NOTICE TO MEMBERS: 78-44
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 6, 1978

TO: ALL NASD MEMBERS AND REGISTERED PERSONS

RE: Sales Practices Relating to Direct Participation Programs

As year-end approaches, many Association members may be participating in public and private distributions of direct participation programs. Direct participation programs are generally limited partnerships which may provide certain tax consequences for investors. Many of these programs will be distributed by member firms acting in compliance with all applicable regulations. Other programs, however, are likely to be marketed with heavy emphasis on projected tax advantages for the current tax year under circumstances which often do not provide potential investors the time or opportunity for thorough consideration of the programs' merits. The Association is issuing this notice to alert members and registered persons that distribution of programs marketed in the latter manner may entail serious rule violations.

Members and registered persons are cautioned to refrain from purchasing or distributing any direct participation program unless they have taken steps to familiarize themselves with the program and its sponsor. Failure to take adequate precautions may expose members and registered persons to substantial liability (both civil and criminal) under federal securities law as well as disciplinary sanctions under the Association's rules.

Members and registered persons should be particularly cautious when claims are made that interests in programs are not securities or that registered representatives may sell program interests without the knowledge or approval of their employer firms. The basis for projected tax results should also be closely scrutinized.

Many direct participation programs are distributed pursuant to the private offering exemption to the Securities Act of 1933. To qualify for that exemption, however, numerous conditions must be satisfied. Members and registered persons should be particularly cautious in relying on claims that programs qualify for the private offering exemption and therefore need not be registered with the Securities and Exchange Commission.

To assure that direct participation programs being offered are in compliance with applicable requirements, the Association recommends that members and registered persons should exercise extra care to assure that all applicable regulations are satisfied prior to distributing any program interests. For example, a registered representative or principal should notify his or her employer firm prior to distributing any direct participation pro-program interests. Interests in direct participation programs are generally securities and are subject to Article III, Section 27 of the Association's Rules of Fair Practice relating to supervision and the Private Transactions Interpretation adopted thereunder. (See NASD Manual (CCH) at p. 2109-2.)

In the case of purportedly private offerings, firms and registered persons should exercise great care in determining, among other things, whether the private offering exemption has been violated either through the integration of the current offering with other offerings, through the absence of disclosure of the same type of information which would be available in a public offering, or through the distribution of the offering to persons not meeting the qualification standards of applicable securities laws.

Association members and registered persons are urged to familiarize themselves thoroughly with federal and state securities and tax laws and all other applicable regulations. Firms and registered persons may wish to consult with their own counsel regarding the legal status of program interests, and the basis of assumptions underlying projections of tax consequences to investors.

Inquiries regarding this notice may be directed to Dennis C. Hensley, Vice President, Corporate Financing, at (202) 833-7240.

Sincerely yours,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 78-45
Notices to members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 6, 1978

MEMORANDUM

TO: NASD Members and Municipal Securities Dealers

RE: SEC Amends Its Confirmation Rule and Proposes New Disclosure Requirements for "Riskless" Principal Transactions in Municipal and Non-Municipal Debt Securities

INTRODUCTION

On October 6, 1978, the Securities and Exchange Commission published two separate releases announcing several new and proposed confirmation disclosure requirements. The purpose of this notice is to explain in summary form certain of the contents of those releases. For reference purposes, reprints of both SEC releases appear later in this notice.

New Confirmation Disclosure Requirements Under Rule 10b-10

In Securities Exchange Act Release No. 15219, the Commission announced the adoption of several far-reaching amendments to its uniform confirmation disclosure rule, Rule 10b-10. These amendments will establish new requirements and revise certain existing requirements for brokers and dealers in confirming certain types of securities transactions to their customers. The new and revised requirements will become effective on December 18, 1978. At that time, the SEC's existing confirmation rule, Rule 15c1-4, will be rescinded. A brief explanation of each amendment to Rule 10b-10 follows:

1. Odd-Lot Differentials

Brokers and dealers will be required to disclose on customer confirmations whether an odd-lot differential was charged and state that the amount of the differential will be made available to the customer upon either oral or written request. If an odd-lot differential is included in the commission charge disclosed to the customer, or if the amount of

remuneration to be paid by the customer has been determined by a separate written agreement, the odd-lot differential would not have to be separately identified. This disclosure requirement will not be satisfied by a standard legend to the effect that a "differential may or may not have been charged." That is, where an amount has been added to or subtracted from the unit price of a security, an affirmative statement must accompany the confirmation stating that a differential was charged and that such will be disclosed upon the oral or written request of the customer.

2. "Riskless" Principal Transactions in Equity Securities; Mark-Ups and Mark-Downs to be Disclosed

The amount of any mark-up, mark-down or similar remuneration received by a broker-dealer in a "riskless" principal transaction in an equity security will be required to be disclosed on the confirmation sent to a customer. This requirement will apply whenever a broker-dealer, not acting as a market maker, after having received an order to buy from a customer, purchases the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from such customer, sells the security to another person to offset the contemporaneous purchase from the customer. The provisions of Rule 10b-10 will require disclosure of mark-ups and mark-downs regardless of whether the same share certificates are to be delivered to the other side of the "riskless" principal transaction.

This mark-up disclosure requirement will not apply to all principal transactions of a broker-dealer. Its application is limited to transactions in equity securities which are structured as "offsetting" or back-to-back principal transactions. These, according to the Commission, are in economic substance, agency transactions.

As noted above, this requirement will not be applicable to market makers. Since the statutory definition of the term "market maker" includes "any dealer acting in the capacity of block positioner," a block transaction may, under certain conditions, be exempt from the requirement of Rule 10b-10. For purposes of the rule, the Commission has indicated that a transaction involving a quantity of securities having a market value of $200,000 will generally be considered to involve a block transaction. The release states, however, that this figure is only a guide and is intended merely to provide a general standard for those seeking to establish their entitlement to the market maker exemption under the rule. The Commission notes that it is not an ". . . exclusive measure for Rule 10b-10 or for other purposes in circumstances where a different result would be appropriate."

3. Market Maker Disclosure

A broker-dealer will be required to disclose on its confirmation sent to a customer that it is a market maker whenever it effects a transaction

with or for a customer in any security in which it makes a market. The term "market maker" is defined in the Securities Exchange Act of 1934 to mean ". . . any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as willing to buy and sell such security for his own account on a regular or continuous basis."

Notwithstanding the fact that the definition of "market maker" includes those acting in the capacity of a block positioner, the Commission has determined to exclude dealer transactions of block size from the market maker disclosure requirement.

4. Investment Company Plans

Changes to Rule 10b-10 have been adopted concerning the sending of quarterly, as opposed to immediate, confirmations of transactions in "investment company plans" as that term is defined in the rule. Among other things, paragraph (d)(5)(i) thereof has been revised to reflect more clearly the Commission's intention that the use of quarterly confirmations will be permitted with respect to any retirement or pension plan established for a single individual and qualifying under the Internal Revenue Code regardless of whether the plan was established under the Employee Retirement Income Security Act of 1974 (ERISA).

Proposed Confirmation Disclosure Requirements; Municipal and Non-Municipal Debt Securities

As noted, beginning December 18, 1978, brokers and dealers will be required to disclose on customer confirmations the amount of remuneration received in "riskless" principal transactions in equity securities. In Securities Exchange Act Release No. 15220, the SEC announced proposed amendments to that rule, as well as a proposed new rule, Rule 15c2-12, to require brokers, dealers and municipal securities dealers to disclose the amount of mark-ups and mark-downs received in "riskless" principal transactions involving municipal and non-municipal debt securities. In announcing these proposals, the Commission said it had previously received comments stating that the disclosure of mark-ups and mark-downs in transactions in debt securities was neither necessary nor appropriate. Notwithstanding these comments, the Commission said it was still unclear as to why investors should not be provided with information concerning such transaction costs. The SEC also said that while there may be differences between the equity and debt markets, it was uncertain as to whether they are of such a consequence so as to warrant non-disclosure of mark-ups and mark-downs in "riskless" principal transactions in debt securities.

In order to give a clearer understanding of the issues involved and as a preliminary step to final rulemaking in this area, the Commission is soliciting additional public comment on and answers to the following:

- Should there be a "riskless" principal disclosure requirement for transactions in debt securities?

- Should certain classes of debt securities be exempted from a disclosure requirement?

- Would the proposed disclosure requirements under Rule 10b-10 and proposed Rule 15c2-12 impose any burden on competition and, if so, would that burden be necessary or appropriate in furtherance of the purposes of the Act?

It should be noted that Rule 10b-10, as amended, contains an exemption from disclosure for "riskless" principal transactions in which a broker-dealer is acting in the capacity of a market maker in the security being purchased or sold. While the proposed amendment to Rule 10b-10 would preserve the market maker exemption for non-municipal debt securities, no similar exemption is contained in proposed Rule 15c2-12 dealing with municipal securities. In this regard, members may additionally wish to comment upon this distinction between the two proposals in terms of whether this dissimilar treatment is either necessary or appropriate and whether the "market maker exemption" should be extended to municipal securities dealers. The comment period for these proposals will expire on December 1, 1978.

In regard to the above, the Association would appreciate receiving copies of any comment letters members may submit to the SEC. Please direct all such letters and any questions you may have regarding this matter to Jack Rosenfield, Assistant Director, Department of Regulatory Policy and Procedures, NASD, 1735 K Street, N. W., Washington, D. C. 20006, telephone (202) 833-4828.

Sincerely,

Gordon S. Macklin
President

Attachments

[Release No . 34-15219; IC-10428; File No. S7-654]

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

Securities Confirmations

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; rule rescission.

SUMMARY: The Commission is adopting several new delivery and disclosure requirements for confirmations sent to customers by brokers and dealers when the they buy for or from their customers or sell for or to those customers any security (other than U.S. Savings Bonds or municipal securities). Under the new requirements, brokers and dealers must make disclosures relating to odd-lot differentials, remuneration received in certain principal transactions, and market making activities. The rule also revises current requirements pertaining to the use of quarterly statements in lieu of immediate confirmations for transactions effected pursuant to "investment company plans." In addition, the Commission is rescinding an existing rule that sets forth confirmation delivery and disclosure requirements that are superseded by the new requirements.

EFFECTIVE DATE: December 18, 1978.

FOR FURTHER INFORMATION CONTACT:

Jeffrey L. Steele, Esq., Office of the Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549, 202-755-7587.

SUPPLEMENTARY INFORMATION: The Commission today announced the adoption of amendments to rule 10b-10 (17 CFR 240.10b-10) under the Securities Exchange Act of 1934 (the "Act"), and the rescission of rule 15c1-4 (17 CFR 240.15c1-4) under the Act. The amendments to rule 10b-10 prescribe certain disclosures to be made by a broker or dealer when effecting transactions in securities (other than U.S. Savings Bonds or municipal securities) for or with a customer, and revise existing requirements for the use of quarterly statements in connection with "investment company plans." Together with the amendments adopted today, rule 10b-10, which was adopted by the Commission on May 5, 1977, becomes effective on December 18, 1978 (with the exception of certain paragraphs of the rule which became effective on June 1, 1977).[1] Rule 15c1-4, which sets forth existing confirmation delivery and disclosure requirements, is rescinded, effective December 18, 1978.

Pursuant to its authority under the Act, the Commission is taking the actions summarized below:

(1) *Disclosure of odd-lot differentials.* As amended, rule 10b-10 will require brokers and dealers to disclose, in confirming an odd-lot transaction in which an odd-lot differential has been charged, that an odd-lot differential has been charged and that the amount of the differential is available upon oral or written request.[2]

(2) *Disclosure of mark-ups and mark-downs in "riskless" principal transactions.* As amended, rule 10b-10 will require a dealer trading for its own account to disclose the mark-up or mark-down in a "riskless" principal transaction in an equity security unless the dealer is acting as a market maker in the security being purchased or sold. In a separate release, issued today, the Commission is soliciting further comment on whether to require such disclosure in the case of transactions in nonmunicipal debt securities and municipal securities.[3]

(3) *Disclosure of market maker status.* As amended, rule 10b-10 will also require a dealer trading for its own account in an equity security to disclose whether it is a market maker in the security being purchased or sold (otherwise than by reason of its acting as a block positioner in that security).

(4) *Investment company plans.* The Commission has adopted revised procedures permitting the use of quarterly statements in lieu of immediate confirmations for certain transactions in securities issued by investment companies.

(5) *Disclosure of best bid and offer prices.* The Commission has withdrawn at this time its proposal to require confirmation disclosure by brokers and dealers of the best bid and offer prices displayed in NASDAQ or an equivalent interdealer quotation system at the time of a transaction in a security that is not listed on an exchange.

(6) *Disclosure of remuneration paid by third parties to dealers.* The Commission has withdrawn at this time its proposal to require disclosure of remuneration paid by third parties to dealers.

(7) *Rescission of rule 15c1-4.* The Commission has rescinded Rule 15c1-4 under the Act. That rescission takes effect on December 18, 1978, the date on which Rule 10b-10, as amended, becomes generally effective.

I. Background and Purpose of Rule 10b-10

On September 16, 1976, the Commission announced a proposal (1) to adopt Rule 10b-10 to establish revised confirmation delivery and disclosure requirements for broker-dealers effecting transactions for or with the account of a customer and (2) to rescind Rule 15c1-4, which sets forth the Commission's basic confirmation requirements.[4] After receiving and considering the comments of interested persons, the Commission adopted Rule 10b-10 with certain revisions on May 5, 1977, and reiterated its intention to rescind Rule 15c1-4.[5] The rule's effective date, however, was subsequently postponed until December 18, 1978.[6] When it adopted Rule 10b-10, the Commission also decided not to adopt at that time certain of the provisions contained in Rule 10b-10 as originally proposed, such as the proposal to require disclosure of markups and markdowns in "riskless" principal transactions. It stated, however, that it would republish those proposals in revised form for further comment, and did so on June 23, 1977,[7] the Commission has now concluded, after considering the views of commentators, to adopt certain of those proposed requirements.

The Commission believes that the confirmation is an important disclosure document. By requiring brokers and dealers to disclose facts to a customer at or before the completion of a transaction, as defined in the rule, the confirmation rule is intended to deter and prevent deceptive and fraudulent acts and practices. At the same time, confirmations can have important informational value to customers beyond whatever value they may have as an investor protection measure. Among other things, confirmations should assist customers in evaluating the costs and quality of services provided by brokers and dealers in connection with the execution of securities transactions.

Numerous factors may be pertinent to the making of an investment decision. In addition to various factors pertaining to the suitability of a security for the customer's investment needs, customers may wish to take into account, as information material to their investment decisions, variations in transaction costs incurred in trading different types of securities and variations in the transaction charges of competing broker-dealers. While confirmations provide investors with only an after-the-fact record of transaction costs, they nevertheless can serve to make investors aware of those costs in making future investment decisions.

II. Commission Action on the Proposed Disclosure Requirements

A. Odd-Lot Differentials

Paragraph (a)(3) of Rule 10b-10, as amended requires the disclosure of whether any odd-lot differential has been charged and that the amount of the differential is available upon oral or written request. Where an odd-lot differential is charged in connection with an odd-lot transaction, the practice within the securities industry has been for dealers to add that differen-

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[1] See Securities Exchange Act Release Nos. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977); and 14942 (July 7, 1978), 43 FR 30270 (July 14, 1978).

[2] Paragraph (c) of rule 10b-10 prescribes the time periods within which information requested by a customer must be given or sent to the customer.

[3] See Securities Exchange Act Release No. 15220 (Oct. 6, 1978).

[4] Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

[5] Securities Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977).

[6] Securities Exchange Act Release Nos. 14942 (July 7, 1978), 43 FR 30270 (July 14, 1978); 14573 (Mar. 16, 1978), 43 FR 11981 (Mar. 23, 1978); and 14184 (Nov. 17, 1977), 42 FR 60734 (Nov. 29, 1977).

[7] Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977)

tial to the round lot price of the security. The Commission has concluded that disclosure of whether any odd-lot differential has been charged by a dealer should be made so long as that charge remains an amount added to or subtracted from the price of a security.[8] If the odd-lot differential were instead reflected in the Commission charge disclosed or exempted from disclosure pursuant to paragraph (a)(4)(ii) of the rule,[9] it would not have to be separately identified.

The Commission understands that some dealers do not charge any differential, that some charge either 12½ cents per share or 25 cents per share and that some charge a differential only under certain circumstances. Perhaps in part because of these disparities in practices, questions have been raised concerning the economic rationale for the odd-lot differential. One commentator asserted, "From all indications, it would seem that an odd-lot charge is a carryover concept from the days of fixed rates that will not survive in the marketplace of tomorrow."[10] Another commentator expressed the view that it would be preferable to eliminate the odd-lot differential altogether rather than to require its disclosure.[11] The Commission is not now prepared to conclude that it is improper to charge an odd-lot differential, but it does believe customers should be made aware of whether an odd-lot differential has been charged and that the amount is available on oral or written request.

The proposed amendment to Rule 10b-10 would have required that the amount of the odd-lot differential, if any, be disclosed on each confirmation. Of the seven commentators that addressed the proposed disclosure requirement, most pointed out that there were practical difficulties in determining whether an odd-lot differential has been charged, identifying the amount of any odd-lot differential charged, and recording that information on the confirmation.[12] Commentators pointed out that differentials are not charged on all odd-lot orders. Furthermore, it was stated that when odd-lot orders have been placed with, and executed by, a specialist, the specialist typically does not indicate whether an odd-lot differential has been charged, or the amount of such differential, when it reports the execution to the customer's broker.[13] It was asserted that even if the amount of an odd-lot differential could be determined, the absence of uniform practices by specialists in charging odd-lot differentials would make it difficult and expensive to design a computer system to capture each charge.[14] On the other hand, it was asserted that manual recordation of the amount of odd-lot differentials could lead to increased chances for error.[15] Commentators who perceived such difficulties generally believed that it would be sufficient to indicate on the confirmation that an odd-lot differential may have been charged and that the amount, if any, would be available on request.[16]

The Commission, nevertheless, believes that it is important that customers at least be made aware of whether an odd-lot differential has in fact been charged so that they may understand the nature of the costs associated with the execution of securities transactions on their behalf. Accordingly, as amended, Rule 10b-10 will require brokers and dealers to disclose on a customer's confirmation whether an odd-lot differential has been charged to the customer and, if so, that the amount is available upon oral or written request. As noted above, an exception to this disclosure requirement is provided if the differential or fee is included in the renumeration disclosed, or exempted from disclosure, pursuant to paragraph (a)(4)(ii) of the rule.

The Commission recognizes that requiring broker-dealers to disclose whether an odd-lot differential has in fact been charged on an odd-lot transaction is more burdensome than requiring that broker-dealers disclose that such a differential may have been charged. The former requires broker-dealers to make a specific entry in confirming an odd-lot transaction on which a differential has in fact been charged, whereas the latter could be satisfied by a standard legend without any specific notation on each odd-lot confirmation. At the same time, requiring disclosure of whether an odd-lot differential has been charged may be somewhat less burdensome than the odd-lot provision as originally proposed, which would have required disclosure in each case of the specific amount of any differential charged. While broker-dealers may have to incur reprogramming and other costs in preparing for either requirement, the requirement adopted by the Commission may involve less risk of error and appears to the Commission to represent, at this time, an appropriate balancing of the need to provide adequately for disclosure to investors and the need to be cautious in imposing regulatory burdens on brokers and dealers.[17]

B. MARKUPS OR MARKDOWNS BY DEALERS EFFECTING "RISKLESS" PRINCIPAL TRANSACTIONS

Paragraph (a)(5)(i) of Rule 10b-10, as adopted, requires a dealer (other than a market maker)[18] acting as a principal for his own account to disclose the amount of any markup, markdown, or similar renumeration received in a transaction in an equity security when, after receiving an order to buy or sell a security from a customer, the dealer purchases the security from another person to offset a contemporaneous sale to such customer or sells the security to another person to offset a contemporaneous purchase from such customer.

The Commission has concluded that it is necessary and appropriate for the protection of investors to require disclosure of the amount of markups or markdowns in "riskless" principal transaction in equity securities. Disclosure of markups and markdowns will enable customers to make their own assessments of the reasonableness of transaction costs in relations to the services offered by broker-dealers. The level of transaction costs for a particular transaction may vary among broker-dealers and may also vary in accordance with the nature of the security being purchased or sold. The Commission believes that it can be important for customers to be aware of such variations in transaction costs to the extent practicable and believes disclosure of markups and markdowns in "riskless" principal transactions in equity securities will help accomplish that goal.

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[8] The Commission understands that odd-lot differentials per se are generally not charged on transactions in debt securities although the prices for small orders in debt securities vary from prices negotiated on large orders. The odd-lot differential requirement is not intended to reach those differences in pricing. See comment letter of Sullivan & Cromwell.

[9] Paragraph (a)(4)(ii) prescribes the renumeration disclosures (including brokerage commissions) to be made by a customer's broker.

[10] Comment letter of the National Association of Securities Dealers, Inc. (the "NASD"). The NASD pointed out, however, that the price to be paid for 100 shares of a security could be different than the price which may be negotiated for orders involving either more or less than 100 shares.

[11] See comment letter of J. & W. Seligman & Co.

[12] See, e.g., comment letters of Sullivan & Cromwell; Merrill Lynch, Pierce, Fenner & Smith Inc; First Manhattan Co.; and White, Weld & Co., Inc.

[13] See comment letters of Sullivan & Cromwell; and First Manhattan Co.

[14] See, e.g., comment letter of Merrill Lynch, Pierce, Fenner & Smith Inc.

[15] See comment letter of J. & W. Seligman & Co.

[16] See comment letters of the NYSE; and Merrill Lynch, Pierce, Fenner & Smith Inc.

[17] As proposed, the odd-lot differential disclosure requirement was phrased in terms of any odd-lot differential paid "directly or indirectly" by the customer. The Commission has deleted those words and refrained from adding them to other parts of the confirmation rule since the rule by its terms would reach any direct of indirect payment of the various types covered even without the addition of the words "directly or indirectly." See also section 20 of the Act.

[18] The term "market maker" is defined in section 3(a)(38) of the Act (15 U.S.C. 78c(a)(38)).

In addition, as is discussed further below, the Commission believes that competition among broker-dealers may well be an effective supplement to existing regulatory controls on markups and markdowns in limiting the opportunity for unreasonable charges. In the absence of disclosure of markups and markdowns in such transactions, the possibility of real competition with respect to the level of such charges appears remote. "Riskless" principal transactions, as defined in the rule, are in many respects equivalent to transactions effected on an agency basis, [19] and customers should be made aware of the costs incurred regardless of technical variations employed by broker-dealers in structuring such transactions. [20]

A substantial portion of the transactions in equity securities effected by broker-dealers for retail customers are effected on exchanges and in the over-the-counter markets on an agency basis and the commissions charged are disclosed to the customer. Consequently, the absence of such disclosure of compensation in "riskless" principal transactions may mislead unsophisticated customers into believing that no such compensation is being paid. Even if the investor is not so misled, he is left with uncertainty as to how the broker-dealer is being compensated as well as the amount of such compensation. This uncertainty can have an adverse effect on investor confidence in the over-the-counter market.

Commentators, however, asserted that for several reasons this requirement is both unnecessary and inappropriate. First, commentators urged that the markup disclosure requirement is not necessary to protect investors. It was suggested that the Rules of Fair Practice of the NASD already provide sufficient protection against overreaching by dealers. [21] In that connection, commentators referred particularly to the NASD's rule requiring a broker-dealer, when acting for his own account, to "buy or sell at a price which is fair" [22] and the "markup rule" or "five percent policy," embodied in an interpretation thereunder. Commentators stated that the NASD's markup rule has been vigorously and effectively enforced. [23] Similarly, it was suggested that the "best execution rule" of the NASD [24] "has been effective in preventing dealers' overreaching and has resulted in customers receiving best execution in the over-the-counter market." [25] Some commentators also expressed the view that industry competition is sufficient to limit opportunities for abuse. [26] In addition, it was suggested that brokers and dealers are constrained to keep markups within reasonable limits because they are aware that the public has access to external sources for quotations in many securities. [27] It was also pointed out that in any event customers are free to request disclosure of the remuneration received by broker-dealers, and customers may stipulate the amount of the markups they are willing to pay. [28]

In proposing the markup disclosure requirement for "riskless" principal transactions, the Commission did not intend to replace any of the NASD investor protection provisions enumerated above. The markup disclosure requirement is intended to supplement those provisions. Nor did the Commission intend to imply that broker-dealers routinely charge excessive or unreasonable markups or markdowns in securities transactions with their customers. As the same time, disclosure of markups and markdowns is an appropriate means of insuring that customers have an opportunity to identify and object to any unreasonably high charges. That opportunity may well serve as a significant means of protecting investors against unfair and unreasonable pricing practices. It may also, as a practical matter, permit those broker-dealers which consistently observe the highest standards of practice to compete more effectively against broker-dealers which on occasion or more frequently charge unreasonably high markups or markdowns. In that way, the "riskless" principal disclosure requirement may help to insure that brokers and dealers adhere to appropriate standards of professional responsibility.

Furthermore, the Commission does not view the "riskless" principal disclosure requirement solely as a means to address abusive practices; as noted above, the "riskless" principal requirement is important also to permit investors themselves to make informed judgments about the transaction services they receive and pay for. Disclosure of markups and markdowns in "riskless" principal transactions should assist investors in comparing the costs they incur in transactions effected by broker-dealers on either an agency or "riskless" principal basis and in assessing those costs in relation to the quality of services provided by competing broker-dealers. [29]

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[19] The Commission does not mean to suggest, however, that all disclosures pertaining to "riskless" principal transactions should be identical to those required for agency transactions. For example, the Commission has not proposed any general requirement that broker-dealers effecting "riskless" principal transactions disclose the identity of the "other side."

[20] The language of the markup disclosure requirement has been revised to eliminate certain ambiguites. As adopted, it applies whenever a broker-dealer not acting as a market maker, after having received an order to buy from a customer, purchases the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from such customer, sells the security to another person to offset a contemporaneous purchase from the customer. That requirement would apply regardless of variations in mechanical techniques for structuring and sequencing transactions that are designed to offset one another. For example, a broker-dealer filling a customer's purchase order would not avoid the requirement by effecting a sale to his customer immediately before purchasing the security from another person instead of first purchasing the security from the other person for resale to the customer and then selling it to the customer. Similarly, a broker-dealer would not avoid the requirement in filling a customer's sale order by first purchasing the security from the customer for resale to another person and then selling it to that other person instead of first selling it to the other person and then purchasing it from his customer. In addition, the provision adopted makes clear that disclosure of the markup or markdown would be required regardless of whether the same share certificates were delivered to the other side of the "riskless" principal transaction in circumstances where the broker-dealer's principal transactions were structured as offsetting transactions.

[21] See e.g., comment letters of Peterson & Co.; Reinholdt & Gardner; Mabon, Nugent & Co.; Roose, Wade & Co.; White Weld & Co.; Inc.; and the NASD.

[22] See article III, section 4, of the NASD Rules of Fail Practice, NASD Manual (CCH) ¶2154.

[23] See, e.g. comment letters of the NASD; Merrill Lynch, Pierce, Fenner & Smith Inc.; and Weinrich, Zitzmann, Whitehead, Inc.

[24] See Interpretation .03 under article III, section 1 of the NASD Rules of Fair Practice, NASD Manual (CCH) ¶2151.

[25] See comment letter of the Securities Industry Association, citing the statement made by Gordon S. Machlin, President, NASD, at the Commission's hearings on off-board trading rules (August 16, 1977), Securities and Exchange Commission File No. 4-180.

[26] See Comment letters of Authurs, Lestrange & Short; Peterson & Co.; and Reinholdt & Gardner.

[27] See comment letters of Reinholdt & Gardner; Mr. G. Shelby Friedricks; and White, Weld & Co. Inc.

[28] See comment letter of Sutro & Co., Inc.

[29] The markup rule of the NASD does not impose any precise upper limit on the range of permissible markups. As the NASD Rules of Fair Practice indicate, the markup policy is "a guide—not a rule" (see interpretation of article III, section 4, NASD Rules of Fair Practice). Some commentators observed that flexibility in any markup policy is desirable in view of the variety of factors relevant to a determination of what constitutes an appropriate markup. The "riskless" principal disclosure requirement should, nevertheless, be useful to investors in evaluating transaction costs in all situations regardless of compliance or noncompliance with NASD rules.

In that connection, the Director of the Corporation and Securities Bureau of the Department of Commerce of the State of Michigan observed:

"From various investigations and enforcement proceedings in this State, a pattern appeared whereby small brokerage firms have been purchasing low-rated securities and using high pressure sales techniques to

The assertion that existing competitive forces may deter unreasonable markups might be true in some instances but does not lead the Commission to conclude that this disclosure requirement is unnecessary. Current quotations are, of course, not always available to public investors for all securities; in addition, many investors, particularly individuals, may not always be able to acquire inside or inter-dealer quotations on over-the-counter securities. In light of the reluctance evident in numerous comment letters to reveal markups to the public,[30] it is not clear that all, or even most, customers would be able to obtain such information in the absence of a requirement of the sort imposed by Rule 10b-10. Unless such information is made available, it seems unlikely that customers can, without great difficulty, compare the costs of effecting transactions that are structured as "riskless" principal transactions.[31]

The second principal concern of commentators was that the markup disclosure requirement would impose costs upon dealers that outweighed the benefits of disclosure. It was observed that to disclose the markup or markdown would increase the expense of confirming transactions.[32] Some suggested that disclosure of markups would adversely affect the income of dealers, in that, as a general rule, markups, although reasonable, might be difficult to justify, and as a result, might have to be decreased.[33] Several commentators stated that in no other business are gross profits required to be disclosed, and they argued that it is unfair to single out the securities industry in this way.[34] A decrease in markups reportedly would destroy the incentive of securities salesmen, and, consequently, the public's interest in purchasing securities would decline.[35] It was also asserted that, because brokers provide numerous uncompensated services, profitable principal transactions are necessary to recoup expenses.[36]

These arguments appear to the Commission to be overstated. The markup disclosure requirement is not applicable to all principal transactions engaged in by broker-dealers, but solely to those transactions in which the dealer structures as two back-to-back principal transactions what is in economic substance an agency transaction. Furthermore, these arguments all appear to be premised upon the assumption that if customers knew what they are routinely being charged on "riskless" principal transactions, they would object because they would invariably view markups or markdowns as unfair and be able without any reasonable basis to force dealers to lower markups currently charged. While competitive forces might cause markups to be lowered in some instances, the Commission has not adopted this disclosure requirement on the basis of any predictions as to its effects on the level of markups. Instead, the Commission has based its decision to adopt the requirement in large part on the belief that investors should have an opportunity to make their own informed judgments as to the reasonableness of transaction charges.

The fact that markup disclosures may or may not be made in other industries does not answer the question whether such a requirement is appropriate for securities transactions. Because of the special nature of securities, analogies to the standards of conduct prevailing in other industries may not be pertinent. Indeed, by the very nature of a broker-dealer's relationship with its securities customers, and particularly its retail customers, the broker-dealer is frequently in an advisory role where principles of caveat emptor and arm's length bargaining are simply not applicable. Although a securities professional generally may act both as broker and as dealer with his securities customers, the Commission, the self-regulatory organizations and the courts have recognized that the existence of special duties toward those customers does not turn on the capacity in which the securities professional acts.[37] In addition to those grounds for finding analogies to other industries not pertinent in this context, there is a practical ground. Whereas the prices of many retail goods are relatively stable, permitting customers to "comparison shop," securities prices are sufficiently volatile to make comparison shopping on the basis of net price extremely difficult in many instances, particularly for retail customers.

Predicting that the cost of preparing confirmations would rise and income would fall as a result of the markup disclosure requirement, many commentators also predicted that the structure of the securities industry would be altered. Some predicted that mergers would increase;[38] others predicted that the financial condition of small securities firms would be threatened.[39] Commentators also predicted that the liquidity in locally and inactively traded securities would be adversely affected by this disclosure requirement.[40] It was suggested that the increased costs occasioned by the difficulty of effecting transactions in these securities justifies a greater markup than for exchange-listed or more widely traded over-the-counter securities. The Commission believes, however, that even if markups for these securities are justified, investors are entitled to know the amounts of such charges. The depth of the markets for, and liquidity of, locally traded securities and the continued ability of small broker-dealers to compete are matters of concern to the Commission, but the

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place them with unsophisticated and inexperienced investors. During the sales period the market price in thinly traded securities was maintained by small purchases. The securities were sold to the public at NASD maximum markup, producing high yields to the firm, followed shortly by substantial investor losses in the millions of dollars.

"I would note also that certain small firms have engaged in the practice of advertising highly rated securities in local papers, drawing in unsophisticated investors, and selling them to the public in riskless transactions at maximum NASD markups, despite the fact that most firms in the area were charging a commission at significantly lower rates."

[30] For example, Weinrich, Zitzmann, Whitehead, Inc. stated in its comment letter that "the customer has no fundamental right to this information."

[31] See also Securities and Exchange Commission, Report of Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 2, 88th Cong., 1st sess. 676 (1963). As noted earlier, brokers acting as agents have been required to disclose commissions on confirmations. Some commentators questioned, however, whether customers are able to judge the fairness of a markup (see, e.g., comment letter of Investment Income Services, Inc.). On the other hand, an investor's ability to judge markups may well improve as a result of disclosure.

[32] See, e.g., comment letters of Mr. Keith Wentz; Richards, Merrill & Peterson, Inc.; Investment Income Services, Inc.; and Jefferies & Co., Inc.

[33] See, e.g., comment letters of Lowell H. Listrom & Co., Inc.; Sutro & Co., Inc.; Investment Income Service, Inc.; Barrett & Co.; and Handel, Lundborg & Co.

[34] See, e.g., comment letters of Adams, Hess, Moore & Co.; Imperial Investment Co.; Mabon, Nugent & Co.; Elmer E. Powell & Co.; and Weinrich, Zitzmann, Whitehead, Inc.

[35] See, e.g., comment letters of Wulff, Hansen & Co.; Mabon, Nugent & Co.; and Carolina Securities Corp.

[36] See comment letter of Martin Nelson & Co.

[37] See, e.g., *Arleen W. Hughes*, 27 SEC. 629 (1948), *aff'd sub nom. Arleen W. Hughes* v. *SEC*, 174 F.2d 969 (D.C. Cir. 1949); *Charles Hughes & Co., Inc.*, 13 SEC 676 ((1943), *aff'd sub nom. Charles Hughes* v. *SEC*, 139 F.2d 434 (2d Cir. 1943); *Duker* v. *Duker*, 6 SEC 386 (1939); *Chasins* v. *Smith Barney & Co. Inc.*, 305 F. Supp. 489 (S.D.N.Y. 1969), *aff'd*, 438 F. 2d 1167 (2d Cir. 1971); *Opper* v. *Hancock Securities Corp., 250 F. Supp. 668 (S.D.N.Y.), aff'd*, 367 F.2d 157 (2d Cir. 1966); *Cani* v. *A. G. Becker & Co., Inc.*, 374 F. Supp. 38 (N.D. Ill. 1974). See generally NASD Rules of Fair Practice, NASD Manual (CCH), para. 2001 et seq.

[38] See comment letters of Martin Nelson & Co.; and Mabon, Nugent & Co.

[39] See, e.g., comment letters of Wulff, Hansen & Co.; Mr. G. Shelby Friedrichs; Handle, Lundborg & Co.; and Smyth, Akins & Lerch, Inc.

[40] See, e.g., comment letters of the NASD; Elmer E. Powell & Co.; Mabon, Nugent & Co.; Lowell M. Listrom & Co.; and Reinholdt & Gardner.

assertions made by commentators are highly speculative, depending in large part on predictions about future investor preferences. Those predictions and certain other competitive implications of the "riskless" principal requirement are further discussed later in this release.[41]

Debt Securities. Finally, the Commission notes that several commentators have argued that a disclosure requirement for "riskless" principal transactions should not apply to debt securities.[42]

The Commission first proposed to require confirmation disclosure of markups and markdowns in "riskless" principal transactions in September 1976, when it published its proposal to adopt Rule 10b-10.[43] As originally proposed, Rule 10b-10 would have required disclosure of markups and markdowns in "riskless" principal transactions in equity and debt securities, including municipal securities. When the Commission adopted Rule 10b-10 in May 1977,[44] it provided that Rule 10b-10 would not apply to municipal securities. At the same time, the Commission determined to revise and republish for further public comment the "riskless" principal markup disclosure provision.[45] The proposal, as then revised, applied to both equity securities and non-municipal debt securities.

Shortly after the Commission proposed those amendments, the MSRB undertook to determine whether confirmation disclosure of markups and markdowns should be required in the case of municipal securities. On August 3, 1977, the MSRB solicited public comment on that question and later held two public meetings in October 1977. Following those meetings, the MSRB sent to the Commission a letter dated November 16, 1977, summarizing some of the arguments made by commentators opposed to disclosure of markups and markdowns. On February 10, 1978, the MSRB sent to the Commission a letter in which it stated its conclusion that "the imposition of a requirement to disclose remuneration in principal transactions in municipal securities is unnecessary and inappropriate."[46]

The Commission has determined to defer a final decision on whether to require disclosure of "riskless" principal compensation in transactions in debt securities, including municipal securities, in order to solicit more specific public comment on that matter. The MSRB has provided its views, as well as those of several commentators in the municipal securities industry, on the application of such a requirement to transactions in municipal securities. Nevertheless, the Commission received very limited comment on the application of "riskless" principal disclosures to nonmunicipal debt securities. In a separate release, issued today, the Commission is soliciting further comment on those matters in connection with specific rule proposals that would require such disclosure for "riskless" principal transactions for municipal and nonmunicipal debt securities.[47]

Exclusion of market makers. The "riskless" principal markup disclosure requirement does not apply to a transaction in a security for which a dealer acts as a "market maker." The term "market maker" is defined in section 3(a)(38) of the act to mean "any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an interdealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis."

The Commission has provided an exemption for market makers because the "riskless" principal disclosure requirement might otherwise create substantial compliance problems for market makers. In making a two-sided market, involving price quotations for both the bid and the offer, a market maker may often engage in transactions that effectively offset one another, giving the appearance of being "riskless" principal transactions, even though the market maker did not structure any particular pair of transactions as offsetting, "riskless" principal transactions. As a result, the problem of identifying when a "riskless" principal disclosure might have to be made could create substantial practical and interpretive difficulties for a bona fide market maker. For that reason, the Commission has determined to provide an exemption from the "riskless" principal disclosure requirement for broker-dealers which are in fact acting as market makers in the security in which customer transactions are being effected. At the same time, the Commission cautions that those not actually making a bona fide market in a security will not qualify for the market maker exemption.

As noted above, the statutory definition of the term "marker maker" includes "any dealer acting in the capacity of block positioner." While the term "block positioner" is not defined in the act, the term is generally used to describe a broker-dealer who facilitates the execution of a block transaction in an equity security by positioning at least some part of the block, that is by committing its own capital to fill a part of a customer's block sale order or effecting a short sale (or a sale from inventory) to fill part of a customer's block purchase order.[48]

Because a block transaction in a particular security is generally distinguishable from other transactions in that security, the Commission has not attempted to define the term "block" or the term "block positioner" for purposes of rule 10b-10. A determination as to whether a quantity of a security is a block necessarily rests to some degree on the purpose for which the determination is being made and frequently involves the number of shares as well as the dollar value of the shares traded.[49] In an effort to provide some objective guidance, the Commission notes that an order involving a quantity of securities having a market value of $200,000 should generally be considered to involve a block for purposes of rule 10b-10.[50] The Commission stresses, however, that the $200,000 guide is intended merely to provide a general standard for those seeking to establish their entitlement to the market maker exemption in rule 10b-10 on the basis of their acting as block positioners and should not be considered to be the exclusive measure for rule 10b-10 or for other purposes in circumstances where a different result would be appropriate.

In assembling the "other side" of a block transaction, broker-dealers are frequently able to fill portions of a block order by affecting transactions with other customers, leaving only a residual portion to be positioned for

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[41] See text accompanying note 51.

[42] See, e.g., comment letters of Goldman, Sachs & Co.; John Nuveen & Co., Inc.; Mabon, Nugent & Co; Merrill Lynch, Pierce, Fenner & Smith Incorporated; the Municipal Securities Rulemaking Board (the "MSRB"); the Securities Industry Association; and Sullivan & Cromwell. A number of persons who did not comment on this proposed amendment to Rule 10b-10 commented on a similar provision published by the Commission when it proposed to adopt Rule 10b-10. See Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

[43] See Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

[44] See Securities Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977).

[45] See Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

[46] The MSRB's letters of November 17, 1977, and February 10, 1978, have been filed in Securities and Exchange Commission File No. S7-654.

[47] See Securities Exchange Act Release No. 15220 (Oct. 6, 1978).

[48] Block positioners are sometimes described as "upstairs market makers" since they augment the market making capacity offered by exchange specialists and other dealers who make two-sided markets.

[49] See, e.g., NYSE Rule 127, 2 NYSE Guide (CCH) ¶2127; and Proposed Rule 13e-2(d), Securities Exchange Act Release No. 10539 (Dec. 6, 1973), 2 Federal Securities Law Reporter (CCH) ¶79,600.

[50] See Rule 17a-17(b)(1), 17 CFR 240.17a-17(b)(1); Regulation U of the Board of Governors of the Federal Reserve System, 12 CFR 221.3(z)(2).

the broker-dealer's own account. Particularly if the block transaction is effected in the over-the-counter market, it appears possible for the broker-dealer to structure such transactions with customers on the "other side" either as agency transactions at disclosed commissions or as "riskless" principal transactions. Accordingly, questions might arise as to whether any such "riskless" principal transactions should be exempt as block positioning (and thus market making) transactions or, instead, treated separately as nonblock positioning transactions and thus subject to the disclosure requirement of rule 10b-10, even though the broker-dealer has positioned, at its own risk, some portion of the block order. As a general matter, the Commission believes that the phrase "acting in the capacity of block positioner," as it relates to the market maker exemption from the "riskless" principal disclosure requirement, should be interpreted to make the exemption available for portions of a block trade which may take the form of "riskless" principal transactions with persons on the "other side" where the broker-dealer has positioned at its own bona fide risk more than a nominal part of the block order.

Competitive implications. Several commentators stated that the "riskless" principal proposal could have anticompetitive effects.[51] Since the proposed disclosure requirement did not apply to market making transactions of bona fide inventory transactions, some commentators suggested that adoption of the requirement might result in a disparity between broker-dealers who routinely deal from a bona fide inventory or act as market makers and those who do not and instead effect "riskless" principal transactions.[52]

While, for practical considerations, the disclosure requirement applies only to "riskless" principal transactions and not to bona fide inventory or market making transactions, the Commission is not persuaded that that disparity will necessarily result in any unjustifiably anticompetitive or discriminatory effect. It has been pointed out that many regional and smaller broker-dealers often effect "riskless" principal transactions, but it appears that some larger, nationally based firms effect either "riskless" principal or agency transactions in securities in which regional firms make markets. In addition, it is by no means clear that the disclosure of markups and markdowns will cause customers of firms making such disclosures to go elsewhere.

Predictions that such a pattern could develop depend in large measure on the speculative assumption that customers will inappropriately conclude that the prices they receive from dealers who disclose markups and markdowns are necessarily inferior to the prices they obtain when dealing "net" with other broker-dealers whose markups and markdowns remain undisclosed. In that connection, the Commission notes that one leading broker-dealer for several years has followed a policy of disclosing markups and markdowns in principal transactions in equity securities, apparently without adverse effects on its competitive position.[53]

At the same time, disclosure of markups and markdowns in "riskless" principal transactions may enhance competition in the pricing of services provided by broker-dealers. In the absence of markup or markdown disclosure in "riskless" principal transactions, it remains difficult for customers to assess the level of transaction costs incurred in relation to the services provided in connection with those transactions.

On balance, and in the absence of any clear support for the proposition that investors will generally make inappropriate decisions regarding disclosed transaction costs, the Commission does not believe that this disclosure requirement will impose any burden on competition that would not be necessary or appropriate in furtherance of the purposes of the act.

C. MARKET MAKING

Paragraph (a)(5)(ii) of rule 10b-10 in the form proposed would require that a dealer effecting a transaction in an equity security disclose whether he is a market maker in that security.[54] This provision codifies certain principles of existing case law.[55] While commentators generally did not object to it, a few questioned the need to apply the requirement to those broker-dealers which are market makers solely by reason of their acting as block positioners.[56] The Commission has concluded that it would be appropriate to exclude from the disclosure requirement a dealer which, in the transaction in question, is a market maker, within the meaning of section 3(a)(38) of the act, solely by reason of its acting as a block positioner.

D. PREVAILING MARKET PRICES

The Commission has decided to withdraw its proposal to amend rule 10b-10 to require disclosure on confirmations of the best bid and offer prices displayed on level 2 of NASDAQ, or on an equivalent interdealer quotation system, at the time the transaction was effected.[57]

Numerous commentators urged for several reasons that the Commission not adopt this proposal. First, it was suggested, in light of the protection provided by the NASD's markup policy [58] and best execution rule [59] and the availability of quotations,[60] that this requirement is unnecessary. It was also conjectured that enforcement of this provision would prove cumbersome.[61]

Second, it was stated that the proposal could increase substantially the costs of doing business for some broker-dealers. It was suggested that, inasmuch as some broker-dealers now subscribe only to level 1 of NASDAQ, this provision would require them either to absorb the expense of subscribing to level 2 of NASDAQ or to forego trading in all securities except those traded on a national securities exchange or those not listed on any electronic quotation service.[62] Commentators further suggested that the proposal might also require some broker-dealers to acquire new computer facilities [63] or to adapt their existing computer facilities so that they could interface with NASDAQ level 2 or some other information system for the purpose of capturing quotations at the time orders are executed.[64] If quotations were instead entered manually, it was noted, the likelihood for error might increase substantially and broker-dealers might have to adopt

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[51] See n. 41, supra.

[52] See, e.g., comment letter of Mabon, Nugent & Co.

[53] In addition, exchange member firms dealing in listed equity securities apparently have not been competitively disadvantaged in doing business at disclosed commissions while third market firms were dealing at net prices in the same securities.

[54] The term "market maker" is defined in section 3(a)(38) of the act.

[55] See *Chasins* v. *Smith Barney & Co., Inc.*, 438 F.2d 1167 (2d Cir. 1971).

[56] See comment letters of Salomon Brothers; and the Securities Industry Association.

[57] See paragraph (a)(4) of the proposed amendments to rule 10b-10, Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

[58] Article III, sec. 4 of the NASD Rules of Fair Practice, NASD Manual (CCH) ¶ 2154. See comment letters of Merrill Lynch, Pierce, Fenner & Smith Inc.; Reinhodt & Gardner; Roose, Wade & Co.; and the National Securities Traders Association.

[59] Article III, sec. 1 of the NASD Rules of Fair Practice, interpretation .03, NASD Manual (CCH) ¶ 2151. See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc.; and the National Securities Traders Association.

[60] See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc., Reinholdt & Gardner; and Herzog, Heine & Co., Inc.

[61] See comment letters of the NASD; and the National Securities Traders Association.

[62] See comment letters of Wulff, Hansen & Co.; Jefferies & Co., Inc.; J. & W. Seligman & Co.; the NASD; the National Securities Traders Association; and S. C. Parker & Co., Inc.

[63] See comment letters of Reinholdt & Gardner; and Goldman Sachs & Co.

[64] See comment letter of Merrill Lynch, Pierce, Fenner & Smith, Inc.

costly procedures to verify the information recorded.[65] Finally, several commentators contended that, for transactions involving more than 100 shares, inside market quotations for 100 shares would be irrelevant[66] and might mislead customers as to the quality of executions they were receiving.[67] In addition, it was conjectured that requiring the disclosure of inside market prices might pressure broker-dealers to lower retail prices to inside market levels.[68] If retail prices fell closer to inside market levels, commentators suggested, broker-dealers might be discouraged from effecting transactions in over-the-counter securities, and the liquidity of markets in those securities might thereby be endangered.[69]

While the Commission has not concluded that any or all of these arguments obviate the ultimate need for disclosure of best bid and offer prices, it has determined to withdraw the proposed requirement at this time. The Commission intends, however, to give additional consideration to the disclosure of "inside" or inter-dealer quotations as other legal and technological developments occur.

E. REMUNERATION PAID BY THIRD PARTIES TO DEALERS

The Commission has decided to withdraw its proposal to require disclosure of the source and amount of certain remuneration received or to be received by a dealer from any person other than the customer.[70] That provision was intended to require disclosure of special or irregular inducements paid by a third party to a dealer in connection with a securities transaction.

In withdrawing its proposal to require confirmation disclosure of such payments, the Commission stresses that it is not in any way suggesting that such disclosure would not be required under other Commission rules or provisions of the act. Indeed, the Commission believes that a failure to disclose special payments intended to induce dealers to effect transactions with customers would violate the anti-fraud provisions of the act.

At the same time, however, the Commission intends to consider whether broker-dealers should be required to disclose the amount of special compensation paid by a broker or dealer to an account executive or any other person associated with the broker or dealer in connection with customer transactions in a security designated by the broker-dealer where (1) investment recommendations for the purchase or sale of that security are made to customers and (2) such compensation exceeds the normal or customary renumeration that would otherwise have been paid by the firm to that employee or associated person. Among other things, it appears that many customers may regard the amount of such additional renumeration as important in evaluating investment recommendations made to them. Before proposing any such requirement, however, the Commission would appreciate receiving any data, views or arguments interested persons may care to make concerning such a requirement.

III. PROPOSAL TO PERMIT THE DELIVERY OF QUARTERLY CONFIRMATIONS FOR INVESTMENT COMPANY PLANS

Paragraph (b) of rule 10b-10, as amended, permits brokers and dealers to use quarterly statments instead of immediate confirmations for transactions effected pursuant to investment company plans as defined in paragraph (d)(5) of the rule. Investment company plans, as defined, include (1) individual, tax qualified retirment plans, (2) contractual or systematic plans pursuant to which a customer agrees to buy specified securites in specified amounts at regular intervals and (3) certain group plans where the members of the group purchase securities collectively through a person designated by the group provided that the purchase arrangements meet several specific requirements.

The Commission has previously permitted the use of quarterly statements rather than immediate confirmations in some circumstances in order to reduce regulatory costs that appear to outweigh the benefits to investor protection. The Commission has examined the existing quarterly statement provisions of rule 15c1-4 in light of its understanding that the quarterly statement procedure has not been used. The Commission has sought to revise those procedures for investment company plans to the extent it believes appropriate in view of the need to maintain adequate protection for investors and has determined to adopt paragraph (b) and the definitions set out in paragraph (d) substantially in the form proposed.

Most of the comments concerning the investment company plan provisions were to the effect that, unless revised still further, the procedure for quarterly statements would remain unused. At the outset, some commentators suggested that the definition of "investment company plan" in paragraph (d)(5) of the rule is too limited to make the quarterly procedure useful.[71] It was suggested that the quarterly procedure would not be economically feasible because qualifying plans do not represent a significant proportion of all accounts and are not readily identifiable. One commentator suggested that the quarterly statement procedure could appropriately be made available for all transactions in securities offered by investment companies where payments are made directly to the investment company by the customer.[72] While the Commission appreciates the concerns for cost savings prompting these suggestions, it nevertheless believes that the cost savings of eliminating the requirement to send immediate confirmations in all such situations would not sufficiently outweigh the risks to investor protection.

Some commentators also stated that they regarded the language in paragraph (d)(5)(i), which stated that an investment company plan includes "an individual retirement or pension plan qualified under the Internal Revenue Code," to be vague and possibly subject to restrictive interpretation.[73] Those commentators suggested that this language might be regarded as permitting use of the quarterly confirmation procedure only with respect to individual retirement accounts established under the Employee Retirement Income Security Act of 1974 ("ERISA"), and perhaps corporate pension plans. In response to that comment, paragraph (d)(5)(i) has been revised to reflect more clearly the Commission's intention that it not have any application to pension plans established for more than one individual. That provision does, however, permit the use of quarterly confirmations with respect to any retirement or pension plan established for a single individual and qualifying under the Internal Revenue Code regardless of whether that plan is also subject to provisions of the Internal Revenue Code added by ERISA.

Most persons commenting upon the investment company plan provisions of proposed rule 10b-10 regarded the "negative" confirmation procedure set

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[65] See comment letters of Arthurs, Lestrange & Short; Jefferies & Co.; and Merrill Lynch, Pierce, Fenner & Smith, Inc.

[66] See, e.g., comment letters of S. C. Parker & Co., Inc.; the NASD; Merrill Lynch, Pierce, Fenner & Smith, Inc.; Reinholdt & Gardner; and Goldman, Sachs & Co.

[67] See, e.g., comment letters of Merrill Lynch, Pierce, Fenner & Smith, Inc.; Sutro & Co., Inc.; J. & W. Seligman & Co.; NASD; and the National Securities Traders Association.

[68] See, e.g., comment letters of Arthurs, Lestrange & Short; Morgan, Olmstead, Kennedy & Gardner, Inc.; and Herzog, Heine & Co., Inc.

[69] See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc.

[70] See paragraph (a)(5)(i) of the rule as proposed to be adopted in Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

[71] See comment letters of the NASD; and USAA Investment Management Co.

[72] See comment letter of the NASD.

[73] See comment letters of the NASD; and the Investment Company Institute.

forth in paragraph (d)(5)(iii)(B) as a continuing deterrent to the employment of quarterly confirmation for group plans.[74] While it was acknowledged that decreasing this requirement to a single confirmation following a period of investment inactivity might result in some cost reduction over current "negative" confirmation procedures, some commentators contended that the principal cost of compliance with this requirement arise from the necessity to establish and operate a confirmation system that includes even a single "negative" confirmation.[75]

The Commission received comments from one company currently employing the quarterly confirmation procedure.[76] That commentator stated generally that it had been able to reduce its costs "considerably" through the use of quarterly statements and that they had been "well received" by customers. It also stated that it sends negative confirmations to participants in its group plans in each quarter in which there is not any account activity and stated that it did "not find the proposed negative confirmation requirements particularly onerous * * *." That experience suggests that these expenses may not be as prohibitive as some have predicted, and the Commission continues to believe that a "negative" confirmation is appropriate for the protection of investors in this context.

Finally, concern was reflected in several comments on proposed paragraph (d)(5)(iii)(C) of the rule, which required, among other things, that the "arrangement" be terminated if payment is not received from a group plan's designated person within 10 days of the date designated for delivery of payment. Some persons indicated that it was unclear whether the "arrangement" required to be terminated referred to the use of quarterly statements or the entire purchase plan.[77] It was noted that this provision would require careful attention to precisely when payments were due, a difficult matter for plans involving employers not following uniform payment patterns.[78] It would also require installation of a confirmation system to back up the quarterly statement procedure should payments not be made within the prescribed period.[79]

The Commission believes that if payment is not received within 10 days of the date specified in the plan, quarterly statements should not be used in lieu of immediate confirmations. The wording of paragraph (d)(5)(iii)(C) has been revised, however, to avoid possible confusion, and the rule, as adopted, will require immediate confirmations to be sent for at least the next three succeeding payments in the event a payment is not received within the prescribed time limits. Thereafter, quarterly statements could again be used in lieu of immediate confirmations. The Commission continues to believe that investors are entitled to assurances that payments made by them or on their behalf are promptly applied to the purchase of securities. The requirement that payments be made within 10 days of a date certain specified for delivery of payment is intended to provide this assurance. The Commission believes that it is realistic to expect employers or other designated persons to deliver payments within 10 days of the dates specified for payment and that it is reasonable to require broker-dealers to advise customers if payments are not received under these circumstances.

IV. Statutory Basis

The Securities and Exchange Commission, acting pursuant to the act, and particularly sections 3, 9, 10, 11, 15, 17, and 23 thereof (15 U.S.C. 78c, 78i, 78j, 78k, 78o, 78q, and 78w), hereby adopts amendments to § 240.10b-10 of Title 17 of the Code of Federal Regulations, effective December 18, 1978. The Commission also rescinds § 240-15cl-4, effective December 18, 1978. The revisions made in these amendments as originally proposed are either technical in nature or make less restrictive existing or proposed requirements; accordingly, the Commission finds, pursuant to the Administrative Procedure Act (5 U.S.C. 551 et seq.), that further notice and public procedure are not necessary.

The Commission also finds that the amendments to rule 10b-10 do not impose any burdens on competition not necessary or appropriate in furtherance of the purposes of the act. The confirmation rule, as adopted, imposes some regulatory burdens and costs on broker-dealers, but the Commission has determined that the rule does not impose any inappropriate burdens on competition. The Commission believes that the disclosures required by rule 10b-10, as amended, are necessary and appropriate not only to protect investors against certain abuses but also to provide investors with information concerning transaction costs. The disclosure of odd-lot differentials may in fact increase competition among dealers which charge such differentials and those who do not. While some commentators have suggested that the "riskless" principal disclosure requirement will burden competition, those concerns are based largely on speculative judgments about future investor preferences. On balance, the Commission believes that any burdens imposed by rule 10b-10, as amended, are justified in view of, among other things, the important role confirmations serve in protecting the investing public.

17 CFR Part 240 is amended by revising § 240.10b-10 to read as follows:

§ 240.10b-10 Confirmation of transactions.

(a) It shall be unlawful for any broker or dealer to effect for or with the account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security (other than U.S. Savings Bonds or municipal securities) unless such broker or dealer, at or before completion of such transaction, gives or sends to such customer written notification disclosing—

(1) Whether he is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for his own account;

(2) The date and time of the transaction (or the fact that the time of the transaction will be furnished upon written request of such customer) and the identity, price, and number of shares or units (or principal amount) of such security purchased or sold by such customer; and

(3) Whether any odd-lot differential or equivalent fee has been paid by such customer in connection with the execution of an order for an odd-lot number of shares or units (or principal amount) of a security and that the amount of any such differential of fee will be furnished upon oral or written request; *Provided, however,* That such disclosure need not be made if the differential or fee is included in the remuneration disclosed, or exempted from disclosure, pursuant to paragraph (a)(4)(ii); and

(4) If he is acting as agent for such customer, for some other person, or for both such customer and some other person,

(i) The name of the person from whom the security was purchased, or to whom it was sold, for such customer or the fact that such information will be furnished upon written request of such customer; and

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[74] Concern was also expressed regarding the applicability of the so-called "negative" confirmation requirement of paragraph (d)(5)(iii)(B) to individual retirement and pension plans described in paragraph (d)(5)(i). See comment letter of American Council of Life Insurance. Paragraph (d)(5)(iii)(B) is included in rule 10b-10 as part of a proviso applicable by its terms only to paragraph (d)(5)(ii); accordingly, it is not a condition to plans under paragraphs (d)(5)(i) or (ii).

[75] See generally comment letters of the NASD; and the Investment Company Institute.

[76] See comment letter of the Variable Annuity Life Insurance Co. ("VALIC").

[77] See comment letters of the NASD; and VALIC.

[78] See comment letter of VALIC.

[79] See comment letter of the NASD.

(ii) The amount of any remuneration received or to be received by him from such customer in connection with the transaction unless remuneration paid by such customer is determined, pursuant to a written agreement with such customer, otherwise than on a transaction basis; and

(iii) The source and amount of any other remuneration received or to be received by him in connection with the transaction; *Provided, however,* That if, in the case of a purchase, the broker was not participating in a distribution, or in the case of a sale, was not participating in a tender offer, the written notification may state whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer; and

(5) If he is acting as principal for his own account—

(i) The amount of any mark-up, mark-down, or similar remuneration received in a transaction in an equity security if he is not a market maker in that security and if, after having received an order to buy from such customer, he purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from such customer, he sold the security to another person to offset a contemporaneous purchase from such customer; and

(ii) In the case of a transaction in an equity security, whether he is a market maker in that security (otherwise than by reason of his acting as a block positioner in that security).

(b) A broker or dealer may effect transactions for or with the account of a customer without giving or sending to such customer the written notification described in paragraph (a) of this section if—

(1) Such transactions are effected pursuant to a periodic plan or an investment company plan; and

(2) Such broker or dealer gives or sends to such customer within 5 days after the end of each quarterly period a written statement disclosing each purchase or sale, effected for or with, and each dividend or distribution credited to, or reinvested for, the account of such customer (pursuant to the plan) during the period; the date of each such transaction; the identity, number and price of any securities purchased or sold by such customer in each such transaction; the total number of shares of such securities in such customer's account; any remuneration received or to be received by the broker or dealer in connection therewith; and that any other information required by paragraph (a) of this section will be furnished upon written request; *Provided, however,* That the quarterly written statement may be delivered to some other person designated by the customer for distribution to the customer; and

(3) In the case of transactions effected pursuant to an investment company plan—

(i) Payments for the purchase of securities by such customer or by such customer's designated agent are made directly to, or made payable to, the registered investment company, or the principal underwriter, custodian, trustee, or other designated agent of the registered investment company; and

(ii) The intention to give or send to the customer the written statement referred to in paragraph (b)(2) of this section, in lieu of the written notification required by paragraph (a) of this section, is disclosed in writing to such customer.

(c) A broker or dealer shall give or send to a customer information requested pursuant to this rule within 5 business days of receipt of the request; *Provided, however,* That in the case of information pertaining to a transaction effected more than 30 days prior to receipt of the request, the information shall be given or sent to the customer within 15 business days.

(d) For the purposes of this rule—

(1) "Customer" shall not include a broker or dealer;

(2) "Completion of the transaction" shall have the meaning provided in rule 15c1-1 under the Act;

(3) "Time of the transaction" means the time of execution, to the extent feasible, of the customer's order;

(4) "Periodic plan" means any written authorization for a broker acting as agent to purchase or sell for a customer a specific security or securities (other than securities issued by an open end investment company or unit investment trust registered under the Investment Company Act of 1940), in specific amounts (calculated in security units or dollars), at specific time intervals and setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them); and

(5) "Investment company plan" means any plan under which securities issued by an open-end investment company or unit investment trust registered under the Investment Company Act of 1940 are purchased or sold by a customer pursuant to—

(i) An individual retirement or individual pension plan qualified under the Internal Revenue Code;

(ii) A contractual or systematic agreement under which the customer purchases at the applicable public offering price, or redeems at the applicable redemption price, such securities in specified amounts (calculated in security units or dollars) at specified time intervals and setting forth the commissions or charges to be paid by such customer in connection therewith (or the manner of calculating them; or

(iii) Any other arrangement involving a group of two or more customers and contemplating periodic purchases of such securities by each customer through a person designated by the group; *Provided,* That such arrangement requires the registered investment company or its agent—

(A) To give or send to the designated person, at or before the completion of the transaction for the purchase of such securities, a written notification of the receipt of the total amount paid by the group;

(B) To send to anyone in the group who was a customer in the prior quarter and on whose behalf payment has not been received in the current quarter a quarterly written statement reflecting that a payment was not received on his behalf; and

(C) To advise each customer in the group if a payment is not received from the designated person on behalf of the group within 10 days of a date certain specified in the arrangement for delivery of that payment by the designated person and thereafter to send to each such customer the written notification described in paragraph (a) of this section for the next three succeeding payments.

(e) The Commission may exempt any broker or dealer from the requirements of paragraphs (a) and (b) of this section with regard to specific transactions of specific classes of transactions for which the broker or dealer will provide alternative procedures to effect the purposes of this section; any such exemption may be granted subject to compliance with such alternative procedures and upon such other stated terms and conditions as the Commission may impose.

(Secs. 3, 9, 10, 11, 15, 17, 23, 48 Stat. 891, 89 Stat. 97, 121, 137, 156 (15 U.S.C. 78c, 78i, 78j, 78k, 78o, 78q, 78w).)

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

OCTOBER 6, 1978.

[FR Doc. 29123 Filed 10-13-78; 8:45 am]

SECURITIES AND EXCHANGE COMMISSION

[17 CFR Part 240]

[Release No. 34-15220; File No. S7-654]

SECURITIES CONFIRMATIONS

Proposed Rulemaking

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking.

SUMMARY: The Securities and Exchange Commission is proposing two related rulemaking actions that would require disclosure on the customer's confirmation of the amount of any markup, markdown or similar remuneration received (1) by any broker or dealer effecting a "riskless" principal transaction in a nonmunicipal debt security with a customer, and (2) by any broker, dealer or municipal securities dealer effecting a "riskless" principal transaction in a municipal security with a customer. The proposals would extend to transactions in debt securities the confirmation disclosure requirements applicable to "riskless" principal transactions in equity securities adopted by the Commission today in amendments to the existing confirmation delivery and disclosure requirements.

DATES: Comments must be received on or before December 1, 1978.

ADDRESSES: All comments should refer to File No. S7-654 and should be sent in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549. All submissions will be made available for public inspection at the Commission's Public Reference Room. Room 6101, 1100 L Street NW., Washington, D.C.

FOR FURTHER INFORMATION CONTACT:

Jeffrey L. Steele, Esq., Office of the Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549 202-755-7587.

SUPPLEMENTARY INFORMATION: The Commission today announced a proposal to amend Rule 10b-10 (17 CFR 240.10b-10) under the Securities Exchange Act of 1934 (the "Act")[1] and to adopt Rule 15c2-12 (17 CFR 240.15c2-12) under the Act.

The proposed amendment to Rule 10b-10 would make it unlawful for any broker or dealer (other than a market maker) trading as principal for its own account to effect a transaction in a non-municipal debt security[2] with a customer unless the broker or dealer, at or before completion of the transaction, gives or sends to the customer written notification disclosing the amount of any markup, markdown, or similar remuneration received if, after having received an order to buy from the customer, he purchased the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from such customer, he sold the security to another person to offset a contemporaneous purchase from the customer.[3] Transactions effected in the manner described above have been generally referred to as "riskless" principal transactions.

Proposed Rule 15c2-12 would require comparable disclosure in the case of transactions of the same type in a municipal security effected by a broker, dealer, or municipal securities dealer.

The amendment to Rule 10b-10 is proposed to be adopted pursuant to the Act, and particularly Sections 3, 10, 11, 15, 17, and 23 thereof (15 U.S.C. 78c, 78j, 78k, 78o, 78q and 78w). Rule 15c2-12 is proposed to be adopted pursuant to the Act, and particularly Sections 3, 10, 11, 15, 15B, 17, and 23 thereof (15 U.S.C. 78c, 78j, 78k, 78o, 78o-4, 78q, and 78w).

BACKGROUND

In a separate release, the Commission today announced the adoption of amendments to Rule 10b-10.[4] That rule generally requires brokers and dealers to give or send to customers written confirmation of transactions in securities other than U.S. Savings

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[1] 15 U.S.C. 78a et seq.

[2] The proposed amendment would amend paragraph (a)(5)(i) of Rule 10b-10 by deleting the phrase "in a transaction in an equity security" which currently causes that paragraph to apply only to transactions in equity securities.

[3] That requirement would apply regardless of variations in mechanical techniques for structuring and sequencing transactions that are designed to offset one another. For example, a dealer filling a customer's purchase order would not avoid the requirement by effecting a sale to his customer immediately before purchasing the security from another person instead of first purchasing the security from the other person for resale to the customer and then selling it to the customer. Similarly, a dealer would not avoid the requirement in filling a customer's sale order by first purchasing the security from the customer for resale to another person and then selling it to the other person instead of first selling it to the other person and then purchasing it from his customer.

[4] See Securities Exchange Act Release No. 15219 (Oct. 6, 1978).

Bonds or municipal securities. As amended, Rule 10b-10 requires brokers and dealers (except market makers) trading for their own account with customers to disclose markups and markdowns in "riskless" principal transactions in equity securities.[5] With the exception of certain paragraphs that became effective on June 1, 1977, Rule 10b-10, as amended, becomes effective on December 18, 1978.

As orginally proposed in September 1976, Rule 10b-10 would have required disclosure of markups and markdowns in "riskless" principal transactions in all equity and debt securities, including municipal securities.[6] When the Commission adopted Rule 10b-10 in May 1977, however, it provided that Rule 10b-10 would not apply to municipal securities.[7] At the same time, it determined to revised and republish for further public comment the "riskless" principal markup disclosure provision. The proposed requirement, as revised, would have applied to both equity securities and nonmunicipal debt securities.[8]

Shortly thereafter, the Municipal Securities Rulemaking Board (the "MSRB") undertook to determine whether confirmation disclosure of markups and markdowns should be required in the case of municipal securities.[9] On August 3, 1977, the MSRB solicited public comment on that question, and it later held two public meetings in October 1977. On November 16, 1977, the MSRB sent to the Commission a letter summarizing arguments made by commentators opposed to disclosure of markups and markdowns. On February 10, 1978, the MSRB sent to the Commission a second letter in which it stated its conclusion that "the imposition of a requirement to disclosure remuneration in principal transactions in municipal securities is unnecessary and inappropriate."

[5] Id.

[6] See Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

[7] See Securities Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977).

[8] See Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977). When the Commission proposed the amendments to Rule 10b-10, it stated at n. 7 that "[s]hould the [MSRB] not resolve to develop such adaptations as may be necessary in the application of the 'riskless' principal requirement, the Commission plans to revisit the question of including municipal securities transactions generally under Rule 10b-10 * * *."

[9] The MSRB has adopted MSRB rule G-15 imposing confirmation delivery and disclosure requirements for municipal securities transactions. MSRB Manual (CCH) ¶3571. See also Securities Exchange Act Release ¶13942 (Sept. 9, 1977).

Basis and Purpose

In Securities Exchange Act Release No. 15219, published today, the Commission has discussed at length its reasons for adopting a provision in Rule 10b-10 that requires disclosure of markups and markdowns in "riskless" principal transactions in equity securities. The Commission has determined that it is important for customers to be provided with the opportunity, to the extent practicable, to make their own assessments of the reasonableness of transaction costs incurred in effecting transactions in equity securities, regardless of technical variations employed by broker-dealers in structuring such transactions. While the Commission has received a number of comment letters opposing the imposition of a "riskless" principal disclosure requirement for debt securities, it has not determined on the basis of those comments that application of a requirement to debt securities would necessarily be inappropriate.

"Riskless" principal transactions in equity securities became a source of concern and controversy in 1963, when the Commission's Special Study of Securities Markets recommended that such transactions be prohibited.[10] The issue of "riskless" principal transactions in nonmunicipal debt securities and municipal securities was not specifically considered in the special study and has not received much public attention until recently. In addition, many of those who previously commented on the "riskless" principal provision in rule 10b-10 focused primarily on the application of that requirement to equity securities and did not separately consider debt securities. The Commission has concluded, therefore, that it would be advisable to solicit further comment on the matter before reaching a final decision, and, accordingly, has issued the proposals set forth in this release.

Previous comments. The Commission has received the views of the MSRB and other commentators to the effect that it would be unnecessary and inappropriate to require disclosure of markups and markdowns in "riskless" principal transactions in municipal securities and other debt securities.[11] Some of those commentators have asserted that the structural and transactional differences between the debt markets and the equity markets are sufficiently important that the Commission should not require disclosure of markups and markdowns for "riskless" principal transactions in debt securities.

Commentators noted that in the debt markets broker-dealers customarily effect transactions on a principal rather than an agency basis, that there is far greater variety in the types of debt securities than in equity securities, that execution of transactions in debt securities is rarely mechanical and requires special judgment and expertise, that many debt instruments are traded primarily among purchasers and sellers who are very sophisticated, that the absence of a centralized clearing facility increases the risks broker-dealers incur if customers fail to deliver funds or securities to the broker-dealer in connection with a transaction, and that, because debt securities are traded on the basis of yield and are priced in relation to developments in the money markets, there are important constraints on the pricing of debt securities.

Evaluation of comments. The Commission recognizes that the markets for debt and equity securities differ in many important respects. It is not currently clear to the Commission, however, that such differences warrant nondisclosure of markups and markdowns in "riskless" principal transactions in debt securities. The fact that most transactions in debt securities may be effected on either a risk principal or "riskless" principal basis does not necessarily answer the question whether disclosure of transaction costs in at least "riskless" transactions should be required. If it may be assumed that comparatively fewer transactions in the debt markets, by comparison to the equity markets, are currently structured on an agency (as opposed to a "riskless" principal) basis, that might be thought to underscore the need for the "riskless" principal disclosure requirement in order to permit investors in debt securities to become aware of possible differences in the level of transaction costs among various markets when they evaluate the benefits and costs of one investment as opposed to another.[12] Inves-

[10] Securities and Exchange Commission, Report of Special Study of Securities Markets, H.R. Doc. No. 95, pt. 2, 88th Cong., 1st sess. 676 (1963).

[11] See, e.g., comment letters of the Securities Industry Association.

[12] The Commission also recognizes that there are some business risks associated with effecting transactions in every class of security and that those risks may be greater for securities traded in the absence of centralized market facilities. Nevertheless, the Commission does not propose to base a decision concerning the "riskless" principal disclosure requirement on any belief that "riskless" principal transactions indeed are totally free of business risks. The term "riskless" has been applied to principal transactions where a dealer essentially performs the functions of an agent and is, of course, only a trade term used to describe a type of securities transaction. While the level of business risks associated with the execution of agency transactions for differ-

Footnotes continued on next page

tors in equity securities are accustomed to receiving disclosure of agency commissions (and will receive disclosure of "riskless" principal compensation upon the effectiveness of rule 10b-10, as amended). Such investors, and particularly retail investors, may be misled or uncertain as to whether any such compensation is being paid on transactions in debt securities.

Similarly, the fact that the execution of "riskless" principal transactions in debt securities may often involve the exercise of special judgment and expertise does not demonstrate that disclosure of transactions costs would necessarily be inappropriate. One might expect that more difficult and time-consuming transactions would involve higher transaction costs than comparatively simpler executions, but it is not clear why investors in debt securities should not be furnished with information concerning those costs in order to enable them to weigh that factor in reaching investment decisions.

Arguments have also been made that the amount of compensation a dealer receives on a "riskless" principal transaction in debt securities is not material information to the investor.[13] Those arguments have been predicated on the fact the debt securities are generally priced on the basis of yield (even if prices are also expressed in dollar amounts) and that a dealer's remuneration in "riskless" principal transactions generally represents a small percentage of the dollar value of transactions. Retail customers are generally not aware of the amount of markups and markdowns and, it was suggested, are interested only in current not yield and yield to maturity or call rather than the dollar price of a security.[14]

The Commission recognizes the importance of yield in the pricing of debt securities and that most investors in debt securities have some knowledge of prevailing yields on various types of debt instruments. Accordingly, even comparatively unsophisticated investors might refuse to purchase a security that was priced at a level that caused its yield to be noticeably outside the range of prevailing yields for similar securities.

Yield is, of course, affected by various factors in addition to prevailing interest rates. Maturity date, quality, source of the security interest being pledged, marketability, and special features, such as callability, affect yield. While bond ratings have some bearing on yield, debt securities having the same rating and maturity (including call features) may nevertheless be priced contemporaneously at different levels, in part because bond ratings represent only an approximate guide as to the quality of the bonds.

Transaction costs, such as markups and markdowns in "riskless" principal transactions, also directly affect the yield to maturity that the customer realizes. The effect on yield to maturity of a transaction charge of specified size would be greater for a short-term security than it would be for a longer term security. As a result, a markup or markdown on short-term securities must be relatively modest in order not to have a noticeable effect on yield to maturity but can be substantially larger for long-term securities.

The Commission understands that, in both corporate and municipal securities, dealers' spreads, as well as markups, markdowns, and concessions, are generally calculated on a basis that reflects yield to maturity. The dollar amount of spreads, concessions, markups, and markdowns is generally greater on long-term securities than on short-term securities. In the case of risk principal transactions, the differential in spreads between short- and long-term debt securities reflects, in part, the fact that long-term debt securities are more volatile in price for a given variation in prevailing interest rates than are short-term debt securities and that, as a result, the risk attendant to carrying long-term securities in a dealer's inventory is greater than the risk for short-term securities.

The Commission understands, however, that the amount of markups and markdowns in "riskless" transactions is greater for long-term securities than for short-term securities even though the risks of market fluctuation attendant to "riskless" transactions are generally conceded to be substantially less than those attendant to maintaining a bona fide inventory. At the same time, it has not been suggested that the costs incurred by broker-dealers in principal transactions vary in accordance with the maturity of securities being purchased and sold in that fashion. Also, while yield to maturity may apply substantial controls on the dollar amount of markups and markdowns for short-term securities, those controls are much less significant in the case of long-term securities. Accordingly, it is not clear that yield to maturity provides any means for comparing transaction costs, particularly between securities of differing maturities.[15] In addition, since various factors, including the amount of a markup or markdown, can affect yield even on securities of the same maturity, it is not clear why investors should not receive specific information concerning the amount of any markup or markdown charged in a "riskless" principal transaction.[16]

Footnotes continued from last page

ent types of securities varies, presumably transaction costs take those risks into account to some extent. In any event, it does not currently appear that the presence of business risks in either agency transactions or "riskless" principal transactions warrants nondisclosure to customers of transaction costs.

[13] See MSRB letter of Nov. 16, 1977, summarizing the views of persons commenting to the MSRB in response to its solicitation of views regarding the development of a "riskless" principal disclosure requirement for municipal securities, Securities and Exchange Commission File No. S7-654.

[14] Some commentators have suggested that transactions with institutional investors should be exempted from the "riskless" principal disclosure requirement. Although many institutional investors may have adequate means to make fully informed investment decisions, a decision to exempt certain classes of institutional transactions on the basis of a presumed level of expertise and sophistication among institutional investors would involve predictive judgments that may not be justified in all cases. Also, many institutional investors are acting in a fiduciary capacity. Disclosure documents, such as confirmations, can provide an important source of information concerning the performance of fiduciary duty.

[15] The MSRB has suggested that a markup policy such as that of the National Association of Securities Dealers, Inc. would be inappropriate for municipal securities since, among other things, published quotations in municipal securities show only the offer side of the market and in some instances it may be extremely difficult to ascertain a representative market price against which to measure the markup. MSRB, Statement on Form 19b-4A (concerning proposed MSRB rule G-30), at 27 (File No. SR-MSRB-77-12), Securities Exchange Act Release No. 13987 (Sept. 22, 1977), 42 FR 49856 (Sept. 28, 1977). As a result, it may be particularly important in the case of municipal securities to place greater reliance on disclosure than on more direct forms of regulation as a means of reducing the opportunity for abuse.

[16] One additional problem with undisclosed "riskless" principal markups is the inducement that may be afforded to an unscrupulous dealer to gain high markups by passing off low quality securities to unsophisticated customers at yields that resemble yields generally characteristic of higher quality securities. While it might take substantial capital to undertake such an operation on a risk principal basis, the "riskless" principal transaction does not require any similar capital commitment. Although the MSRB has proposed rules of fair practice which would require dealers to deal fairly with their customers and to charge customers only net prices that are fair and reasonable, the existence of such rules alone does not prevent fradulent conduct. The confirmation rule, together with the recordkeeping rules, can have a further deterrent effect. It is doubtful whether the practice referred to above would withstand disclosure. At the same time, if disclosure were required, a failure to disclose such markups and to retain appropriate records, once discovered, would provide a predicate for administrative or judicial sanction.

SOLICITATION OF FURTHER COMMENT

The Commission concluded, in adopting a "riskless" principal requirement for transactions in equity securities, that such a requirement would be appropriate for that class of securities. The Commission's reasons for reaching that conclusion are set forth in Securities Exchange Act Release No. 15219 (Oct. 6, 1978).

At the same time, the Commission noted that the MSRB had earlier concluded that a "riskless" principal disclosure requirement was not necessary or appropriate for municipal securities, and the Commission also noted that other commentators had not focused specifically on the application of such a requirement to nonmunicipal debt securities. Accordingly, the Commission believed it should solicit further comment on that matter before reaching a final decision. Commentators are specifically invited to consider and to provide data, views and arguments concerning the following questions:

(1) In view of the Commission's reasons for adopting a "riskless" principal disclosure requirement for transactions in equity securities, and the discussion of previous comments set forth above in this release, should such disclosure nevertheless not be required for transactions in debt securities?

(2) Would it be appropriate for the Commission to require "riskless" principal disclosure for certain classes of debt securities but not for others? In particular, should a different result be reached for municipal securities than for U.S. Government or corporate debt securities?

(3) Would the proposed amendment to Rule 10b-10 or proposed Rule 15c2-12 impose any burden on competition and, if so, would that burden be necessary or appropriate in furtherance of the purposes of the Act?

Commentators may also wish to take note of one difference between proposed Rule 15c2-12 and paragraph (a)(5)(i) of Rule 10b-10, which contains the "riskless" principal remuneration provision in that rule for equity securities (and, as proposed to be amended, for nonmunicipal debt securities). Largely because of the problems in determining which transactions should be covered by the "riskless" principal disclosure requirement in the case of a market maker quoting a two-sided market in an equity security, and certain features of block positioning in equity securities, Rule 10b-10 contains an exemption for transactions in which a broker-dealer is a market maker in the security being purchased or sold. The proposed amendment to Rule 10b-10 would preserve the market maker exemption for nonmunicipal debt securities to the extent dealers in such securities act as market makers in those securities. This exemption has not been included in proposed Rule 15c2-12 dealing with municipal securities because the Commission understands that the term "market maker," as defined in section 3(a)(38) of the Act,[17] has little or no application to transactions in municipal securities because of differences between municipal securities and other types of securities.[18] Commentators may wish to consider whether compliance problems, similar to those faced by equity market makers, or considerations similar to those identified for block positioners in equity securities,[19] may nevertheless make it appropriate to extend this or a similar exemption to municipal securities transactions or whether it would be more appropriate to eliminate any exemption for nonmunicipal debt securities as well as for municipal securities.

The Commission proposes to amend part 240 of chapter II of title 17 of the Code of Federal Regulations as follows:

1. By revising paragraph (a)(5)(i) of § 240.10b-10 to read as follows ("[ ]" indicates material to be deleted):

§ 240.10b-10 Confirmation of transactions.

(a) * * *

(5) * * *

(i) The amount of any markup, markdown, or similar remuneration received [in a transaction in an equity security] if he is not a market maker in that security and if, after having received an order to buy from such customer, he purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from such customer, he sold the security to another person to offset a contemporaneous purchase from such customer; and

* * * * *

2. By adopting § 240.15c2-12 to read as follows:

§ 240.15c2-12 Confirmation of municipal securities transactions.

(a) It shall be unlawful for any broker, dealer, or municipal securities dealer, acting as principal for its own account, to effect with the account of a customer any transaction in any municipal security unless the broker, dealer, or municipal securities dealer, at or before completion of the transaction, gives or sends to the customer written notification disclosing the amount of any markup, markdown, or similar remuneration received if, after having received an order to buy from the customer, he purchased the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from the customer, he sold the security to another person to offset a contemporaneous purchase from the customer.

(b) For the purposes of this rule,

(1) "Customer" shall not include a broker, dealer or municipal securities dealer; and

(2) "Completion of the transaction" shall have the meaning provided in § 240.15c1-1.

* * * * *

All interested persons are invited to submit three copies of written data, views, and arguments on the proposed amendment to Rule 10b-10 and on proposed Rule 15c2-12 to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549, not later than December 1, 1978. Reference should be made to File No. S7-654. All submissions will be made available for public inspection at the Commission's Public Reference Room, Room 6101, 1100 L Street NW., Washington, D.C.

By the Commission.

GEORGE A. FITZSMMONS,
Secretary.

OCTOBER 16, 1978.

[FR Doc. 78-29124 Filed 10-13-78; 8:45 am]

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[17] 15 U.S.C. 78c(a)(38).

[18] See MSRB letter to the Commission, November 16, 1977 (Securities and Exchange Commission File No. S7-654), in which the MSRB stated:

Securities professionals ordinarily to not make two-sided markets in municipal securities, principally because the nonfungible, serial nature of most municipal securities would make it extremely difficult to cover short positions. There are also considerations relating to the tax status of municipal securities sold short. However, many municipal securities professionals stand ready and willing to bid for securities of issues in their region. Although they do not make two-sided markets, and may not have an inventory position in certain maturities of certain issues of a particular issuer, many commentators have suggested that municipal securities professionals are market makers in a broad sense and that transactions effected by them in the issues in which they make markets should be exempt from a [riskless principal] disclosure requirement.

[19] See Securities Exchange Act Release No. 15219 (Oct. 6, 1978).

NOTICE TO MEMBERS: 78-46
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 8, 1978

IMPORTANT

MAIL VOTE

Officers * Partners * Proprietors

TO: Members of the National Association of Securities Dealers, Inc.

RE: Mail Vote on Proposed Article III, Section 37 of the Rules of Fair Practice

Last Voting Date is December 8, 1978

Enclosed herewith is a proposed new Section 37 of Article III of the Association's Rules of Fair Practice concerning the content of member advertising and sales literature and related requirements regarding member approval, recordkeeping and filing with the Association. Prior to becoming effective, this new rule must be approved by the membership and filed with the Securities and Exchange Commission for approval pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended.

The proposed rule was submitted to the membership for comment on October 6, 1977 (Notice to Members 77-34), in addition to a previous request for member comment on the appropriate course the Association should take with respect to existing filing requirements (Notice to Members 77-10 dated March 31, 1977). The Board of Governors has considered the comments received and appropriate changes have been made to the proposal. The primary changes are intended to clarify the purpose and application of certain provisions and no substantive changes have been made.

The primary authority for this proposal is contained in Section 15A(b)(6) of the Securities Exchange Act of 1934, as amended (15USC 78 o-3 (b)(6), and Article VII of the Association's By-Laws.

Background and Explanation of Proposed Rule

As explained in Notice to Members No. 77-10, the Association has reviewed the action taken by the New York and American Stock Exchanges to eliminate their requirements for prior approval of member advertising. After careful consideration, the Board of Governors recommends the elimination of its general after-the-fact filing requirement and the adoption of a new spot-check procedure similar to that used by some of the exchanges. In addition,

however, the Board believes that the separate requirements for investment company material should be retained and that new advance filing requirements should be instituted in certain limited areas. The Board has also taken this opportunity to codify some of its existing interpretations into rule form, to propose new requirements for options, and to consolidate various requirements into one place which are now contained in different sections of the NASD Manual. Of course, if the subject proposal is ultimately adopted, existing Board Interpretations would be repealed or amended as appropriate, including the recently adopted options advertising standards contained in Section 23 of Appendix E to Article III, Section 33 of the Rules of Fair Practice.

It is proposed that advance filing requirements be applied to options advertising to bring the Association's requirements into line with the various options exchanges. It is also proposed that advance filing requirements be applied to all new members for one year and that, in addition, District Business Conduct Committees be specifically authorized to direct a member to file advertising in advance for a period not exceeding one year. This latter provision is designed to provide District Committees with added flexibility to deal with situations where a member appears to be having difficulty in designing advertising or sales literature in accordance with applicable standards but the Committee does not feel that the situation warrants formal disciplinary proceedings. The procedure would not displace the Formal Complaint procedure or the Admission, Waiver and Consent Procedure and District Committees could still utilize these procedures where appropriate. A member who desired further consideration of the requirement imposed by the District Committee could request a hearing on the matter.

Both of these latter two new provisions result from the Association's belief that, except for the special product areas mentioned, difficulties experienced with the content of the members' advertising tend to be concentrated in a relatively small number of firms. Often the members experiencing difficulties are new members or members who haven't advertised in the past. Occasionally, however, problems are experienced by other than new members, due to a change in personnel or other factors. These two new provisions are intended to focus the Association's regulatory effort on the likely problem areas, while lifting a substantial compliance burden from the majority of members. This consideration has also resulted in an expansion of the types of material which would be exempted from the filing requirements and spot-check procedures.

The Association will, of course, continue to review and comment upon members' material which is voluntarily submitted. With respect to material submitted pursuant to any of the advance filing requirements contained in Section 37, or material voluntarily submitted in advance of use, the Association's Advertising Department will, in the absence of highly unusual circumstances, respond to members within the specified ten day period.

Summary of Changes in Filing Requirements by Type of Product

For the convenience of the membership, the following summarizes the proposed changes in filing requirements by type of security:

Type of Security	Change in Requirement
Investment Company Securities (including mutual funds, unit trusts and variable contracts)	No substantive change in requirement to file advertising and sales literature within 3 days of use - Elimination of requirement for prior clearance of certain withdrawal plan illustrations
Direct Participation Programs (Oil, Gas, Real Estate, etc.)	Withdrawal of previously proposed requirement for filing of advertising and sales literature prior to use - New spot-check procedure to be implemented
Options*	New 10 day prior filing requirement
All other advertising*	Elimination of requirement for filing within five days of use - New spot check procedure to be implemented

Section-by-Section Analysis

The following is an analysis of each section of the proposed rule which would be different from the current provisions in any significant respect. Of course, the consolidation of various provisions has caused changes in wording, sequence or designation.

Section A(1) — This definition of "advertisement" is essentially the same as that contained in the Board's Advertising Interpretation (paragraph 2151.01 NASD Manual) except for the addition of specific types of advertising which have become more popular and which weren't previously specified.

Section A(2) — This definition of "sales literature" is basically the same as that in the Board's Advertising Interpretation except that it includes a new definition of "form letter" which will hopefully resolve some confusion in this respect. This new definition is based primarily on the definition contained in SEC Rule 24b-1 under the Investment Company Act of 1940. As is currently the case, "advertisement" and "sales

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* As is currently the case, material in these categories would not be subject to filing or spot-check procedures if reviewed by an exchange having substantially the same standards as the Association. There are also broad categories of material exempted from these procedures.

Section A(2) (Cont.)

literature" are defined separately to distinguish material subject to different filing and spot-check requirements. As specified later, certain requirements apply only to advertising while others also apply to sales literature. Of course, the general standards apply to all public communications.

Section B(1)

This requirement for approval of advertising and sales literature by a registered principal or his designee is a substitute for the current requirement that such approval be by "an officer, partner or official of the member designated to supervise such matters." The requirement that options material be approved by the senior registered options principal is new but it is comparable to the requirements of the options exchanges. While this section permits the principal to designate another competent person to actually review the material, it also places the ultimate responsibility with the principal.

Section B(2)

This recordkeeping requirement is similar to that contained in the Board's Advertising Interpretation except that it eliminates a requirement that the material be readily accessible for two years since this seems redundant in terms of current SEC record-keeping requirements.

Section C(1)

This filing requirement for investment company related literature is essentially the same as that currently in effect (Page 5011 NASD Manual). The separate requirement for prior clearance of certain withdrawal plan illustrations would be eliminated, however (Page 5062 NASD Manual).

Section C(2)

This new advance filing requirement for options material is comparable to that of the options exchanges. Consistent with the Board's current Advertising Interpretation, it includes, however, an exemption for material approved by an exchange having similar rules. Thus, members who receive approval of options ads from one of these exchanges need not file them with the Association.

Section C(3)

This is a proposed requirement for advance filing of advertising by members for one year. This provision also contains an exemption for material filed with an exchange having comparable standards; however, the exemption would not apply to material concerning

Section C(3) (Cont.)	investment companies or direct participation programs. While primarily aimed at new members, this advance filing requirement would be applicable to existing members for one year from the date of filing of the first advertisement. Thus, a member who had been filing advertisements for nine months on the effective date of the rule would be subject to a three-month requirement. An existing member who had been filing advertising with the Association or with an exchange for at least one year prior to the effective date of the rule would not be subject to this requirement.
Section C(4)	As explained earlier in this notice, this new provision would give District Business Conduct Committees added flexibility to require that a member file one or more types of material in advance of use, for periods up to one year, without the necessity of utilizing more formal disciplinary processes. The member could request a hearing if further consideration of the requirement imposed by the District Committee was desired.
Section C(5)	This provision outlines the spot-check procedure to be used by the Association with respect to material not previously reviewed. It includes an exemption for members of an exchange which utilizes a comparable spot-check procedure. It does not, of course, preclude on-site inspections of such material. While it may not be necessary to outline this procedure in the rule, the Board believes it may be helpful to members to do so.
Section C(6)	This provision continues the pattern, established in the Board's Advertising Interpretation, of excluding certain types of material from the filing requirements. As a direct result of trying to focus on the potential sources of problems, however, the list of exclusions has been broadened.
Section C(6) (a) and (b)	These provisions broaden the list of routine announcements excluded from the filing requirements.
Section C(6)(c)	This provision extends an existing exemption, for straightforward offers, to sales literature as well as advertising.
Section C(6)(d)	This provision continues an existing exemption for internal communications.

Section C(6)(e)	This provision continues an existing exemption for prospectuses and offering circulars on registered offerings. The exemption would cover prospectuses for securities registered under the Securities Act of 1933 or exempt therefrom, regardless of whether registration with a state is required.
Section C(6)(f)	This provision exempts so-called "tombstone" ads concerning securities registered with the SEC under the Securities Act of 1933, except for ads concerning options, investment company securities and direct participation programs.
Section D	This provision restates the general standards of accuracy and fairness contained in the Board's Advertising Interpretation. It contains an additional provision dealing with seminars, public speaking, etc., which is intended to clarify that the Association's standards apply to such activities. The Board recognizes that often interviews or speaking engagements do not always lend themselves to prepared texts or formalized responses; however, members should apply the same high standards of accuracy, fairness and responsibility in such situations as would apply to more formal communications. Except as noted below, the specific standards have not otherwise been changed.
Section D(2)	This provision is essentially the same as the current requirements of the Board's Advertising Interpretation except that it deletes an existing requirement that a member's intention to act as principal be disclosed. The Board feels that such a requirement duplicates confirmation disclosure of capacity, is often duplicative of market-making disclosures and may be too subjective to be of major value.
Section D(2)(c)	This is a new provision comparable to exchange rules requiring disclosure that the member managed a recent public offering of the recommended issuer.
Section D(8)	This provision continues the prohibition against exaggerated claims about employment opportunities in the securities business but adds a new prohibition regarding specific earnings figures which are unreasonable.

Section D(9)	This is a new provision dealing with disclosures regarding periodic investment plans. This standard is comparable to the SEC's Statement of Policy and existing exchange rules.
Section D(10)	This new provision prohibits misleading references to SEC, NASD or other regulatory organizations. It essentially incorporates two provisions contained in the previously published standards which would be applicable to direct participation program literature. Inclusion in this rule will make these standards applicable to all public communications.
Section D(11)	This new provision also comes from the recently published standards for direct participation programs and it generally requires disclosure of the source of statistical material.
Section E	This section essentially incorporates into the rule the Securities and Exchange Commission's Statement of Policy on investment company literature.
Section F	These new provisions are applicable to public communications regarding options. These standards are comparable to the existing standards of the options exchanges except that they are not limited to options traded in any specific market and certain provisions have been clarified by minor language changes. Section F(1) and F(2) are applicable to all options material while Section F(3) is applicable to material concerning options issued by the Options Clearing Corporation. Framing the rules this way recognizes that member communications may not identify any particular options market. It also eliminates the need for amendment of the rule as new options programs are implemented.
Section G	This provision incorporates the requirements of the Municipal Securities Rulemaking Board into the rule.

While the proposed standards for advertising and sales literature regarding direct participation programs (Appendix F to Article III, Section 35 of the Rules of Fair Practice) have not been specifically incorporated into this rule, appropriate cross-references would be made regarding these and any other relevant standards contained elsewhere in the NASD Manual.

* * * *

The proposed new Rule of Fair Practice is important and merits your immediate attention. Please mark the ballot according to your convictions and return it in the enclosed stamped envelope to "The Corporation Trust Company." Ballots must be postmarked no later than December 8, 1978.

The Board of Governors believes the Rule of Fair Practice is necessary and appropriate and recommends that members vote their approval.

Very truly yours,

Christopher R. Franke
Secretary

Text of Proposed Article III, Section 37, Rules of Fair Practice
(Substantive additions to current requirements are underlined)

Communications with the Public

A. Definitions

(1) Advertisement - For purposes of this Section 37 and any interpretation thereof, the term "advertisement" means material published, or designed for use in, a newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, telephone directories (other than routine listings), or other public media.

(2) Sales Literature - For purposes of this Section 37 and any interpretation thereof, sales literature means any notice, circular, report (including research reports), newsletter (including market letters), form letter, or reprint or excerpt of the foregoing or of any published article, or any other promotional literature designed for use with the public, which material does not meet the foregoing definition of "advertisement." For purposes of this subsection, a form letter shall include one of a series of identical letters, or individually typed or prepared letters which contain essentially identical statements or repeat the same basic theme and which are sent to 25 or more persons.

B. Approval and Recordkeeping

(1) Each item of advertising and sales literature shall be approved by signature or initial, prior to use, by a registered principal (or his designee) of the member. In the case of advertising or sales literature pertaining to options, the approval must be by the senior registered options principal or his designee.

(2) A separate file of all advertisements and sales literature, including the name(s) of the person(s) who prepared them and/or approved their use shall be maintained for a period of three years from the date of each use.

C. Filing Requirements and Review Procedures

(1) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) shall be filed with the Association's Advertising Department by any member preparing it, or who has such material prepared, within three business days after first use or publication. Dealers need not file material prepared and filed by sponsors or underwriters unless a change in content or

format is contemplated. Filing of such material in advance of use is permitted and encouraged but is not required.

(2) Advertisements pertaining to options shall be submitted to the Association's Advertising Department for review at least ten days prior to use (or such shorter period as the Department may allow in exceptional circumstances), unless such advertisement is submitted to and approved by a registered securities exchange or other regulatory body having substantially the same standards with respect to options advertising as set forth in this Section 37.

(3) (a) Each member of the Association which has not previously filed advertisements with the Association (or with a registered securities exchange having standards comparable to those contained in this Section 37) shall file its initial advertisement with the Association's Advertising Department at least ten days prior to use and shall continue to file its advertisements at least ten days prior to use for a period of one year.

(b) Each member which, on the effective date of this Section 37, had been filing advertisements with the Association (or with a registered securities exchange having standards comparable to those contained in this Section 37) for a period of less than one year shall continue to file its advertisements, at least ten days prior to use, until the completion of one year from the date the first advertisement was filed with the Association or such exchange.

(c) Except for advertisements related to direct participation programs or to investment company securities, members subject to the requirements of subsection (a) or (b) above may, in lieu of filing with the Association, file advertisements on the same basis, and for the same time periods specified in those subsections, with any registered securities exchange having standards comparable to those contained in this Section 37.

(4) Notwithstanding the foregoing provisions, any District Business Conduct Committee of the Association, upon review of a member's advertising and/or sales literature and after determining that the member has departed and there is a reasonable likelihood that the member will again depart from the standards of this Section 37, may require that such member file all advertising and/or sales literature, or the portion of such member's material which is related to any specific types or classes of securities or services, with the Association's Advertising Department and/or the District Committee, at least ten days prior to use.

The Committee shall notify the member in writing of the types of material to be filed and the length of time such requirement is to be in effect. The requirement shall not exceed one year, however, and shall not take effect until 30 days after the member receives the written notice, during which time the member may request a hearing before the District Business Conduct Committee, and any such hearing shall be held in reasonable conformity with the hearing and appeal procedures of the Code of Procedure for Handling Trade Practice Complaints.

(5) In addition to the foregoing requirements, every member's advertising and sales literature shall be subject to a routine spot-check procedure. Upon written request from the Association's Advertising Department, each member shall promptly submit the material requested. Members will not be required to submit material under this procedure which has been previously submitted pursuant to one of the foregoing requirements and the procedure will not be applied to members who have been, within the preceding calendar year, subjected to a spot-check by a registered securities exchange or other self-regulatory organization utilizing comparable procedures.

Explanation

While the procedures may vary with experience, it is the Association's current intention to request a one month's sample of material from each member annually.

(6) The following types of material are excluded from the foregoing filing requirements and spot-check procedures:

(a) advertisements or sales literature solely related to changes in a member's name, personnel, location ownership, offices, business structure, officers or partners, telephone or teletype numbers, or concerning a merger with, or acquisition by, another member;

(b) advertisements or sales literature which do no more than identify the NASDAQ symbol of the member and/or of a security in which the member is a NASDAQ registered market maker;

(c) advertisements or sales literature which do no more than identify the member and/or offer a specific security at a stated price;

(d) material sent to branch offices or other internal material that is not distributed to the public;

(e) prospectuses, preliminary prospectuses, offering circulars and similar documents used in connection with an offering of securities which has been registered or filed with the Securities and Exchange Commission or any state, or which is exempt from such registration;

(f) advertisements prepared in accordance with Section 2(10)(b) of the Securities Act of 1933, as amended, or any rule thereunder, such as Rule 134, unless such advertisements are related to options, direct participation programs or securities issued by registered investment companies.

D. Standards Applicable to Communications with the Public

All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the advertising or sales literature to be misleading.

Exaggerated, unwarranted or misleading statements or claims are prohibited in all public communications of members. In preparing such literature, members must bear in mind that inherent in investment are the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield, and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

When sponsoring or participating in a seminar, forum, radio or television interview, or when otherwise engaged in public appearances or speaking activities which may not constitute advertisements, members and persons associated with members shall nevertheless follow the standards of this subsection 37 D.

In addition to the foregoing general standard, the following specific standards apply:

(1) Necessary Data: Advertisements and sales literature shall contain the name of the member, the person or firm preparing the material, if other than the member, and the date on which it is first published, circulated or distributed (except, that in

advertisements, only the name of the member need be stated; and except also that in any so-called "blind" advertisement used for recruiting personnel, the name of the member may be omitted). If the information in the material is not current, this fact should be stated.

(2) Recommendations: In making a recommendation, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose the price at the time the recommendation is made, as well as any of the following situations which are applicable:

(a) that the member usually makes a market in the securities being recommended;

(b) that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;

(c) that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last 3 years.

The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendations.

A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade, or classification of securities made by a member within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended, and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the fact that the period was one of generally rising markets, if such was the case.

Also permitted is material which does not make any specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in the previous paragraph.

(3) Claims and Opinions: Communications with the public must not contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis, or forecasts of future events which are unwarranted, or which are not clearly labeled as forecasts. Nor may references to past specific recommendations state or imply that the recommendations were or would have been profitable to any person and that they are indicative of the general quality of a member's recommendations.

(4) Testimonials: Testimonial material concerning the member or concerning any advice, analysis, report or other investment or related service rendered by the member must make clear that such experience is not necessarily indicative of future performance or results obtained by others. Testimonials must also disclose that compensation has been paid to the maker directly or indirectly, if applicable, and if they imply an experienced or specialized opinion, the qualifications of the maker of the testimonial should be given.

(5) Offers of Free Service: Any statement to the effect that any report, analysis, or other service will be furnished free or without any charge must not be made unless such report, analysis or other service actually is or will be furnished entirely free and without condition or obligation.

(6) Claims for Research Facilities: No claim or implication may be made for research or other facilities beyond those which the member actually possesses or has reasonable capacity to provide.

(7) Hedge Clauses: No cautionary statements or caveats, often called hedge clauses, may be used if they are misleading or are inconsistent with the content of the material.

(8) Recruiting Advertising: Advertisements in connection with the recruitment of sales personnel must not contain exaggerated or unwarranted claims or statements about opportunities in the investment banking or securities business and should not refer to specific earnings figures or ranges which are not reasonable under the circumstances.

(9) Periodic Investment Plans: Communications with the public should not discuss or portray any type of continuous or periodic investment plan without disclosing that such a plan does not assure a profit and does not protect against loss in declining markets. In addition, if the material deals specifically with the principles of dollar-cost-averaging, it should point out that since such a plan involves continuous investment in securities, regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels.

(10) References to Regulatory Organizations: Communications with the public shall not make any reference to membership in the Association or to registration or regulation of the securities being offered, or of the underwriter, sponsor, or any member or associated person, which reference could imply endorsement or approval by the Association or any federal or state regulatory body.

References to membership in the Association or Securities Investors Protection Corporation shall comply with all applicable By-Laws and Rules pertaining thereto.

(11) Identification of Sources: Statistical tables, charts, graphs or other illustrations used by members in advertising or sales literature should disclose the source of the information if not prepared by the member.

E. Standards Applicable to Investment Company-Related Communications

In addition to the provisions of Paragraph D of this Section, members' public communications concerning investment company securities shall conform to all applicable rules of the SEC, including the Commission's Statement of Policy, as in effect at the time the material is used.

F. Standards Applicable to Options-Related Communications

In addition to the provisions of Paragraph D of this Section, members' public communications concerning options shall conform to the following provisions:

(1) As there may be special risks attendant to some options transactions and certain options transactions involve complex investment strategies, these factors should be reflected in any communication which includes any discussion of the uses or advantages of options. Therefore, any statement referring to the opportunities or advantages presented by options should be balanced by a statement of the corresponding risks. The risk statement should reflect the same degree of specificity as the statement of opportunities, and broad generalities should be avoided. Thus, a statement such as, "by purchasing options, an investor has an opportunity to earn profits while limiting his risk of loss," should be balanced by a statement such as, "Of course, an options investor may lose the entire amount committed to options in a relatively short period of time."

(2) It should not be suggested that speculative option strategies are suitable for most investors, or for small investors.

(3) Options issued by the Options Clearing Corporation (OCC Options) are securities registered under the Securities Act of 1933, and they are the subject of a currently effective registration statement. Section 5 of the Securities Act prohibits the use of any written material or radio or television advertisements (or other material constituting a "prospectus" as defined

in the Act) relating to a registered security unless certain conditions are met. With respect to communications concerning OCC Options, the following rules shall apply:

(a) Except as provided in paragraph (b) below, no written material with respect to OCC Options may be sent to any person unless prior to or at the same time with the written material a current OCC Options Prospectus is sent to such person.

(b) Advertisements may be used (and copies of the advertisements may be sent to persons who have not received a Prospectus) if the material meets the requirements of Rule 134 under the Securities Act of 1933, as that Rule has been interpreted as applying to OCC Options. Under Rule 134, advertisements are limited to general descriptions of the security being offered and of its issuer. In the case of OCC Options, advertisements under this Rule must have the following characteristics: (i) The advertisement should state the name and address of the person from whom a current OCC Options Prospectus may be obtained (this would usually be the member sponsoring the advertisement); (ii) The text of the advertisement may contain a brief description of OCC Options, including a statement that the issuer of every OCC Option is the Options Clearing Corporation. The text may also contain a brief description of the general attributes and method of operation of the Options Clearing Corporation and/or a description of any of the options traded in different markets, including a discussion of how the price of an option is determined; (iii) The advertisement may include any statement or legend required by any state law or administrative authority; (iv) Advertising designs and devices including borders, scrolls, arrows, pointers, multiple combined logos and unusual type faces and lettering as well as attention-getting headlines and photographs and other graphics may be used, provided such material is not misleading.

G. Standards Applicable to Communications Concerning Municipal Securities

Members' public communications concerning municipal securities shall conform to the requirements of the Municipal Securities Rulemaking Board as in effect at the time the material is used.

* * * *

NOTICE TO MEMBERS: 78-47
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 14, 1978

TO: All NASD Members and Municipal Securities Bank Dealers
Attention: All Operations Personnel

RE: Settlement Schedule - Thanksgiving Day

Securities markets and the NASDAQ System will be closed on Thursday, November 23, 1978, Thanksgiving Day. The following settlement date schedule shall apply.

Trade Date-Settlement Date Schedule
For "Regular-Way" Transactions

Trade Date	Settlement Date	*Regulation T Date
November 16	November 24	November 28
17	27	29
20	28	30
21	29	December 1
22	30	4
--	--	--
24	December 1	5

These settlement dates should be used by all brokers, dealers and municipal securities dealers for purposes of clearing and settling

*Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) days of the date of purchase. The date upon which members must take such action for the trades indicated is shown in the column entitled "Regulation T Date."

transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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

Sincerely,

Christopher R. Franke
Secretary

NOTICE TO MEMBERS: 78-48
Notices to members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 22, 1978

IMPORTANT

TO: All NASD Members

RE: SEC Lost and Stolen Securities Program

SUMMARY

In Securities Exchange Act Release No. 15289, dated November 1, 1978, the Securities and Exchange Commission made several announcements concerning its Lost and Stolen Securities Program established under Rule 17f-1. Specifically, the following action was taken by the SEC:

- the pilot period of the Lost and Stolen Securities Program was extended to June 30, 1979;
- Securities Information Center, Inc., (SIC) was redesignated as the Commission's designee; and,
- certain financial institutions are being required to reregister with SIC before December 15, 1978.

A more detailed discussion of each of these actions follows.

Pilot Period Extended

The Commission's Lost and Stolen Securities Program (the "Program") first became operational on October 3, 1977, at which time all reporting institutions (i.e., brokers, dealers, municipal securities dealers and other financial institutions) were required to begin filing reports of missing, lost, stolen and counterfeit securities with SIC and the Federal Reserve System. As of January 2, 1978, all institutions registered with SIC as direct inquirers were required to make inquiries on their own behalf and on behalf of indirect inquirers with whom they had

agreements with respect to securities in bearer form, street name or registered to a third person coming into their possession. The Program was implemented on a pilot basis in order to give the SEC a reasonable period of time in which to monitor the effectiveness of Rule 17f-1 and the various systems designed to carry out its provisions. During the pilot period, which was originally scheduled to end on December 31, 1978, exemptions were provided for registered transfer agents; for transactions involving securities of $10,000 face value or less in the case of bonds and market value in the case of stocks; and, corporate and municipal issues not assigned CUSIP numbers. As noted above, the pilot period and each of these attendant exemptions have been extended to June 30, 1979.

Redesignation of Securities Information Center, Inc.

On July 31, 1978, the SEC issued a release soliciting comments on the operation of the Program and whether SIC should be redesignated as the Commission's designee to operate and maintain the data base of missing, lost, stolen and counterfeit securities. After consideration of all comments received concerning SIC's general performance to date, among other factors, the Commission determined to redesignate SIC for a two-year period commencing January 1, 1979. According to the Commission, SIC has managed the Program satisfactorily during the pilot period and its initial term of designation. In addition, the SEC believes the two-year redesignation period may allow SIC to have more flexibility in its planning and in making appropriate operational and budgetary projections.

Reregistration of Reporting Institutions

Under SEC Rule 17f-1, a broad range of financial institutions involved in handling securities are required to file reports of missing, lost, stolen and counterfeit securities and to make an inquiry whenever bearer securities come into their possession. When the Program was first implemented, brokers, dealers and municipal securities dealers, among other financial institutions, were required to register with SIC as reporting institutions to facilitate the prompt receipt and delivery of reports and inquiries to the Commission's designee. Reporting institutions had the option of registering with SIC as either direct inquirers or indirect inquirers with the primary distinction between the two classes being access to SIC for inquiry purposes. For the first year of operations, the costs of the Program were allocated among direct inquirers only and for that reason, firms registered as such have not been permitted to change their registration status. However, the SEC is allowing firms to change their registration status. Such change, however, will be binding through June 30, 1979, the end of the extended pilot period.

In order to effect a change in its registration status, a reporting institution must reregister with SIC by completing a new registration form, a copy of which is attached to this notice. Designated as "1979 Registration Form Lost and Stolen Securities Program," it must be completed and returned to SIC no later than December 15, 1978, by all financial institutions subject to SEC Rule 17f-1. There is one exception, however, and that pertains to firms which have previously registered as indirect inquirers and which desire to maintain that status.*

Any reporting institution currently registered as a direct inquirer which does not submit a properly completed 1979 Registration Form will be deemed to be a direct inquirer and assessed their proportionate share of the costs of the Program under the revised fee schedule established by the SEC. Members may use the attached form for purposes of complying with the reregistration requirement under SEC Rule 17f-1.

1979 Fee Schedule

A revised fee schedule and pricing structure have been established by the SEC for calendar year 1979. Financial institutions which are registered as direct inquirers will be charged an annual registration fee and usage fees. While indirect inquirers will not be charged these fees by SIC or the SEC, such institutions may expect to be charged certain fees by the financial institution which is its designated direct inquirer.

Registration Fees - The annual registration fees for primary access and secondary access stations have been increased from $18.00 to $20.00, and from $9.00 to $10.00, respectively. These fees are payable by direct inquirers and are for the purpose of covering the costs of SIC maintaining registration data, assigning access codes, and billing of all charges incidental to the Program.

Prompt Written Confirmation Service Fees - Written confirmations of reports, and of inquiries that do not result in a match (negative confirmations), are mailed to direct inquirers on a monthly basis. Such confirmations are sent to a direct inquirer's primary access station. An optional "prompt written confirmation service" is available whereby SIC

*Financial institutions which are subject to SEC Rule 17f-1 include every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, registered transfer agent, registered clearing agency, participant therein, member of the Federal Reserve System, and bank whose deposits are insured by the Federal Deposit Insurance Corporation.

will provide prompt written confirmations of all reports and inquiries received from a direct inquirer. The quarterly cost of this service has been increased from $16.00 to $20.00.

Usage Fees - These fees cover the costs of verifying authorized system access; matching of reports and inquiries; notification of matches; confirmation of inquiries; retention of files; and, system improvements. Usage fees will continue to be apportioned among all financial institutions which register as a direct inquirer. These fees are billed quarterly, in advance, to a single primary access station. The following usage fee schedule for securities firms has been established by the SEC and reflects the varying fees to be imposed based on the number of firms which register as a direct inquirer.

Securities Organizations

Annual Revenue (Most recent fiscal year)	Estimated Annual Usage Charges: If 500 Direct Inquirers	If 1000 Direct Inquirers	If 1500 Direct Inquirers
Over $25 million	$3200	$3000	$2800
$5 million to $25 million	2100	1800	1600
$500,000 to $5 million	600	500	400
Less than $500,000	300	250	200

* * *

Please direct any questions you may have concerning this matter to Jack Rosenfield, Assistant Director, Department of Regulatory Policy and Procedures, NASD, 1735 K Street, N.W., Washington, D.C., 20006, (202) 833-4828.

Sincerely,

Gordon S. Macklin
President

Attachment

1979
REGISTRATION FORM

LOST AND STOLEN
SECURITIES PROGRAM

Return This Form To:

Securities Information Center, Inc.
Post Office Box 421
Wellesley Hills, Massachusetts 02181

Deadline for Filing This Form is December 15, 1978

(A photocopy of the completed form should be retained for your records)

1979 Registration Form
Lost and Stolen Securities Program

Instructions

COMPLETION AND FILING OF THE FORM - All institutions completing and filing this form should fill in Part I and Part IV and either Part II or Part III of the form. Completed forms should be returned to:

Securities Information Center, Inc.
Post Office Box 421
Wellesley Hills, Massachusetts 02181

The deadline for filing this form is December 15, 1978.

WHO SHOULD USE THIS FORM - This form should be completed and filed by all institutions subject to Rule 17f-1 (17 CFR §240.17f-1) 1/

(1) Who have NOT submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc., OR

(2) Who have submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc. and registered as a DIRECT INQUIRER, OR

(3) Who have submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc., and registered as an INDIRECT INQUIRER AND desire to amend their prior registration form to either update the information submitted OR change their inquiry participation status.

WHO SHOULD NOT USE THIS FORM - Institutions should NOT complete or file this form if they have previously registered as an INDIRECT INQUIRER in the Lost and Stolen Securities Program by submission of a registration form to Securities Information Center, Inc. AND the data submitted thereon is current AND they do not desire to change their inquiry participation status. If an institution does not submit this form, the prior election of inquiry participation status will continue and be binding through June 30, 1979.

1/ The institutions subject to Rule 17f-1 are as follows: every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, registered transfer agent, registered clearing agency, participant therein, member of the Federal Reserve System and bank whose deposits are insured by the Federal Deposit Insurance Corporation.

PART I

A. Name of Institution _____

Mailing Address _____

_____

Zip Code _____

FINS Identification No. 2/ __ __ __ __ __ __

Name, Title, and Telephone
Of Person to Whom Bills
Should Be Directed: _____

( )_____

Name, Title and Telephone
of Person Responsible
for Institution's
Compliance with Rule
17f-1 (if different
from above): _____

( )_____

B. Type of Institution - Check all classifications listed below that describe the institution. 3/

( ) 1. Federal Reserve System member.
( ) 2. Bank whose deposits are insured by the Federal Deposit Insurance Corporation.
( ) 3. National Securities Exchange.
( ) 4. National Securities Exchange member.
( ) 5. National Securities Exchange member firm.
( ) 6. Registered Securities Association.
( ) 7. Registered Securities Association member.
( ) 8. Securities broker.
( ) 9. Securities dealer.
( ) 10. Municipal securities dealer.
( ) 11. Registered transfer agent.
( ) 12. Registered clearing agency.
( ) 13. Participant in a registered clearing agency.

2/ FINS ("Financial Industry Number Standard") numbers are compiled in the 1976 FINS Directory (First Edition), published by the Depository Trust Company. If an institution is uncertain as to whether it has a FINS number, it should consult this Directory, its

(Footnote Continued)

C. Size of Institution - Check the line below that describes the size of the institution.

1. Banks (those who checked lines 1 or 2 of B, above)

( ) More than $1 billion in deposits
( ) $500 million to $1 billion in deposits
( ) Less than $500 million in deposits

2. Securities Organizations (those who checked lines 3 through 10 of B, above)

( ) More than $25 million in annual revenues
( ) $5 million to $25 million in annual revenues
( ) $500,000 to $5 million in annual revenues
( ) Less than $500,000 in annual revenues

3. Non-Bank Transfer Agents (those who checked only classification 11 of B, above)

( ) That issued 100,000 shares or more last year
( ) That issued less than 100,000 shares last year

(Continued Footnote)

self-regulatory organization, its trade association, or SEC personnel at 202-376-8129. If an institution has not been assigned a FINS number, a number may be obtained at no cost by writing the Depository Trust Company, Attention: FINS Publication, 55 Water Street, New York, New York 10041.

3/ If no classification describes the institution, the institution is not subject to Rule 17f-1. If the institution desires to participate in the Lost and Stolen Securities Program as a "permissive inquirer," a special application must be made to the Commission pursuant to paragraph (d) of Rule 17f-1 in accordance with the instructions given in Securities Exchange Act Release No. 13832 at 42 FR 41024 (August 12, 1977).

PARTS II & III

Election of Inquiry Participation Status

To register as a DIRECT INQUIRER, complete Part II below. To register as an INDIRECT INQUIRER, complete Part III below. This election of inquiry participation status is binding through June 30, 1979.

Direct inquirers will be able to make inquiries of the data base directly and will be charged usage fees and registration fees as described in the Appendix of Securities Exchange Act Release No. 15289. Indirect inquirers will NOT be able to make inquiries directly and so must make arrangements with a registered direct inquirer to inquire on its behalf. Indirect inquirers will NOT be charged any fees by Securities Information Center, Inc. but should be aware that the institution making inquiries on their behalf may assess costs and service charges. (Indirect inquirers, however, should make reports of loss directly).

PART II

DIRECT INQUIRER

To register as a direct inquirer, please complete (A), (B), and (C) below.

A. Registration of Access Stations - Indicate the number of primary and secondary access stations the institution will use to make inquiries of the system. 4/ All institutions must have at least one primary access station. There is an annual registration fee of $20.00 for each primary access station and $10.00 for each secondary access station. 5/

NUMBER OF PRIMARY ACCESS STATIONS-----_____
NUMBER OF SECONDARY ACCESS STATIONS---_____

4/ Access stations are described in the discussion of the "Description of the System" in SEC Release No. 34-15289, dated November 1, 1978.

5/ Institutions establishing secondary access stations should append to this form a list of the titles, addresses, and names of the responsible individual for each secondary access station.

B. Optional Prompt Written Confirmation Service - Indicate whether the institution desires prompt written confirmation service. If an institution desires this service, the Securities Information Center, Inc. will send the institution written confirmations of all inquiries and reports received by telephone, telex, and mail on a daily basis. If an institution does not desire this service, confirmations of inquiries will be sent on a monthly basis. There is a $20.00 per quarter charge for each primary access station using this service.

( ) We do NOT desire prompt written confirmation service.
( ) We do desire prompt written confirmation service and agree to pay the fee for this service.

C. Agreement to Pay Fees - After reading the statement below, please sign in the space provided.

Beginning January 3, 1979, we will participate in the Lost and Stolen Securities Program as a direct inquirer. We agree to pay Securities Information Center, Inc. the annual registration fee of $20.00 for each primary access station and $10.00 for each Secondary Access Station. We also agree to pay in advance quarterly usage fees, charges for optional services we request, and all sales, use and excise taxes, or other taxes, which may be levied on or in connection with, the furnishing of the facilities or services of the Securities Information Center, Inc. We understand that all fees are due and payable within ten days of date of invoicing.

_____
(Signature of Authorized Institutional Representative)

_____
(Type or Print) (TITLE)

PART III
INDIRECT INQUIRER

To register as an indirect inquirer, please complete the statement below and sign in the space provided.

Beginning January 3, 1979, we will participate in the Lost and Stolen Securities Program as an indirect inquirer. We have entered into an agreement with _____ who will (Name of Registered Direct Inquirer) make inquiries on our behalf and we have a copy of this agreement on file available for inspection. We are aware that we will receive no direct confirmations from Securities Information Center, Inc., and that the institution that makes inquiries for us may pass through to us the costs of using the system on our behalf as well as additional service charges.

_____
(Signature of Authorized Institutional Representative)

_____
(Type or Print) (TITLE)

PART IV

ALL institutions filing this form must complete (A) and (B) below.

A. Agreement - After reading the statement below, please sign in the space provided.

We understand that our participation in the Lost and Stolen Securities Program is required by Rule 17f-1 (17 CFR §240.17f-1) under the Securities Exchange Act of 1934, as amended. We agree that we will make reports of missing, lost, counterfeit and stolen securities and make inquiries relative thereto, in accordance with Rule 17f-1 and instructions of the Commission or its designee.

We understand that the Securities Exchange Commission has designated Securities Information Center, Inc. to operate the Lost, Missing, Stolen, and Counterfeit Securities Information System. Securities Information Center, Inc. will perform its work in a businesslike manner and in accordance with reasonable standards of care. It does not, however, guarantee the accuracy of any information contained in the records of the System or of the responses to inquiries concerning missing, lost, counterfeit, and stolen securities furnished by it. Securities Information Center, Inc. shall not be liable for any unintentional delays, inaccuracies, errors or omissions in said responses, or for any damages arising therefrom or occasioned thereby, nor will it be liable for non-performance or interruption of services due to fire, storms, strikes, labor disputes or any causes beyond its control or due to the act or omission of any other person, firm or corporation.

_____
(Signature of Authorized Institutional Representative)

_____
(Type or Print) (TITLE)

B. Names and Signatures of Persons Making Reports on Behalf of the Institution - All reports of missing, lost, counterfeit or stolen securities and all reports of recoveries must be submitted on Form X-17F-1A and signed by an individual whose signature is on file with Securities Information Center, Inc. All individuals having this authority should fill in the spaces below (attach additional pages on institution letterhead if necessary).

_____
(Signature and Date)

_____
(Print or Type) (TITLE)

_____
(Signature and Date)

_____
(Print or Type) (TITLE)