NOTICE TO MEMBERS: 79-1
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 12, 1979

PLEASE DIRECT THIS NOTICE
TO ALL
FINANCIAL AND OPERATIONS PRINCIPALS

TO: All NASD Members

RE: SEC Rule 15c3-1; Recision of Temporary Amendments and Effectiveness of Permanent Amendments Concerning Municipal Securities

On December 21, 1978, the Commission announced the adoption of various amendments to the net capital rule (Rule 15c3-1) relating to transactions in municipal securities (see Securities Exchange Act Release No. 15423). These amendments, described below, are scheduled to become effective on February 1, 1979. On that date, the temporary amendments covering these matters will no longer be applicable.

The first amendment reduces from 90 to 60 days the time period during which good faith deposits and receivables arising from a firm's participation in municipal securities underwriting syndicates and joint underwriting accounts will be given allowable asset treatment. This conforms the respective provisions of the net capital rule to certain provisions in MSRB Rule G-12 on uniform practice which specify the time periods by which municipal securities dealers must take action with respect to, among others, the settlement of the syndicate account. In addition, the amendment provides that profits receivable from a secondary joint account in municipal securities may be given allowable asset treatment for 60 calendar days.

The 60 day period with respect to good faith deposits and receivables arising from a firm's participation in a municipal underwriting begins on the day settlement is made with the issuer. The 60 day period in the case of profits receivable from municipal securities secondary joint accounts commences on the date all securities have been delivered by the account manager to the account members.

The second amendment requires that the undue concentration haircut provisions of the net capital rule be applied to municipal securities. The criteria established by the amendment for determining whether such an undue concentration haircut is appropriate are a municipal issue having the same security provisions, date of issue, interest rate, maturity date and having a market value in excess of $500,000 in bonds ($5,000,000 in notes) or 10% of tentative net capital (whichever is greater). In addition, the security must have been held in position in excess of 20 business days.

In situations involving commitments by firms to purchase municipal securities from the issuer, the 20 consecutive business day period shall begin on the date delivery of such securities is made to the syndicate manager by the issuer.

The text of both amendments will be incorporated in the Regulation T/SEC Rules section of the NASD Manual with the publication of the next Manual Supplement.

* * * *

Should you have any questions concerning this notice, please contact John J. Cox, Assistant Director, Department of Regulatory Policy & Procedures, (202) 833-7320.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 79-2
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 16, 1979

TO: All NASD Members

RE: Procedures for Allocation of Exercise Assignment Notices

In Notice to Members No. 78-50, dated December 1, 1978, the Association announced SEC approval of the NASD options "access firm" rules and indicated that the program would be implemented on February 1, 1979. This notice is to remind members doing an options business on an access basis (i.e., trading exchange listed options while not members of the exchange on which the options traded are listed) that pursuant to new Section 63 of the Uniform Practice Code they must establish fixed procedures for the allocation of exercise notices among customers in respect to short positions in option contracts issued by the Options Clearing Corporation.

Each member conducting a business on an access basis must file its proposed method of allocation with the Association and obtain the Association's approval thereof prior to its implementation. In order to facilitate such approval, the Association has developed an application form, attached as Exhibit A, which can be used by members to report their proposed allocation method to the Association as required by Section 63(c).

Allocation methods may be on a "first in, first out" basis, random selection or another method that is fair and equitable to a member's customers. It is recommended that members adopting a random selection method for allocation review the "Discussion of a Random Allocation Method" which is attached as Exhibit B, for a description of the type of random allocation procedure which the Association believes meets the requirements of the rules.

Members choosing to utilize the enclosed application should file such with the Market Surveillance Department of the Association. Members are reminded that the effective date of the Association's options "access firm" program is February 1, 1979, after which date only approved exercise assignment procedures may be utilized.

If you have any questions with regard to this matter, please contact Bruce Brett at (202) 833-4898.

Sincerely,

Frank J. Wilson

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

Exhibit A

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

APPLICATION FOR APPROVAL OF OPTION EXERCISE ASSIGNMENT ALLOCATION METHOD

Name of Firm _____

Address _____

I. Clearing Arrangement

A. Member of the Options Clearing Corporation ☐

B. Clear through a member of the Options Clearing Corporation

(1) On a fully disclosed basis ☐

(2) On an omnibus basis ☐

Name of Clearing Firm _____

Member firms clearing options transactions on a fully disclosed basis may omit Sections II and III below.

II. Service Bureau

If the allocation of exercise assignment notices among your firm's customer accounts is performed by a service bureau, provide the following information on the service bureau:

Name of Organization _____

Service Representative _____

Address _____

Telephone Number _____

Member firms employing a service bureau may omit Section III below providing the service bureau has submitted and obtained the approval of the Association for the particular method of allocation utilized.

III. Method of Allocation

Please indicate the method of allocation to be employed:

A. Random Method (see accompanying discussion) ☐

B. First In, First Out (FIFO) ☐

C. Alternate Random Method ☐

In the event your firm proposes to employ a random method which differs from the one described in the accompanying discussion, it is necessary that a complete description of such method accompany this application. The areas that must be covered in the description include:

- whether the proposed allocation is automated, manual or a combination of the two;
- treatment of proprietary accounts as compared to customer accounts;
- treatment of exercise notices and short positions by size as provided under the NASD's Uniform Practice Code, Section 63;
- the procedure through which a particular account is chosen for allocation; and,
- method of choosing random numbers (table of random numbers, psuedo random).

IV. Authorizations

Requested by:

_____
Name of Broker/Dealer

_____ _____
Authorized Person (print or type) Signature

Title _____ Date _____

FOR NASD USE ONLY

APPROVED BY: _____ _____
Name Title

DATE APPROVED _____

Discussion of a Random Allocation Method

The following method of allocation based on random selection may be modified to provide for allocation of exercise notices of block size to customers having open short positions of block size (25 or more option contracts) as permitted under Section 63 of the NASD's Uniform Practice Code.

Step 1: Sequencing of Accounts - All customer and firm accounts having an open short position in the option series which is the subject of the exercise notice must be included. Accounts should be arranged by account number or by some other specific method, such as alphabetically. Open short positions in each account should be adjusted to reflect any allocations of exercise notices made previously.

Step 2: Assigning Sequence Numbers - Each account in the sequence must be assigned a separate sequential number based on the number of contracts short in the account. This is illustrated in the following example:

Account Number	XYZ Oct 20's # of Contracts Short	Sequential Number
1	5	1 through 5
2	8	6 through 13
3	2	14 through 15
4	10	16 through 25
5	11	26 through 36
Total	36	

In this example, all accounts having a short position in XYZ Oct 20's, which is the series for which an exercise notice has been received, have been arranged in order according to account number. The number of contracts short in each account has been noted and shows that there are a total of 36 contracts short in all customer and firm accounts. Account #1 is assigned a range of numbers that begin with "1" and end with the number reflecting the total number of contracts short in the account which is "5." Thus the sequential number assigned to this account is 1 - 5, thereby reserving the set of numbers from 1 to 5 for Account #1. The sequential number for Account #2 must begin with 6 and encompass the next eight numbers representing the 8 contracts short in the account. This results in a sequential number of 6 - 13 being assigned to Account #2. Account #3 is short 2 contracts and similarly is assigned a sequential number beginning with 14 and ending with 15, (14 - 15), reserving two numbers for Account #3 representing the total number of contracts short in the account. This process is continued until all accounts in the sequence have been assigned unique sequential numbers. By assigning sequential numbers in this manner, the likelihood that a par-

Step 3: Random Number Generation - After completing the assignment of sequential numbers, choose a random decimal number lying between 0 and 1. There are several acceptable ways of doing this, two of which will be mentioned:

- Table of Random Digits - a Table of Random Digits is a computer-generated listing of random numbers. Such a table can be found in publications relating to statistics or operations or in the publication entitled A Million Random Digits with 100,000 Normal Deviates by the Rand Corporation, the Free Press, Glencoe, Ill., 1955. The table which is selected should contain numbers with at least five digits.

  Any number can be selected from the Table and should be converted into a decimal fraction between 0 and 1. For example, if the number selected from the Table is 48555, the decimal fraction to be used in the assignment procedure would be .48555.

- Computer Program (e.g., pseudo random number generator) - many computer installations have programs which can produce random number listings. If it is necessary to write one, the methodology can be found in Operations Research by Hillier & Lieberman, Holden-Day Inc., San Francisco, 1974. These computer programs ordinarily supply a decimal number between 0 and 1.

Step 4: Selection of an Account Using the Random Number - Taking the random decimal number between 0 and 1 selected in Step 3, multiply it by the total number of contracts short in all accounts. The number resulting from this multiplication will determine which account is to be first selected to satisfy the exercise assignment. In the example above there were a total of 36 contracts short in all of the accounts that had a short position in XYZ Oct 20's. Assume that 13 contracts of XYZ Oct 20's have been called and that the random number of .48555 referenced above is selected and multiplied by 36. The result of this multiplication is 17.48. Since Account #4 was assigned a sequential range of numbers in which the number 17 falls, it will be the first account selected to absorb the exercise assignment.

Step 5: Allocation of the Exercise Notice - Continuing with the example, since Account #4 is short 10 contracts, all 10 contracts will be exercised and the next account in the sequence, Account #5, will be assigned the remaining 3 contracts. If the exercise notice related to more than 13 contracts, the assignment would continue to be absorbed by succeeding accounts in the sequence established in Step 1 until the entire assignment was absorbed.

In the event that the last account in the sequence (if the sequence is arranged by account number, this would be the account having the highest account number) is either selected initially or is reached in the course of the assignment and is not short a sufficient number of contracts to satisfy the full assignment, the first account in the sequence would be the next account to be assigned and so forth through the sequence. When the allocation of the exercise notice has been completed, the short positions in all accounts that have been assigned should be adjusted in preparation for receipt of a subsequent exercise notice.

NOTICE TO MEMBERS: 79-3
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 22, 1979

TO: All NASD Members

RE: CORRECTION To Notice to Members No. 79-2, dated January 16, 1979, Entitled: "Procedures for Allocation of Exercise Assignment Notices"

Due to a printing error in Notice to Members No. 79-2, a corrected version of Exhibit B entitled "Discussion of a Random Allocation Method" has been reproduced and is enclosed for the information of the membership.

If you have any questions regarding this correction, please contact Bruce Brett at (202) 833-4898.

Sincerely,

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

Exhibit B

CORRECTED COPY

Discussion of a Random Allocation Method

The following method of allocation based on random selection may be modified to provide for allocation of exercise notices of block size to customers having open short positions of block size (25 or more option contracts) as permitted under Section 63 of the NASD's Uniform Practice Code.

Step 1: Sequencing of Accounts - All customer and firm accounts having an open short position in the option series which is the subject of the exercise notice must be included. Accounts should be arranged by account number or by some other specific method, such as alphabetically. Open short positions in each account should be adjusted to reflect any allocations of exercise notices made previously.

Step 2: Assigning Sequence Numbers - Each account in the sequence must be assigned a separate sequential number based on the number of contracts short in the account. This is illustrated in the following example:

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Total	36	

In this example, all accounts having a short position in XYZ Oct 20's, which is the series for which an exercise notice has been received, have been arranged in order according to account number. The number of contracts short in each account has been noted and shows that there are a total of 36 contracts short in all customer and firm accounts. Account #1 is assigned a range of numbers that begin with "1" and end with the number reflecting the total number of contracts short in the account which is "5." Thus the sequential number assigned to this account is 1 - 5, thereby reserving the set of numbers from 1 to 5 for Account #1. The sequential number for Account #2 must begin with 6 and encompass the next eight numbers representing the 8 contracts short in the account. This results in a sequential number of 6 - 13 being assigned to Account #2. Account #3 is short 2 contracts and similarly is assigned a sequential number beginning with 14 and ending with 15, (14 - 15), reserving two numbers for Account #3 representing the total number of contracts short in the account. This process is continued until all accounts in the sequence have been assigned unique sequential numbers. By assigning sequential numbers in this manner, the likelihood that a particular account will be selected for exercise will be proportional to its share of the total short position.

Step 3: Random Number Generation - After completing the assignment of sequential numbers, choose a random decimal number lying between 0 and 1. There are several acceptable ways of doing this, two of which will be mentioned:

- Table of Random Digits - a Table of Random Digits is a computer-generated listing of random numbers. Such a table can be found in publications relating to statistics or operations or in the publication entitled A Million Random Digits with 100,000 Normal Deviates by the Rand Corporation, the Free Press, Glencoe, Ill., 1955. The table which is selected should contain numbers with at least five digits.

  Any number can be selected from the Table and should be converted into a decimal fraction between 0 and 1. For example, if the number selected from the Table is 48555, the decimal fraction to be used in the assignment procedure would be .48555.

- Computer Program (e.g., pseudo random number generator) - many computer installations have programs which can produce random number listings. If it is necessary to write one, the methodology can be found in Operations Research by Hillier & Lieberman, Holden-Day Inc., San Francisco, 1974. These computer programs ordinarily supply a decimal number between 0 and 1.

Step 4: Selection of an Account Using the Random Number - Taking the random decimal number between 0 and 1 selected in Step 3, multiply it by the total number of contracts short in all accounts. The number resulting from this multiplication will determine which account is to be first selected to satisfy the exercise assignment. In the example above there were a total of 36 contracts short in all of the accounts that had a short position in XYZ Oct 20's. Assume that 13 contracts of XYZ Oct 20's have been called and that the random number of .48555 referenced above is selected and multiplied by 36. The result of this multiplication is 17.48. Since Account #4 was assigned a sequential range of numbers in which the number 17 falls, it will be the first account selected to absorb the exercise assignment.

Step 5: Allocation of the Exercise Notice - Continuing with the example, since Account #4 is short 10 contracts, all 10 contracts will be exercised and the next account in the sequence, Account #5, will be assigned the remaining 3 contracts. If the exercise notice related to more than 13 contracts, the assignment would continue to be absorbed by succeeding accounts in the sequence established in Step 1 until the entire assignment was absorbed.

In the event that the last account in the sequence (if the sequence is arranged by account number, this would be the account having the highest account number) is either selected initially or is reached in the course of the assignment and is not short a sufficient number of contracts to satisfy the full assignment, the first account in the sequence would be the next account to be assigned and so forth through the sequence. When the allocation of the exercise notice has been completed, the short positions in all accounts that have been assigned should be adjusted in preparation for receipt of a subsequent exercise notice.

NOTICE TO MEMBERS:79-4
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 22, 1979

TO: ALL NASD MEMBERS
ATTENTION: REGISTRATION PERSONNEL

RE: Procedures for Identifying and Registering Options Personnel with the Association

CONTENTS

Introduction

On December 1, 1978, the Association forwarded Notice to Members No. 78-50 notifying members of the approval of an options rule package by the Securities and Exchange Commission. These rules are designed to govern, among other things, the listed option activities of NASD member "access firms" as well as member activity in conventional over-the-counter options. The effective date of the rules package is February 1, 1979. On that date, the By-Law amendments relating to option principal registration, designation of a Senior Registered Options Principal and option representative registration will be effective. This notice details the methods for processing registration applications with the Association for your options personnel and should be useful to those individuals in your organization responsible for registration matters.

Definition of a Registered Options Principal (ROP)

Schedule "C" of the Association's By-Laws has been amended, in part, by the addition of a new paragraph requiring every member which engages in any put or call options activities, whether for the account of a customer or for the account of the firm, to have at least one of its associated persons registered as a Registered Options Principal (ROP). No member may conduct any options business on or after February 1, 1979, without having a ROP. The amendments also require that as a condition to becoming a ROP, a person associated with a member must pass an appropriate qualification examination. A person will not qualify as an ROP for both put and call options contracts unless that person has passed an examination which tests for both. An individual may qualify for this position by taking and passing the ROP Qualification Examination (Series 4), which is administered by the NASD.

Grandfather Provision - Registered Options Principal

Individuals who, as of February 1, 1979, are registered with the Association as either a general securities representative or a general securities principal and who have taken and passed a Registered Options Principal qualification examination for both puts and calls may be "grandfathered". Members which desire to grandfather qualified individuals as ROPs should complete the enclosed form entitled, "Request for Grandfathering as a Registered Options Principal". All request forms for grandfathering of ROPs should be received no later than March 31, 1979. Completed "Request for Grandfathering" forms should be sent to:

National Association of Securities Dealers, Inc.
Membership Department
Attention: Nancy Crowley, Projects Coordinator
1735 K Street, N. W.
Washington, D. C. 20006

Additional copies of the form can be obtained by contacting Ms. Crowley at the above address.

Individuals who return to the securities industry after February 1, 1979, and who were not grandfathered as ROPs may qualify for the grandfathering provision provided they meet the conditions for ROP grandfathering detailed above and do not have more than two years intervening since their last NASD registration. If such conditions exist, a ROP grandfather form should be submitted to the NASD together with the Form U4 application at the time of the individual's transfer to your organization.

Initial ROP Registration

Beginning February 1, 1979, the Uniform Application for Securities Representatives (Form U4) should be utilized to indicate ROP designation. In this regard, item 11 on such form should be completed so as to indicate each type of registration requested. For example, in the case of an individual who for the first time requested registration as a general securities principal and a ROP, two boxes under the Principal Registration section of item 11 would need to be completed.

ROP Qualification Examination Candidates

As previously detailed in Notice to Members 77-14 and 78-23, members which cannot avail themselves of the ROP grandfather provisions on behalf of their employees must seek qualification of an individual as a ROP by completing and returning an "Examination Request Form", Form ER-1, to the NASD. A $30 examination fee should accompany each such request form. A copy of this form is enclosed. Additional copies may be obtained from the Association's Membership Department or your local District Office.

Designation of a Senior Registered Options Principal (SROP)

The amended Schedule C further requires each member conducting any options activity to designate one Senior Registered Options

Principal (SROP) and to inform the Association of this individual's identity. This may be accomplished by either:

- Initially checking the appropriate box on the Grandfather Form; or,

- Forwarding a letter to the NASD's Membership Department to the attention of Ms. Nancy Crowley requesting designation of a particular ROP as the SROP for the firm. In this notification, the individual's full name and social security number should be included for proper identification.

Termination of ROPs and/or SROPs and Redesignation of SROPs

In the event any Registered Options Principal or Senior Registered Options Principal ceases to act in that capacity, the member firm must promptly notify the Association's Registration Section in writing together with a brief statement of the reason therefor. If the ROP or SROP is terminating registration with the member firm, completion of the Uniform Termination Notice (Form U-5) will be sufficient. Under these circumstances, the member should ensure that the individual's designation as a ROP or SROP is clearly indicated on the form.

When there is a termination of the SROP, the designation of the new SROP should be made simultaneously. This can be accomplished by sending a cover letter detailing the name and social security number of the newly-designated SROP, along with the Form U-5 Termination Notice for the former SROP.

If a ROP or the designated SROP does not terminate association with the member, but is no longer acting in the capacity of a ROP or SROP, the member must forward to the Association's Registration Section a letter briefly outlining the reasons for this status change. When this situation arises with the SROP, the letter should simultaneously designate the new SROP.

Definition of a Registered Options Representative (ROR)

The amended Schedule "C" requires that persons associated with a member whose activities include the solicitation and/or sale of

options contracts must be certified as Registered Options Representatives (RORs). In order to qualify as a ROR, an individual must take and pass an appropriate certification examination or an equivalent examination acceptable to the NASD. The By-Law amendment additionally provides that an individual does not qualify as a ROR for both put and call options activities unless that individual has passed an examination which tests for both put and call options products.

Grandfather Provision - Registered Options Representative (ROR)

Grandfather provisions similar to those detailed for ROPs also pertain for RORs. In this regard, individuals who, as of February 1, 1979, are registered with the Association as either a general securities representative or general securities principal and who have taken and passed a ROR certification examination, can be grandfathered. Such would apply to all individuals who are engaged in the solicitation and/or sale of options contracts and are not otherwise qualified as Registered Options Principals. Individuals who became qualified as general securities representatives by taking and passing the Qualification Examination for General Securities Representatives (Series 7) on or after May, 1977, are also grandfathered by definition. The Association will be notifying each member's Senior Registered Options Principal of the procedures for identifying such grandfather candidates to the NASD.

Registered Options Representative Certification Examination

The Association's certification program is essentially the same as that used by the various options exchanges. Under this program, a Registered Options Principal is permitted to administer a certification examination to Registered Options Representative candidates who qualified as general securities representatives prior to May, 1977, and who have not been previously certified by one or more of the existing options exchanges. May, 1977, marked the introduction of option related questions to the Series 7 examination program, and as mentioned previously, candidates qualifying via the Series 7 program on or after May, 1977, are eligible for the ROR grandfather provision. Requests for copies of the certification examination for RORs should be made in writing by the member's Senior Registered Options Principal and directed to :

Ms. Janet Hale
Assistant Director
Examination Section
National Association of Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D. C. 20006

Questions regarding the amendments to Schedule "C" of the NASD's By-Laws or the procedures for implementation of such as discussed herein, should be directed to the attention of Mr. Kevin McEvoy at area code (202) - 833-7812 or Ms. Nancy Crowley at area code (202) - 833-7302.

Sincerely,

John T. Wall
Senior Vice President
Compliance

Enclosures

NASD

Notice to Members: 79-5
Notices to Members should be retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 29, 1979

TO: All NASD Members

Attn: Corporate Finance Department
Underwriter's Counsel

RE: Payment of Underwriter's Concession to Foreign Broker/ Dealers Not Eligible for Association Membership

It has come to the attention of the Association's Corporate Financing Department that amendments to the eligibility standards for membership in the Association made by the Securities Acts Amendments of 1975 (the "1975 Amendments") may have caused language appearing in many agreements among underwriters to be in violation of the Association's rules. This notice is intended to clarify the effect of those changes on such agreements.

Article III, Section 25 of the Association's Rules of Fair Practice ("Section 25") provides in paragraph (b)(1) that no member of the Association shall "allow or grant to [a] non-member broker or dealer any selling concession, discount or other allowance" granted to Association members but not to the public. Paragraph (c) of Section 25 provides, however, that the above prohibition does not apply with respect to "any non-member broker or dealer in a foreign country who is not eligible for membership" in the Association. Paragraph (c) specifies conditions to be satisfied by members in transactions with such foreign broker/ dealers.

Eligibility for membership in the Association is determined by the Association's By-Laws and by the provisions of the Securities Exchange Act of 1934, as amended (the "Act"), pursuant to which the Association is registered as a self-regulatory organization. The 1975 Amendments changed the eligibility standards in the Act and, although the language of Section 25 (c) has not been amended, the scope of its application has been changed.

Prior to the 1975 Amendments, Section 15A(b)(3) of the Act provided that membership in the Association could be restricted on a "specified geographical basis." Pursuant to this provision, Article I, Section 1 of the Association's By-Laws was adopted which states that:

> Any broker or dealer authorized to transact and whose regular course of business consists in actually transacting any branch of the investment banking or securities business in the United States, under the laws of any State and/or the laws of the United States, shall be eligible to membership [unless otherwise unqualified].

The 1975 Amendments revised Section 15A(b)(3) of the Act to provide as follows:

> (b) An association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that --
>
> (3) . . . the rules of the association provide that any registered broker or dealer may become a member of such association and any person may become associated with a member thereof. [Emphasis added.]

Amendments to Article I, Section 1 of the Association's By-Laws to reflect this change are being considered. In the interim, the Association is of the opinion that the provisions of the Act are controlling in determining eligibility for membership. Therefore, any broker/dealer registered with the Securities and Exchange Commission (the "Commission") will be considered eligible for membership for purposes of Section 25. Any determination as to whether the activity of a foreign broker/dealer requires registration with the Commission should be made by the Commission. The determination of eligibility for Association membership will be made on the basis of a firm's continuing registered status and a decision to refrain from sales within the United States in connection with a particular offering will not qualify a firm to receive concessions or discounts from members in that offering.

Member firms which engage in underwriting activity and counsel to underwriters should note this change in the applicability of Section 25 and should review the terms of future agreements among underwriters to assure that such agreements do not permit Association members to grant concessions or discounts to non-members which are eligible for membership.

Questions regarding this matter should be addressed to Dennis C. Hensley, Vice President, Corporate Financing, at telephone number (202) 833-7240.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 79-6
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 29, 1979

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

RE: February, 1979, Trade Date/Settlement Date Schedule

The schedule of trade dates/settlement dates below reflects the observance by the financial community of Lincoln's Birthday, Monday, February 12, and Washington's Birthday, Monday, February 19. On Monday, February 12, the NASDAQ System and the exchange markets will be open for trading. However, it will not be a settlement date since many of the nation's banking institutions will be closed in observance of Lincoln's Birthday. All securities markets will be closed on Monday, February 19, in observance of Washington's Birthday.

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

Trade Date	Settlement Date	*Regulation T Date
February 5	February 13	February 14
6	14	15
7	15	16
8	16	20
9	20	21
12	20	22
13	21	23
14	22	26
15	23	27
16	26	28
19	Markets Closed	--
20	27	March 1

* 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 is shown in the column entitled "Regulation T Date."

It should be noted that February 12 is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on Monday, February 12, will be combined with transactions made on the previous business day, February 9, for settlement on February 20. Securities will not be quoted ex-dividend and settlements, marks to the market, reclamations, buy-ins and sell-outs, as provided in the Uniform Practice Code will not be made and/or exercised on February 12.

The above settlement dates should be used by brokers, dealers, and municipal securities dealers for purposes of clearing and settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions concerning the application of these settlement dates should be directed to the Uniform Practice Department of the NASD at (212) 422-8841.

Sincerely,

Christopher R. Franke
Secretary

NOTICE TO MEMBERS: 79-7
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

February 13, 1979

TO: All NASD Members

RE: SEC Release 34-15194 - Fair Treatment of Customer Accounts

Enclosed for your review is a copy of the above-referenced SEC release entitled "Fair Treatment of Customer Accounts," which expresses the Commission's concern that certain of the described practices are "inconsistent with just and equitable principles of trade." This matter has received considerable publicity since its release on September 28, 1978.

The Association readily recognizes that only a few of its members utilize the practices described in the Commission's release and, therefore, the NASD does not view this as a widespread problem. However, it is appropriate to alert the membership that the Commission feels strongly that practices such as these constitute violations of Article III, Section 1 of the Association's Rules of Fair Practice.

In recognition of the Commission's position, consideration must be given to compliance in these areas. Therefore, you may wish to note that a review of these practices will be incorporated in future examinations conducted by the NASD and accordingly, will be reviewed by the Business Conduct Committee.

Questions concerning this notice or the Commission's release may be directed to Mr. Lynn Nellius, Assistant Director, Surveillance Department, at 202-833-7342.

Sincerely,

John T. Wall
Senior Vice President
Compliance

Enclosure

[Rel. No. 34-15194]

FAIR TREATMENT OF CUSTOMER ACCOUNTS

Notice to Broker Dealers

The Securities and Exchange Commission today expressed concern about certain practices engaged in by broker-dealers. During recent months the Commission has received investor complaints regarding:

(a) Issuance to customers of checks drawn on distant banks, a practice referred to as "remote checking";

(b) Retention of interest and dividend payments rather than disbursing such payments to customers promptly upon receipt, without affording customers adequate prior notice and a reasonable opportunity to elect either immediate or deferred payment;

(c) Imposition of increased commission rates without adequate prior notice;

(d) Imposition of custodial fees on "inactive" customer accounts without adequate prior notice; and

(e) Failure to transfer customer accounts promptly to another broker-dealer in response to customer requests.

Remote Checking

Many investors have complained that they are being deprived of the prompt use of their funds by a device currently being used by some broker-dealers. That practice, commonly referred to as "remote checking," involves the issuance of checks drawn on banks located far away from customers in order to delay clearance of those checks and thereby to prolong a broker-dealer's use of its customers' funds. For example, some brokerage firms have implemented a policy of paying customers located east of the Mississippi River with checks drawn on west coast banks and paying customers located west of the Mississippi with checks drawn on east coast banks. In fact, certain broker-dealers have acknowledged that they have engaged in this practice specifically to prolong the firms' use of customers' funds.

The selection of a distant bank for the purpose of prolonging a broker-dealer's use of customer funds unfairly deprives customers of their immediate use of funds, is inconsistent with a broker-dealer's obligation to deal fairly with its customers[1] and is inconsistent with just and equitable principles of trade.[2] Such a purpose may be inferred from the circumstances surrounding the selection of a distant bank and is particularly evident in cases where a broker-dealer arranges its use of two or more disbursing banks with a view to paying customers in a particular region from a bank in a distant location.[3]

Retention of Interest and Dividend Payments

It has been reported to the Commission that customers of several broker-dealers have experienced prolonged delays in receiving dividend and interest payments on securities held for them by broker-dealers. In particular, it appears that some broker-dealers have recently instituted the practice

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[1] See, e.g., *Opper* v. *Hancock Securities Corporation*, 250 F. Supp. 668 (S.D.N.Y.), *aff'd* 367 F. 2d 157 (2d Cir. 1966); *Arleen W. Hughes*, 27 S.E.C. 629 (1948), *aff'd sub nom. Hughes* v. *Securities and Exchange Comm'n*, 174 F 2d 969 (D.C. Cir. 1949); *Charles Hughes & Co., Inc.*, 13 S.E.C. 676, *aff'd sub nom. Charles Hughes & Co., Inc.* v. *Securities and Exchange Comm'n*, 139 F. 2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944); *Duker & Duker*, 6 S.E.C. 386 (1939).

[2] See, e.g., art. III, sec. 1 of the National Association of Securities Dealers, Inc. bylaws, NASD Manual (CCH) par. 2151; art. XIV, sec. 6 of the New York Stock Exchange constitution, 2 New York Stock Exchange, Inc. Guide (CCH) par. 1656.

[3] The Commission recognizes, however, that it may be a desirable business practice for broker-dealers to limit the number of banks used for disbursing funds to customers, or indeed to use only a single bank for that purpose, so long as customers are not deprived of reasonably prompt access to their funds. As a result, some brokerage firm customers will be paid with checks drawn on out-of-State banks.

of disbursing dividend and interest payments monthly rather than promptly upon receipt of the funds, and have done so without notifying their customers in advance or offering them the alternative of immediate payment. While the Commission recognizes that some customers, if adequately informed, may decide to receive payments on a monthly basis, it believes that dividend and interest payments should not be deferred unless the customer has been so informed sufficiently in advance and has been given a reasonable opportunity to elect either immediate or deferred payment. Indeed, the imposition of a system of deferred payments without informed and timely notice is inconsistent with a broker-dealer's obligation to deal fairly with its customers and is inconsistent with just and equitable principles of trade.

IMPOSITION OF INCREASED COMMISSION RATES WITHOUT PRIOR NOTICE

One of the most common investor complaints since the abolition of fixed commission rates has been that broker-dealers raise their commission rates without adequate prior notice. In some egregious cases, investors have been charged commissions exceeding those quoted at the time they placed their orders. That practice is inconsistent with a broker-dealer's obligation to deal fairly with its customers and is inconsistent with its responsibilities under the Federal securities laws. In other cases, customers have placed orders with broker-dealers with which they have recently done business and have not been notified of commission rate increases until the transactions were confirmed. In those situations, the customer's reasonable expectations with respect to the commission rates to be charged based on his prior dealings with the broker-dealer have not been fulfilled. The imposition of an increased rate in that fashion is inappropriate and, the Commission believes, is inconsistent with a broker-dealer's duty to deal fairly with its customers and inconsistent with just and equitable principles of trade.

IMPOSITION OF CUSTODIAL FEES ON CUSTOMER ACCOUNTS WITHOUT PRIOR NOTICE

It has also been reported to the Commission that a number of broker-dealers have recently imposed charges for custodial services on inactive accounts without giving adequate advance notice to enable customers to consider closing or transferring their accounts. The Commission believes that this practice is also inconsistent with a broker-dealer's obligation to deal fairly with its customers and inconsistent with just and equitable principles of trade.

DELAY IN TRANSFERRING ACCOUNTS

Finally, a number of investors have complained that, when they attempt to transfer their accounts from one broker-dealer to another, the broker-dealer who has the account does not transfer it promptly. Those investors have encountered unusual delays, frequently accompanied by attempts to persuade them to allow their accounts to remain with the first broker-dealer. During such delays, customers may experience difficulty in liquidating securities positions held in those accounts unless the transactions are effected through the broker-dealers retaining the accounts.

The Commission recognizes that unusual circumstances may necessitate some delay in transferring a customer's account. Where such circumstances do exist, they should, of course, always be explained to the customer. Where unusual circumstances are not present, however, such delays are improper and are inconsistent with a broker-dealer's obligation to deal fairly with its customers and inconsistent with just and equitable principles of trade.

* * * * *

The Commission is particularly disturbed to discover that many of the practices described above appear not to be isolated occurrences, but instead to reflect established policies and practices of several of the Nation's leading broker-dealers. The Commission believes that action to correct these abuses is overdue and should be undertaken promptly by broker-dealers and self-regulatory organizations. In addition to violating standards of fair dealing, and the rules of various self-regulatory organizations requiring members to refrain from conduct that is inconsistent with just and equitable principles of trade, some instances of the practices described above appear to violate the antifraud provisions of the Federal securities laws. Customers of broker-dealers who believe they have been victims of these practices should write to the Office of Consumers Affairs, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Brokers and dealers should be fully aware that the Commission will take prompt enforcement action against individual firms and persons if such action is warranted.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

SEPTEMBER 28, 1978.

[FR Doc. 78-28225 Filed 10-5-78; 8:45 am]

NOTICE TO MEMBERS: 79-8
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

February 16, 1979

MEMORANDUM

TO: All NASD Members

RE: Conducting an Options Business with Public Customers

On December 1, 1978, the Association distributed Notice to Members No. 78-50 which, among other things, announced SEC approval of the NASD's options access firm rule proposals and established February 1, 1979, as the implementation date of the access firm program. The notice also described in detail the provisions of the access firm rules, including those which pertain to conducting an options business with public customers.

In this connection, members were informed that the Association was preparing a reprint of certain customer-oriented rules which could be used by each firm's registered options personnel as a reference and source of information on their obligations in dealing with public customers engaged in options trading. Enclosed with this notice is a booklet containing those rules together with explanations of their applicability and operation. The Association has printed a limited additional supply of this booklet and will provide such to members upon request on a cost reimbursable basis. This material may also be reproduced as deemed necessary by members and made available to each of their Registered Options Principals (ROP's) and Registered Options Representatives (ROR's).

Should you have any questions either with respect to the contents of this material or with regard to any other aspect of the Association's options access firm program, please contact S. William Broka, Assistant Director, Regulatory Policy and Procedures, at (202) 833-7247.

Sincerely,

Frank J. Wilson

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

Enclosure

OPTION TRANSACTIONS
WITH
PUBLIC CUSTOMERS

A Guide To Compliance
For Member Firms
Conducting An Options Business

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS INC.
1735 K STREET N. W., WASHINGTON, D. C. 20006

INTRODUCTION

This booklet is prepared as an easy reference source for NASD members and their employees. Its intent is to provide an informative and educational vehicle to assist the Registered Options Principal (ROP) and the Registered Options Representative (ROR) in their efforts to obtain a better understanding of those NASD rules which pertain to customers' option transactions and accounts. This booklet does not, however, address itself to all NASD rules governing options trading. The reader should, therefore, read and understand all aspects of such rules as set forth in both NOTICE to Members No. 78-50, dated December 1, 1978, and the appropriate sections of the NASD's Manual.

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BY-LAWS OF THE ASSOCIATION

Registration of Options Principals and Representatives

(Article I, Section 2(d), Schedule C)

Requirement: Registered Options Principals; Requirements For New and Existing Members (Part I, Paragraph (4))

Every member of the Corporation which is engaged in, or which intends to engage in transactions in put or call options with the public, or for its own account, shall have at least one Registered Options Principal who shall have satisfied the requirements of Part I, Paragraph (5) hereof. Each such member shall also designate a Senior Registered Options Principal and identify such person to the Corporation. A member which has a Registered Options Principal qualified in either put or call options shall not engage in both put and call option transactions until such time as it has a Registered Options Principal qualified in both such options. Every person engaged in the management of the day-to-day options activities of a member shall also be registered as a Registered Options Principal. In the event any Registered Options Principal ceases to act in such capacity, such fact shall be reported promptly to the Corporation together with a brief statement of the reasons therefor.

> Explanation: It is important to note that all NASD members engaged in options trading for their own accounts and/or for the accounts of public customers must have at least one person who is an officer or partner of the firm registered as a Registered Options Principal. This requirement applies even to members who conduct an options business on a fully-disclosed basis through another firm.
>
> Every member shall designate a general partner or officer as a ROP who will be responsible for the training of ROR's and related options employees and who will be responsible for the overall supervision of the member's option transactions.

Requirement: Registered Options Principal (Part I, Paragraph (5))

(a) Each person required by Part I, Paragraph (4) hereof to be a Registered Options Principal shall pass the appropriate qualification examination for Registered Options Principal, or an equivalent

examination acceptable to the Corporation, for the purpose of demonstrating an adequate knowledge of options trading generally, the rules of the Corporation applicable to trading of option contracts and the rules of the Options Clearing Corporation, and be registered as such before engaging in the duties or accepting the responsibilities of a Registered Options Principal.

(b) A person shall not qualify as a Registered Options Principal for both put and call options unless he has passed an examination testing him with respect to both put and call options.

> Explanation: Since the Association may exempt any applicant who has previously passed an acceptable examination administered by a national securities exchange from the ROP examination required by this Section, it is the intention of the Association to so waive the examination if the examination and standards of approval of that exchange are compatible with Association standards.

Requirement: Registered Options Representative (Part II, Paragraph (4))

Each person associated with a member whose activities in the investment banking or securities business include the solicitation and/or sale of option contracts shall be required to be certified as a Registered Options Representative and to pass an appropriate certification examination for such or an equivalent examination acceptable to the Corporation. Registered Options Representatives qualified in either put or call options shall not engage in both put and call option transactions until such time as they are qualified in both such options. Members shall be required to report to the Corporation the names of any associated persons certified as Registered Options Representatives pursuant to an examination approved by the Corporation. Registered Options Representatives of members that are members of a national securities exchange which has standards of approval acceptable to the Corporation may be deemed to be approved by and certified with the Corporation, so long as such Representatives are approved by and registered with such exchange.

> Explanation: The Association has established a certification program for registered representatives similar to the types of certification programs used by the options exchanges. Under such program, the Association is making available to Registered Options Principals a certification examination to be administered by a ROP to all representatives qualified prior

to May, 1977, as General Securities Representatives who have not otherwise been certified for puts and calls by one or more of the options exchanges. The cut-off date of May, 1977, has been used because the General Securities Examinations administered subsequent to that time cover both put and call option contracts.

As required pursuant to Article XV, Section 5 of the By-Laws, termination of employment or affiliation of any Registered Options Principal or Registered Options Representative shall be reported promptly to the Association together with a brief statement of the reason for such termination.

The continuing education of a member's Registered Options Representatives shall be the responsibility of a Registered Options Principal. A written record should be retained by a ROP of all seminars, meetings and training materials utilized for the continuing education of the ROR's.

* * *

RULES OF FAIR PRACTICE OF THE ASSOCIATION

Option Accounts

(Article III, Section 33, Appendix E)

Requirement: Opening of Accounts (Section 17)

(a) Approval Required - No member or person associated with a member shall accept an order from a customer for the purchase or sale (writing) of an option contract unless the customer's account has been approved for options trading in accordance with the provisions of subsections (b) and (c) hereof.

(b) Diligence in Opening Accounts

(1) Before approving a customer's account for options trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives. Based upon such facts, the member or a general partner or officer of the member who is a Registered Options Principal, and who is personally informed of such essential facts shall specifically approve or disapprove in writing the customer's account for options trading; provided, however, that in the case of a branch office, an account may be approved for options trading by the manager of such branch office, in which event the action of such branch office manager shall within seven (7) business days be submitted to and approved or disapproved by a Registered Options Principal. A record of the information obtained pursuant to this Section and of the approval or disapproval of each such account shall be maintained by the member as part of its permanent records.

(2) In connection with approving the account of a customer for options trading, members should seek information in particular as to whether the customer has had prior experience in trading options, whether he is aware of the nature and extent of the obligations as well as the risks attendant to options trading, whether he has accounts with other brokerage firms, and the extent of any positions or commitments therein, and whether the customer has financial resources adequate to cover option positions he may intend to establish in such account.

(3) Before approving an account of a trust, pension fund, profit sharing plan or other fiduciary for options trading, a member shall obtain written evidence that the instruments under which the fiduciary is acting permit options trading.

(4) Before approving an account with respect to which trading authorization has been granted to a third person who is not an employee of the member for options trading, the member shall obtain written evidence of the agent's authority to act and that such authority specifically includes options trading.

(5) Before approving an account of an investment partnership or an investment club for options trading, the member shall obtain written evidence of the authority of the person signing the agreement required by this Section to sign such agreement on behalf on such partnership or club, as the case may be, and that such authority specifically includes options trading. Information shall also be obtained with respect to any current long or short option positions of the respective partners or members of the partnership or investment club.

(c) Account Agreement - Within 15 calendar days after a customer's account has been approved for option transactions, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to be bound by the rules of the Corporation applicable to the trading of option contracts and, if he desires to engage in transactions in options issued by the Options Clearing Corporation, that the customer has received a copy of the current prospectus and that he is aware of and agrees to be bound by the rules of the Options Clearing Corporation. In addition, the customer should indicate on such written agreement that he is aware and agrees not to violate the position limits established pursuant to Section 3 and the exercise limits established pursuant to Section 4 of this Appendix E.

. . . Interpretation of the Board of Governors

In approving customers' accounts for options trading, each member should consider employing a separate option account approval form for option customers in conjunction with, or in the case of established accounts, as a supplement to the standard new account approval form so as to ensure the receipt of all the required information and, in the case of established customers, that such information is correct.

Explanation: It is important to note that before an order to purchase or sell an option can be accepted from a customer, that customer's account must have been approved for options trading in writing in accordance with the provisions of this Section. Approval of a customer's account for general securities transactions does not meet the requirements of this Section.

An account agreement must be received by a member within 15 calendar days after the account has been approved for option transactions. This agreement must be received regardless of whether the customer has had any option transactions. It is mandatory that this agreement contain a provision stating that the account will be handled in accordance with the Rules of the Association and, with respect to options issued by the Options Clearing Corporation, the rules of the Options Clearing Corporation. It is also mandatory that this agreement contain a provision stating that the customer, acting alone or "in concert with" others, will not exceed the position and exercise limits established by the Association. Agreements that do not state that the customer will comply with the position and exercise limits thus established fail to meet the requirements of this Section. It is suggested that members include a provision in the customer account agreement spelling out the obligations that are incurred by a customer writing options. Further, members may wish to structure the agreement so that it contains a provision whereby the customer will advise the member of any significant changes which have taken place in the customer's investment objectives, financial situation and needs.

Since the Association may from time to time set different levels of position or exercise limits either for all options or particular option classes or series, each member, Registered Options Principal and Registered Options Representative has an obligation to know and enforce the limits currently in effect.

Every member has an affirmative obligation to determine the investment objectives, financial situation and needs of every customer seeking approval to trade options. The member shall act through the Registered Options Principal and the Registered Options Representative handling the account and, therefore, the obligation to make the inquiry lies not only with the member but also with the Registered Options Principal and the Registered Options Representative.

The inquiry should attempt to determine pertinent facts about the customer. The information concerning the customer shall be recorded and maintained

with the customer's new account information. Should a customer decline to provide any or all of the information requested during the inquiry, the Registered Options Principal should note that an inquiry was made, and that the customer declined to provide either all or a part of the information requested. A member should also consider obtaining a statement from the customer evidencing that he declined to provide this information.

The Registered Options Principal is under an obligation to make a judgment, based upon the information obtained from the customer or based on other information known to the Registered Options Principal, as to the advisability of accepting the customer for option transactions. It is entirely consistent with the intent of this Section for a customer to be approved only for certain types of option transactions and not others. In light of the suitability provisions of the Association's options rules (outlined on pages 12 and 13 hereafter), a customer may be approved for one or more of the following types of option transactions: (i) unsolicited transactions, (ii) purchases and covered writing transactions, (iii) recommended uncovered writing transactions, and (iv) discretionary transactions. Members should consider minimum equities in accounts approved for certain types of option transactions or should consider placing dollar limitations on option transactions of various types.

Requirement: Discretionary Accounts (Section 18)

(a) Authorization and Approval - No member and no person associated with a member shall exercise any discretionary power with respect to trading in option contracts in a customer's account, or accept orders for option contracts for an account from a person other than the customer, except in compliance with the provisions of Section 15 of the Rules of Fair Practice and unless:

(1) the written authorization of the customer required by Section 15 shall specifically authorize options trading in the account;
(2) the account shall have been accepted by a general partner or officer of the member who is a Registered Options Principal; and,

(3) the person approving all option transactions in such account shall be a Registered Options Principal;

provided, however, that in the case of a branch office, discretionary orders may be approved and initialed on the day entered by the branch office manager, provided that such approval shall be subsequently approved within five (5) business days by a general partner or officer of the member who is a Registered Options Principal. The provisions of this subsection shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts shall be executed.

(b) Record of Transactions - A record shall be made of every transaction in option contracts in respect to which a member or person associated with a member has exercised discretionary authority, clearly reflecting such fact and indicating the name of the customer, the designation and number of the option contracts, the premium and the date and time when such transaction was effected.

(c) Prohibited Transactions - No transactions shall be executed in a discretionary account which would result in an uncovered short position in option contracts or in the uncovering of any existing short position in option contracts unless the person for whom the account is maintained has specifically authorized, in writing, transactions of this nature and such transactions are effected with due regard to the provisions of Section 19 of this Appendix E.

Explanation: Discretionary accounts present special surveillance responsibilities for members and Registered Options Principals. The Association recommends that discretionary accounts be reviewed by a Registered Options Principal on a basis more frequent than he would review other accounts. The frequency of this review would depend upon the activity in the account. Such review should look for potential abuses such as excessive transactions. The written supervisory procedures required by Appendix E, Section 20 should include a description of the special supervisory procedures employed for discretionary transactions and accounts. Furthermore, such frequent reviews should be performed by someone other than the person to whom discretionary authority has been granted.

Requirement: Supervision of Accounts (Section 20)

Every member shall provide for the diligent supervision of all of its customer accounts, and all orders in such accounts, to the extent such accounts and orders relate to option contracts, by a general partner (in the case of a partnership) or officer (in the case of a corporation) of the member who is a Registered Options Principal and who has been specifically identified to the Corporation as the member's Senior Registered Options Principal. A Senior Registered Options Principal, in meeting his responsibility for supervision of customer accounts and orders, may delegate to qualified employees (including other Registered Options Principals) responsibility and authority for supervision and control of each branch office handling transactions in option contracts, provided that the Senior Registered Options Principal shall have overall authority and responsibility for establishing appropriate procedures of supervision and control over such employees.

Explanation: In order to effect compliance with this Section, a member must prepare, maintain and enforce written supervisory procedures governing option transactions. These procedures should state the frequency and manner of reviewing customers' option transactions and accounts. They should also indicate what procedures are performed for each account to insure compliance with all relevant Association rules, in-house rules of the member, and the investment objectives of the customer. The written procedures should also include margin maintenance requirements for option transactions, position limits and requirements for discretionary accounts.

The supervisory review should be designed to enable a Registered Options Principal, or person to whom he has delegated supervisory responsibility, to analyze the activity in all customer accounts, to detect unusual concentration in any option class, and also to enable such person to analyze activity in each customer account for suitability, potential churning, problems with respect to "inside" information, violations of position or exercise limits or any other violations of the Association's option rules.

The review methods should be so designed as to identify customers whose accounts have been approved for recommended and unsolicited transactions, and to ascertain whether or not option transactions have been executed within the limits of the original approval.

Any problem discovered by a Registered Options Principal or other supervisory personnel in their review of put and call option activity in customer accounts should be investigated by the member. The disposition of such investigations should be fully documented and maintained in a separate file in the main office of the member for review by the Association during examination of the member. Any serious problems discovered during the supervisory review should be immediately brought to the attention of the Association.

* * *

Option Transactions

Requirement: Delivery of Current Prospectus (Section 12)

Every member shall deliver a current prospectus to each customer at or prior to the time such customer's account is approved for trading of options issued by the Options Clearing Corporation. Thereafter, each new or revised current prospectus shall be distributed to every customer having an account approved for such trading or in the alternative, shall be distributed not later than the time a confirmation of a transaction is delivered to each customer who enters into a transaction in options issued by the Options Clearing Corporation. The Corporation will advise members when a new or revised current prospectus meeting the requirements of Section 10(a)(3) of the Securities Act of 1933 is available.

Where a broker or dealer enters his orders with another member in a single omnibus account, the member holding the account shall take reasonable steps to assure that such broker or dealer is furnished reasonable quantities of current prospectuses, as requested by him in order to enable him to comply with the requirements of Section 5 of the Securities Act of 1933.

Where an introducing broker or dealer enters orders for his customers with, or clears transactions through, a member on a fully disclosed basis and that member carries the accounts of such customers, the responsibility for delivering a current prospectus as provided in this Section shall rest with the member carrying the accounts. However, such member may rely upon the good faith representation of the introducing broker or dealer that a current prospectus has been delivered in compliance with this Section.

Explanation: It is the responsibility of a member to maintain adequate records evidencing the distribution of a current prospectus to all new and existing customers approved for options trading. The written supervisory procedures required by Appendix E, Section 20 should describe the system of distribution and the procedures developed to evidence compliance with this Section.

The term "current prospectus" means that edition of the prospectus of the Options Clearing Corporation which at the time it is to be furnished to a given customer, meets the requirements of Section 10(a)(3) of the Securities Act of 1933.

Requirement: Suitability (Section 19)

(a) No member or person associated with a member shall recommend to any customer any transaction for the purchase or sale (writing) of an option contract unless such member or person associated therewith has reasonable grounds to believe upon the basis of information furnished by such customer after reasonable inquiry by the member or person associated therewith concerning the customer's investment objectives, financial situation and needs, and any other information known by such member or associated person, that the recommended transaction is not unsuitable for such customer.

(b) No member or person associated therewith shall effect with or for any customer any transaction whereby such customer writes, or after writing, is obligated as a writer with respect to:

(1) a call option contract with respect to an underlying security which is not long in the customer's account with the member or which, at the time of writing, is not concurrently purchased by such customer for such account; provided, however, an account shall be deemed long an underlying security if it is long in a security immediately exchangeable or convertible, without restriction other than the payment of money, into such underlying security; or

(2) a put option contract

unless on the basis of information obtained by such member or person associated with such member from such customer, after reasonable and diligent inquiry, and any other information known by such member or person associated with such member, such member or person associated with such member has a reasonable basis for believing that the customer, at the time of the transaction, is capable of evaluating the additional risks in such transactions, and has the financial capability to meet reasonably foreseeable margin calls pursuant to applicable margin requirements with respect to the proposed position in such call option contract or put option contract and any related short position in the underlying security.

Explanation: Members and their employees have an obligation to make a reasonable inquiry as to a customer's investment objectives, financial situation and needs. Members and their employees must have reasonable grounds to believe that the entire recommended transaction is not unsuitable for a customer on the basis of

the information known about that customer, regardless of whether such information was directly supplied by the customer.

Members may find it advisable to indicate on all option order tickets whether such transaction is "solicited" or "unsolicited."

In order to adhere to the Association's suitability requirements, a customer's investment objectives should be reviewed periodically and documented in the customer file. Changes in employment and financial situation should be reviewed in light of a customer's investment objectives.

Members and their employees when making a recommendation for the purchase of an option, should take into consideration the relationship which exists between the option's exercise price and the market value of the underlying stock, the time remaining until the option expires, price volatility and other characteristics of the underlying stock. Where appropriate, a customer should be advised of these factors at the time the recommendation is made.

A customer may not write an uncovered call option, uncover a previously covered call option or write <u>any</u> put option unless that customer is capable of evaluating the additional risks involved and has the financial ability to enter into such transaction(s). Members and their employees have an obligation to know the customer's ability to evaluate such transactions and to know his capability to withstand the financial risks involved.

<u>Requirement</u>: <u>Confirmations (Section 13)</u>

Every member shall promptly furnish to each customer a written confirmation of each transaction in option contracts for such customer's account. Each such confirmation shall show the type of option, the underlying security, the expiration month, the exercise price, the number of option contracts, the premium, the commission, the trade and settlement dates, whether the transaction was a purchase or a sale (writing) transaction, whether the transaction was an opening or a closing transaction, and whether the transaction was effected on a principal or agency basis and for other than exchange listed options the date of

expiration. The confirmation shall by appropriate symbols distinguish between exchange listed option transactions and other transactions in option contracts.

Explanation: The requirement to send written confirmations to customers does not differ significantly from the corresponding requirement dealing with stock and bond transactions. However, the option confirmation must contain additional information, such as expiration month, exercise price and opening or closing transaction, among other things, and must distinguish between exchange listed option transactions and other transactions in option contracts.

Members are reminded that confirmations should be prepared and mailed on the day of the transaction or the following business day.

Requirement: Statements of Account (Section 16)

Statements of account showing security and money positions and entries shall be sent no less frequently than once every month to each customer in whose account there has been an entry during the preceeding month with respect to an option contract and quarterly to all customers having an open option position or money balance.

Explanation: If a customer effected an option transaction, paid or received money relative to an option transaction or delivered or received options or underlying securities during a month, in order to be in compliance with Association rules, a member would have to send a complete statement of account to that customer.

Once a calendar quarter, any customer whose account reflects an open option position and/or a money balance at the end of the quarter, either debit or credit, must also receive a full statement of account. An account has an open option position when it contains an option contract which has neither been the subject of a closing sale transaction or a comparable closing transaction nor has been exercised nor reached its expiration date.

* * *

Option Contract Limits

Requirement: Position Limits (Section 3)

Except in highly unusual circumstances and with the prior written approval of the Corporation in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction in an option contract of any class of options if the member or partner, officer, director or employee thereof, or customer, would acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate position in excess of either:

(a) 1,000 option contracts of the put class and the call class on the same side of the market covering the same underlying security, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or

(b) such other number of option contracts as may be fixed from time to time by the Corporation as the position limit for one or more classes or series of options provided that reasonable notice shall be given of each new position limit fixed by the Corporation.

The Corporation will notify the Securities and Exchange Commission at any time it approves a request to exceed the limits established pursuant to this Section.

The following examples illustrate the operation of position limits established by Section 3:

(1) Customer A, who is long 1,000 XYZ calls, may at the same time be short 1,000 XYZ calls, since long and short positions in the same class of options (i.e., in calls only, or in puts only) are on opposite sides of the market and are not aggregated for purposes of Section 3.

(2) Customer B, who is long 1,000 XYZ calls, may at the same time be long 1,000 XYZ puts. Section 3 does not require the aggregation of long call and long put (or short call and short put) positions, since they are on opposite sides of the market.

(3) Customer C, who is long 700 XYZ calls, may not at the same time be short more than 300 XYZ puts, since the 1,000 contract limit applies to the aggregation of long call and short put positions in options covering the same underlying security. Similarly, if Customer C is also short 600 XYZ calls, he may not at the same time be long more than 400 puts, since the 1,000 contract limit applies separately to the aggregation of short call and long put positions in options covering the same underlying security.

Explanation: The rules pertaining to position limits apply to all accounts of members, their associated persons and their public customers. No account is permitted to have a position in excess of the limits prescribed by the Association. Examples of how the position limits operate have been provided in order to assist members, registered personnel and public customers in determining their compliance with Association rules in this area. The "acting in concert" aspect of the position limit rule is designed to prohibit any attempt by two or more accounts to act together to accrue a joint position which is in excess of established limits. It should be noted that in highly unusual circumstances, the Association may approve a request to exceed the position limits. All such requests should be directed to the NASD's Market Surveillance Section, 1735 K Street, N.W., Washington, D.C. 20006.

Requirement: Exercise Limits (Section 4)

Except in highly unusual circumstances and with the prior written approval of the Corporation, in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with a member has an interest, or for the account of any partner, officer, director or employee thereof or for the account of any customer, any option contract if as a result thereof such member or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly, has or will have exercised within any five (5) consecutive business days more than 1,000 option contracts of a particular class of options or such other limitations concerning the exercise of option contracts as may be fixed from time to time by action of the Corporation. Reasonable notice shall be given of each new limitation fixed by the Corporation.

Explanation: As with position limits, the scope of this rule is all inclusive. There is no account which may act in contravention of limits on the exercise of option contracts set forth above. Again, there is a prohibition against "acting in concert" to evade the limitation. Further, the Association may, under highly unusual circumstances, approve a request to exceed the exercise limits. Requests to exceed the exercise limits should also be directed to the Association's Market Surveillance Section.

Requirement: Liquidation of Positions and Restrictions on Access (Section 6)

(a) Whenever the Corporation determines that a person or group of persons acting in concert holds or controls, or is obligated in respect of, an aggregate position in option contracts covering any underlying security in excess of the position limits established by Section 3 hereof, it may, when deemed necessary or appropriate in the public interest and for the protection of investors, direct:

(1) any member or all members carrying a position in option contracts covering such underlying security for such person or persons to liquidate such position or positions, or portions thereof, as expeditiously as possible and consistent with the maintenance of an orderly market, so as to bring such person or persons into compliance with the position limitations contained in Section 3;

(2) that such person or persons named therein not be permitted to execute an opening transaction, and that no member shall accept and/or execute for any person or persons named in such directive, any order for an opening transaction in any option contract, unless in each instance express approval therefor is given by the Corporation, the directive is rescinded, or the directive specifies another restriction appropriate under the circumstances.

(b) Prior to the issuance of any directive provided for in subsection (a) hereof, the Corporation shall notify, in the most expeditious manner possible, such person, or group of persons of such action, the specific grounds therefor and provide them an opportunity to be heard

thereon. In the absence of unusual circumstances, in the case of a directive pursuant to the provisions of subsection (a)(1) hereof, the hearing shall be held within one business day of notice. In the case of a directive pursuant to the provisions of subsection (a)(2) hereof, the hearing shall be held as promptly as possible under the circumstances. In any such proceeding a record shall be kept. A determination by the Corporation after hearing or waiver of hearing, to implement such directive shall be in writing and shall be supported by a statement setting forth the specific grounds on which the determination is based. Any person aggrieved by action taken by the Corporation pursuant to this Section may make application for review to the Securities and Exchange Commission in accordance with Section 19 of of the Securities and Exchange Act of 1934, as amended.

> Explanation: Whenever an account maintained by a member has a position in options which exceeds the position limits established by the Association, it is required to report such information to the NASD's Market Surveillance Section. From these reports and/or on the basis of other market surveillance procedures the Association may, following an opportunity for a hearing on the matter, direct the firm to take action to liquidate expeditiously such position or a portion thereof, consistent with the maintenance of an orderly market. The Association may also issue a general notice to members advising them of any person or persons determined to hold a position in options that exceeds the position limits. At this point, no member could accept an order for an opening transaction in option contracts from such a person or persons unless the order was specifically approved in advance by the Association, until such time as the Association withdraws its directive, or until the expiration of some other appropriate restriction which may be specified in the directive.

Requirement: Limit on Uncovered Short Positions (Section 7)

Whenever the Corporation shall determine in light of current conditions in the markets for options, or in the markets for underlying securities, that there are outstanding a number of uncovered short positions in option contracts of a given class in excess of the limits established by the Corporation for purposes of this Section or that a percentage of outstanding short positions in option contracts of a given class are uncovered, in excess of the limits established by the Corporation for purposes of this Section, the Corporation, upon its determination that such action is in the public interest and necessary for the protection of investors and the

maintenance of a fair and orderly market in the option contracts or underlying securities, may prohibit any further opening writing transactions in option contracts of that class unless the resulting short position will be covered, and it may prohibit the uncovering of any existing covered short position in option contracts of one or more series of options of that class. The Corporation shall rescind such restrictions upon its determination that they are no longer appropriate.

Explanation: From time to time, the Association may issue specific guidelines that establish a special ceiling on uncovered short option positions. Such action would be taken, for instance, if there was an indication than an excessive number of the outstanding option contracts of a given class were uncovered. Once a limit was established, members would be prohibited from effecting any transactions which would result in either the creation of uncovered short positions or the uncovering of existing covered short positions in that class of option contracts.

* * *

Reporting of Options Positions

Requirement: Reporting of Options Positions (Section 5)

(a) Each member shall file with the Corporation a report with respect to each account in which the member has an interest, each account of a partner, officer, director, or employee of such member, and each customer account, which has (1) an aggregate long position, or (2) an aggregate short position, or (3) an aggregate uncovered short position, of 100 or more option contracts of any class of options.

Such report shall identify the person or persons having an interest in such account and shall identify separately the total number of option contracts of each such class comprising the long position, short position and uncovered short position, in such account. The report shall be in such form as may be prescribed by the Corporation and shall be filed no later than the close of business on the next business day following the day on which the transaction or transactions requiring the filing of such report occurred. Whenever a report shall be required to be filed with respect to an account pursuant to this subsection, the member filing such shall file with the Corporation such additional periodic reports with respect to such account as the Corporation may from time to time prescribe.

(b) In addition to the reports required by subsection (a) of this Section, each member shall report promptly to the Corporation any instance in which such member has a reason to believe that a person, acting alone or in concert with others, has exceeded or is attempting to exceed the position limits or the exercise limits set forth in Sections 3 and 4 hereof.

(c) Every member who has an uncovered short position in any class of options shall file with the Corporation a report reflecting such in:

(1) each account in which the member has an interest,

(2) all accounts of partners, officers, directors and employees of such member; and,

(3) all accounts of customers.

Such report shall be made as of the 15th of each month (or more frequently if required by the Corporation) and shall be submitted not later than the second business day following the date as of which the report is made.

Explanation: The Association has established reporting requirements relative to option positions maintained

by members, associated persons of members and public customers.

Pursuant to these requirements, members must file a report, on a form prescribed by the Association, with respect to each account which maintains an aggregate long, aggregate short or aggregate uncovered short position of 100 or more option contracts in any class of options. Such report is to be filed not later than the close of business on the business day following the day on which the reportable position is established and must identify, among other things, the person or persons having an interest in the account and the total number of option contracts comprising the reportable position. It should be noted that position reporting is the responsibility of every NASD member whose options activities are governed by the provisions of Appendix E. Such should be of particular concern to those members which conduct their business on a fully-disclosed basis. These firms, while not required to actually file the daily position reports themselves, are under an obligation to insure that the firms carrying their accounts are aware of the responsibility to report option positions in such accounts to the Association.

Members are also required to report promptly to the Association any cases of which they have knowledge that a person or persons, acting alone or in concert with others, have exceeded or are attempting to exceed the established option position and exercise limits.

Further, members must report monthly the uncovered short positions in any class of options held in their own accounts, the accounts of their partners, officers, directors and employees and the accounts of their public customers. The report is to be made as of the 15th day of each month and is to be submitted no later than the second business day following the date as of which the report is made. The obligation for introducing firms to insure that the firms carrying their accounts comply with Association reporting requirements with respect to such accounts applies as well to the submission of the monthly uncovered short position report.

Each of the above reports should be filed with the Association's Market Surveillance Section, 1735 K Street, N. W., Washington, D. C., 20006

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Prohibited Transactions

Requirement: Transactions With Issuers (Section 14)

No member under any circumstances shall enter a transaction for the sale (writing) of a call option contract for the account of any corporation which is the issuer of the underlying security thereof.

> Explanation: The basis for this restriction is the registration requirement of the Securities Act of 1933. Under the 1933 Act, there are very few instances when an issuer may sell its securities without complying with the provisions of Section 5 of the 1933 Act. For example, if ABC Co. wrote a call for 1,000 shares of ABC Co. stock, it is possible that the market price of ABC Co. stock could rise to a point where the buyer of the call would exercise it. As ABC Co. would be required to sell the ABC Co. shares, it would indirectly be doing what it could not do directly.
>
> There is no prohibition on issuers buying options. The 1933 Act prohibitions pertain to sales by issuers, not purchases.

Requirement: Restricted Stock (Section 15)

For the purposes of covering a short position in a call option contract, delivery pursuant to the exercise of a put option contract, or satisfying an exercise notice assigned in respect of a call option contract, no member shall accept shares of an underlying stock, which may not be sold by the holder thereof except upon registration pursuant to the provisions of the Securities Act of 1933 or pursuant to SEC rules promulgated under the Securities Act of 1933, unless, at the time such securities are accepted and at any later time such securities are delivered, applicable provisions of the Securities Act of 1933 and the rules thereunder have been complied with by the holder of such securities.

> Explanation: The activities prohibited by this Section are to insure that the basic tenets of the Securities Act of 1933 are followed. If a person holding restricted stock or unregistered stock were able to tender it when he was exercised against without complying with certain exemptive provisions of the 1933 Act, it would permit him to do indirectly what he is

not permitted to do directly, i.e., sell the restricted or unregistered shares. It is important to note that if restricted or unregistered securities were used to cover an option which was written or used as a margin deposit, the member would find itself in a position where it could not move against these securities in order to deliver them if the option was exercised or, sell them if a margin call was not met. In effect, the member is as restricted in its ability to sell or deliver (in the case of exercise of an option) unregistered shares as is the beneficial owner thereof. However, it must be remembered if an individual complies with Rule 144 or some other exemption granted in the 1933 Act, the securities covered would not be regarded as restricted or unregistered insofar as this Section is concerned.

Requirement: Restrictions on Out-of-the-Money Options Transactions (Section 8)

(a) Subject to the provisions of subsections (b) and (c) hereof, no member or person associated with a member shall enter on behalf of a customer, on behalf of any officer, director, partner, employee or affiliate of the member, or on behalf of the investment account of the member, any order for an opening transaction in any exchange listed call option contract if (1) the exercise price is more than $5.00 above the closing market price of the underlying security for such call option on the last previous day in which such underlying security was traded; and (2) the closing market price of such call option, in all markets in which such call option was traded on the last previous day on which there was a trade of the call option on any exchange, was less than $.50 per share at option; and no member or person associated with a member shall enter on behalf of a customer, on behalf of any officer, director, partner, employee or affiliate of the member, or on behalf of the investment account of the member any order for an opening transaction in any exchange listed put option contract if (1) the exercise price is more than $5.00 below the closing market price of the underlying security for such put option on the last previous day in which such underlying security was traded; and (2) the closing market price of such put option, in all markets in which such put option was traded, on the last previous day on which day there was a trade of the put option on any exchange, was less than $.50 per unit at option.

(b) The restrictions set forth in subsection (a) hereof shall not apply to:

(1) The entry of an order for any opening writing transaction resulting in a covered short position or, in the case of a call option contract, a short position that is covered in the account on a unit-for-unit

basis by a long position in a security immediately exchangeable or convertible without restriction, other than the payment of money, into the underlying security;

(2) The entry of a spread order for the purchase and sale of option contracts of the same class covering the same number of units. Provided that, if there is a subsequent liquidation of one side of the spread and if, apart from the exception provided in this subsection, subsection (a) would have been applicable to the other side of the spread when the order was entered, there shall be a concurrent liquidation of such other side.

(3) The entry of an order for any opening transaction which would, upon execution, create a spread position for option contracts of the same class of options covering the same number of units provided that, if there is a subsequent liquidation of one side of the spread and if, apart from the exception provided in this subsection, subsection (a) would have been applicable to the other side of the spread when the order was entered, there shall be a concurrent liquidation of such other side.

(4) The entry of an order for the purchase of a put against a long position on a unit-for-unit basis in either the underlying security or a security immediately exchangeable or convertible without restriction, other than the payment of money, into the underlying security.

(c) The Corporation may (1) interpret or modify any of the foregoing provisions of this Section 8 with respect to particular orders and transactions, and (2) make exceptions, modifications or additions to any of the foregoing provisions with respect to one or more series of options whenever the Corporation determines that such exceptions, modifications, or additions are necessary in the interest of maintaining a fair and orderly market in option contracts or in underlying securities or otherwise are necessary in the public interest or for the protection of investors; provided, however, that any such exception, modification or addition shall become effective not earlier than 15 minutes after it is announced by the Corporation and shall not remain in effect for more than two (2) business days unless ratified by a committee of the Board of Governors authorized by it to do so.

(d) All action taken under Section 8(c) and the reasons therefor shall be reported in writing to the said committee of the Board not later than the business day immediately following the one on which such action is taken.

Explanation: The restrictions outlined above on out-of-the-money options are applicable only to option contracts issued and guaranteed by the Options Clearing Corporation (OCC). Such restrictions operate automatically

whenever the criteria for imposing a restriction are satisfied. In this connection, in order to become a restricted option, the exercise price of the option contract must be either $5.00 above (in the case of a call) or $5.00 below (in the case of a put) the closing market price of the underlying security and the closing price of the option contract must be less than $.50 per share at option in all markets where such option is traded. Members and their registered personnel should be aware when opening purchase and sale prohibitions in particular options series are applicable, giving due consideration to those provisions of the rule which permit certain exceptions to the restrictions which may be imposed.

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Advertisements and Sales Literature

Requirement: Advertisements and Sales Literature (Section 23)

(a) Approval by Registered Options Principal

(1) Each item of advertising and sales literature issued by a member pertaining to options shall be approved by signature or initial, prior to use, by the Senior Registered Options Principal or his designee.

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

(b) Corporation Review of Advertisements - In addition to the approval required by paragraph (a) of this Section, and in lieu of the filing requirements specified in the Advertising Interpretation of the Board of Governors contained in Article III, Section 1 of the Rules of Fair Practice, every advertisement by a member pertaining to options shall be submitted to the Corporation'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. The Corporation's Advertising Department shall, within the ten-day review period specified in this paragraph (b), in the absence of highly unusual circumstances, either notify members as to its views with respect to any advertisement filed pursuant to this Section or indicate that its comments are being withheld pending further analysis or the receipt of additional information.

(c) Standards Applicable to Options Related Communications - In addition to the provisions of the Advertising Interpretation of the Board of Governors, members' public communications concerning options shall conform to the following provisions:

(1) As there may be special risks attendant to some option transactions and certain option 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 options 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 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 current 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 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 and 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.

Explanation: The term "advertisement" means material published, or designed for use in, a newspaper, magazine or other periodical, radio, telephone or tape

recording, motion picture, television, videotape display, signs or billboards, telephone directories (other than routine listings), or other public media. The term "sales literature" means any notice, circular, report (including research report), newsletter (including market letter), 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 definition of "advertisement." 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.

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Violations of NASD or OCC Regulations

Requirement: Violations of By-Laws and Rules of the Corporation or the Options Clearing Corporation (Section 21)

(a) In Corporation disciplinary proceedings, a finding of violation of any provision of the rules, regulations or by-laws of the Options Clearing Corporation by any member or person associated with a member engaged in transactions involving options issued, or subject to issuance, by the Options Clearing Corporation, may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Corporation's Rules of Fair Practice.

(b) In Corporation disciplinary proceedings, a finding of violation of any provision of the rules, regulations or by-laws of the Corporation by any member engaged in option transactions may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Corporation's Rules of Fair Practice.

Explanation: The Association may deem any finding of violation of OCC rules and any finding of violation of NASD rules, regulations or by-laws to be conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Association's Rules of Fair Practice. Such violations shall therefore be handled in accordance with the provisions of the Association's Uniform Practice Code.

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