Deliver"**

(a) No member, or person associated with a member, shall sell a security for his or her own account, or buy a security as a broker for a customer (except exempt securities), if,

(1) in respect to domestic securities, he or she has a fail to deliver in that security 60 days old or older; or

(2) in respect to foreign securities, he or she has a fail to deliver in that security 90 days old or older (except American Depositary Receipt and Canadian securities, which shall be subject to the provisions of subparagraph (1)).

(b) Pursuant to the Rule 9600 Rule Series, for good cause shown and in exceptional circumstances, Nasdaq may exempt a member or a person associated with a member.

### **3220. Adjustment of Open Orders**

(a) A member holding an open order from a customer or another broker/dealer shall, prior to executing or permitting the order to be executed, reduce, increase or adjust the price and/or number of shares of such order by an amount equal to the dividend, payment or distribution, on the day that the security is quoted ex-dividend, ex-rights, ex-distribution or ex-interest, except where a cash dividend or distribution is less than one cent (\$.01), as follows:

(1) In the case of a cash dividend or distribution, the price of the order shall be reduced by subtracting the dollar amount of the dividend or distribution from the price of the order and rounding the result to the next lower minimum quotation variation used in the primary market, provided that if there is more than one minimum quotation variation

in the primary market, then the greater of the variations shall be used (e.g., if a market has minimum quotation variations of 1/16 or 1/32 of a dollar for securities trading in fractions, depending on the price of the security or \$.01 for securities trading in decimals, then the adjustment to open orders shall be in increments of 1/16 of a dollar for issues trading in fractions, and \$.01 for issues trading in decimals);

(2) In the case of a stock dividend or split, the price of the order shall be reduced by rounding the dollar value of the stock dividend or split to the next higher minimum quotation variation used in the primary market as specified in paragraph (a)(1) and subtracting that amount from the price of the order; provided further, that the size of the order shall be increased by (A) multiplying the size of the original order by the numerator of the ratio of the dividend or split, (B) dividing the result by the denominator of the ratio of the dividend or split, and (C) rounding the result to the next lower round lot; and

(3) In the case of a dividend payable in either cash or securities at the option of the stockholder, the price of the order shall be reduced by the dollar value of the cash or securities, whichever is greater, according to the formulas in subparagraph (1) or (2), above; provided, that if the stockholder opts for securities, the size of the order shall be increased pursuant to the formula in subparagraph (2), above.

(b) If the value of the distribution cannot be determined, the member shall not execute or permit such order to be executed without reconfirming the order with the customer.

(c) If a security is the subject of a reverse split, all open orders shall be cancelled.

(d) The term "open order" means an order to buy or an open stop order to sell, including but not limited to "good 'til cancelled," "limit" or "stop limit" orders which remain in effect for a definite or indefinite period until executed, cancelled or expired.

(e) The provisions of this Rule shall not apply to:

(1) orders governed by the rules of another registered securities exchange or the NASD ;

(2) orders marked "do not reduce" where the dividend is payable in cash;

(3) orders marked "do not increase" where the dividend is payable in stock, provided that the price of such orders shall be adjusted as required by this Rule;

(4) open stop orders to buy;

(5) open sell orders; or

(6) orders for the purchase or sale of securities where the issuer of the securities has not reported a dividend, payment or distribution pursuant to SEC Rule 10b-17.

Selected NASD Notices to Members: 94-09, 94-28, 94-63.

## **3300. TRADING**

### **3310. Publication of Transactions and Quotations**

No member shall publish or circulate, or cause to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to report any transaction as a purchase or sale of any security unless such member believes that such transaction was a bona fide purchase or sale of such security; or which purports to quote the bid price or asked price for any security, unless such member believes that such quotation represents a bona fide bid for, or offer of, such security. If nominal quotations are used or given, they shall be clearly stated or indicated to be only nominal quotations.

*Cross Reference - IM-3320, Firmness of Quotations*

### **IM-3310. Manipulative and Deceptive Quotations**

Rule 2110 provides that:

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

Rule 3310 provides that:

No member shall publish or circulate, or cause to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to report any transaction as a purchase or sale of any security unless such member believes that such transaction was a bona fide purchase or sale of such security; or which purports to quote the bid price or asked price for any security, unless such member believes that such quotation represents a bona fide bid for, or offer of, such security. If nominal quotations are used or given, they shall be clearly stated or indicated to be only nominal quotations.

Rule 2120 provides that:

No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

It would be inconsistent with the above provisions for a member to publish or circulate or cause to be published or circulated, by any means whatsoever, any report of any securities transaction or of any purchase or sale of any security unless such member knows or has reason to believe that such transaction was a bona fide transaction, purchase or sale.

Similarly, it would be inconsistent with the above provisions for a member, for itself or for any other person, to publish or circulate or to cause to be published or circulated, by any means whatsoever, any quotation for any security without having reasonable cause to believe that

such quotation is a bona fide quotation, is not fictitious and is not published or circulated or caused to be published or circulated for any fraudulent, deceptive or manipulative purpose.

For the purposes of this interpretation, the term "quotation" shall include any bid or offer or any formula, such as "bid wanted" or "offer wanted," designed to induce any person to make or submit any bid or offer.

### **3320. Offers at Stated Prices**

No member shall make an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell.

### **3330. Payment Designed to Influence Market Prices, Other than Paid Advertising**

No member shall, directly or indirectly, give, permit to be given, or offer to give, anything of value to any person for the purpose of influencing or rewarding the action of such person in connection with the publication or circulation in any newspaper, investment service, or similar publication, of any matter which has, or is intended to have, an effect upon the market price of any security, provided that this Rule shall not be construed to apply to matter which is clearly distinguishable as paid advertising.

### **3340. Prohibition on Transactions During Trading Halts**

No member or person associated with a member shall, directly or indirectly, effect any transaction in a security as to which a trading halt is currently in effect.

Selected NASD Notices to Members: 88-46, 89-2.

*Cross Reference - Rule 4120, Trading Halts*

### **3350. Short Sale Rule**

(a) No member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the current best (inside) bid when the current best (inside) bid as displayed by Nasdaq is below the preceding best (inside) bid in the security.

(b) In determining the price at which a short sale may be effected after a security goes ex-dividend, ex-right, or ex-any other distribution, all quotation prices prior to the "ex" date may be reduced by the value of such distribution.

(c) The provisions of paragraph (a) shall not apply to:

(1) Sales by a qualified market maker registered in the security on Nasdaq in connection with bona fide market making activity. For purposes of this paragraph, transactions unrelated to normal market making activity, such as index arbitrage and risk

arbitrage that are independent from a member's market making functions, will not be considered bona fide market-making activity.

(2) Any sale by any person, for an account in which he has an interest, if such person owns the security sold and intends to deliver such security as soon as possible without undue inconvenience or expense.

(3) Sales by a member, for an account in which the member has no interest, pursuant to an order to sell which is marked "long" in which the member does not know, or have reason to know, that the beneficial owners of the account have, or would as a result of such sales have, a short position in the security.

(4) Sales by a member to offset odd-lot orders of customers.

(5) Sales by a member to liquidate a long position which is less than a round lot, provided that such sale does not change the position of the member by more than one unit of trading.

(6) Sales by a person of a security for a special arbitrage account if the person then owns another security by virtue of which the person is, or presently will be, entitled to acquire an equivalent number of securities of the same class of securities sold; provided such a sale, or the purchase which such sale offsets, is effected for the bona fide purpose of profiting from a current difference between the price of the security sold and the security owned and that such right of acquisition was originally attached to or represented by another security or was issued to all the holders of any such class of securities of the issuer.

(7) Sales by a person of a security effected for a special international arbitrage account for the bona fide purpose of profiting from a current difference between the price of such security on a securities market not within or subject to the jurisdiction of the United States and on such a securities market subject to the jurisdiction of the United States; provided the person at the time of such sale knows or, by virtue of information currently received, has reasonable grounds to believe that an offer enabling the person to cover such sale is then available to the person in such foreign securities market and intends to accept such offer immediately.

(8) Sales by an underwriter, or any member of a syndicate or group participating in the distribution of a security, in connection with an over-allotment of securities, or any layoff sale by such a person in connection with a distribution of securities through rights pursuant to SEC Rule 10b-8 or a standby underwriting commitment.

(d) No member shall effect a short sale for the account of a customer or for its own account indirectly or through the offices of a third party to avoid the application of this Rule.

(e) No member shall knowingly, or with reason to know, effect sales for the account of a

customer or for its own account to avoid the application of this Rule.

(f) A member that is not currently registered as a Nasdaq market maker in a security and that has acquired a security while acting in the capacity of a block positioner shall be deemed to own such security for the purposes of this Rule notwithstanding that such member may not have a net long position in such security if and to the extent that such member's short position in such security is the subject of one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage, or bona fide hedge activities.

(g) For purposes of this Rule, a depositary receipt of a security shall be deemed to be the same security as the security represented by such receipt.

(h) (1) A member shall be permitted, consistent with its quotation obligations, to execute a short sale for the account of an options market maker that would otherwise be in contravention of this Rule, if:

(A) the options market maker is registered with a qualified options exchange as a qualified options market maker in a stock options class on a Nasdaq National Market security or an options class on a qualified stock index; and

(B) the short sale is an exempt hedge transaction.

(2) For purposes of this paragraph:

(A) (i) An "exempt hedge transaction," in the context of qualified options market makers in stock options classes, shall mean a short sale in a Nasdaq National Market security that was effected to hedge, and in fact serves to hedge, an existing offsetting options position or an offsetting options position that was created in a transaction(s) contemporaneous with the short sale,\* provided that when establishing the short position the options market maker is eligible to receive(s) good faith margin pursuant to Section 220.12 of Regulation T under the Act for that transaction.

(ii) An "exempt hedge transaction," in the context of qualified options market makers in stock index options classes, shall mean a short sale in a Nasdaq National Market security that was effected to hedge, and in fact serves to hedge, an existing offsetting stock index options position or an offsetting stock index options position that was created in a transaction(s) contemporaneous with the short sale, provided that:

a. the security sold short is a component security of the index underlying such offsetting index options position;

b. the index underlying such offsetting index options position is a "qualified stock index;" and

c. the dollar value of all exempt short sales effected to hedge the offsetting stock index options position does not exceed the aggregate current index value of the offsetting options position.

(iii) Notwithstanding any other provision of this paragraph (h), any transaction unrelated to normal options market making activity, such as index arbitrage or risk arbitrage that in either case is independent of an options market maker's market making functions, will not be considered an "exempt hedge transaction."

(B) A "qualified options market maker" shall mean an options market maker who has received an appointment as a "qualified options market maker" for certain classes of stock options on Nasdaq National Market securities and/or index options on qualified stock indexes pursuant to the rules of a qualified options exchange.

(C) A "qualified options exchange" shall mean a national securities exchange that has approved rules and procedures providing for:

(i) designating market makers as qualified options market makers, which standards shall be designed to identify options market makers who regularly engage in market making activities in the particular options class(es);

(ii) the surveillance of its market maker's utilization of the exemption set forth in paragraph (h)(1) to assure that short sales effected by qualified options market makers are exempt hedge transactions and that other non-qualified market makers are not utilizing the exemption; and

(iii) authorization of Nasdaq to withdraw, suspend or modify the designation of a qualified options market maker but only if a qualified options exchange has determined that the qualified options market maker has failed to comply with the terms of the exemption, and that such a withdrawal, suspension or modification of the market maker's exemption is warranted in light of the substantial, willful, or continuing nature of the violation.

(D) A "qualified stock index" shall mean any stock index that includes one or more Nasdaq National Market securities, provided that more than 10% of the weight of the index is accounted for by Nasdaq National Market securities and provided further that the qualification of an index as a qualified stock index shall be reviewed as of the end of each calendar quarter, and the index shall cease to qualify if the value of the index represented by one or more Nasdaq National Market securities is less than 8% at the end of any subsequent calendar quarter.

(E) "Aggregate current index value" shall mean the current index value

times the index multiplier.

(F) A member will not be in violation of paragraph (a) above if the member executes a short sale for the account of an options market maker that is in contravention of this paragraph (h), provided that the member did not know or have reason to know that the options market maker's short sale was in contravention of this paragraph (h).

(i) (1) A member shall be permitted, consistent with its quotation obligations, to execute a short sale for the account of a warrant market maker that would otherwise be in contravention of this Rule, if:

(A) the warrant market maker is a registered Nasdaq market maker for the warrant; and

(B) the short sale is an exempt hedge transaction that results in a fully hedged position.

(2) For purposes of this paragraph, an "exempt hedge transaction" shall mean a short sale in a Nasdaq National Market security that was effected to hedge, and in fact serves to hedge, an existing offsetting warrant position or an offsetting warrant position that was created in a transaction(s) contemporaneous with the short sale.\*

Notwithstanding any other provision of this paragraph, any transaction unrelated to normal warrant market making activity, such as index arbitrage or risk arbitrage that in either case is independent of a warrant market maker's market making functions, will not be considered an "exempt hedge transaction."

(3) Nasdaq may withdraw, suspend or modify the exemption for a warrant market maker upon determination that the market maker has failed to comply with the terms of the exemption, and that such a withdrawal, suspension or modification of the market maker's exemption is warranted in light of the substantial, willful, or continuing nature of the violation.

(4) A member will not be in violation of paragraph (a) above if the member executes a short sale for the account of a warrant market maker that is in contravention of this paragraph (i), provided that the member did not know or have reason to know that the warrant market maker's short sale was in contravention of paragraph (i).

(j) Pursuant to the Rule 9600 Series or on Nasdaq's own motion, Nasdaq may exempt either unconditionally, or on specified terms and conditions, any transaction or class of transactions from the provisions of this Rule.

(k) Definitions:

(1) The term "short sale" shall have the same meaning as contained in SEC Rule 3b-3, adopted pursuant to the Act, reprinted as follows:

The term "short sale" means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. A person shall be deemed to own a security if: (1) he or his agent has title to it; or (2) he has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it but has not yet received it; or (3) he owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) he has an option to purchase or acquire it and has exercised such option; or (5) he has rights or warrants to subscribe to it and has exercised such rights or warrants; provided, however, that a person shall be deemed to own securities only to the extent that he has a net long position in such securities.

(2) The term "block positioner" shall have the same meaning as contained in SEC Rule 3b-8(c) for "Qualified Block Positioner" adopted pursuant to the Act, reprinted as follows:

The term "Qualified Block Positioner" means a dealer who: (1) is a broker or dealer registered pursuant to Section 15 of the Act, (2) is subject to and in compliance with Rule 15c3-1, (3) has and maintains minimum net capital, as defined in Rule 15c3-1 of \$1,000,000 and (4) except when such activity is unlawful, meets all of the following conditions: (i) he engages in the activity of purchasing long or selling short, from time to time, from or to a customer (other than a partner or a joint venture or other entity in which a partner, the dealer, or a person associated with such a dealer, as defined in Section 3(a)(18) of the Act, participates) a block of stock with a current market value of \$200,000 or more in a single transaction, or in several transactions at approximately the same time from a single source to facilitate a sale or purchase by such customer, (ii) he has determined in the exercise of reasonable diligence that the block could not be sold to or purchased from others on equivalent or better terms, and (iii) he sells the shares comprising the block as rapidly as possible commensurate with the circumstances.

(3) The term "qualified market maker" shall mean a registered Nasdaq market maker that meets the criteria for a Primary Nasdaq Market Maker as set forth in Rule 4612.

\* The phrase "contemporaneously with" includes transactions occurring simultaneously as well as transactions occurring within the same brief period of time.

Selected NASD Notices to Members: 94-68, 94-83.

### **IM-3350. Short Sale Rule**

(a) (1) In developing a Short Sale Rule for Nasdaq National Market securities, Nasdaq adopted an exemption to the Rule for certain market making activity. This

exemption was deemed an essential component of the Rule because bona fide market making activity is necessary and appropriate to maintain continuous, liquid markets in Nasdaq National Market securities. Rule 3350(c)(1) states that short selling prohibitions shall not apply to sales by qualified Nasdaq market makers in connection with bona fide market making activity and specifies that transactions unrelated to normal market making activity, such as index arbitrage and risk arbitrage that are independent from a member's market making functions, will not be considered as bona fide market making. Thus two standards are to be applied: one must be a "qualified" Nasdaq market maker and one must engage in "bona fide" market making activity to take advantage of this exemption. With this interpretation, Nasdaq wishes to clarify for members some of the factors that will be taken into consideration when reviewing market making activity that may not be deemed to be bona fide market making activity and therefore would not be exempted from the Rule's application.

(2) First, as the Rule indicates, bona fide market making activity does not include activity that is unrelated to market making functions, such as index arbitrage and risk arbitrage that is independent from a member's market making functions. While these types of arbitrage activity appear to be suitable for the firm's overall hedging or risk management concerns, they do not warrant an exemption from the Rule. However, short sales of a security of a company involved in a merger or acquisition will be deemed bona fide market-making activity if made to hedge the purchase or prospective purchase (based on communicated indications of interest) of another security of a company involved in the merger or acquisition, which purchase was made, or is to be made, in the course of bona fide market making activity. The purchase of a security of a company involved in a merger or acquisition made to hedge a short sale of another security involved in the merger or acquisition, which sale was made in the course of bona fide market making activity, will not cause the sale to be deemed unrelated to normal market-making activity. Short sales made to hedge any such purchases or prospective purchases must be reasonably consistent with the exchange ratio (or exchange ratio formula) specified by the terms of the merger or acquisition.

(3) Similarly, bona fide market making would exclude activity that is related to speculative selling strategies of the member or investment decisions of the firm and is disproportionate to the usual market making patterns or practices of the member in that security. Nasdaq does not anticipate that a firm could properly take advantage of its market maker exemption to effectuate such speculative or investment short selling decisions. Disproportionate short selling in a market making account to effectuate such strategies will be viewed by Nasdaq as inappropriate activity that does not represent bona fide market making and would therefore be in violation of Rule 3350.

(b) (1) Rule 3350 requires that no member shall effect a short sale for the account of a customer or for its own account in a Nasdaq National Market security at or below the current best (inside) bid when the current best (inside) bid as displayed by The Nasdaq Stock Market is below the preceding best (inside) bid in the security. Nasdaq has determined that in order to effect a "legal" short sale when the current best bid is lower than the preceding best bid the short sale

must be executed at a price of at least 1/16th point above the current inside bid when the current inside spread is 1/16th point or greater. The last sale report for such a trade would, therefore, be above the inside bid by at least 1/16th of a point. If the current spread is less than 1/16th of a point, however, the short sale must be executed at a price equal to or greater than the current inside offer price.

(2) Moreover, Nasdaq believes that requiring short sales to be a minimum increment of 1/16th point above the bid when the current spread is 1/16th or greater and equal to or greater than the offer when the current spread is less than 1/16th ensures that transactions are not effected at prices inconsistent with the underlying purpose of the Rule. It would be inconsistent with Rule 3350 for a member or customer to cause the inside spread for an issue to narrow when the current best bid is lower than the preceding best bid (e.g., lowering its offer to create an inside spread less than 1/16th) for the purpose of facilitating the execution of a short sale at a price less than 1/16th above the inside bid.

(c) (1) Rule 3350 prohibits a member from effecting a short sale for the account of a customer or for its own account directly or through the offices of a third party for the purpose of avoiding the application of the Short Sale Rule. Further, the Rule prohibits a member from knowingly, or with reason to know, effecting sales for the account of a customer or for its own account for the purpose of avoiding the Rule. With this interpretation, Nasdaq wishes to clarify some of the circumstances under which a member would be deemed to be in violation of Rule 3350.

(2) For example, in instances where the current best bid is below the preceding best bid, if a market maker alone at the inside best bid were to lower its bid and then raise it to create an "up bid" for the purpose of facilitating a short sale, Nasdaq would consider such activity to be a manipulative act and a violation of Nasdaq's Short Sale Rule. Nasdaq also would consider it a manipulative act and a violation of the Rule if a market maker with a long stock position were to raise its bid above the inside bid and then lower it to create a "down bid" for the purpose of precluding market participants from selling short. In addition, if a market maker agrees to an arrangement proposed by a member or a customer whereby the market maker raises its bid in The Nasdaq Stock Market in order to effect a short sale for the other party and is protected against any loss on the trade or on any other executions effected at its new bid price, the market maker would be deemed to be in violation of Rule 3350. Similarly, a market maker would be deemed in violation of the Rule if it entered into an arrangement with a member or a customer whereby it used its exemption from the rule to sell short at the bid at successively lower prices, accumulating a short position, and subsequently offsetting those sales through a transaction at a prearranged price, for the purpose of avoiding compliance with the Rule, and with the understanding that the market maker would be guaranteed by the member or customer against losses on the trades.

(3) Nasdaq believes that members' activities to circumvent the Rule through indirect actions such as executions with other members or through facilitation of customer orders while being protected from loss are antithetical to the purposes of the Rule. Accordingly, Nasdaq will consider any such activity as a violation of Rule 3350.

**3360. Short-Interest Reporting**

(a) Each member shall maintain a record of total "short" positions in all customer and proprietary firm accounts in securities included in The Nasdaq Stock Market and in each other security listed on a registered national securities exchange and not otherwise reported to another self-regulatory organization and shall regularly report such information to Nasdaq in such a manner as may be prescribed by Nasdaq. Reports shall be made as of the close of the settlement date designated by Nasdaq. Reports shall be received by Nasdaq no later than the second business day after the reporting settlement date designated by Nasdaq.

(b) For purposes of this Rule, "short" positions to be reported are those resulting from "short sales" as that term is defined in SEC Rule 3b-3, under the Act, with the exception of positions that meet the requirements of Subsections (e)(1), (6), (7), (8), (9), and (10) of SEC Rule 10a-1 adopted under the Act.

Selected NASD Notices to Members: 86-4, 86-15, 86-61, 87-15, 95-08.

**3370. Prompt Receipt and Delivery of Securities****(a) Purchases**

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

**(b) Sales****(1) Long Sales**

No member or persons associated with a member shall accept a long sale order from any customer in any security (except exempt securities other than municipals) unless:

(A) The member has possession of the security;

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

(C) The member or person associated with a member makes an affirmative determination that the customer owns the security and will deliver it in good deliverable form within three (3) business days of the execution of the order;  
or

(D) The security is on deposit in good deliverable form with a member of Nasdaq, a member of another national securities exchange, a member of the NASD, or any organization subject to state or federal banking regulations and

that instructions have been forwarded to that depository to deliver the securities against payment.

**(2) "Short Sales"**

**(A) Customer short sales**

No member or person associated with a member shall accept a "short" sale order for any customer in any security unless the member or person associated with a member makes an affirmative determination that the member will receive delivery of the security from the customer or that the member can borrow the security on behalf of the customer for delivery by settlement date.

**(B) Proprietary short sales**

No member shall effect a "short" sale for its own account in any security unless the member or person associated with a member makes an affirmative determination that the member can borrow the securities or otherwise provide for delivery of the securities by the settlement date. This requirement will not apply to bona fide market making transactions by a member in securities in which it is registered as a Nasdaq market maker, to bona fide market maker transactions in Bulletin Board securities in which the market maker publishes a two-sided quotation, or to transactions which result in fully hedged or arbitrated positions.

**(3) Public Offering**

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

**(4) "Affirmative Determination"**

(A) To satisfy the requirements for an "affirmative determination" contained in paragraph (b)(1)(C) above for long sales, the member or person associated with a member must make a notation on the order ticket at the time the order is taken which reflects the conversation with the customer as to the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member within three (3) business days.

(B) To satisfy the requirement for an "affirmative determination" contained in paragraph (b)(2) above for customer and proprietary short sales, the

member or person associated with a member must keep a written record which includes:

(i) if a customer assures delivery, the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member within three (3) business days; or

(ii) if the member or person associated with a member locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing by settlement date and the number of shares needed to cover the short sale.

(C) The manner by which a member or person associated with a member annotates compliance with the "affirmative determination" requirement contained in subsection (b)(2) above (e.g., marking the order ticket, recording inquiries in a log, etc.) is not specified by this Rule and, therefore, shall be decided by each member. Members may rely on "blanket" or standing assurances that securities will be available for borrowing on settlement date to satisfy their affirmative determination requirements under this Rule, provided: (i) the information used to generate the "blanket" or standing assurance is less than 24-hours old; and (ii) the member delivers the security on settlement date. Should a member relying on a blanket or standing assurance fail to deliver the security on settlement date, Nasdaq shall deem such conduct inconsistent with the terms of this Rule, absent mitigating circumstances adequately documented by the member.

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

In determining the availability of the exemption provided in paragraph (b)(2)(B) above and in Rule 11830 from short sale requirements for "bona fide fully hedged" and "bona fide fully arbitrated" transactions, the following guidelines shall apply. These guidelines are for illustrative purposes and are not intended to limit Nasdaq's ability to determine the proper scope of the terms "bona fide fully hedged" or "bona fide fully arbitrated" pursuant to this provision, on a case-by-case basis.

##### **(A) Bona Fide Fully Hedged**

The following transactions shall be considered bona fide fully hedged:

(i) Short a security and long a convertible debenture, preferred or other security which has a conversion price at or in the money and is convertible within ninety days into the short security.

Example: Long ABCD Company 9% convertible subordinated debentures due 2003. Each debenture is convertible into common at \$27.90 per share of common equal to 35.842

shares of common per 1M debenture.

With the price of the ABCD at  $8\frac{3}{4}$  - 9 or 8.75 - 9 and a short position of 100 shares of ABCD the short position would not be exempt.

If the price of ABCD was \$28 with a short position of 100 shares, 35 shares would be exempt and the remaining 65 shares would not be exempt.

(ii) Short a security and long a call which has a strike price at or in the money and which is exercisable within 90 calendar days into the underlying short security.

Example: Long 1 call of EFGH at a price of either  $44\frac{1}{8}$  or \$44.10 with a strike price of 40 expiring within 90 calendar days.

With the circumstances as above 100 shares would be exempt.

If the strike price was 50 a short position of 100 shares would not be exempt.

With any strike price and the call expiring in more than 90 days any short of the common would not be exempt.

(iii) Short a security and long a position in warrants or rights which are exercisable within 90 days into the short security. To the extent that the long warrants or rights are "out of the money," then the short position shall be exempt up to the market value of the long warrants or rights.

Example: Long 100 warrants of IJKL (IJKLW:  $2\frac{1}{4}$  -  $2\frac{3}{4}$  or 2.25 - 2.75). Each warrant is exercisable into 1 share of common at \$2. (IJKL: 4 -  $4\frac{1}{2}$  or \$4 - 4.50).

With the circumstances as above a short position of 100 shares would be exempt.

If the price of IJKL is \$1.50 and the market value of long warrants is  $\frac{1}{4}$  of a point or \$.25, a short position of 16 shares would be exempt.

## **(B) Bona Fide Fully Arbitrated**

The following transactions shall be considered bona fide fully arbitrated:

(i) Long a security purchased in one market together with a short position from an offsetting sale of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in price in the two markets.

Example: Purchase 100 shares of EFGH on the London Stock Exchange and simultaneously effecting a short sale of 100 shares of EFGH on Nasdaq.

Under the above circumstances, the 100 shares short would be exempt.

(ii) Long a security which is without restriction other than the payment of money exchangeable or convertible within 90 calendar days of the purchase into a second security together with a short position from an off-setting sale of the second security at or about the same time for the purpose of taking advantage of a concurrent disparity in the prices of the securities.

Example: Long 100 shares of MNOP (MNOP: 51 - 51 ¼ or 51.00 - 51.25) which is being acquired by QRST Corp. (QRST: 52 1/8 - 52 3/8 or 52.10 - 52.30) at the rate of 1.15 shares per MNOP share.

If the exchange is to take place within 90 days then a short of 115 shares of QRST would be exempt from the mandatory buy-in. Also, if the exchange was to take place at a date later than 90, all short positions in the above example would be subject to the mandatory buy-in.

(C) The transaction date of the short sale shall govern when a fully hedged or fully arbitrated position exists.

Selected NASD Notices to Members: 86-69, 88-47, 90-51, 94-80, 95-36.

### **3400. COMPUTER SYSTEMS**

#### **3410. Mandatory Decimal Pricing Testing.**

(a) Clearing firms and market makers must conduct or participate in the testing of their computer systems to ascertain decimal pricing conversion compatibility of such systems in such manner and frequency as Nasdaq may prescribe.

(b) Every clearing firm and market maker required to conduct or participate in testing of computer systems shall provide to Nasdaq such reports relating to the testing as Nasdaq may

prescribe.

(c) Clearing firms and market makers shall maintain adequate documentation of tests required pursuant to this Rule and the results of such testing for examination by Nasdaq.