NOTICE TO MEMBERS: 78-1
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 17, 1978

MEMORANDUM

TO: All NASD Members

RE: Forms Supply -- Official NASD "Don't Know Notices" Form #101

Due to recent increases in printing and shipping costs, the Association has found it necessary to increase the price to members of the NASD's "Don't Know Notice," "DK" Form #101. The DK form is used by members which wish to avail themselves of the "DK" Procedures set forth in Section 9(c) the NASD's Uniform Practice Code. Consistent with established policy, the Association will continue to provide members with adequate supplies of these forms on a pure cost recapture basis.

DK forms may be ordered through the NASD's Uniform Practice Department, 17 Battery Place, Room 1325, New York, New York 10004. Full payment must accompany each order and checks should be drawn payable to the National Association of Securities Dealers, Inc., or NASD, Inc. Upon receipt of payment, shipment will be made to the ordering member. Arrangements may also be made to pick up DK forms on order directly from the office of the Uniform Practice Department during normal business hours.

Minimum Order		
1000 forms	@	$38.00 per 1000
Additional Orders		
Additional forms may be ordered only in multiples of 1000	@	$38.00 per 1000

In the alternative, a member may prepare and use its own DK form, but such must conform in all respects to the official DK form used by the Association.

As to transactions in municipal securities, the Municipal Securities Rulemaking Board (MSRB) has advised that the NASD's DK form may also be used in complying with the procedures of MSRB Rule G-12(d) involving "unrecognized transactions." However, it should be understood that the NASD's procedures referred to on the form do not apply to municipal securities transactions.

Questions regarding DK forms may be directed to the Uniform Practice Department at (212) 422-8841.

Sincerely,

C. Richard Justice
Senior Vice President

NOTICE TO MEMBERS: 78-2
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 20, 1978

TO: All NASD Members and Interested Persons

RE: Proposed Changes in the Annual Review of Coverage Section of the Fidelity Bonding Rule (Paragraph (c) of Appendix C to Article III, Section 32 of the Rules of Fair Practice)

Upon the recommendation of its Fidelity Bonding Committee, the Board of Governors of the Association has proposed an amendment to paragraph (c) of Appendix C to Article III, Section 32 of the Association's Rules of Fair Practice. The amendment would relieve members who have been in business for one year from being required to purchase amounts of fidelity bonding coverage in excess of the amounts necessary for protection of the public and contemplated when Section 32 was adopted in 1974. This situation has arisen because of certain changes which were made in the net capital rule, SEC Rule 15c3-1, since Section 32 was promulgated. This proposal is being published by the Board at this time to enable members and other interested persons to comment thereon. Comments on the proposal must be submitted in writing and received by the Association by February 20, 1978, in order to receive consideration. After the comment period has expired, the proposal will again be reviewed by the Fidelity Bonding Committee taking into consideration the comments received. The proposal will then be reviewed and voted upon by the Board. If approved, the amendment must be submitted to the Securities and Exchange Commission which will publish it for public comment. The proposed amendment must be approved by the Securities and Exchange Commission prior to becoming effective.

Explanation of Proposal

Paragraph (c) of Appendix C requires a member to review its bonding coverage annually and to adjust its bond amount to at least 120% of its highest required net capital during the preceding twelve month period. When Section 32 was adopted members were required to maintain minimum net capital of $5,000 and aggregate indebtedness was not permitted to exceed net capital by a ratio of more than 20/1.

When the net capital rule was amended in 1975 it contained provisions requiring an increase in minimum net capital for certain broker/dealers to $25,000 and also required broker/dealers to maintain a ratio of aggregate indebtedness to net capital of not more than 8/1 in the first year in business and 15/1 in subsequent years.

This meant that the Section 32 bonding requirement during the second year for members who had only been in business for one year would now be computed at 120% of an 8/1 ratio rather than a 15/1 ratio. Thus, the bonding coverage required to be carried by a member in its second year would be higher than that originally intended when the rule was adopted. In fact, the bonding requirement for such second year members would be approximately twice as high as the bond required to be carried by members in similar circumstances in their third and subsequent years in business.

To illustrate, assume a member commences business with a required minimum net capital of $25,000. The minimum fidelity bond it would be required to carry in its first year would be $30,000 (120% x $25,000). Assume that its highest aggregate indebtedness during its first year was $1,200,000. At that point in time it would have been required to maintain minimum net capital of $150,000 ($1,200,000 ÷ 8). At the end of the year when it reviews the adequacy of its bonding coverage it would be required to increase the coverage to $180,000 (120% x $150,000). A member in similar circumstances in its third and subsequent years would use the 15/1 ratio and the minimum bond amount would be $96,000 ($1,200,000 ÷ 15 x 120%).

Specifically, the proposed amendments accomplish the following:

1) The first sentence to present paragraph (c) is deleted because it was pertinent only during the initial implementation of Section 32 in 1974.

2) New paragraph (c)(1) describes the basic procedure which must be used by each member which has been in business longer than one year in determining the minimum amount of fidelity bonding coverage it must carry for a succeeding year when it performs its annual review on each anniversary date of the issuance of its bond.

3) New paragraph (c)(2) allows a member which has been in business for one year, when it performs its first annual review, to use a 15/1 rather than an 8/1 ratio of the

highest aggregate indebtedness it experienced during its first year when calculating the minimum bonding coverage it must carry in its second year.

4) The last sentence of present paragraph (c) is retained but renumbered as subparagraph (3).

All comments should be addressed to Mr. Christopher R. Franke, Secretary, National Association of Securities Dealers, Inc., 1735 K Street, N. W., Washington, D. C. 20006 on or before February 20, 1978. All communications will be available for inspection. Any inquiries should be directed to Mr. A. John Taylor at 202/833-7318.

Sincerely,

Gordon S. Macklin
President

PROPOSED AMENDMENTS TO APPENDIX C OF ARTICLE III, SECTION 32 OF THE RULES OF FAIR PRACTICE

(Deleted material is stricken; new material is indicated by underlining.)

APPENDIX C

Coverage Required

(a) No change

Deductible Provision

(b) No change

Annual Review of Coverage

(c) ~~Each member shall initially determine minimum required coverage of the bond pursuant to subsections (a)(2), (3), (4) and (5) herein, by reference to the highest required net capital during the twelve month period immediately preceding issuance of the bond thereafter. Thereafter,~~

(1) Each member, other than members covered by subsection (c)(2) herein, shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subsections (a)(2), (3), (4) and (5) herein.

(2) Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest aggregate indebtedness it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under Rule 15c3-1 in determining the minimum required coverage to be carried in the members' second year pursuant to subsections (a)(2), (3), (4) and (5) herein. Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than thirty days after the anniversary date of the issuance of such bond.

Notification of Change

(d) No change

NOTICE TO MEMBERS: 78-3
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 23, 1978

TO: All NASD Members

RE: Quarterly Check List of Notices to Members (Fourth Quarter, 1977)

Topically indexed below are the Notices to Members which were issued during the fourth quarter of 1977.

The "Reference" column on the right gives the numbers of Notices to Members which were issued on the corresponding topic during the first three quarters of 1977.

Topic	Serial No. and Summary Description	Date	Reference
Advertising and Sales Literature	77-34 Proposed New Rules	10/6/77	77-10
Check List of Notices	77-41 Quarterly Check List (Third Quarter)	11/3/77	77-1, 77-11, 77-24
Clearance & Settlement Rules	77-45 Mail Vote on Proposed Amendments to By-Laws	12/9/77	
Direct Participation Programs	77-47 Required Filing of Private Offerings for Special Study	12/12/77	77-3
Holidays	77-44 NASD 1978 Schedule	12/2/77	77-2
Investment Companies	77-35 Prompt Payment by Members for Shares of	10/6/77	
Lost or Stolen Securities	77-48 SEC Rule 17f-1	12/21/77	77-25, 77-26, 77-32
MSRB Rules	77-50 Uniform Practice Rules	12/27/77	77-16
Receivers & Trustees, Appointments of	77-36 I.E.S. Management Group 77-40 Price, Allen & Stevens Securities Corp. 77-42 James A. Finan & Co., Inc.	10/3/77 10/25/77 11/4/77	77-4, 77-6, 77-9, 77-20, 77-22, 77-29

	77-49	Brokers' Trading, Inc.	12/21/77	
	77-51	Willis E. Burnside & Co.	12/27/77	
	77-52	Brokers' Trading, Inc.	12/28/77	
Securities Distribution Practices	77-37	Discussion Forums on Section 24	10/7/77	77-31
	77-39	Discussion Forums on Section 24	10/19/77	
Service Bureaus	77-43	Statements to be Provided SEC	11/16/77	
Settlement Schedule	77-38	Election Day & Veterans Day	10/21/77	77-8, 77-30
	77-46	Christmas & New Year	12/8/77	

Members should note that only one copy of each Notice to Members is mailed to every main office of every member. Copies are not mailed to branch offices or to additional personnel in the main office other than the Executive Representative. Therefore, we suggest that all members retain the original copy of each Notice to Members in a separate file in their main office, and that copies needed for internal or branch office distribution be duplicated from the original Notice.

If your main office file is missing any of the above notices, please write to the Office Services Administrator at the NASD Executive Office. Requests for copies should be accompanied by a self-addressed label.

NOTICE TO MEMBERS: 78-5
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 24, 1978

IMPORTANT NOTICE

PROPOSED RULE CHANGES
AND INTERPRETATIONS CONCERNING SECURITIES
DISTRIBUTION PRACTICES

To: All NASD Members and Interested Persons

Re: Proposed Changes in and Interpretations of the Rules of Fair Practice, as Revised, Consisting of:

1. New Subsection (m) of Section 1 of Article II;

2. Amendment to Section 8 of Article III and New Interpretation Thereof;

3. Amendment to Section 24 of Article III and New Interpretation Thereof; and

4. New Section 36 of Article III

On September 23, 1977, the NASD Board of Governors in Notice to Members No. 77-31 published Proposed Rule Changes and Interpretations Concerning Securities Distribution Practices and solicited comments from members of the Association and other interested persons. The Board's Ad Hoc Committee on Section 24, appointed to review the distribution practices of the industry, and the Board itself, thereafter reviewed the written comments received as well as the oral comments expressed at a series of public meetings held during the month of October. The Board also expanded

the membership of the Ad Hoc Committee on Section 24 to include additional representatives of regional firms. Subsequently the Ad Hoc Committee submitted revised proposals to the Board. At its January 16, 1978 meeting the Board considered these revised proposals and directed that they be published and that members and other interested persons be given an opportunity to comment thereon.

This Notice delineates the Board's action at that meeting and is divided into four sections. For persons unfamiliar with the September 23, 1977 Notice, the first section reviews certain background information which led to the proposals. The second summarizes the significant revisions of the proposals published last September. The third responds to certain comments by members and others, analyzes the proposals, as revised, and discusses the reasons for the revisions. The fourth section sets forth the revised proposals.

The revised proposals are published by the Board at this time to provide members and other interested persons another opportunity to comment. After the comment period has expired, the comments will be reviewed by the Ad Hoc Committee on Section 24 and by the Board itself at its regular meeting in March, 1978. If the revised proposals are adopted by the Board at that meeting, the proposals will be submitted to members for approval as required by Article VII of the By-Laws of the Association and submitted to the Securities and Exchange Commission for approval as required by Section 19(b) of the Securities Exchange Act of 1934, as amended.

In submitting these proposals to the membership for comment, the Board wishes to emphasize their importance to maintaining the current, highly efficient system for the distribution of securities which exists in the United States. The proposals were developed with that thought in mind and as they are reviewed, the reader should remember that they are designed to prevent practices which are inimical to that system, which cut across established rules or are inconsistent with disclosures made in prospectuses accompanying securities in distribution. In view of their importance, the Board urges all members to submit comments on the proposals as they deem appropriate.

All comments should be addressed to Mr. Christopher R. Franke, Secretary, National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006. Comments must be submitted in writing and received by the Association no later than February 24, 1978, to receive consideration. Comments will be available for inspection. Questions may be addressed to Robert E. Aber, Senior Attorney, NASD (202) 833-7259.

Sincerely,

Gordon S. Macklin

Gordon S. Macklin
President

I

BACKGROUND OF PROPOSED RULES AND INTERPRETATION

Beginning in the early 1970's investment advisers of registered investment companies and others were subject to litigation under various theories of fiduciary responsibility for their failure to devise means by which fixed brokerage commissions could be recaptured for the benefit of the shareholders of the investment companies they managed. The judicial decisions in this area discuss the various brokerage recapture devices available, including their legality under various circumstances and at various times, and the obligation of an investment company adviser effectively to inform independent directors of the investment company of the possibility of recapture in order that they be in a position to exercise their business judgment concerning the matter.

Although the judicial decisions discussing recapture focus primarily on the methods of recapturing brokerage commissions, two decisions have addressed the question of recapturing selling concessions available to dealers and underwriters participating in public offerings. The District Court in Moses v. Bergin, 316 F. Supp. 31 (D. Mass. 1970) essentially concluded that such recapture was prohibited by Article III of the NASD's Rules of Fair Practice. While that decision was reversed on appeal, the question of underwriting recapture was not before the Court of Appeals and was not, therefore, disturbed.

The Federal District Court for the Southern District of New York, in Papilsky v. Berndt, CCH Fed. Sec. L. Rep., ¶95,627 (S.D. N.Y. 1976), had occasion to consider the question of recapture generally, as well as its applicability to selling concessions in underwritten offerings. Plaintiffs in Papilsky argued that the investment adviser to a registered investment company could be a member of the NASD, participate in underwritings as a syndicate member or selling group member, and credit against the advisory fee any sales concessions received from sales by it to the fund with which it was affiliated. Defendants argued that the suggestion advanced by plaintiff would have caused them to violate various laws, including provisions of the NASD's Rules of Fair Practice. Thus, the defendants argued, among other things, that the recapture of selling concessions and credit against the advisory fee would result in violations of Sections 23 and 24 of Article III of the NASD's Rules of Fair Practice and in a violation of the NASD's Interpretation under Section 1 of that Article concerning the practice of Free-Riding and Withholding.

Without any meaningful discussion, the court rejected defendants' argument and concluded that it would not be a violation of Section 23 or 24 of the NASD's Rules or of the Free-Riding and Withholding Interpretation if an investment company were indirectly permitted to receive a

selling concession through the utilization of a recapture device in underwritings. The Court did, however, express some reservation in that regard when it stated that ". . . in the absence of a ruling from either the NASD or the SEC that they would have treated underwriting recapture as somehow different, it must be concluded that recapture of underwriting fees was available and legal."

Shortly following the Papilsky decision a number of investment advisers inquired of the NASD whether its Rules of Fair Practice indeed did permit an investment company to devise a method by which it could recapture selling concessions in underwritten offerings. Particular emphasis was placed on Sections 23 and 24 of Article III and on the Free-Riding and Withholding Interpretation under Section 1 of that Article.

The Board of Governors, in September, 1976, was advised by the Association's staff of several letters requesting clarification of the applicability of NASD Rules to the recapturing of selling concessions by investment companies. Thereafter an Ad Hoc Committee on Section 24 was appointed to study and advise the Board of Governors with respect to the questions raised by Papilsky and the inquiries that had been received.

In letters, dated November 23 and December 3 and 6, 1976, the Association, through its General Counsel, responded to these letters and stated the Association's view that recapturing selling concessions by an investment company would be a violation of Section 24 as follows:

> ". . . the payment of concessions or commissions to a mutual fund in the form of a reduction in its management or advisory fee, as distinguished from a direct purchase with a reduction of the public offering price in the amount of the concession, does not change the substance of the transaction. The net effect of such is the receipt of underwriting discounts by the mutual fund. Such flies directly into the face of Section 24."

The Association also advised that such a recapture device would result in discrimination among customers and would be inconsistent with disclosure generally found in offering documents. In this connection it stated that.

> ". . . To permit such would unfairly and improperly discriminate against customers generally; in particular, small investors . . . Such is not only inconsistent with the public interest but, in the opinion

> of the Association's Board of Governors, it constitutes unfair discrimination, a fortiori, in a situation where no disclosure had been made in the prospectus that preferential treatment of the type suggested would take place or be permitted."

With respect to questions raised under Section 23 and the Free-Riding and Withholding Interpretation under Section 1, the Association indicated that those provisions do not directly prohibit recapturing selling concessions. In effect, it was stated that Section 23 applied only to secondary trading and that the Free-Riding and Withholding Interpretation was only directed at so-called "hot issues" and does not have any direct bearing on the permissibility of underwriting recapture.

After responding to various inquires on this subject, the Securities and Exchange Commission communicated with the Association concerning its interpretation as contained in the General Counsel's letters. In addition, the Commission advised that it had received a request to issue an order declaring that recapture of underwriting fees would not involve fraudulent or manipulative acts or practices or would not involve a failure to observe just and equitable principles of trade. The Commission also noted that it had pending applications for exemptions under Section 17(a) of the Investment Company Act of 1940 to permit investment companies to engage in underwriting recapture.

With respect to the General Counsel's letters which conclude that underwriting recapture would violate Section 24, the Commission expressed concern that such an approach raised important policy questions of general application, including questions pertaining to the public interest and unnecessary burdens on competition. Moreover, the Commission questioned the Association's authority to adopt a rule which has the effect given to it in the General Counsel's letters.

Based on the foregoing, the Commission requested that the General Counsel's letters be filed as a proposed rule change under Section 19(b)(2)(B) of the Securities Exchange Act to enable public review and consideration of all the relevant issues.

The Association considered the matter, and in a letter to the Commission, dated April 1, 1977, explained that its recently expressed views on Section 24 did not represent a new position on the subject and did not, therefore, require consideration as a rule proposal under Section 19(b)(2)(B) of the Exchange Act. In an effort to resolve the matter, the Association requested a meeting with the Commission.

The Commission agreed to meet with the Association to discuss this matter and on May 26, 1977, such a meeting occurred. At this meeting the Association's representatives urged the Commission to accept the Association's position that the statements in the General Counsel's letters concerning Section 24 represented no new position and that it was unnecessary and undesirable to question at that time the overall validity of Section 24.

In the course of the meeting with the Commission, two general concerns emerged. First, certain of the Commissioners expressed concern that Section 24 effectively permits certain customers to receive selling concessions, discounts or allowances in their purchases of securities from public offerings. It was suggested, for example, that this might occur if a customer satisfied soft dollar obligations with purchases from an underwriting or if a member of a selling syndicate or selling group agreed to engage in so-called "overtrading" and purchase the securities taken in trade at a price higher than the then prevailing market price. Moreover, the apparent widespread practice of designated sales, according to certain of the Commissioners, suggested that some dealers were not rendering distribution services in connection with public offerings and were nevertheless being granted a selling concession by the syndicate manager agreeing to the designation. The second area of concern focused generally on the NASD's authority to adopt or retain Section 24 in light of prior Commission decisions and recent amendments to Section 15A of the Securities Exchange Act of 1934.

As a result of the meeting with the Commission, the Association agreed to undertake a review of current underwriting practices and to formulate specific policy positions. As a result, the Association published Notice To Members No. 77-31 on September 23, 1977, which solicited comments on various proposals designed to correct certain of the abuses discussed at the meeting with the Commission and to state authoritatively that recapture devices such as those suggested in the Papilsky decision would violate Section 24 of Article III of the Association's Rules of Fair Practice.

As indicated above, the Committee and Board of Governors reviewed the various comments received and, as a result of those comments, developed the revised proposals which are part of this Notice.

II

SUMMARY OF SIGNIFICANT REVISIONS OF PROPOSALS PREVIOUSLY PUBLISHED

A. Proposal No. 1 - Definition of "Fixed Price Offering" -- Article II, Section 1

The definition of "fixed price offering" has been modified in two respects to make it clear that the phrase does not include wholly foreign offerings or offerings of redeemable securities of registered investment companies where the price is determined by the net asset value of the security.

B. Proposal No. 2 - Swap Transactions -- Article III, Section 8

The definition of "fair market price", for purposes of determining the price at which securities may be taken in trade, has been changed by elimination of the highest independent bid as the lower limit for fair market price. It continues to specify that fair market price shall not be higher than the lowest independent offer for the securities taken

in trade at the time of purchase. However, in an exceptional or unusual case, a member may purchase securities taken in trade at a price above the lowest offer if the member can meet the burden of clearly demonstrating that the higher price was justified taking into consideration all factors relevant to the transaction. Examples of such factors are included in subparagraph (b)(2)(ii) of the Section and in the interpretation thereof.

C. Proposal No. 3 - Allowance of Selling Concessions, Discounts and Other Allowances; Designated Orders; Soft Dollar Payments -- Article III, Section 24

The previously published provisions designed to implement the Section's existing requirement that selling concessions, discounts and other allowances be granted only as consideration for services rendered in distribution have been substantially revised. The restrictions on designated orders and bill and deliver practices have been deleted. A person would still be required to render services in distribution to receive a selling concession, discount or allowance for the sale of securities from fixed price offerings, and the interpretation would continue to provide that the existence of underwriting services or selling effort are essential to meeting the requirement.

The interpretation concerning indirect concessions, so-called soft dollar payments, has also been revised to clarify the circumstances under which a dealer will be determined to be offering services or products for an agreed upon consideration.

Recordkeeping and reporting requirements concerning designated orders have been added to facilitate enforcement of the Section. Members who are designated to receive orders would be required to maintain certain records, and members who are requested by purchasers to comply with their designation of other broker-dealers would be required to file certain reports with the Association. Also, members who grant selling concessions, discounts or other allowances to another person would have to obtain certain written agreements from those persons. The agreements could be obtained in advance and used on a continuing basis for all succeeding fixed price offerings. The provisions to require written agreements from foreign dealers incorporates the substance of original Proposal No. 4, which involved an amendment to Section 25(c). Original Proposal No. 4 has been deleted and Section 25(c) will not be amended.

D. Proposal No. 4 - Sales to Related Persons -- Article III, Section 36

Proposed Section 36 would continue to permit a member to retain securities or sell securities in a fixed price offering to a related person (i.e., a person in an ownership relationship with the member) only if the member has made a bona fide public offering of the securities. As originally proposed, a member would have been presumed not to have made a bona fide public offering if the securities being

offered immediately traded in the secondary market at prices above the member's cost. As revised, a member is presumed not to have made a bona fide public offering if the securities being offered immediately trade in the secondary market at prices at or above the public offering price.

The Section has also been revised to permit members to sell to related persons who are themselves members and, hence, would themselves be subject to the provisions of proposed Section 36, or to non-member foreign brokers or dealers who agree in writing to make a bona fide public offering of the securities and otherwise comply with Sections 8, 24, 25 and 36 of Article III of the Rules of Fair Practice.

III

EXPLANATION OF REVISED PROPOSALS

A. Introduction

The rationale and approach underlying the proposals has not been changed. The proposals are designed to assure, among other things, that members who agree among themselves to distribute securities to the public at a fixed, stated public offering price conduct the distribution in a manner consistent with their public representations. The proposals also are designed to assure that all customers are treated fairly and in a nondiscriminatory manner when purchasing securities in a fixed price offering, and that members do not engage in practices which result in maintaining books and records which do not reflect the accurate purchase or sale price of securities. All of the proposals apply only to "fixed price offerings" as that phrase is defined in proposed Section 1(m) of Article II.

Most of the revisions to the proposals resulted from comments received from members and are designed to respond to the various criticisms without jeopardizing the overall goals to be achieved. Certain revisions relating to recordkeeping and reporting respond to an evaluation by the Association's staff concerning the enforceability of the proposed rules. Other changes in the original proposals arose from comments on technical matters and from the Ad Hoc Committee's and the Board's further deliberations.

B. Proposal No. 1 -- Section 1(m) of Article II

As indicated above, two revisions in the definition of "fixed price offering" clarify that wholly foreign offerings and offerings of certain redeemable securities are not included in the coverage of the Association's rules concerning fixed price offerings. The words "or any territory thereof" have also been added immediately after the words "securities . . . publicly offered in the United States" to clarify that offerings in Puerto Rico and other territories of the United States are covered by such rules.

C. Proposal No. 2 -- Section 8 of Article III

Section 8 presently requires that members purchase securities taken in trade at a fair market price at the time of purchase or act as agent in the sale of such securities.

Proposal No. 2 generally clarifies, and lends some objectivity to, the meaning of "fair market price" to allow effective enforcement of Section 8. In the original proposal fair market price was to be determined from quotations and defined as the range between, and including, the highest independent bid and the lowest independent offer. That definition was criticized by many commentators as too restrictive, since many transactions may occur outside that range at prices which are believed to be, and are, fair market prices. Also, several commentators criticized the attempt to establish objective standards for determining fair market price. They felt that no such standards could reliably indicate fair market price because of the numerous factors involved in that determination, including such things as the size of the transaction and the circumstances of a dealer's pattern of trading in the securities taken in trade or comparable securities. While the Board recognizes that fair market price, particularly for debt securities, is not subject to precise determination, because of the limited purpose to which the definition in Section 8 applies and the flexibility afforded by permitting transactions to occur at prices as high as the lowest independent offer, it decided that the proposal should, as much as possible, retain the objectivity afforded by reliance on quotations.

The Board believes that quotations are an efficient and reliable means of determining fair market price for most swap transactions and that reliance upon them provides an objective standard allowing members to determine easily their obligations. Reliance upon them also facilitates enforcement of the Section. The revised proposal, however, does provide some additional flexibility. As revised, in an exceptional or unusual case, if a member can meet the heavy burden of demonstrating that a higher price was justified, after consideration of all factors relevant to the transaction, the member will be allowed to effect a swap transaction at a price above the lowest independent offer. In such cases the member will be responsible for maintaining adequate records to substantiate its analysis of fair market price for the traded security. Thus, the new proposal retains the advantages of objectivity, yet affords some flexibility to accommodate special circumstances. The types of special circumstances contemplated are embodied in subparagraph (b)(2)b. of Section 8 and are discussed more extensively in the interpretation thereof.

While the Board now proposes to revise Section 8 to afford the additional flexibility referred to, it is expected that reliance on subparagraph (b)(2)b. will occur only in exceptional circumstances. The Association will review records of swap transactions and all transactions which occur at prices above the lowest independent offer will be reviewed very carefully. As indicated, a member will have the heavy burden in all cases to demonstrate that it was justified in paying the higher prices.

The original proposal also established a minimum price a member could pay for a security taken in trade. While swap transactions at prices lower than fair market price would not result in a customer acquiring offered securities at an effective discount from the public offering price, such a limitation would complement the Association's Free-Riding and Withholding Interpretation. On reconsideration, the Board determined that, in the absence of any known abuses in the area, it would be inappropriate to impose the type of restriction originally proposed. Moreover, if abuses are revealed, the Board believes that they should be resolved by way of the Free-Riding and Withholding Interpretation of Article III, Section 1 of the Rules of Fair Practice.

The Board has proposed an amendment to the provision requiring that quotations for equity securities which are traded on an exchange or quoted in NASDAQ be obtained from the exchange or NASDAQ. This provision, as revised, would be applicable only to common stocks. This revision recognizes that trading characteristics of preferred stocks more closely resemble trading characteristics of debt securities than those of common stocks. Accordingly, the Board believes that, in obtaining quotations for preferred stocks and debt securities taken in trade, a member should not be restricted to quotations obtainable on an exchange or in an automated quotation system.

Certain commentators on the proposed revisions to Section 8 questioned the related issues of enforceability of the Section and the burden of its recordkeeping requirements. Recently the Association staff evaluated the enforceability of Section 8, as proposed for revision, and concluded that the recordkeeping requirements would be necessary and sufficient to facilitate enforcement of the Section. On the basis of that report, the Board concluded that the burden imposed by the proposed recordkeeping requirements would be reasonable and necessary.

D. Proposal No. 3 -- Section 24 of Article III

1. Eligibility Criteria

Section 24 presently requires that selling concessions, discounts and other allowances be allowed only to brokers or dealers engaged in the investment banking or securities business and only as consideration for services in distribution. As originally proposed, the interpretation suggested a prophylactic approach for determining whether services in distribution were rendered. This prophylactic approach suggested a dichotomy between direct sales on the one hand and designated sales on the other. Direct sales necessarily involve direct contact between the dealer and customer, giving rise, at least implicitly, to a presumption that a service in distribution had been rendered. In a designated sale, however, the syndicate manager would not ordinarily know of, and could not reasonably be required to find out about, any direct selling effort by the dealer. But the syndicate manager would know of the underwriting services of dealers who were syndicate members. Accordingly, the original proposal prohibited members from accepting designated orders for any dealer not a member of the underwriting group and from accepting designated orders as to members of the underwriting group in an amount in excess of their individual underwriting commitments.

Many commentators criticized the prophylactic approach taken in the original proposal because of its recognition of only a few forms of distribution services. Moreover, commentators argued that a designated order does not necessarily imply an absence of direct contact or selling effort by the designated dealer. In light of considerable comment on this issue the prophylactic approach has been discarded, and an interpretation is proposed which continues to recognize generally that a dealer renders services in distribution if it provides underwriting services in that particular offering or exercises some selling effort with respect to a sale. The proposed interpretation also recognizes that furnishing research services generally might aid a dealer in making a sale of specific securities or securities generally. Furnishing research services, by itself, however, would not constitute services in distribution. Thus, a dealer would have to engage in some selling effort with respect to the particular offering in order to have met the requirement that services in distribution be rendered. While furnishing research might be one factor which aids a dealer in selling securities, the proposal would still prohibit the dealer from reallowing all or part of the selling concession to a customer directly or indirectly by crediting that selling concession against a soft dollar obligation resulting from supplying that research or otherwise. This aspect of the proposals is discussed below under the caption "Indirect Concessions".

The original proposal also would have restricted bill and deliver practices in both direct sales and designated orders. Many commentators criticized the proposal, emphasizing that the practices contributed to the mechanical efficiency of the distribution process. The Board agrees. Therefore, the restrictions on bill and deliver practices have been deleted from the revised proposal.

2. Indirect Concessions

As indicated, the restrictions on designated orders contained in the original proposal were designed to serve as a prophylactic for determining when a dealer rendered services in distribution. Those restrictions also were designed to serve as a prophylactic against dealers granting concessions or discounts indirectly to customers through devices such as crediting those selling concessions or discounts received on a sale against a soft dollar obligation of the customer. While not all designated orders result in such indirect credits, it was felt that in many cases they do. In light of the criticism that the original restrictions acted unfairly against regional and smaller dealers, on reconsideration the Board believes that the restrictions on designated orders are also not justified for purposes of preventing the granting of indirect concessions. Having discarded the prophylactic approach entirely, more attention has been focused on the interpretation concerning indirect concessions, including soft dollar payments. This attention has resulted in clarifying the types of arrangments which might give rise to a member's indirectly granting a selling concession, discount or other allowance to a customer in violation of Section 24.

In the current proposals the basic factors for determining the existence of indirect concessions do not depart from the original proposed interpretation of Section 24. Thus, if a customer purchases securities from a member from a fixed price offering, the member will have granted that customer a selling concession, discount or allowance if the member also supplies that customer with services or products which are commercially available or are offered by the member to that customer or others for cash or agreed upon consideration unless that customer fully compensated the member for such services or products with consideration other than the selling concession received on the sale.

In clarifying the types of arrangements which might result in a member indirectly granting a customer a selling concession, discount or other allowance, the interpretation concerning the phrase "agreed upon consideration" has been revised. Services or products will be considered to be provided for an agreed upon consideration if there is

> an express or implied agreement between the person providing the service or product and the recipient thereof calling for the provider of the service or product to be compensated therefor with an agreed upon or mutually understood source and general amount of consideration.

Thus, a recipient's representation, express or implied, that it will compensate the provider of a service or product with consideration, including a general minimum level of brokerage commissions or other business, constitutes "agreed upon consideration." Once it is determined that a dealer supplies its customers with products or services which either are commercially available or are supplied to the customer or others for an "agreed upon consideration" the dealer will then be expected to show that it received full payment, other than selling concessions, for those services or products.

Some commentators objected to an interpretation of Section 24 which effectively would prohibit customers from satisfying soft dollar obligations with selling concessions received or retained by a dealer from a sale of securities from a fixed price offering. These commentators were concerned that such an interpretation would alter the manner in which some dealers have distributed securities. Also, some commentators felt that research was a legitimate part of services in distribution. The first comment goes to the fundamental purpose of Section 24. The Board has concluded that allowing a customer to satisfy certain soft dollar obligations with selling concessions results in the customer receiving the selling concessions. Pursuant to Section 24, as well as disclosure statements repeated in virtually all prospectuses and underwriting and selling dealer agreements concerning fixed price offerings, selling concessions and allowances from the public price are available only to brokers or dealers who are engaged in the investment banking or securities business and only as consideration for rendering services in distribution.

The Board generally does not disagree with the second comment. Indeed, the current proposal concerning services in distribution recognizes that supplying research may be one factor which aids in making a sale. The Board, however, believes that research, by itself, does not satisfy the requirement that the dealer perform some selling effort with respect to the particular offering. Accordingly, the proposed interpretation would also require a dealer to engage in some direct selling contact.

One additional revision to the Interpretation extends its coverage of indirect concessions to assure that an affiliate of a member may not, under specified circumstances, provide products or services to another person and be compensated therefor through the receipt of selling concessions. As originally proposed, the Interpretation might have been viewed as applying only to services or products furnished by a member itself.

3. Obligations to Keep Records and Obtain Agreements

Subsection (b) of Section 24 continues to require members who grant selling concessions to other persons to obtain a written agreement from such persons that they will make a bona fide public offering of the offered securities. As revised, subsection (b) also requires that persons receiving selling concessions agree to comply with Section 24. The substance of the original proposed amendment of subsection (c) of Section 25 has been incorporated into Section 24(b). Thus, Section 24(b) would also require a member who grants a selling concession to a non-member broker or dealer in a foreign country to obtain from that broker or dealer a written agreement that it will comply with Sections 8, 24, 25, and 36 of Article III. The original proposal to modify subsection (c) of Section 25, therefore, has been deleted.

The written agreement required by subsection (b) of Section 24 may be obtained in blanket form, covering all instances when a member grants a selling concession, discount or other allowances to the other party to the agreement or they may be incorporated in the agreement among underwriters or selling dealers' agreements pertaining to particular offerings.

These additional obligations to obtain agreements are believed to be necessary to facilitate compliance with and enforcement of Section 24. A person receiving a selling concession, discount or other allowance is in the best position to evaluate compliance with Section 24, particularly those aspects which require that services in distribution be rendered and those which prohibit reallowances of all or part of the concession, discount or allowance by soft dollar credits and other indirect means. Requiring the agreements specified in subsection (b) will affirmatively remind underwriters and dealers of their obligations in this regard.

Since the revised proposals do not rely on the prophylactic measures embodied in the original proposals, the Board recognizes that the current proposals will require different enforcement techniques. The Association's staff has evaluated the problems of enforcement and made recommendations concerning recordkeeping and reporting. These recommendations were adopted and appear in substance in proposed subsections (c) and (d) of Section 24. Subsection (c) would require members who effect designated orders, particularly syndicate managers, to file certain reports with the Association. Reports of designated orders would have to be filed within 30 days after the end of each calendar quarter. The reports would pertain to all fixed price offerings which terminated during the preceding quarter and would be required to contain the name of the person making the designation, the identity of the brokers or dealers designated, the identity and amount of securities for which each broker or dealer was designated and the date of the offering. Subsection (d) of Section 24 would require members who are designated for the sale of securities to keep records of such designations. The records would be required to be maintained for 24 months and would be required to identify the customer making the designation, the amount of securities for which the member was designated, the manager or managers of the offering, if any, and the date of the offering.

The Board believes that these recordkeeping and reporting requirements are not unreasonably burdensome and that they will lend helpful assistance to the Association's staff in its enforcement of Section 24. While the requirements apply only to designated sales, that does not mean that enforcement efforts will disregard direct sales.

E. Proposal No. 4 -- Section 36

Proposed Section 36 has been revised in several minor respects. The original proposal would have prohibited a member, in connection with securities which are part of a fixed price offering, from selling such securities to, or placing such securities with, any related person of a member. A related person is defined generally as a person in an ownership relationship with a member. The Section has been revised to permit sales of securities to related persons who are either subject to the Section or non-member foreign brokers or dealers who agree to make a bona fide offering, and otherwise comply with Sections 8, 24, 25, and 36 of Article III of the Rules of Fair Practice.

Section 36 as originally proposed permitted a member to sell securities to, or place securities with, a related person after the termination of the fixed price offering if the member had made a bona fide public offering but was unable to sell its entire allotment or retention. The Section would have provided that a member is presumed not to have made a bona fide public offering if the securities offered immediately trade in the secondary market at prices above the member's cost. Several commentators objected that this standard was unnecessarily harsh. Among other things, it would have effectively prohibited a member from placing unsold securities in a trading account if, at the time the syndicate terminated, the securities traded below the public offering price but above the member's cost.

As a result of the public comments, the presumption has been revised. As revised, a member will be presumed not to have made a bona fide public offering for the purposes of Section 36 if the securities being offered immediately trade in the secondary market at a price at or above the public offering price.

IV

PROPOSED CHANGES IN AND INTERPRETATIONS OF THE RULES OF FAIR PRACTICE, AS REVISED

Proposal No. 1

PROPOSED AMENDMENT TO ARTICLE II, SECTION 1 OF THE RULES OF FAIR PRACTICE

Article II, Section 1 is proposed to be amended by the addition of a new subsection (m). All other subsections of Section 1 remain unchanged.

"Fixed Price Offering"

(m) The term "fixed price offering" means the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act of 1933, except that the term does not include offerings of "exempted securities" or "municipal securities" as those terms are defined in Section 3(a)(12) and 3(a)(29), respectively, of the Securities Exchange Act of 1934 or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act of 1940 which are offered at prices determined by the net asset value of the securities.

Proposal No. 2

PROPOSED AMENDMENT TO ARTICLE III, SECTION 8 OF THE RULES OF FAIR PRACTICE

Article III, Section 8 is proposed to be amended by adding the language indicated by underlining and by deleting the language indicated by striking out.

Section 8

(a) A member, ~~when a member of a selling syndicate or a selling group, shall purchase~~ engaged in a fixed price offering, who purchases or arranges the purchase of securities taken in trade shall purchase the securities at a fair market price at the time of purchase, or shall act as agent in the sale of such securities and charge a normal commission therefor.

(b) When used in this section -

(1) the term "taken in trade" means the purchase by a member as principal, or as agent for the account of another, of a security from a customer pursuant to an agreement or understanding that the customer purchase securities from the member which are part of a fixed price offering.

(2) the term "fair market price" means -

a. a price which is not higher than the lowest independent offer for the securities at the time of purchase, if offer quotations for the securities are readily available. If such quotations are not readily available, the fair market price may be determined by comparing the security taken in trade with other securities having similar characteristics and of similar quality and for which offer quotations are readily available; or

b. in an exceptional or unusual case, a price higher than the lowest independent offer when all factors relevant to the transaction are taken into consideration, including, among other things, whether a customer of a member has given an indication of interest to purchase the securities taken in trade at a higher price; the member's pattern of trading in the securities or comparable securities at the time of the transaction; the member's position in and the availability of, the securities taken in trade; the size of the transaction; and the amount by which the price paid exceeds the lowest independent offer. In all such cases the burden for demonstrating justification that the higher price was the fair market price shall be on the member.

(3) the term "normal commission" means an amount of commission which the member would normally charge to that customer or a similarly situated customer in transactions having similar characteristics but not involving a security taken in trade.

(c) A member, in determining fair market price pursuant to this Section, shall with respect to -

(1) common stocks, which are traded on a national securities exchange or for which quotations are entered in an automated quotation system, obtain the necessary quotation from the national securities exchange or from the automated quotation system; and

(2) other securities and common stocks not included in subparagraph (1) of this subsection (c) obtain directly or with the assistance of an independent agent necessary quotations from two or more independent dealers.

(d) A member who purchases a security taken in trade shall keep or cause to be kept adequate records to demonstrate compliance with this Section and shall preserve the records for at least 24 months after the transaction. If an independent agent is used for the purpose of obtaining quotations, the member must request the agent to identify the dealers from whom the quotations were obtained and the time and date they were obtained or request the agent to keep and maintain for at least 24 months a record containing such information.

* * * * *

The following new interpretation of Section 8 is proposed.

--- INTERPRETATION OF THE BOARD OF GOVERNORS ---

Fair Market Price

A member who, in reliance on subparagraph (b)(2)b. of Section 8 of this Article, pays a price for securities taken in trade which is higher than the lowest independent offer will have a heavy burden to demonstrate that the price paid was the fair market price. Subparagraph (b)(2)b. lists factors which might be considered relevant to justify paying a price higher than the lowest offer. The existence of only one such factor, however, will not necessarily be sufficient to meet the heavy burden, though in a given case it may be sufficient. In any event, all facts and circumstances must be considered. For example, a member may be able to satisfy the burden of demonstrating that fair market price was paid by showing that the price paid did not exceed the price, less an amount equal to a normal commission on an agency transaction, at which a customer had given the member an indication of interest to purchase the securities, or that the member held a short position in the security purchased, that it desired to cover that short position, that the availability of the security was scarce and that the amount of securities taken in trade could not have been acquired at a lower price.

Adequate Records

If the member purchases securities taken in trade at a price which is no higher than the lowest independent offer as determined according to this Section, it will have kept adequate records if it records the time and date quotations were received, the identity of the security to which the quotations pertain, the identity of the dealer from whom, or the exchange or quotation system from which, the quotations were obtained, and the quotations furnished. If a member uses the services of an independent agent to obtain the quotations and the agent does not disclose the identity of the dealers from whom quotations were obtained, the member will have kept adequate records if it otherwise complies with subsection (d) of Section 8 hereof and it records the time and date it received the quotations from the agent, the identity of the agent, and the quotations transmitted by the agent.

If a member, in reliance on subparagraph (b)(2) b. of this Section, pays more than the lowest independent offer, it will have kept adequate records if, in addition to the foregoing records, it keeps records of all relevant factors it considered important in concluding that the price paid for the securities was fair market price.

Proposal No. 3

PROPOSED AMENDMENT TO ARTICLE III, SECTION 24
OF THE RULES OF FAIR PRACTICE

Article III, Section 24 is proposed to be amended by adding the language indicated by underlining and by deleting the language indicated by striking out.

Section 24

In connection with the sale of securities which are part of a fixed price offering --

(a) ~~Selling concessions, discounts, or other allowances, as such, shall be allowed only as consideration for services rendered in distribution and in no event shall be allowed~~ a member may not grant or receive selling concessions, discounts, or other allowances except as consideration for services rendered in distribution and may not grant such concessions, discounts or other allowances to anyone other than a broker or dealer actually engaged in the investment banking or securities business; provided, however, that nothing in this rule shall prevent any member from selling any security owned by him to any person at any net price which may be fixed by him unless prevented therefrom by agreement.

(b) a member who grants a selling concession, discount or other allowance to another person shall obtain a written agreement from that person that he will make a bona fide public offering of such securities and will otherwise comply with the provisions of this Section, and a member who grants such selling concession, discount or other allowance to a nonmember broker or dealer in a foreign country shall also obtain from such broker or dealer a written agreement to comply with the provisions of Sections 8, 25 and 36 of this Article.

(c) a member who receives an order from any person designating another broker or dealer to receive credit for the sale shall, within 30 days after the end of each calendar quarter, file reports with the Association containing the following information with respect to each fixed price offering which terminated during that calendar quarter: the name of the person making the designation; the identity of the brokers or dealers designated; the identity and amount of securities for which each broker or dealer was designated; the date of the commencement and termination of the offering and such other information as the Association shall deem pertinent.

(d) a member who is designated by its customer for the sale of securities shall keep, and maintain for a period of 24 months, records in such form and manner to show the following information: name of customer making the designation; the identity and amount of securities for which the member was designated; the identity of the manager or managers of the offering, if any; the date of the commencement of the offering and such other information as the Association shall deem pertinent.

* * * *

The following new interpretation of Section 24 is proposed.

--- INTERPRETATION OF THE BOARD OF GOVERNORS ---

Services in Distribution

The proper application of Section 24 requires that, in connection with fixed price offerings, selling concessions, discounts or other allowances be paid only to brokers or dealers actually engaged in the investment banking or securities business and only as consideration for services rendered in distribution.

A dealer has rendered services in distribution in connection with the sale of securities from a fixed price offering if the dealer is either an underwriter of a portion of that offering or has engaged in some selling effort with respect to the sale. While furnishing a customer with research or other services might aid a dealer in selling particular securities or securities generally to that customer, the furnishing of such research will not by itself constitute sufficient selling effort to satisfy the provisions of Section 24. Rather, some direct selling contact on a particular offering will be necessary. Even though the furnishing of research to a customer may aid a dealer in the sale of securities, the furnishing of such research under certain circumstances, as described below, could result in the dealer granting that customer a selling concession, discount or other allowance in violation of Section 24.

A broker or dealer who has received or retained a selling concession, discount or other allowance may not grant or otherwise reallow all or part of that concession, discount or allowance to anyone other than a broker or dealer engaged in the investment banking or securities business and only as consideration for services rendered in distribution. The improper grant or reallowance of a selling concession, discount of other allowance might occur directly or indirectly through such devices as transactions in violation of Section 8 of this Article, or other indirect means as described below.

A member granting a selling concession, discount or other allowance to another person is not responsible for determining whether such other person may be violating Section 24 by granting or reallowing that selling concession, discount or other allowance to another person, unless the member knew, or had reasonable cause to know, of the violation.

Selling Concessions, Discounts or Allowances

General

A member who, itself or through its affiliate, (i) supplies another person with services or products which are commercially available or are provided by the member or its affiliate to such person or to others for cash or for some other agreed upon consideration, including brokerage commissions, and (ii) also retains or receives selling concessions, discounts or other allowances from purchases by that person or its affiliate of securities from a fixed price offering, is improperly granting a selling concession, discount or other allowance to that person unless the member or its affiliate has been, or has arranged and reasonably expects to be, fully compensated for such services or products from sources other than the selling concession, discount or allowance retained or received on the sale.

Commercially Available

As used in this interpretation, a product or service is "commercially available" if it is generally available on a commercial basis. It would include such things as office space, secretarial services, quotation equipment, news periodicals, certain research products or services, airline tickets, and other items which could be purchased directly or indirectly by the recipient from a third party.

The term includes products or services which a person receives from another for redistribution if the same service or product, or a service or product which is substantially an identical service or product, is offered to others on a commercial basis. Thus, a service or product may be commercially available even though the person engaged in redistributing it does not itself make the service or product commercially available.

This interpretation is not intended to prohibit members from providing products or services which are commercially available but which are not of a substantial value. No question arises under Section 24 if a member furnishes such things as incidental business gifts, food, entertainment, or other items not having a substantial value.

Cash or Other Agreed Upon Consideration

A person will be deemed to be providing services or products for cash or other agreed upon consideration if the service or product, or a substantially identical service or product, is provided to any person for cash or for some other agreed upon consideration. A service or product will be deemed to be provided for an agreed upon consideration if there is an express or implied agreement between the person providing the service or product and the recipient thereof calling for the provider of the service or product to be compensated therefor with an agreed upon or mutually understood source and general amount of consideration. For example, if a person provides another with a service or product and the

recipient thereof agrees or represents, expressly or impliedly, that it will compensate the provider of the service or product with a specified amount of consideration, such as brokerage commissions or a range of brokerage commissions depending on the commission rate charged, or with a general minimum amount of brokerage commissions or other consideration, that service or product will be deemed to be offered for an agreed upon consideration. Thus, under such circumstances a member or its affiliate providing such service or product would be required to demonstrate that it was fully compensated for the service or product with consideration other than selling concessions, discounts or other allowances received or retained on the sale of securities from fixed price offerings.

Full Consideration

A member may show that it or its affiliate received or reasonably expects to receive full consideration, independent of selling concessions, discounts or other allowances, for providing certain services and products, by identifying the arrangement for the consideration (including its source and amount) and, if appropriate, the collection process for obtaining it.

In order to demonstrate that the cash, brokerage commissions or other consideration serves as full consideration, records of account should be kept which identify the recipient of the services or products, the amount of cash, brokerage commissions or other consideration paid or to be paid by such person or its affiliate.

Unless the amount of cash, brokerage commissions or other consideration agreed upon appears on its face to be unreasonably low, it will not be necessary for the member or its affiliate to demonstrate that the agreed upon price represented fair market price. Likewise, as long as price differentials are based on factors other than the customer's willingness to, or practice of, purchasing securities from the member out of fixed price offerings, it is not necessary, for purposes of Section 24, that the member or its affiliate charge the same amount to each person to whom they provide the same or similar services or products.

Proposal No. 4

PROPOSED NEW SECTION 36 OF ARTICLE III AND INTERPRETATION THEREOF

Article III is proposed to be amended by the addition of a new Section 36 and an interpretation thereof.

Section 36

(a) Except as otherwise provided in subsection (d) of this Section, no member engaged in a fixed price offering of securities shall sell the securities to, or place the securities with, any person or account which is a related person of the member unless such related person is itself

subject to this Section or is a nonmember foreign broker-dealer who has entered into the agreements required by Section 24(b) of this Article.

(b) For purposes of this Section 36, a "related person" of a member includes any person or account which directly or indirectly owns, is owned by or is under common ownership with the member.

(c) A person owns another person or account for purposes of this Section if the person directly or indirectly:

(1) has the right to participate to the extent of more than 25 percent in the profits of the other person; or

(2) owns beneficially more than 25 percent of the outstanding voting securities of the person.

(d) The prohibition contained in subsection (a) does not apply to the sale of securities to, or the placement of securities in, a trading or investment account of a member or a related person of a member after termination of the fixed price offering if the member or the related person of the member has made a bona fide public offering of the securities. A member or a related person of a member is presumed not to have made a bona fide public offering for the purpose of this subsection if the securities being offered immediately trade in the secondary market at a price or prices which are at or above the public offering price.

--- INTERPRETATION OF THE BOARD OF GOVERNORS ---

A member who is acting, or plans to act, as sponsor of a unit investment trust will not violate Section 36 if it accumulates securities with respect to which the member has acted as a syndicate member, selling group member or reallowance dealer in an account of the member or related person of the member if, at the time of accumulation, the member in good faith intends to deposit the securities into the unit investment trust at the public offering price and intends to make a bona fide public offering of the participation units of that trust. Members engaged in such activity, however, will continue to be subject to the Board of Governors' Interpretation of Article III, Section 1 of the Rules of Fair Practice concerning Free-Riding and Withholding.

While subsection (d) of Section 36 provides that a person is presumed not to have made a bona fide public offering if, immediately following the termination of the fixed price offering, the securities trade at or above the public offering price, there is no presumption that a person has made a bona fide public offering if, at such time, the securities trade below the public offering price. Whether a person has made a bona fide public offering will be determined on the basis of all relevant facts and circumstances.

NOTICE TO MEMBERS: 78-6
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

Feburary 1, 1978

MEMORANDUM

TO: All NASD Members

Due to a change in scheduling, there is no Notice to Members 78-4. The Notice which was intended to carry that number will be issued later, with a new number.

NOTICE TO MEMBERS: No. 78-7
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

February 1, 1978

TO: All NASD Members

RE: February, 1978, Trade Date/Settlement Date Schedule

The schedule of trade dates/settlement dates below reflects the observance by the financial community of Lincoln's Birthday, Monday, February 13, 1978, and Washington's Birthday, Monday, February 20, 1978.

On Monday, February 13, the NASDAQ System and the exchange markets will be open for trading. However, it will not be a settlement date since many of the nation's banking institutions will be closed in observance of Lincoln's Birthday.

As previously reported in Notice to Members No. 77-44, Washington's Birthday will be observed by the financial community on Monday, February 20, 1978. All securities markets will be closed on that date.

Trade Date/Settlement Date Schedule
(For "Regular-Way" Transactions)

Trade Date	Settlement Date	*Regulation T Date
February 6	February 14	February 15
7	15	16
8	16	17
9	17	21
10	21	22
13	21	23
14	22	24
15	23	27
16	24	28
17	27	March 1
20	Holiday	--
21	28	2

*Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate

For member firms which process and clear transactions pursuant to the Association's Uniform Practice Code, transactions made on Monday, February 13, will be combined with transactions made on the previous business day, February 10, for settlement on February 21. On this day, securities will not be quoted ex-dividend. Also, marks to the market, reclamations, buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on February 13.

As to transactions in municipal securities, the Municipal Securities Rulemaking Board (MSRB) has advised that the adjusted trade date/settlement date schedule shall apply. Therefore, February 13, 1978, will not be considered a business day for purposes of the procedures set forth in MSRB Rule G-12, Uniform Practice, with respect to transactions in municipal securities.

Questions regarding this notice may be directed to the Uniform Practice Department at (212) 422-8841.

Sincerely,

Gordon S. Macklin
President

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a customer purchase transaction in a cash account if full payment is not received within seven days of the date of purchase. The dates upon which members must take such action for the trade dates indicated is shown in the column entitled "Regulation T Date."