

CHAPTER V

OPTIONS SELLING PRACTICES

INTRODUCTION

The Options Study examined the manner in which brokerage firms and their registered representatives sell listed options to the public in order to determine if significant patterns of selling practice abuses existed. Some of the selling practices surveyed were sound, while others appeared unethical and still others were clearly unlawful. Therefore, the internal controls and procedures of brokerage firms were analyzed for the specific weaknesses which had permitted these abuses to occur. Although no attempt was made to quantitatively measure unsound selling practices throughout the industry or throughout a firm, it became evident that, wherever brokerage firms lacked adequate internal controls, serious selling abuses were likely to occur. Most options selling abuses are rooted in the failure of many brokerage firms to prohibit registered representatives from selling listed options to the public before the firms themselves have established necessary supervisory systems to control their sales force. In many firms adequate internal controls are still lacking. This chapter discusses the selling practice abuses and internal control deficiencies found by the Options Study.

The Options Study had access to all the Commission's investigative files relating to options selling practices and reviewed more than one hundred and fifty options examinations of broker-dealer firms conducted

by the Commission's staff during the past 15 months. The Options Study also reviewed the options complaint files of the Commission and those of brokerage firms of all sizes and interviewed compliance and sales personnel from brokerage firms. Finally, to gain a better perspective of their options business policies, and internal controls, the Options Study sent a detailed questionnaire to a sample of brokerage firms selling listed options to the public. The sample consisted of all brokerage firms carrying and clearing their own public customer accounts which reported to the Commission listed options commission revenues for 1977 of \$500,000 or more (46 firms) and a random sample drawn from 89 smaller brokerage firms whose listed options commission revenues for the same period were between \$100,000 and \$500,000 (12 firms). The 58 firms which comprised the industry group sample accounted for more than 70 percent of the total options commission revenues earned in 1977 by brokerage firms which dealt with public customers.

Brokerage firms are required by both the Exchange Act and the rules of self-regulatory organizations to maintain adequate systems of supervision and control over the activities of all their employees. A brokerage firm's supervision of its employees must be adequate to protect its customers from illegal and unethical practices because, as the Commission has explained:

Customers dealing with a securities firm expect, and are entitled to receive, proper treatment and to be protected against fraud and other misconduct, and may properly rely on the firm to provide this protection. 1/

A high standard of supervision over registered representatives is required because of the potential for abuse of a customer's trust. One court recently noted:

The registered representative and the broker-dealer earn their money, directly and indirectly, by sales activity. Customers often rely on their broker-representatives for investment advice. 'The opportunity and temptation to take advantage of the client is ever present.' 2/

The complexity and leverage features of listed options trading pose significant risks for public investors and require unique supervisory systems within broker-dealer firms. Adequate supervision of listed options trading requires brokerage firms to actively and continuously ensure that knowledgeable supervisory personnel oversee the activities of registered representatives, that registered representatives are adequately trained and that they transact business only with those customers who can appreciate and bear the risks which options trading entails. As part of its supervisory responsibilities, each brokerage firm must perform timely reviews of its account openings and of the

1/ Reynolds & Co., 39 SEC 902, 917 (1960).

2/ Kravitz v Pressman, Frohlich & Frost, Inc., 447 F. Supp. 203, 213 (D. Mass. 1978)

selling documents shown or sent to customers. In addition, each firm must systematically oversee the trading activity in customer accounts and follow sound recordkeeping and back-office procedures.

In many cases examined by the Options Study, customers have suffered unnecessary losses that might have been prevented by adequate supervisory controls. For example, because brokerage commissions alone provide a strong incentive for registered representatives to recommend listed options, the Options Study found that customers had been switched from conservative long-term investment positions into active short-term trading in listed options with little or no regard to the suitability of this new type of trading for the customer. Other customers were initially attracted to options trading by misleading advertising and other promotional materials produced by the firm or its registered representatives. Although some of these customers did not understand options, or have the financial ability to bear the risks of options trading, they were permitted to open options accounts and trade options. Too frequently, registered representatives, lacking proper training and supervision, involved customers in elaborate options transactions or programs so complex that neither they nor their customers fully understood them. As a result, these transactions were occasionally constructed in such a way that, unknown to the customer, the best outcome he could possibly achieve would be to break even. In other transactions, the customer's maximum potential profit was much less than the commissions he was charged.

Customers generally are not provided adequate, usable information to enable them to appreciate fully the risks or results of trading listed options. Monthly account statements, which are supposed to inform the customer of the status of his account, generally do not give the customer sufficiently detailed information to monitor his trading activity. Options customers, on the other hand, often do receive from brokerage firms detailed selling documents, such as worksheets and performance reports. These documents may be misleading because they sometimes provide little or no explanation of the risks of the options transactions being recommended, or because they contain unrealistic projections of high rates of return.

Most brokerage firms rely on a system of branch office managers, complemented by a home office compliance unit, to oversee the trading in customer accounts. Many local supervisors, however, are not properly prepared to understand options or to control listed options trading in customer accounts. Similarly, home office compliance systems often do not provide adequate review of customer options trading, especially trading in discretionary accounts opened as part of some options investment programs. These problems of supervision are further compounded by inadequacies in certain back-office and recordkeeping practices which decrease the efficiency of both the firms and regulators in determining compliance with rules.

On the basis of its review, the Options Study is recommending changes in the rules of self-regulatory organizations for the purpose of improving and strengthening internal control systems in brokerage firms. The Options Study recommends that these minimum requirements be imposed on all brokerage firms selling listed options to the public regardless of the self-regulatory affiliation of the firm.

The examples used in the chapter to illustrate abuses and regulatory problems are drawn from the Commission's files. All customer accounts described were selected from among actual customer accounts analyzed by the Commission's staff although some numbers have been rounded and, in one case, part of an account was deleted to simplify analysis without compromising conclusions. Names and dates have been changed wherever appropriate. Excerpts from registered representative - customer conversations or from sworn testimony are taken from tapes and transcripts reviewed by the Options Study.

Certain selling practice issues which the Options Study has not addressed, but which deserve future scrutiny by the Commission and its staff, are:

- Exercise practices, at both OCC and broker-dealer firms including the fairness of certain practices such as automatic exercise and exercise of abandoned customer options and the risks these and other exercise practices entail for public investors;

- The role of the investment adviser as an options consultant and the relationship of options advisors and their services to brokerage firms;
- The relationship between options selling practices and the growth in the number and size of margin accounts;
- The relationship among firm proprietary trading, firm research recommendations on underlying stock, customer options trades and the recommendations made to customers;
- The effect of listed options trading on the customer account transfer practices of brokerage firms.
- The need for an options regulatory program for SECO broker-dealers.

A. REGISTERED REPRESENTATIVE QUALIFICATION, PREPARATION AND MOTIVATION1. Introduction

The soundness of options selling practices rests ultimately on the training and attitude of the persons who sell options to the public. While many of the selling practice problems found by the Options Study might have been avoided if brokerage firms had better supervisory or surveillance programs, the first means of avoiding such problems is to establish controls and to develop incentives which encourage integrity and promote high standards of performance on the part of registered representatives who deal directly with public investors.

A number of controls and incentives are essential if high standards are to be established and maintained:

(1) First, the industry-wide requirements for allowing individuals to become "qualified" as options salespersons should be stringent enough, and the on-the-job and classroom training provided to registered representatives within each firm should be rigorous enough, to assure that only persons reasonably proficient in options are permitted to sell options to the public.

(2) Second, a system of incentives must be developed within each firm to encourage registered representatives to give adequate consideration to their customers' best interests when recommending or effecting options transactions for customer accounts.

(3) Third, the hiring and termination practices in the industry must be directed toward assuring that persons seeking employment as registered representatives are properly screened, and that registered representatives who have demonstrated an inability or unwillingness to deal fairly and honestly with their customers are removed from the business.

In all three areas, the Options Study has found that controls are inadequate to assure that only knowledgeable and properly motivated registered representatives sell listed options to the public.

2. The Qualifications of Persons Who Sell Options

Several of the options-related customer problems reviewed by the Options Study were caused by registered representatives who did not understand listed options. These problems might have been avoided if the registered representative involved had been required to undergo a meaningful qualifying and training process before he was permitted to sell options to customers. The present requirements are inadequate in this regard, and, as a result, many registered representatives now servicing the accounts of options customers lack the necessary knowledge and skill to perform their functions professionally.

a. The options qualifying examination

The options exchanges all require that employees of member firms be registered with the exchange before they are permitted to sell that exchange's listed options to customers. As a prerequisite to registration, the salesperson must pass an options qualifying examination.

Two examinations are presently in use. The NASD "Series 7" qualifying examination is given to all applicants who are new to the securities industry and who are seeking to become registered to sell securities for the first time (i.e., to become "registered representatives"). The "Puts and Calls" examination is given to persons who are already registered representatives, but who passed the Series 7 examination (or became registered on the basis of earlier standards) before listed options were included in the registration requirements. 3/

The Series 7 examination consists of 250 multiple choice questions and covers virtually all types of securities products available to investors. Questions relating to listed call options have been included in the examination since May 1977. At present, approximately twenty questions — eight percent of the examination — directly concern options, and, on occasion, as many as ten more

3/ For a short period of time the Series 7 examination included questions on calls but not puts, and persons who took the test during that period subsequently had to pass a separate "Puts" examination if they wished to offer puts to customers.

questions may be devoted to the margin treatment of options transactions. An applicant must achieve a seventy percent correct score to pass the examination (175 correct answers); none of the subjects is scored separately. The examination is "closed book" and is administered once a month at various NASD testing centers around the country.

As presently structured, the Series 7 examination has little relationship to the actual qualifications of a person to sell listed options. Since only twenty questions directly concern options and since an applicant may miss a full seventy-five questions without failing the examination, an applicant may miss every options question and still become "qualified" to sell options.

On the other hand, the "Puts and Calls" examination, which consists of forty to fifty multiple choice questions, is devoted entirely to options. To pass this test, a person would appear to need some understanding of the product. As with the Series 7 examination, however, the industry has permitted those who take the "Puts and Calls" test to pass it without necessarily possessing any knowledge of options. First, the examination is given "in house" which means that brokerage firms may devise their own procedures for administering the test. The opportunity for abuse is apparent, and it is not surprising that rumors abound as to widespread misconduct in the administering of the test.

Second, no official passing grade has ever been established for the examination (although a "rule-of-thumb" seventy-five percent passing score has been suggested by the CBOE). The established brokerage firm procedure following the examination is for the options supervisor who administered the test to "review" with each candidate his incorrect answers and then to retest him until he "passes." For this reason, the "Puts and Calls" test, like the Series 7 examination, does not serve to assure that options "qualified" registered representatives are knowledgeable about options.

In view of the present unsatisfactory status of the qualifying examinations given to persons seeking certification to sell options to the public, the Options Study recommends:

THE SELF-REGULATORY ORGANIZATIONS SHOULD AMEND THEIR RULES TO REQUIRE THAT THE REGISTERED REPRESENTATIVE "OPTIONS QUALIFYING" EXAMINATIONS BE REVISED TO REQUIRE A THOROUGH KNOWLEDGE OF OPTIONS AND OF APPLICABLE OPTIONS RULES DESIGNED TO PROTECT CUSTOMERS. THESE EXAMINATIONS SHOULD BE READMINISTERED TO ALL OPTIONS SALESPERSONS, AND ALL EXAMINATIONS SHOULD BE GIVEN UNDER CONTROLLED SURROUNDINGS BY INDEPENDENT EXAMINERS.

b. The training requirement

The rules of the AMEX and CBOE provide that, in order to be registered, a prospective options salesperson must not only pass an options examination, but must also "successfully complete a training course" (CBOE) or "have a minimum period of four months

training and experience" (AMEX). 4/ The training component of the registration requirement is not strictly enforced, however, so that firms are free to decide for themselves how much, and in what manner, options training should be given to prospective salespersons. As a result, the amount of time and effort devoted to classroom and on-the-job training varies widely from firm to firm.

Registered representatives who wish to offer options to customers should be given practical, supervised, on-the-job training which the present system does not assure.

Accordingly, the Options Study recommends:

THE SELF-REGULATORY ORGANIZATIONS SHOULD ADOPT RULES TO REQUIRE THAT THE TRAINING OF REGISTERED REPRESENTATIVES WHO RECOMMEND OPTIONS TRANSACTIONS TO CUSTOMERS BE FORMALIZED TO INCLUDE A MINIMUM NUMBER OF HOURS OF APPROVED CLASSROOM AND ON-THE-JOB INSTRUCTION.

3. Motivation

Adequately trained and tested registered representatives must also be properly motivated if they are to serve customers fairly. 5/

4/ Rule 9.3, CBOE Guide (CCH) ¶ 2203;
Rule 341, 2 ASE Guide (CCH) ¶ 9391.

5/ The duty of a registered representative to inquire about a customer's investment objectives, financial situation and needs and, based on that information, to determine whether or not options transactions are suitable for the customer, is discussed in subchapter C, "Suitability", infra.

But, registered representatives are subject to a serious conflict of interest that arises from the dual role they must play when servicing customer accounts. On one hand, the registered representative is an advisor to his customers and an agent who ought to act with his customers' best interests in mind. At the same time, in most firms the registered representative is a salesperson whose only, or principal, compensation comes from commissions which are related to the size and frequency of transactions in his customers' accounts. This compensation system creates a temptation for the registered representative to effect trades in his customers' accounts - trades which may or may not be in the interests of his customers - in order to derive income.

Coupled with the short-term nature of options, the industry's commission rate structure makes options a particularly attractive sales item to a registered representative whose livelihood depends upon commissions. The commission structure of the securities industry has traditionally called for higher charges for transactions in low-priced securities. This structure has been retained in the commission rates most firms charge their options customers. For example, a customer generally will pay a larger commission on an options trade consisting of 10 calls at \$5 (\$500 per contract) than on a stock trade consisting of 100 shares at \$50, even though the value of the securities in both transactions is \$5,000.

To give a specific example, consider an investor who buys 5 call contracts, priced at \$200 a contract, for a total purchase price of \$1,000, plus commission. Most firms do not calculate this commission as though 5 units were purchased at \$200 each. Instead, each call option contract is equated to 100 shares of stock, and the option on each share is assigned a unit value of \$2. The commission is based on a purchase of 5 contracts of 100 units each, or 500 units at \$2 for each unit. Using rates typical in the industry, the investor is charged \$57.20 for 500 units at \$2 instead of \$25.00 for 5 units at \$200.

The Options Study requested from each firm in the industry group sample a current commission rate schedule. Table I below summarizes certain of the information provided. This table displays commissions as a percentage of the cost of buying 100 shares, 500 shares and 1000 shares of stock at \$50 per share, and 1, 5 and 10 options contracts equivalent to 100, 500 and 1000 units at prices of \$.87, \$5 and \$10 per unit.

TABLE I

<u>The Trade</u>	<u>Dollar Value of Trade</u>	<u>Industry Sample Range</u>		<u>Industry Sample Average</u>	<u>Average Commissions As Percentage of Dollar Invested</u>
		low	high		
1 call @ \$.87	\$ 87.50	\$ 6.25	- 30.00	\$ 13.77	15.74%
5 calls @ .87	437.50	20.00	- 53.75	40.44	9.24%
10 calls @ .87	875.00	35.00	- 101.60	78.34	8.95%
1 call @ \$5	500.00	18.04	- 29.40	23.30	4.66%
5 calls @ \$5	2500.00	74.50	- 106.70	86.83	3.47%
10 calls @ \$5	5000.00	127.00	- 181.05	149.16	2.98%
1 call @ \$10	1000.00	25.00	- 37.50	29.08	2.91%
5 calls @ \$10	5000.00	97.00	- 132.89	114.08	2.28%
10 calls @ \$10	10000.00	172.00	- 247.68	211.26	2.11%
100 shares @ \$50	5000.00	71.50	- 96.12	82.18	1.64%
500 shares @ \$50	25000.00	325.00	- 390.48	343.64	1.37%
1000 shares @ \$50	50000.00	499.28	- 599.14	524.97	1.05%

As Table I portrays, the commission rate applied to low-priced securities is substantially higher than that applied to higher priced securities. Three trades involving an investment of \$5,000 are included: 100 shares at \$50, 5 call contracts at \$10, and 10 call contracts at \$5. The commission charges (industry average) for these trades are as follows:

100 shares @ \$50	\$82.18
5 calls @ \$10	\$114.08
10 calls @ \$5	\$149.16

The higher commission structure on listed options, however, is only one of the incentives to a registered representative to recommend listed options to his customers.

This incentive is greatly magnified by the opportunity for repeated trades of options which is a result of their limited life span. For example, assume a customer desiring to buy 500 shares of Upjohn at \$50 per share could be convinced by his registered representative also to start a covered options writing program by writing five Upjohn calls three months from expiration, and to repeat the process at each expiration date. The registered representative could realistically anticipate eight to twelve additional commission charges during the next year, just from the options. Thus, based on the industry group sample commission average, the registered representative could expect to receive a stock commission of \$343 as well as \$500 to \$1,000 in options commissions from the above transactions. Of course, if any of the calls were exercised, additional stock commissions would be earned on the exercise and the repurchase of Upjohn stock required to continue the covered options writing program. Still further options charges would also accrue if, as a result of a significant move in the price of the stock, an existing options position level was closed out and a new options position established.

A sales guide of a national brokerage firm, which was distributed to its registered representatives, pointed out the commission-related incentives to salespersons for engaging their customers in options trading. The guide stated:

[Options Writing] can be the best revenue producer available to [a registered representative].

1. An account will generate 5-10% in commissions based on the money in the program i.e. if [the customer] invests \$25,000, [you] will receive \$1,250 to \$2,500 a year in commissions.
2. If [you] open one \$25,000 account a week, you will earn at the rate of \$62,500 to \$125,000 per year.
3. If [you] margined all of them - you would be earning in the \$125,000 to \$250,000 category - with only 50 accounts.

The same document included the statement:

Options are like an annuity. Once in operation, they must do business several times each year. As options come due, action must be taken... Many registered representatives move money six to seven times a year. Easy to see how [you] can generate 10% in commissions. (Emphasis added.)

The effects of the commission rate structure on the selling of listed options underscore the need for adequate preparation of options salespersons and for strong supervisory controls over their selling activities.

4. Hiring and Termination Procedures

While the overall quality of the options sales force would be enhanced, and its performance improved, if the testing, training and supervision of registered options salespersons were upgraded, still another regulatory control must exist if the public is to

be protected from the unsatisfactory performance of salespersons. Brokerage firms must design — and implement — hiring and employment termination procedures capable of identifying and removing individuals whose on-the-job performance has proved harmful to customers.

a. Hiring procedures

To assure that persons applying for positions as securities salespersons have the requisite character and capabilities to service customer needs adequately, the NYSE requires that member firms "make a thorough inquiry into the previous record and reputation of persons whom they contemplate employing." The NYSE recommends that "[t]he background and reputation check should, whenever possible, include at least personal conversations with all employers during the previous 3 years ..." 6/ The options exchanges likewise require that their members make a reasonable investigation of the credentials of all prospective employees. 7/

Virtually all the firms in the industry group sample, when queried by the Options Study about their hiring practices, responded that their procedures included some background review of every job applicant, including a check of the applicant's most recent employer and other employers. However, the responses of most firms in the sample

6/ Rule 345, 2 NYSE Guide (CCH) ¶ 2345.18.

7/ See, e.g., Rule 340.02, 2 ASE Guide (CCH) ¶ 9390.

indicated that these firms did little more than comply with the minimum regulatory requirements. And, while existing or former customers are generally an excellent source of information concerning a registered representative's performance, very few firms indicated that they contacted such customers as part of their background check procedures.

Even the limited checks required by the existing self-regulatory rules, if followed, might be adequate to screen individuals seeking positions as registered representatives. In practice, however, particularly with respect to registered representatives already employed in the industry, individuals who have patently unsatisfactory performance records seem to be able to find employment at new firms if they have records of generating large commissions.

The breakdown in hiring controls appears to result from two pervasive industry practices. First, when asked by the hiring firm to evaluate a registered representative's performance, the registered representative's existing or previous employer does not always give a candid assessment. The lack of candor may be explained in several ways. One reason suggested to the Options Study is that firms are fearful of being subject to defamation lawsuits brought by registered representatives who believe their careers have been damaged or

retarded by their employers' unfair or untrue assessments of their performance. Other reasons for lack of candor may be the desire of a firm to rid itself quietly of an unsatisfactory salesperson, or the concern by the firm that lawsuits brought by unhappy customers of the departing registered representative might be aided by evidence that the firm was aware of the registered representative's shortcomings.

The concern about defamation lawsuits is legitimate only insofar as a firm's negative impressions of an employee cannot be substantiated by objective evidence. Thus, such evidence as written or oral customer complaints and repeated (and recorded) violations of a firm's procedures should, in most circumstances, enable a firm to avoid, or to counter successfully, a charge of defamation. Only with regard to those employees who violate no rules, or create no significant problems for customers, but who simply make an unfavorable "subjective" impression, is a firm justified in withholding a negative report. The desire to be rid of a problem salesperson, or the desire to avoid recompensing injured customers — are not legitimate reasons to avoid candor in a self-regulatory system designed to foster integrity of the marketplace and to protect public customers.

A second cause for the breakdown of hiring controls is that the hiring firm does not always heed warnings from the former employer about a registered representative's unsatisfactory performance record.

The Options Study has reviewed several cases in which the quest for the "big producer" has caused a firm deliberately to disregard warnings. In one such case the firm knowingly hired two salesmen who were under suspension by their former firm because of serious unresolved customer problems. The salesmen were hired over the objections of the firm's compliance officer who later complained that the salesmen had been "shoved down [his] throat." In another case a registered representative, who had already been suspended once by the Commission, passed through two firms and was hired by a third in a short period. His job application was being considered not because he was a "big producer", but because his brother was a "big producer," and the two together formed part of the sales "package". In each firm the salesperson created customer problems which the next employer firm knew about, or would have known about if it had been warned by or had diligently asked the prior employers.

Two cases particularly illustrate how lack of candor by former employers, and indifference to obvious problems by prospective employers, have allowed options salespersons with unsatisfactory records to stay in business:

- Mr. B, a reputed "options expert," was employed at ten brokerage firms from 1969 to 1978. Mr. B's employment was terminated by major brokerage firms in 1975, 1976 and 1977. In each case Mr. B left behind customers complaining of his mistreatment of their options accounts. A self-regulatory

organization had taken disciplinary action against Mr. B in both 1977 and 1978 on the basis of customer complaints. Mr. B and each of the firms he was associated with in 1975, 1976 and 1977 have been sued by customers alleging fraud and churning by Mr. B. A termination notice filed with a self-regulatory organization by one of these firms was false as was one application for employment completed by Mr. B and filed with several self-regulatory organizations. Mr. B is today the national sales manager of a registered brokerage firm.

Mr. A's employment was terminated by a major brokerage firm in 1975. The firm filed a termination notice which stated that Mr. A had been the subject of several serious customer complaints and that the brokerage firm believed that Mr. A should not be rehired in the securities industry because he had admitted doing unauthorized options trades in customer accounts. Nonetheless, Mr. A was hired by another major brokerage firm within two days even though it was aware of the termination notice. Sixteen months later, Mr. A left to join still a third firm as an options salesman. At the third firm Mr. A filed an application for employment which was false in that it denied any former serious customer complaints or related conduct. Within six months Mr. A was fired from the third brokerage firm again for doing unauthorized options trades in customer accounts.

b. Termination procedures

As discussed in Chapter VI, the NYSE, NASD and the options exchanges all require member firms to file notices with them when a salesperson leaves the firm for any reason. Notification forms are provided which specify the reasons for termination. The reasons generally fall into the following categories: (1) voluntary resignation; (2) permitted to resign; (3) discharged; (4) deceased. The rules require that member firms file the termination forms promptly

following termination, and, among other things, that the firms disclose whether the terminated salesperson had been the subject of any major customer complaints.

The notification requirements enable the self-regulatory organizations to learn of possible misconduct which might reflect on the qualifications of a registered representative to serve public customers. For the notification requirements to serve useful purposes, the circumstances of employee termination must be stated accurately and truthfully. The Options Study has seen indications, however, that firms are not always truthful in their disclosures. For example:

- . A major broker-dealer firm fired a registered representative and quietly settled the claims of six complaining customers (paying more than \$60,000 in claims, some options-related), before notifying the various self-regulatory organizations of the termination of the salesman involved. In the notification forms, the firm answered "no" to the question whether the salesman ever had been the subject of any major complaint by a customer of the firm.
- . After receiving written complaints about a salesman from at least three customers, and being aware that others would be forthcoming, a firm discharged the salesman. The firm answered "no" to the question on the termination form which asked about customer complaints.

Misrepresentations made by firms to each other or to self-regulatory organizations seriously undermine an important premise on which securities industry self-regulation is based — that brokerage

firms will deal honestly with each other and with the self-regulatory organizations of which they are members, to assure that high standards of conduct prevail in the industry. When such misrepresentations involve employee misconduct, however, they seriously hinder self-regulatory efforts to shield public customers from unsatisfactory registered representatives.

The Options Study believes that the recommendations in Chapter VI, concerning the establishment of a central file containing, among other information, all customer complaints received on particular registered representatives, will greatly reduce the problems presently caused by inaccurate and false termination notices. Nonetheless, the self-regulatory organizations must protect the integrity of their filing systems by bringing prompt disciplinary action against those member firms and their employees who file false termination or registration notices with them.