NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000
notice to members 83-7

February 3, 1983

IMPORTANT

TO: All NASD Members

RE: Solicitation of Comments on SEC Proposed Anti-Internalization Rule

SUMMARY

The Securities and Exchange Commission has published for comment a proposed rule addressing the issue of exchange and over-the-counter market makers internalizing customer orders in Rule 19c-3 securities and whether intermarket exposure of customer orders should be required. Internalization has been defined by the Commission as a dealer executing customer transactions as principal or crossing agency transactions in-house without exposing those orders to buying and selling interest in other markets.

The Board of Governors is publishing this Notice to inform the membership of the proposed rule and to elicit members' comments. The Board believes that this is a most important issue for Association members in light of the competitive impact the rule will have on market makers, its impact on the efficiency of execution of customer orders and the possible future implications its adoption may have on the market for NASDAQ National Market System securities.

The proposed rule would apply to all broker/dealers executing transactions as principal with their customers and generally would prohibit the execution of a customer order as principal unless (1) the transaction is executed on an exchange or the broker/dealer is registered in the Association's Computer Assisted Execution System (CAES) as an ITS market maker, (2) the broker/dealer's quotations can be reached through the ITS/CAES interface, and (3) the order is executed in compliance with the proposed rule's order exposure requirements or order export requirements.

The rule's order exposure requirement would require a broker/dealer to stop (i.e., guarantee) each customer order at the proposed execution price, and then publish a bid or offer on behalf of the order for 30 seconds at a price 1/8 better than the proposed execution price. The rule's order export alternative would require the broker/dealer to

"export" the order to CAES or the Cincinnati Stock Exchange's National Securities Trading System in such a manner that the order is not designated to a market maker and the broker/dealer either (1) establishes procedures reasonably designed to separate the firm's order entry and execution functions, or (2) has not improved its quotation in the 30 seconds prior to trading with a customer order.

A more detailed description of the proposed rule is provided later in this Notice and a copy of the proposed rule is attached.

The Board's views on the proposed rule are summarized as follows:

- The Board believes that adoption of the proposed rule would be a classic example of over-regulation. Both the SEC and NASD conducted studies of off-board trading and found that off-board transactions were being executed at prices at least as favorable and in some cases better than transactions on exchanges and that virtually no evidence was found that customers were being taken advantage of when their transactions were executed in the over-the-counter market. The Commission has stated in the release that "it has not observed any objectively identifiable negative impacts of internalization on Rule 19c-3 trading in the past that would justify imposition of an order exposure rule."

- The Commission has now stated that the decision to adopt an order exposure rule would have to be based on a determination that there would be incremental benefits resulting from such a rule that would outweigh the costs of the additional regulation. The Board believes that the costs of this burdensome regulation far outweigh any speculative benefits that may result. The complexity of the exposure requirement and the steps involved in complying with the rule would render the efficient execution of retail principal transactions extremely difficult, if not virtually impossible.

- The Board believes that the insignificant off-board volume in 19c-3 securities does not justify such an all encompassing regulation and certainly does not represent a threat to the manner of doing business on stock exchanges.

- It is the Board's view that the proposed rule will result in imposing an insurmountable burden on competition in off-board transactions and would constitute a de facto repeal of Rule 19c-3.

- The Board notes that the proposed rule would substantially reduce the efficiency of industry built systems which automatically process customer orders. The proposal would not only affect the Association's Computer Assisted Execution System, but would also require modifications to the automated systems of the regional stock exchanges. The proposed rule would impair the the progress made in developing facilities to efficiently automate the execution of small orders which facilities are even more crucial today in light of the recent increase in volume in all markets.

- The Board is deeply concerned with the potential for the proposed rule applying to NASDAQ/National Market System securities. The Commission has publicly stated that it has no intention of expanding the coverage of the rule to securities traded exclusively in the over-the-counter market. The Board recognizes, however, that no firm commitment can be made as to the action of a future Commission. The Commission has already by rule designated certain NASDAQ securities as national market system securities subject to the same trade reporting and quotation display rules as listed securities. The number of NASDAQ securities designated as national market system securities will increase as the national market system evolves. The Board is concerned that at some future time more of the distinctions between listed national market securities and over-the-counter national market system securities will be eliminated. Since the rule is heavily biased against in-house principal transactions, this could substantially impact the long-term profitability of a large portion of the membership's business.

For these reasons, the Board of Governors believes that the proposed rule is of vital interest to the entire membership and urges members to analyze the rule and to communicate their views to the Commission. Substantial comments have already been received by the Commission from proponents of the rule. The Board believes it essential for the membership to recognize the importance of this issue and to communicate their views in a comment letter to the Commission as soon as possible. All comments should be submitted by March 1, 1983 to:

George A. Fitzsimmons
Secretary
Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

In addition, the Association would appreciate receiving a copy of your comments. Please send a copy to:

S. William Broka
Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D. C. 20006

Sincerely,

Gordon S. Macklin
President

Attachments

DISCUSSION OF THE SECURITIES AND EXCHANGE COMMISSION'S RE-PROPOSAL OF AN ORDER EXPOSURE RULE

The SEC proposed order exposure rule is the second publication of this issue by the Commission. Last year the Commission published for comment three alternative means of dealing with internalization. The first alternative was to defer Commission action on an anti-internalization rule. The second alternative, which was based on a New York Stock Exchange proposal, would have applied only to over-the-counter market makers and would have required the exposure of customer orders and market maker principal interest in these orders to other markets prior to execution. The third alternative which was based on principles developed by a special Securities Industry Association committee would have required both exchange and over-the-counter market makers to expose customer orders to other markets prior to execution.

The Association commented to the Commission that action on an anti-internalization rule should be deferred until such time that a demonstration has been made that internalization has created a regulatory problem warranting further action. The Association reminded the Commission that this had been the Commission's long-standing policy on this issue and that it should continue to adhere to this policy.

The basis for publishing the previous anti-internalization rules was the argument put forth by stock exchanges that customer orders executed off of an exchange will result in inferior executions for those orders because of a loss of order interaction in the exchange auction crowd and the potential for dealers to overreach and take advantage of their customers. The basis for this argument is that dealers executing transactions in the over-the-counter market will execute customer buy orders at their offer price and execute customer sell orders at their bid price. The argument is made that dealer executions will be inferior to exchange auction executions because the auction process is characterized by order interaction in the auction crowd. Theoretically, a customer order when brought to the floor of an exchange and exposed in the auction crowd will have the opportunity to be matched with another customer order exposed in the crowd. The specialists' bid and ask quotation will only come into play when there are imbalances of buy or sell orders. Therefore, orders can meet in the crowd and be matched in between the specialist's bid and ask and will only be executed at the bid or ask when there is an imbalance of orders on the buy or sell side and the order cannot be matched. The argument concludes that this can only occur through an auction process and removing customer orders from this process will result in inferior executions for customer orders because it eliminates the possibility of these orders being executed in between the quotation at better prices.

The Association's response to these arguments contained an analysis of the results of the SEC's own Monitoring Report on the Operation and Effects of Rule 19c-3 as well as the NASD's surveillance and monitoring program both of which revealed that off-board transactions in these securities were being executed at prices at least as favorable and in some cases better than transactions on exchanges. In addition, the analysis concluded that virtually no evidence was found of inferior executions or that customers were being taken advantage of when their transactions were executed in the over-the-counter market. The Association concluded in its comments to the Commission:

> The Commission's policy as enunciated in its various releases is a sound one. That is, added regulation and rules are not appropriate until there is some demonstrated adverse effects on the markets resulting from dealer internalization of customer orders. The limited trading which has taken place in 19c-3 securities is insufficient to form the definite conclusions necessary to resolution of the question with finality. However, this limited experience does reveal that off-board trading in 19c-3 securities has not had negative consequences and that the theoretical dangers have not materialized. Thus, no substantive case can be made at this time that the experience with off-board trading in 19c-3 securities requires regulatory action. The Commission should adhere to its historical position that regulatory action on internalization should be reserved until such time as a regulatory problem has been established and such action is demonstratably appropriate. This has been the Commission's firm position for many years. No empirical evidence exits requiring an alteration of its policy.

After several months of studying the comments received, the Commission has now republished a proposed anti-internalization rule, but the basis upon which the rule is to be adopted has changed. Previous anti-internalization rules have been proposed in an attempt to curb the potential regulatory abuses which could result from internalization. The Commission has now concluded that "it has not observed any objectively identifiable negative impacts of internalization on Rule 19c-3 trading in the past that would justify imposition of an order exposure rule." The basis for adopting the proposed rule would be the benefits that would flow from order exposure. The Commission states in its release:

> The Commission recognizes the arguments made by a number of commentators that increased OTC competition in Rule 19c-3 securities inherently increases depth, liquidity, and pricing efficiency. The Commission, in adopting Rule 19c-3, made the determination that, in that limited context, these potential competitive benefits outweighed any potential concerns arising from the absence of exposure by OTC market makers. The Commission has not to date been provided any data or analysis which would cause it to reverse that determination. Therefore, any decision to adopt an order exposure rule would have to be based on a determination that there would be incremental benefits resulting from such a rule that would outweigh the costs of the additional regulation.
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> In this connection, the Commission believes that adoption of an order exposure rule for linked securities could possibly provide benefits for the markets for those securities and give the Commission experience with which to consider and evaluate the role of order exposure generally as a means to improve intermarket competition and best execution and thereby foster development of a national market system. The Commission is mindful, however, that some commentators have raised concerns that an order exposure rule could negate benefits already achieved through enhanced opportunities for intermarket competition and best execution afforded by adoption of Rule 19c-3. The Commission specifically requests comment on this issue.

The Board of Governors believes that under this new basis for adopting an anti-internalization rule, the costs involved in complying with the rule results in substantial inefficiencies in executing transactions and anti-competitive impacts which far outweigh any potential benefits. The Board is also very concerned as to the future application of the proposed rule. As proposed, the rule only applies to 19c-3 securities, that is, those securities which have listed on an exchange since April 26, 1979. There are currently 484 19c-3 securities and 53 members making markets in these securities. The Commission has publicly stated that it has no intention of expanding the coverage of the rule to securities traded exclusively in the over-the-counter market. The Board recognizes, however, that no firm commitment can be made as to the action of a future Commission. In addition, as the national market system evolves and the number of NASDAQ stocks designated as national market system securities increases, the potential exists for an anti-internalization rule to be expanded to cover NASDAQ securities. This could occur either through the granting of unlisted trading privileges on NASDAQ stocks to exchanges or the adoption of the view that all national market system stocks and exchange listed stocks should trade under the same rules. Following is a brief description of the proposed rule and we suggest that the membership keep in mind the possible extension of the rule to NASDAQ securities when analyzing its provisions. A copy of the proposed rule is attached to this notice.

The rule provides that no broker/dealer may buy a 19c-3 security from a customer or sell such security to a customer for the broker/dealer's account unless:

(1) the broker/dealer is registered and acting as an ITS/CAES market maker or the transaction is executed on an exchange (an ITS/CAES market maker is an over-the-counter market maker making quotations available on the Association's Computer Assisted Execution System and is utilizing the ITS interface. See recently adopted ITS/CAES rules governing ITS/CAES market makers); and,

(2) the broker/dealer has access to the ITS/CAES interface and its quotations can be executed against through the ITS/CAES interface; and,

(3) the broker/dealer complies with the rule's order exposure requirements or its order export requirements.

(The following explanation will only refer to broker/dealer purchases from customers, but is equally applicable to broker/dealer sales to customers.)

<u>Order Exposure Requirements</u>

Before a broker/dealer could execute a customer's order as principal it would be required to:

(1) "Stop" the total number of shares of the order, i.e., guarantee the execution of the order at the intended execution price. The stop price would have to be at least the best price available in any participating ITS market;

(2) Publish and maintain for at least 30 seconds an offer on behalf of the customer, in a size equal to the number of shares it intends to buy from the customer at a price 1/8th better than the intended execution price (stop price).

If the broker/dealer receives an order from the published offer 1/8th above the stop price, the customer will receive the improved price. If no one takes the published offer after 30 seconds, the broker/dealer can execute the order at the stop price.

The requirement to publish at 1/8th above the stop price will not be required if:

(1) an offer for the broker/dealer's account is already being published at 1/8th above the stop price, at or greater than the size of the customer order and such offer is maintained for at least 30 seconds from the receipt of the customer's order;

(2) the customer's order is not executed as principal for 30 seconds after receipt; and,

(3) any transaction during the 30 second period with the broker/dealer at its published offer up to the size of the customer's order shall be for the account of the customer.

If a broker/dealer is publishing an offer on behalf of a customer order at 1/8th above the stop price, and a second order is received, the second order may be executed immediately as principal at the stop price of the first order in any size up to 1,000 shares more than the size of the first order.

If a broker/dealer is publishing an offer on behalf of a customer order at 1/8th above the stop price, that order may be immediately executed as principal at the stop price if:

(1) An unrelated transaction is executed by the broker/dealer at a price equal to or lower than the stop price; (an unrelated transaction could be the "second order" referred to above) or

(2) The broker/dealer lowers its offer to the stop price to match an offer published by another ITS market.

<u>Order Export Requirements</u>

A broker/dealer need not comply with the order exposure requirements if it complies with the order export requirements. The broker/dealer can enter the customer's order in the Computer Assisted Execution System (CAES) on a neutral basis, i.e., not directed to a particular market maker, or enter the order in the Cincinnati Stock Exchange's National Securities Trading System (NSTS) provided that the broker/dealer either:

(1) adopts procedures reasonably designed to preclude all persons responsible for making bids and offers or dealing for the firm's account from having any knowledge of the existence of the customer order and all persons responsible for solicitation of customer orders or entering such orders in CAES or NSTS from having knowledge of positions or trading strategies for the firm's account in that security; or

(2) the broker/dealer's bid has not been raised for 30 seconds before receipt of the customer's order and the size of such bid has been equal to or greater than the customer's order.

The rule also provides that agency cross transactions executed off of an exchange or CAES may only be executed at a price between the best ITS bid and offer if the spread is 1/4 or more or at the best ITS bid or offer if the spread is 1/8.

The rule also provides a number of exclusions, the most important of which relates to block transactions. The rule would require the ITS participants to submit to the Commission within 18 months of the effective date of the rule a plan providing for an effective means of exposing blocks to other markets. Until the adoption of such a plan, block transactions would be excluded from the rule. The rule defines a block as 10,000 shares or more or a quantity of a security having a market value of $200,000 or more.

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The Commission has stated that the decision to adopt an order exposure rule would have to be based on a determination that there would be incremental benefits resulting from such a rule that would outweigh the costs of the additional regulation. They have specifically requested comments on this issue. The Board of Governors believes that the costs of this burdensome regulation far outweigh any speculative benefits that may result. The Board believes that the complexity of the exposure requirement and the mechanical steps involved in complying with the rule would render the efficient execution of retail principal transactions extremely difficult, if not virtually impossible. Each retail principal transaction would require separate mechanical input entries and display through the firm's terminal and a waiting period of up to 30 seconds prior to execution of the order. In addition, the process of determining what price to expose, when the firm's quotation would have to be altered, a determination of the applicable holdout period and whether the various exceptions are available creates a process for executing each transaction that is extremely cumbersome and inefficient. A firm with a steady flow of retail orders would simply be physically unable to execute customer orders with any degree of efficiency.

With respect to the order export alternative, it would not, under any circumstances, result in a customer receiving a better execution than if the firm executed the transaction internally. Conversely, the customer could receive an inferior price taking into consideration commissions and costs of execution. First, since the firm is currently obligated under NASD rules to achieve best execution, the execution price to the customer, if executed internally, would be required to be the best bid or offer. Therefore the blind routing of the order would not result in an improved execution price. Secondly, firms dealing directly with their customers are able to execute such transactions at a lesser cost than if the order were routed to another market. There are significant costs savings (e.g., clearing costs, resolving questioned trades) resulting from the internalization of customer orders which could be passed on to the customer in the form of reduced commissions and/or markups. We, therefore, do not view the order export alternative as having any advantages for customers and could result in disadvantages. The alleged conflict of interest on the part of the dealer is dealt with by existing rules and regulations. More importantly, this conflict is controlled by the widespread disclosure of current quotations and transaction reports and the active competition in the market for these securities. From the data available with respect to customer executions in 19c-3 securities, this alleged conflict has resulted in virtually no evidence of overreaching or inferior executions.

It is the Association's view that the anti-internalization proposal will clearly result in imposing an insurmountable burden on competition in off-board transactions in 19c-3 securities and would constitute a de facto repeal of Rule 19c-3. Firms participating in the 19c-3 experiment have indicated that they could not continue trading 19c-3 securities under the proposed rule. Not only would it effectively repeal Rule 19c-3, but the rule would also impose an insurmountable burden on non-exchange member market makers who have been trading listed securities for many years. In effect, the rule would eliminate the over-the-counter market in 19c-3 securities. We believe this result would be clearly inconsistent with the '75 Act Amendments, eliminate the recent gains that have been made in promoting competition in listed securities and be contrary to the public interest.

We believe that the objectives of the '75 Act could best be achieved by establishing an industry-wide best execution rule applicable to all markets and equally enforced in all markets. Customers ought to receive the best price displayed from any market. We do not believe the current ITS trade through rule goes far enough due to its many exceptions, its unequal treatment of market centers and the fact that only a complaint by a market center within five minutes of an execution gives rise to action under the rule. We believe that the focus of the national market system should be on the execution of customer orders and insuring that customers receive the best price displayed from any market center.

The Board of Governors believes that this proposed anti-internalization rule is a classic example of overregulation. The Commission itself has stated that no regulatory abuses are evident which would justify adoption of a rule. We believe that the burdens imposed by the rule not only clearly outweigh any benefits, but would stifle competition among market makers. For the past 10 years the securities industry has spent a considerable amount of time and money to develop automated systems which have resulted in the establishment of more efficient facilities to automatically process customer orders. These facilities are even more crucial today in light of the recent increase in volume in all markets. The Board believes that adoption of the proposed rule would not only impair the progress made so far, but would require modifications to these systems and their use by members to such an extent as to substantially reduce their efficiency. It should be noted that the proposed rule would not only affect the Association's Computer Assisted Execution System, but would also require modifications to the automated systems of the regional stock exchanges which are specifically covered by the proposed rule.

Finally, the Board urges members to consider the potential of this rule applying to the trading of NASDAQ NMS securities. Despite the assurances from the Commission that this will not happen, the Board is very concerned that at a future date it will occur. This concern is based on the evolution of the national market system as envisaged by the '75 Act Amendments as a unified trading system for all national market system securities. The Commission has already by rule designated certain NASDAQ securities as national market system securities subject to the same trade reporting and quotation display rules as listed securities. The Board is concerned that at some future time more of the distinctions between listed national market securities and over-the-counter national market system securities will be eliminated.

The Board believes that there has clearly been no demonstration of a need for an anti-internalization rule. Such a rule would eliminate competition among market makers; would be harmful to existing industry automated facilities; and poses a dangerous threat to the manner in which securities are traded. In addition, since the rule is heavily biased against in-house principal transactions, it could substantially impact the long-term profitability of a large portion of the membership's business.

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

§ 240.11A-1 Exposure of principal and agency cross transactions.

Preliminary Note to Rule 11A-1—.Rule 11A-1 applies both to broker-dealer principal transactions with customers and agency cross transactions in specified securities. With respect to broker-dealer principal transactions, the rule applies both to broker-dealer purchases from customers and broker-dealer sales to customers. In order to make the substantive requirements of the rule as easy to follow as possible, only subparagraph (a)(1) of the ruler refers both to broker-dealer purchases and sales. Throughout the remainder of the rule, the text of the rule refers only to the situation where the broker-dealer buys from the customer. With respect to broker-dealer sales to a customer, the requirements of the rule parallel the requirements specified for broker-dealer purchases, but on the opposite side of the market. For example, while the rule provides the broker-dealer with the alternative requirement of "exposing" a customer sell order at a price ⅛ dollar higher than the stop price with respect to broker-dealer purchases, the broker-dealer would have to expose customer buy orders at a price ⅛ dollar lower than the stop price. As a general matter in interpreting requirements with respect to broker-dealer purchases from customers, unless the context requires otherwise, terms such as "purchase," "offer," "higher," "sell," "lowered," "bid," and "raised" used with respect to broker-dealer purohases, should be road as "sale," "bid," "lower," "purchase," "raised" "offer," and "lowered" with respect to broker-dealer sales.

(a) *Principal transactions.* (1) No broker-dealer shall buy a subject Rule 19c-3 security from a customer (or sell such a security to a customer) for a proprietary account of the broker-dealer unless the broker-dealer (i) is registered and acting as an ITS/CAES market maker in the subject security or executes the purchase (or sale) on or through the facilities of a national securities exchange; (ii) has access to, and the published bids and offers of such broker-dealer in the subject Rule 19c-3 security can be reached through, the ITS/CAES Interface; and (iii) complies with either paragraph (a)(2) or (a) (3) of this section.

(2) *Alternative 1: Order exposure.* The broker-dealer, prior to execution of any purchase from a customer as principal, shall complete the steps set forth in this paragraph.

(i) The broker-dealer must "stop" (*i.e.*, guarantee the execution of) the total number of shares he intends to buy at his intended purchase price from the customer (hereinafter referred to as the "stop price");

(ii) Subject to the provisions of paragraph (a)(2)(iv), the broker-dealer must publish and maintain for at least 30 seconds an offer on behalf of the customer, in a size equal to the total number of shares he intends to buy from the customer, at an offer price which is ⅛ dollar higher than the stop price;

(iii) After completing the steps required by paragraphs (a)(2)(i) and (a)(2)(ii), the broker-dealer may execute the customer's order (or whatever portion thereof remains unexecuted after publication of an offer on behalf of the customer in accordance with subparagraph (a)(2)(ii)) at the stop price, as principal;

(iv)(A) The requirements of paragraph (a)(2)(ii) shall be deemed to be satisfied with respect to a customer order if, subject to the other provisions of this paragraph (a)(2)(iv), (*1*) an offer already being published by the broker-dealer for its proprietary account meets the price requirement and meets or exceeds the size requirement of subparagraph (a)(2)(ii) and is maintained for at least 30 seconds from the time the customer order is received; (*2*) the customer's order is not executed as principal for 30 seconds after it is received; and (*3*) during such 30 second period any transaction with the broker-dealer that would otherwise be for its proprietary account at the broder-dealer's published offer price in a size up to the size of the customer's order shall be for the account of the customer.

(B) Any offer required to be published and maintained under paragraph (a)(2)(ii) may be reduced in size to the extent of any partial acceptance by one or more third parties of the offer occurring during the 30 second period contemplated by that paragraph.

(C) A customer's order to sell (hereinafter referred to as the "first order") with respect to which publication of an offer is being maintained in compliance with paragraph (a)(2)(ii) may be executed immediately by the broker-dealer as principal at the stop price if, after such publication has commenced or, in the case of an order to which paragraph (a)(2)(iv)(A) applies, after the order is received:

(1) An unrelated transaction is executed in that broker-dealer's ITS market at a price equal to or lower than the stop price;

(2) The broker-dealer lowers his offer to the stop price to match an offer published by another ITS market; or

(3) The published offer in that broker-dealer's ITS market is lowered to the stop price to reflect an independent offer in that market at that price.

(D) A customer's order to sell (hereinafter referred to as the "second order") received by a broker-dealer while that broker-dealer is maintaining a published offer with respect to the first order in compliance with paragraph (a)(2)(ii) may be executed in whole or in part immediately by the broker-dealer as principal at the stop price of the first order in any size up to 1,000 shares in excess of the amount of the first order that was stopped by the broker-dealer pursuant to paragraph (a)(2)(i).

(3) *Alternative 2: Order export.* The customer's order shall be entered in ITS/CAES on a neutral basis (*i.e.*, otherwise than by directing the order to the broker-dealer for execution) or in the National Securities Trading System (NSTS) of the Cincinnati Stock Exchange and executed in ITS/CAES or NSTS (as the case may be) at the price of the bid published by the broker-dealer for his proprietary account at the time the order is entered either:

(i) Under circumstances reasonably designed to preclude (A) all persons responsible for making bids and offers or effecting transactions for the broker-dealer's proprietary account in that security from having any knowledge of the existence of that customer's order prior to its entry in ITS/CAES or NSTS, and (B) all persons responsible for the solicitation of customers' orders or for the manner and timing of entry of such orders in that security in ITS/CAES or NSTS from having knowledge of positions or trading strategies then existing for the broker-dealer's proprietary account in that security; or

(ii) where (A) the broker-dealer's bid has not been raised for at least 30 seconds before receipt of the customer order, and (B) the size of such bid during such 30 second period has been equal to or greater than the size of the customer order or that portion of the customer order purchased by the broker-dealer.

(b) *Principal transactions in automated execution or derivative pricing systems.* No broker-dealer who provides executions to others within or by means of an automated execution or derivative pricing system shall buy a subject 19c-3 security for a proprietary account of the broker-dealer from any person within or by means of such a system, whether on an immediate or delayed basis, unless the broker-dealer (1) complies with paragraph (a)(1) of this rule, and (2) complies with the procedures set forth in paragraph (a)(2) or (a)(3) of this section with respect to the execution of such order. For purposes of applying paragraphs (a)(2) and (a)(3) to the execution of orders covered by this paragraph (b), all such orders shall be deemed customer orders whether or not the person for whose account the order is effected is a customer of the broker-dealer within the meaning of paragraph (g)(14) of this section.

(c) *Agency cross transactions.* No broker-dealer shall effect an agency cross transaction involving a subject Rule 19c-3 security unless such transaction is executed on or through the facilities of a national securities exchange or in ITS/CAES; *Provided, however,* that an ITS/CAES market maker may effect an agency cross transaction otherwise than on or through the facilities of a national securities exchange or in ITS/CAES (1) at a price higher than the best bid and lower than the best offer for the subject 19c-3 security then being disseminated by any ITS market(s) (if the spread between such best bid and best offer is ¼ or more); or (2) at a price equal to the best bid or best offer for the subject 19c-3 security then being disseminated by any ITS market(s) (if the spread between such best bid and best offer is ⅛).

(d) *Exclusions.* The provisions of this section shall not apply to: (1) A principal transaction or agency cross transaction involving a block of a subject Rule 19c-3 security effected on or through the facilities of a national securities exchange or with or through an ITS/CAES market maker, except as provided in paragraph (e) of this section;

(2) Any transaction which is part of a primary distribution by an issuer, or a registered or unregistered secondary distribution;

(3) Any transaction made in reliance on Section 4(2) of the Securities Act of 1933;

(4) Any trade at a price unrelated to the current market price for the subject Rule 19c-3 security involved for the purpose of correcting an error or to enable the seller to make a gift;

(5) Any transaction pursuant to a tender offer;

(6) Any purchase or sale of a subject Rule 10c-3 security effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire a subject Rule 19c-3 security at a pre-established consideration unrelated to the current market for such security;

(7) Any transaction in any subject security for less than 100 shares;

(8) Any transaction effected outside of normal operating hours of the ITS/CAES interface;

(9) Any transaction effected in any foreign country;

(10) Any principal transaction in a subject Rule 19c-3 security effected on or through the facilities of a national securities exchange or with or through an ITS/CAES market maker during any period when the principal exchange market for that security is relieved of its obligation to collect, process and make available to quotation vendors bids and offers in such security pursuant to paragraph (b)(3)(i) of § 240.11Ac1-1 (Rule 11Ac1-1 under the Act);

(11) Any principal transaction in a subject Rule 19c-3 security effected on or through the facilities of a national securities exchange during any period when such exchange is relieved of its obligation to collect, process and make available to quotation vendors bids and offers in such security pursuant to paragraph (b)(3)(i) of § 240.11Ac1-1 (Rule 11Ac1-1 under the Act;

(12) Any transaction effected in any opening or reopening of a stock in conformity with the provisions of the plan governing operation of ITS as approved by the Commission pursuant to § 240.11Aa3-2 (Rule 11Aa3-2 under the Act);

(13) Any transaction effected with an order (i) which was received within one minute of the close of the ITS market in which that transaction is effected, or (ii) as to which instructions were given to execute the order "at the close";

(14) Any purchase from a customer by a broker-dealer with respect to a non-marketable limit order of that customer if (i) there is published and maintained for at least 30 seconds prior to the purchase (and up to the time the purchase or sale is effected) an offer with respect to the customer order at the limit price of that order in a size at least equal to the number of shares purchased or sold; and (ii) for at least 30 seconds prior to the broker-dealer's purchase, that published offer price is equal to or lower than the price of the lowest offer published by any ITS market for the same security during that 30 second period. For purposes of this paragraph (d)(14), a "non-marketable limit order" shall mean a limited price order to sell at a price at least ⅛ above the price of the highest bid, published by any ITS market for the same security at the time the order was received;

(15) Any purchase from a customer by a broker-dealer with respect to any limit order in an ITS market which is executed in connection with a block transaction in that or another ITS market effected outside the best bid or best offer from any ITS market; and

(16) Any purchase from a customer by a broker-dealer on or through the facilities of a national securities exchange executed pursuant to a percentage order.

(e) *Exposure of block transactions.*

(1) On or before the last business day of the eighteenth month following the effective date of this section, the participants in the Intermarket Trading System shall jointly file with the Commission a plan establishing procedures for the exposure of covered block transactions prior to execution

("block exposure plan"). Such plan shall specify, at a minimum:

(i) The length of time, and the method by which, covered block transactions will be exposed;

(ii) Procedures designed to assure that buying and selling interest represented in any ITS market at the time a covered block transaction is exposed has a reasonable opportunity to respond to such exposure and, subject to the rules of priority, parity, and precedence in the market where the block transaction is to be effected, participates in the transaction;

(iii) Safeguards designed to prevent "step-ins" or other participation by any person whose interest in buying or selling the security which is the subject of the covered block transaction is not represented in an ITS market at the time the block transaction is exposed; and

(iv) Appropriate penalties in the event of non-compliance with the terms of the block exposure plan.

(2) The block exposure plan required by paragraph (e)(1) of this section shall be deemed to be a national market system plan within the meaning of § 240.11Aa3-2 (Rule 11Aa3-2 under the Act) and shall be considered by the Commission, and shall become effective, in accordance with the procedures specified in §240.11Aa3-2.

(3) Once the block exposure plan becomes effective pursuant to § 240.11Aa3-2, notwithstanding any other provision of this section, no broker-dealer shall effect any covered block transaction without complying with the provisions of such effective block exposure plan.

(f) *Exemptions.* The Commission may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, and broker, dealer, transaction or class of transactions if the Commission determines that such exemption is consistent with the public interest, the protection of investors the maintenance of fair and orderly markets or the removal of impediments to, and perfection of the mechanisms of, a national market system.

(g) *Definitions.* For purposes of this section, (1) The term "Rule 19c-3 security," shall mean any security listed and registered on a national securities exchange for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan, other than a "covered security" as defined in § 240.19c-3 (Rule 19c-3 under the Act).

(2) The term "effective transaction reporting plan" shall mean any plan approved by the Commission pursuant to § 240.11Aa3-1 (Rule 11Aa3-1 under the Act) for collecting, processing and making available transaction reports with respect to transactions in an equity security or class of equity securities.

(3) The term "transaction report" shall mean a report containing the price and volume associated with a completed transaction involving one or more round lots of a security.

(4) The term "subject Rule 19c-3 security" shall mean any Rule 19c-3 security which is eligible to be traded through the ITS/CAES Interface.

(5) The term "Intermarket Trading System" ("ITS") shall mean the intermarket communications linkage operated jointly by certain self-regulatory organizations pursuant to a plan filed with, and approved by, the Commission pursuant to § 240.11Aa3-2 (Rule 11Aa3-2 under the Act) ("ITS Plan").

(6) The term "participant," when used with respect to the Intermarket Trading System, shall mean any self-regulatory organization which is included in the ITS Plan and has agreed to act in accordance with the terms of the ITS Plan.

(7) The term "Computer Assisted Execution System" ("CAES") shall mean the computerized order routing and execution system owned and operated by the National Association of Securities Dealers, Inc. ("NASD") as part of the NASDAQ inter-dealer quotation system.

(8) The term "ITS/CAES" shall mean the linked trading systems connected by the ITS/CAES Interface.

(9) The term "ITS/CAES Interface" shall mean the automated interface between the ITS and CAES.

(10) The term 'ITS market" shall mean, with respect to any subject Rule 19c-3 security, any national securities exchange which is a participant in the ITS and trades such security through ITS and any ITS/CAES market maker in such security.

(11) The term "ITS/CAES market maker" shall mean, with respect to any subject Rule 19c-3 security, any third market maker that is registered as a market maker in such security with the NASD for purposes of use of ITS/CAES.

(12) The term "third market maker" shall mean, with respect to any subject Rule 19c-3 security, any broker-dealer who holds himself out as being willing to buy and sell such security for his own account on a regular or continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such person who also represents, as agent, orders to buy and sell such security on behalf of any other person and communicates bids and offers to a national securities association pursuant to § 240.11Ac1-1 (Rule 11Ac1-1 under the Act) on behalf of such other persons as well as for his own account).

(13) The term "broker-dealer" shall mean any broker or dealer.

(14) The term "customer" of a broker-dealer shall mean (i) any person other than a broker or dealer, except that the term "customer" shall include a broker or dealer (A) which, directly or indirectly controls, is controlled by, or is under common control with such broker-dealer, or (B) whose customers' accounts are introduced to the broker-dealer and are carried by it on either a disclosed or undisclosed basis; and (ii) any person from whom an order has been accepted by the broker-dealer for execution, but only with respect to orders so accepted.

(15) The term "proprietary account" shall mean any one or more accounts in which the broker-dealer has a direct or indirect interest.

(16) A bid or offer made available by a national securities exchange or national securities association pursuant to § 240.11Ac1-1 (Rule 11Ac1-1 under the Act) shall be deemed "published" when it is displayed on or through the facilities of such exchange or in CAES (as the case may be).

(17) The term "intended purchase price from the customer" in a principal transaction shall exclude any commission, commission equivalent, differential or comparable charge to be imposed by the broker-dealer in connection with the transaction.

(18) The term "block" shall mean a transaction involving 10,000 shares or more of a subject Rule 19c-3 security or a quantity of such security having a market value of $200,000 or more.

(19) The term "covered block transaction" shall mean a block of a covered Rule 19c-3 security which is an agency cross transaction or in which a broker-dealer buys such security from a customer for a proprietary account of the broker-dealer.

By the Commission.

December 23, 1982.

George A. Fitzsimmons,

Secretary.

[FR Doc. 82-35493 Filed 12-29-82; 8:45 am]

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BY-LAWS

NASD

National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 83-8

February 4, 1983

TO: All NASD Members And Interested Persons

RE: Amendments to Association By-Laws

Attached are amended By-Laws of the Association which are being published at this time for comment by members and interested persons. The proposal is the product of the Association's Committee on Rule and By-Law Amendments which is reviewing and revising all of the Association's By-Laws, Rules and Interpretations. The initial step in the Committee's review was adoption by the Board of Governors of a revised Code of Procedure for Handling Trade Practice Complaints which is currently on file with the Securities and Exchange Commission for approval. The enclosed revision of the By-Laws is the second step in the Committee's review and it has been approved by the Association's Board of Governors for submission to the membership for comment.

After the comment period expires, the amended By-Laws and the comment letters received will be submitted to the Committee for review and, thereafter, the By-Laws as may be further amended as a result of the comments received, will be resubmitted to the Board of Governors. If the By-Laws are approved by the Board, they will be submitted to the membership for a vote. If approved by the membership, the proposed amendments will be filed with the Securities and Exchange Commission for approval.

The proposed By-Law amendments are primarily designed to conform the language to certain statutory changes, codify existing Board interpretations, clarify the application of certain provisions and generally to update and modernize the By-Laws. Where appropriate, an explanation of the change follows each section. Some of the more significant changes are:

Article I defines the terms "municipal securities" and "municipal securities dealer" to parallel the statutory definitions thereof. The term "registered broker, dealer or municipal securities dealer" is defined to reflect the present statutory framework under which only brokers and dealers registered with the SEC are eligible for membership in the Association. The definition of "person associated with a member" has been revised to clarify that the Association's jurisdiction extends to all persons associated with a member although a person may not be engaged in the investment banking or securities business on behalf of the member.

Article II is a complete redrafting of the qualification requirements for members and associated persons. Section 1 thereof provides that any registered broker-dealer shall be eligible for admission to membership and any person shall be eligible to become an associated person of a member except those which are excluded under other provisions of the Article. Section 2 authorizes the Board of Governors to adopt examination and other qualification requirements for members and their associated persons. Section 3 provides that members and associated persons who fail to meet the qualification requirements or who are subject to bars or other disqualifications are not eligible for membership or association. It also establishes a procedure for seeking relief from such ineligibility. Section 4 contains a revised definition of "disqualification" consistent with the statutory definition of the term. It is broader than the Association's present definition because the statute has expanded the types of misconduct constituting disqualifications.

Article VII, Section 2, containing the general powers of the Board of Governors has been expanded by incorporating authority presently appearing in other By-Law provisions. Specifically, the authority to require members to use clearing agencies has been moved from existing Article XVII and the authority to organize automated systems has been transferred from present Article XVI. Article VII, Sections 21, 23 and 24 incorporate a recent Board of Governors' resolution that Nominating Committees should be composed of a majority of persons who have previously served on the District Committee and/or the Board of Governors.

Article X, Section 2 codifies the Association's authority to impose disciplinary sanctions based upon a refusal to submit a dispute to arbitration when required by the Association's Code of Arbitration Procedure and for failure to abide by any rulings of the Board of Governors or Uniform Practice Committee under the Association's Uniform Practice Code.

The Association encourages members and other interested persons to comment on the amended By-Laws. All comments should be directed to:

S. William Broka, Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Comments must be received no later than March 4, 1983. Any questions should be directed to John F. Mylod, Jr., Assistant General Counsel, at (202) 728-8288.

Sincerely,

Frank J. Wilson
Executive Vice President
Legal and Compliance

Attachment

NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 83-9

February 14, 1983

TO: All NASD Members

RE: Bell & Beckwith
234 Erie Street
Toledo, Ohio

ATTN: Operations Officer, Cashier, Fail-Control Department

On Thursday, February 10, 1983, the United States District Court for the Northern District of Ohio, Western Division, appointed a SIPC Trustee for the above-captioned firm. Previously, a temporary receiver had been appointed for the firm on February 5, 1983.

Members may use the "immediate close-out" procedures as provided in Section 59(i) of the NASD's Uniform Practice Code to close out open OTC contracts. Also, MSRB Rule G-12 (h)(iv) provides that members may use the above procedures to close out transactions in municipal securities.

Questions regarding the firm should be directed to:

SIPC Trustee

Patrick A. McGraw, Esquire
Fuller & Henry
P. O. Box 1956
Toledo, Ohio 43603

Telephone: (419) 255-8220

* * * *

NASD National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 83-10

February 22, 1983

TO: All NASD Members

ATTENTION: Officers, Partners, and Proprietors

RE: The Tax Equity and Fiscal Responsibility Act of 1982

BACKGROUND

On September 3, 1982, President Reagan signed into law the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA" or the "Act"). The purpose of the law was to raise nearly $100 billion in additional federal revenues through targeted tax increases and reform measures designed to improve taxpayer compliance.

It is anticipated that the new requirements prescribed by the Act and the attendant regulations being developed by the Internal Revenue Service will have a significant impact on the broker-dealer community. Because of this, it is essential that members become thoroughly familiar with the law and the accompanying regulations so that planning for the most cost-effective means for compliance can begin.

Although pressure is building to repeal certain aspects of the Act, there can be no assurance that any statutory changes will result. The IRS regulations are, however, simply proposals at this time and are not scheduled to become effective until July 1, 1983. It is hoped that recent appearances at public hearings by the NASD and other organizations have served to lessen some of the administrative burdens that may otherwise have developed. The NASD will continue to monitor all developments in this area and will alert members to changes in the law and the proposed regulations when, as and if they should occur.

The key provisions of the Act as they relate to the securities industry are as follows:

- a 10% withholding on dividends and interest including Original Issue Discount, i.e., debt obligations issued at a discount from par value;

- the reporting of interest and Original Issue Discount;
- the reporting on a transactional basis of the gross proceeds of customers' transactions; and,
- the registration of debt obligations.

A summary of each of these provisions of the TEFRA legislation, coupled with a discussion of the regulations that have been proposed to implement it, appears below.

WITHHOLDING ON INTEREST AND DIVIDENDS

For TEFRA purposes, all interest is subject to withholding including Original Issue Discount except:

- interest on an individual's debt;
- interest which is otherwise not subject to taxation;
- interest on All-Savers certificates;
- interest paid to nonresident alien individuals or a foreign corporation either already subject to withholding tax or exempted by a U.S. treaty;
- interest from a foreign source paid outside the United States by U.S. corporations;

Regarding dividends, the withholding rate is similarly applied to any dividend distribution made by a corporation to its shareholders that is not a return of capital or a capital gain dividend. This includes "short dividends" and most monies reinvested in a dividend reinvestment plan, except for dividend reinvestment plans of qualified public utilities.

A withholding rate of 10 percent must be applied to interest and dividends paid after June 30, 1983. The tax must be withheld when the interest or dividends are actually paid or credited to the account of a non-exempt payee. Generally this would place the primary liability to withhold on those who make the payment of the interest or dividend (i.e., the issuer). However, broker-dealers who act as intermediaries between such payors and their customers (e.g., they hold securities in safekeeping for customer accounts) will be obliged to effect the 10% withholding when they are paid or credited to a non-exempt customer's account.

The Act provides that regulations relating to the deposit of withheld taxes take into account the costs of implementing a withholding system. Therefore, the proposed regulations provide that for a one-year period — July 1, 1983 to June 30, 1984 — a payor may have use of the withheld funds for approximately 30 days before depositing them with an authorized financial institution or Federal Reserve Bank. The regulations provide for an extension of this time period through June 1986, depending on the size of the financial institution. At the moment, however, a "broker-dealer" is not included within the definition of this term in the proposed

415 which are registered on Form S-3. The earlier exemption was available to "shelf" offerings of large, closely-followed issuers when their securities were distributed through transactions in which broker/dealer compensation was limited by competitive market forces. The Association has concluded that these conditions are generally present in offerings which are made pursuant to Rule 415 and registered on Form S-3. Therefore, the Association has determined that all offerings made pursuant to Rule 415 and registered on Form S-3 are exempt from the filing requirements of the Corporate Financing Interpretation. Those offerings, however, remain subject to the substantive requirements of the Corporate Financing Interpretation. In addition, any offering which comes within the provisions of Schedule E to the Association's By-Laws (NASD Manual (CCH) Para. 1402) is required to be filed with the Association unless exempt from the Schedule E filing requirements.

* * * *

Any questions concerning this Notice may be directed to Dennis C. Hensley or Suzanne E. Rothwell of the Corporate Financing Department at (202) 728-8258.

Sincerely,

Frank J. Wilson
Executive Vice President
Legal and Compliance

NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 83-11

February 22, 1983

TO: All NASD Members

RE: Formation of Federal Task Group on Regulation of Financial Services

Recently, Norman T. Wilde, Jr., Chairman of the NASD, received a letter from Vice President George Bush advising of the Administration's formation of a Task Group to review the existing system of federal regulation of financial institutions and services.

The Vice President explained in his letter that the Task Group would very much appreciate obtaining the views of interested organizations and individuals on the issues it intends to study. He also states that the Task Group ". . .also hope(s) to obtain specific suggestions on how best to reform or streamline the federal regulatory structure, including areas in which the role and responsibilities of self-regulatory organizations could be enhanced."

In order to obtain responses from the largest number of individuals, institutions and organizations, Mr. Bush has asked the Association to inform its members of his request for public comment and urge them to reply individually or collectively.

The Board of the Association believes that the issues to be explored by the Task Group are extremely far-reaching and worthy of thoughtful reflection. As the change our industry is experiencing continues, (see the NASD's Special Report entitled The Financial Services Industry of Tomorrow, dated November 1982), it makes great sense for those who are at the focal point of this change to participate directly in the process that may shape the future framework within which they will operate. The Association therefore strongly encourages each and every member to consider the issues under study by the Task Group and to thereafter provide it with constructive comments and helpful suggestions. March 14, 1983, has been set as the comment deadline date.

To assist members in their review of the Task Group study project, a copy of the Vice President's letter and a reprint of the Federal Register announcement of the study and request for public comment are enclosed.

To assist the Association in the formulation of its long range policy planning, it would be appreciated if copies of letters to be sent to the Task Group were simultaneously provided the NASD. Kindly send them to the attention of:

S. William Broka
Corporate Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D. C. 20006

Questions concerning this notice may be directed to Douglas F. Parrillo, Vice President, Department of Policy Research, at (202) 728-8272.

Sincerely,

Gordon S. Macklin
President

Enclosures

Notice to members 83-11

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NOT AVAILABLE AT THIS TIME

Notice to members 83-11

PAGE 4

NOT AVAILABLE AT THIS TIME

Customers must also be provided with a copy of any information returns made to the IRS.

Exemptions

These reporting requirements are not applicable to sales effected for customers who are exempt from the withholding requirements previously noted.

Method of Reporting

In general, a member who effects sales for 250 or more customers may, in lieu of filing Forms 1099, submit the aforementioned information to the IRS on computer readable magnetic tapes or disks which have been authorized by the IRS. The IRS will consider the submission of broker returns on other media if undue hardship is shown through an application filed with it.

WITHHOLDING AND REPORTING OF ORIGINAL ISSUE DISCOUNT ("OID")

The provisions with respect to Original Issue Discount are perhaps the most complex in the proposed regulations. They are summarized below.

Short-Term Obligations

A "short-term obligation" is defined in the regulations as one with a fixed maturity date not exceeding one year from the date of issuance. The withholding requirements for this type of security are as follows:

- The amount of OID will be subject to withholding only at maturity.
- If a payment of interest is paid or credited prior to maturity, such interest will be subject to withholding at that time.
- If the instrument is transferred before maturity, the purchaser would be subject to the amount of OID at maturity determined on the basis of his purchase price in the secondary market.

Long-Term Obligations

- If no periodic payments of interest are made before maturity, withholding is required at maturity for only the amount of OID includable in the holder's gross income for the year in which the obligation matures.
- On registered long-term instruments with periodic interest payments prior to maturity, withholding is required on the interest and, pursuant to the amortization procedure prescribed, on the OID includable in the gross income of the holder for the calendar year of the payment.
- Long-term bearer obligations with periodic interest payable before maturity requires withholding on the payment but not on any OID.

- If a long-term obligation is transferred prior to maturity, the subsequent holder will be subject to withholding as if he were the original holder, notwithstanding his purchase price in the secondary market.

Original Issue Discount Reporting

- Reporting requirements will apply only to instruments with a maturity date of more than one year.

- The amount of Original Issue Discount must be reported each year under the amortization method described by the regulation which is based on a yield to maturity, compounding method.

Although reporting on Original Issue Discount obligations was scheduled to be effective January 1, 1983, the IRS has announced that penalties for failure to report will be suspended until April 1, 1983, for short-term obligations and July 1, 1983, for long-term obligations.

Because of the complexity of the regulations, the lack of reference data with respect to OIDs and the changes with respect to the computation of Original Issue Discount, the Association has gone on record with the IRS that compliance with both the reporting and withholding requirements would be difficult, if not impossible, to achieve, and has expressed the opinion that corrective legislation should be introduced to eliminate the requirements under TEFRA with respect to Original Issue Discount obligations. We hope to hear more on this subject shortly.

REGISTRATION OF DEBT OBLIGATIONS

Effective July 1, 1983, most debt obligations will be required to be issued in registered form. The Act exempts from this registration requirement:

- securities with maturities of one year or less;

- securities which are not of a type offered to the public;

- securities which are sold to non-U.S. nationals and are payable outside the United States.

Debt obligations of the United States and those of state and local governments must also be issued in registered form. Failure of an issuer to issue its debt securities in registered form will result in a loss of tax-exempt status for interest on these obligations, a denial of the taxpayer's deductions for the related interest and a disallowance of the issuer's tax deduction for the related interest expense. Obligations may also be considered issued in registered form if transfer is effected through a book entry system. The law further directs that a book entry registration system be established by regulation which would require that the rights to principal and interest can be transferred only by means of such book entry.

ASSOCIATION ACTIVITIES WITH RESPECT TO THE IMPLEMENTATION OF TEFRA

The Association has taken an active role in attempting to assess the impact of the new law by identifying various areas of concern to its members. In addition to participating in a working conference on the regulations sponsored by the IRS, the proposed regulations were reviewed by the Association's Municipal and Uniform Practice Committees which made certain recommendations to the NASD Board of Governors concerning the regulations. As a result of this review, on January 14, 1983, the Association filed an extensive comment letter to the IRS expressing its opposition to the burdens posed by the regulations.

Additionally, the Association participated in public hearings which were held by the IRS on January 25, 27, and February 1, 1983, and reinforced its comments in several major areas; namely, interest and Original Issue Discount reporting; information reporting of broker-dealers; and regulations with respect to withholding on dividends and interest.

Henry C. Alexander, Vice President and Director of Operations and Systems for Merrill Lynch Capital Markets Group and Chairman of the Association's Uniform Practice Committee, acted as the Association's principal spokesman. Also representing the Association were William Jennings, Chief Financial Officer, Salomon Brothers and an officer with the Wall Street Tax Association; Roger Gerber, a partner with Fahnstock and Company also with the Wall Street Tax Association; Wendie Wachtel, Vice President, Wachtel and Company, Washington, D.C., and a member of District Committee No. 10; and Thomas McAuliffe, Director of Operations for Bellamah, Neuhauser and Barrett in Washington, D.C. These individuals provided broad based representation for the Association's membership since their firms ranged from those with a manual recordkeeping system to those with sophisticated automated systems.

* * *

Since the regulations are not yet final, the purpose of this notice is simply to alert members to what is coming and to encourage them to make the necessary preparations.

The Association will disseminate the final regulations under TEFRA, complete with explanations, shortly after their publication.

* * *

Questions concerning TEFRA or any of the applicable regulations thereunder may be directed to James M. Cangiano at (202) 728-8273. Copies of the Association's comment letters and testimony presented to the IRS at the TEFRA hearings are available upon request.

Sincerely,

John T. Wall
Executive Vice President
Member and Market Services