

ARTICLE XI

COMMITTEES

National Standing Committees

Sec. 1. The Board of Governors may appoint such standing and other committees as it deems necessary or desirable, and it shall fix their powers, duties and terms of office.

District Standing Committees

Sec. 2. Each District Committee, in the exercise of its powers and performance of its duties as provided in the By-Laws, may, except as otherwise herein provided, appoint such standing or other committees or subcommittees as it deems necessary or desirable, and shall fix their powers, duties and terms of office.

Removal of Committee Member

Sec. 3. Any member of any committee appointed pursuant to Sections 1 or 2 of this Article may be removed from office, after appropriate notice from the District Committee appointing such member, or from the Board of Governors, if it is the appointing authority, for refusal, failure, neglect or inability to discharge his duties, or for any cause the sufficiency of which shall be decided by the District Committee or the Board of Governors, whichever is the appointing authority.

Executive Committee

Sec. 4. By resolution passed not less than annually by a majority of the entire Board of Governors, there may be created an Executive Committee, consisting of five or more members of the Board which shall exercise such of the powers of the Board in the management of the Corporation between meetings of the Board of Governors as may be delegated to it from time to time by the Board. The Executive Committee created hereunder shall keep minutes of its meetings and shall report its proceedings to the Board of Governors at the next meeting thereof.

ARTICLE XII

RULES OF FAIR PRACTICE

To promote and enforce just and equitable principles of trade and business, to maintain high standards of commercial honor and integrity among members of the Corporation, to prevent fraudulent and manipulative acts and practices, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, to protect investors and the public interest, to collaborate with governmental and other agencies in the promotion of fair practices and the elimination of fraud, and in general to carry out the purposes of the Corporation and of the Act, the Board of Governors is hereby authorized to adopt for submission to the members of the Corporation such Rules of Fair Practice for the members and persons associated with members, and such amendments thereto as it may, from time to time, deem necessary or appropriate. The Board of Governors, upon the adoption of any such Rules of Fair Practice or amendments thereto, shall forthwith cause copies thereof to be sent to each member of the Corporation to be

voted upon. If any such Rules of Fair Practice or amendments thereto are approved by a majority of the members voting, within thirty (30) days after the date of submission to the membership, and are approved by the Commission as provided in the Act, they shall become effective Rules of Fair Practice of the Corporation as of such date as the Board of Governors may prescribe. In any case, however, where a particular provision of a Rule of Fair Practice provides that membership approval is not required, the Board may amend that provision without submission to the membership for a vote as hereinbefore required. In addition, where the Board of Governors by resolution finds an emergency to exist, such Rules of Fair Practice or amendments thereto, if adopted by a two-thirds vote of the Board of Governors, may become effective as of such time as the Board of Governors may prescribe, without submission to the members for a vote as hereinbefore required. An emergency which is found by the Board of Governors to exist shall continue until the Board of Governors by resolution terminates such but in no event shall an emergency continue for a period in excess of six months. The Board of Governors shall have the authority, however, after, in each instance, reassessing the facts and circumstances which gave rise to the emergency, by resolution to declare, if it deems such appropriate under the facts and circumstances then existing, the emergency to continue to exist for successive six-month periods as required. All emergency rules adopted during the period of the emergency shall cease to be effective upon the termination of the emergency as hereinbefore provided. The Board of Governors is hereby authorized, subject to the provisions of the By-Laws and the Act, to administer, enforce, suspend, or cancel any Rules of Fair Practice adopted hereunder.

ARTICLE XIII

DISCIPLINARY PROCEEDINGS

Sec. 1. The Board of Governors shall have authority to establish procedures relating to disciplinary proceedings involving members and their associated persons, and neither the adoption nor any amendment to such procedures need be submitted to the membership for approval and such procedures and any amendments thereto shall become effective as the Board of Governors may prescribe.

Sec. 2. Except as otherwise permitted under these By-Laws or the Act, in any disciplinary proceeding before the Corporation, any member or person associated with a member shall be given the opportunity to have a hearing at which he shall be entitled to be heard in person and/or by counsel. Such persons may present any relevant material. In any such proceeding against a member or against a person associated with a member to determine whether the member and/or the person associated with a member shall be disciplined:

- (a) specific charges shall be brought;
- (b) such member or person associated with a member shall be notified of and be given an opportunity to defend against such charges;
- (c) a record shall be kept; and
- (d) any determination shall include a statement setting forth:

- (1) any act or practice, in which such member or person associated with a member may be found to have engaged or which such member or person associated with a member may be found to have omitted;
- (2) the rule, regulation or statutory provision of which any such act or practice, or omission to act, is deemed to be in violation;
- (3) the basis upon which any findings are made; and
- (4) the penalty imposed.

ARTICLE XIV

POWER OF BOARD TO PRESCRIBE SANCTIONS

The Board of Governors is hereby authorized to prescribe appropriate sanctions applicable to members, including censure, fine, suspension or expulsion from membership, suspension or barring from being associated with all members, limitation of activities, functions and operations of a member, or any other fitting sanction, and to prescribe appropriate sanctions applicable to persons associated with members, including censure, fine, suspension or revocation of registration, if any, suspension or barring a person associated with a member from being associated with all members, limitation of activities, functions and operations of a person associated with a member, or any other fitting sanction, for:

- (a) breach by a member or a person associated with a member of any covenant with the Corporation or its members;
- (b) violation by a member or a person associated with a member of any of the terms, conditions, covenants, and provisions of the rules of the Corporation, the federal securities laws, including the rules and regulations adopted thereunder, and the rules of the Municipal Securities Rulemaking Board;
- (c) failure by a member or person associated with a member to submit a dispute for arbitration under the Code of Arbitration Procedure ("Code") as required by the Code, or to fail to appear or to produce any document in their possession or control as directed pursuant to provisions of the Code, or to fail to honor an award of arbitrators properly rendered pursuant to the Code where a timely motion has not been made to vacate or modify such award pursuant to applicable law;
- (d) refusal by a member or person associated with a member to abide by an official ruling of the Board of Governors or Uniform Practice Committee acting within its appropriate authority, with respect to any transaction which is subject to the Uniform Practice Code; or
- (e) failure by a member or a person associated with a member to adhere to any ruling, order, direction or decision of, or to pay any penalty, fine or costs, imposed by, the Board of Governors or any District Business Conduct Committee.

ARTICLE XV

UNIFORM PRACTICE CODE

Authority to Adopt Code

Sec. 1. The Board of Governors is hereby authorized to adopt a Uniform Practice Code and amendments, interpretations and explanations thereto, designed to make uniform, where practicable, custom, practice, usage, and trading technique in the investment banking and securities business with respect to such matters as trade terms, deliveries, payments, dividends, rights, interest, reclamations, exchange of confirmations, stamp taxes, claims, assignments, powers of substitution, computation of interest and basis prices, due-bills, transfer fees, "when, as and if issued" trading, "when, as and if distributed" trading, marking to the market and close-out procedure, all to the end that the transaction of day-to-day business by members may be simplified and facilitated, that business disputes and misunderstandings, which arise from uncertainty and lack of uniformity in such matters, may be eliminated, and that the mechanisms of a free and open market may be improved and impediments thereto removed. Neither the adoption nor any change in the Uniform Practice Code need be submitted to the membership for approval and the Code as adopted or amended shall become effective at such time as the Board of Governors may prescribe.

Administration of Code

Sec. 2. The administration of any Uniform Practice Code, or any amendment thereto, adopted by the Board of Governors pursuant to Section 1 of this Article, shall be vested in the Board of Governors, and the Board is hereby granted such powers as are reasonably necessary to achieve its effective operation. In the exercise of such powers, the Board may issue explanations and interpretations and make binding rulings with respect to the applicability of the provisions of this Code to situations in which there is no substantial disagreement as to the facts involved. The Board may delegate to appropriate committees such of its powers, hereunder as it deems necessary and appropriate to achieve effective administration and operation of the Code.

Transactions Subject to Code

Sec. 3. All over-the-counter transactions in securities by members, except transactions in securities which are exempted under Section 3(a)(12) of the Act, or are municipal securities as defined in Section 3(a)(29) of the Act, are subject to the provisions of the Uniform Practice Code and to the provisions of Section 2 of this Article unless exempted therefrom by the terms of the Code.

ARTICLE XVI

LIMITATION OF POWERS

Prohibitions

Sec. 1. Under no circumstances shall the Board of Governors or any officer, employee or member of the Corporation have power to:

(a) make any donation or contribution from the funds of the Corporation or to commit the Corporation for the payment of any donations or contributions for political or charitable purposes; or

(b) use the name or facilities of the Corporation in aid of any political party or candidate for any public office.

Use of Name of Corporation by Members

Sec. 2. No member shall use the name of the Corporation except to the extent that may be authorized by the Board of Governors.

Unauthorized Expenditures

Sec. 3. No officer, employee, member of the Board of Governors or of any District or other Committee, shall have any power to incur or contract any liability on behalf of the Corporation not authorized by the Board of Governors. The Board may delegate to the President of the Corporation, or his delegate, such authority as it deems necessary to contract on behalf of the Corporation or to satisfy unanticipated liabilities during the period between Board meetings.

Conflicts of Interest

Sec. 4. No member of the Board of Governors or of any committee of the Corporation shall directly or indirectly participate in any adjudication of the interests of any party which would at the same time substantially affect his interest or the interests of any person in whom he is directly or indirectly interested. In any such case, the member shall disqualify himself or shall be disqualified by the Chairman of the Board or Committee.

Municipal Securities

Sec. 5 The provisions of the By-Laws conferring rulemaking authority upon the Board of Governors shall not be applicable to the municipal securities activities of members or persons associated with members to the extent that the application of such authority would be inconsistent with Section 15B of the Act.

ARTICLE XVII

PROCEDURE FOR ADOPTING AMENDMENTS TO BY-LAWS

Any member of the Board of Governors by resolution, any District Committee by resolution, or any twenty-five members of the Corporation by petition signed by such members, may propose amendments to these By-Laws. Every proposed amendment shall be presented in writing to the Board of Governors and a record shall be kept thereof. The Board of Governors may adopt any proposed amendment to these By-Laws by affirmative vote of a majority of the members of the Board of Governors then in office. The Board of Governors, upon adoption of any such amendment to these By-Laws, except as otherwise provided in these By-Laws shall forthwith cause a copy to be sent to and voted upon by each member of the Corporation. If such amendment to these By-Laws is approved by a majority of the members voting within thirty (30) days after the date of submission to the membership, and is approved by the Commission as provided in the Act, it shall become effective as of such date as the Board of Governors may prescribe.

ARTICLE XVIII

CORPORATE SEAL

The corporate seal shall have inscribed thereon the name of the Corporation, the year of its organization and the words "Corporate Seal, Delaware." Said seal may be used by causing it or a facsimile thereof to be imposed or affixed or reproduced or otherwise.

ARTICLE XIX

CHECKS

All checks or demands for money and notes of the Corporation shall be signed by such officer or officers or such other person or persons as the Board of Governors may from time to time designate.

ARTICLE XX

ANNUAL FINANCIAL STATEMENT

As soon as practicable from the end of each fiscal year, the Board of Governors shall send to each member of the Corporation a reasonably itemized statement of receipts and expenditures of the Corporation for such preceding fiscal year.

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CODE OF PROCEDURE *

ARTICLE I

APPLICATION AND PURPOSE OF CODE

Purpose

Sec. 1. (a) This Code of Procedure shall apply to proceedings relating to disciplinary actions involving members and associated persons; to proceedings relating to eligibility requirements; to proceedings relating to limitation or denial of access to services; and to any other proceeding when the Corporation deems it appropriate.

(b) Unless otherwise specified, persons associated with a member ("associated persons") shall have the same rights as members and shall be subject to the same duties and obligations under the Code of Procedure.

Definitions

Sec. 2. (a) Unless otherwise provided, terms used in the Code of Procedure shall have the meaning as defined in Article I of the By-Laws and Article II, Section 1 of the Rules of Fair Practice.

(b) The term "Committee" used in the Code of Procedure shall mean either a District Business Conduct Committee or the Market Surveillance Committee.

(c) The "Market Surveillance Committee" is a standing committee of the Board of Governors which is responsible for handling alleged violations of applicable rules of the Corporation concerning trading of securities, including applicable rules involving quotations, transaction execution and reporting, trading practices and insider trading as well as other such matters delegated to it by the Board of Governors.

(d) The "National Business Conduct Committee" is a standing committee of the Board of Governors which is authorized to exercise powers delegated to it by the Board in connection with disciplinary and other matters.

*

The text herein reflects amendments to Articles VI, VII and X which have been filed with the Securities and Exchange Commission in File No. SR-NASD-85-2 but which are not yet effective. See, Securities Exchange Act Release No. 21839 (March 12, 1985). These amendments codify existing Association practice. The Association anticipates that, absent significant adverse comment, the Commission will approve these amendments in the near future. Pending Commission approval, the Association will nevertheless act in accordance with the amended text.

Interpretation

Sec. 3. The provisions of the Code of Procedure shall not be construed to limit the By-Laws or Rules of the Corporation.

Communications Relating to Grievances

Sec. 4. Communications received by the Corporation from any person regarding any grievance against a member or person associated with a member need not be considered privileged communications and may be dealt with by the Corporation as it considers to be fair and proper under the circumstances.

ARTICLE II

DISCIPLINARY ACTIONS BY DISTRICT BUSINESS CONDUCT COMMITTEES, THE MARKET SURVEILLANCE COMMITTEE AND OTHERS

Issuance of Complaints by Committees

Sec. 1. If a Committee believes that the nature and extent of the probable violations require disciplinary action, the Committee may issue a complaint as set forth in Section 2 of this Article. The issuance of any complaint by any other person shall also be in accordance with Section 2 of this Article.

Form, Content, Notice and Withdrawal of Complaints

Sec. 2. (a) All complaints shall be made in writing, on the form to be supplied by the Board of Governors, and shall specify in reasonable detail the nature of the charges and the rule, regulation or statutory provision allegedly violated. The party making the complaint shall be termed the complainant and the party against whom the complaint is made shall be termed the respondent. If the complaint consists of several allegations, each such allegation shall be stated separately. All complaints must be signed by the complainant and should be directed to any Committee. A copy of the complaint shall be sent to all respondents and to the member of the Corporation with whom any respondent is presently an associated person.

(b) After prior approval by the National Business Conduct Committee, a complaint may be withdrawn by a Committee at any time prior to the issuance of a written decision. Withdrawal of a complaint shall not preclude a Committee from filing a complaint at a future date involving the same allegations.

Answers to Complaints

Sec. 3. (a) All answers to complaints shall be in writing on the form to be supplied by the Board of Governors, and shall be submitted to the Committee within 20 calendar days from the date of the complaint sent to the respondent. The Committee may extend the 20 calendar day period for good cause. The Committee, upon the receipt of the answer of the respondent, shall forthwith, on the form to be supplied by the Board of Governors, send notice in writing of the receipt of such answer, together with a copy of such answer, to the complainant, if other than a Committee.

(b) If a complaint is amended, the time period for filing an answer or amended answer shall be extended for 10 calendar days from the date of the amended complaint. If an answer has already been filed, a respondent shall have 10 calendar days from the date of the amended complaint within which to file an amended answer.

(c) If no answer is received by the Committee within the time required, the Committee shall send a second notice, on the form to be supplied by the Board of Governors, to the respondent by certified mail, return receipt requested, requiring an answer within ten calendar days from the date of the second notice, or within such longer period as the Committee in its discretion may determine, stating that failure of the respondent to reply within the period specified may be treated by the Committee as an admission of the allegations of the complaint. If no answer is received by the Committee within the time required by the second notice, the Committee may consider the allegations of the complaint as admitted by the respondent.

(d) In complaints involving multiple respondents, copies of the answers submitted by each respondent shall be mailed promptly by the Corporation to all other respondents.

Request for Hearing

Sec. 4. Upon the filing of an answer and due notice thereof to the complainant, either the complainant, if other than a Committee, or the respondent may request a hearing before the Committee having jurisdiction to hear the complaint. If a request is made, a hearing shall be granted complainant and respondent. In the absence of a request for a hearing, the Committee may order any complaint set down for hearing. A notice stating the date, time and place of the hearing shall be mailed to both complainant and respondent at least 10 calendar days before the hearing, unless extraordinary circumstances require a shorter notice period, or unless the notice period is waived.

Venue

Sec. 5. (a) Normally, complaints before a District Business Conduct Committee shall be considered by the District Business Conduct Committee of the district in which the principal office of the member is located. If the act or omission which is the subject of the complaint occurred entirely or largely in a branch office of a member, the complaint shall be considered by the District Business Conduct Committee of the district in which the branch office is located. Complaints before the Market Surveillance Committee shall be considered at the time and place established by that Committee or its hearing panel established pursuant to Section 6(b), below.

(b) The Committee considering the matter may be changed, if:

(1) the respondents, in writing, consent to having the complaint considered by some other Committee and such action is approved by the Committee having jurisdiction; or

(2) the National Business Conduct Committee determines that the circumstances make it appropriate to transfer the matter to another Committee; or

(3) a respondent has requested, in writing, a change in the Committee considering the matter, specifying the basis for the request, and the National Business Conduct Committee grants the request.

(c) In the event the Committee considering a complaint is changed, the complaint shall be processed to completion by the Committee to which the complaint was transferred. In the event the boundaries of one or more districts should be changed any complaint pending in a district shall be processed to completion by the District Business Conduct Committee for the newly constituted district which would have had jurisdiction had the complaint been filed subsequent to the effective date of the boundary changes.

(d) For the purpose of proceedings under this Code, the principal office of the member shall be the office so designated in the member's application for membership.

Hearing Panels

Sec. 6. (a) The entire District Business Conduct Committee may sit as a hearing panel, or it may appoint a hearing panel of three or more persons, all of whom are associated with members of the Corporation, at least two of whom shall also be members of the District Business Conduct Committee unless otherwise directed by the National Business Conduct Committee.

(b) The entire Market Surveillance Committee may sit as a hearing panel or that committee may appoint a hearing panel consisting of three or more persons, all of whom are persons associated with members of the Corporation or with issuers whose securities are included in an automated quotation system of the Corporation, at least one of whom shall be a member of the Market Surveillance Committee.

(c) The requirements regarding composition of the hearing panel contained in Sections 6 (a) and 6 (b), above, may be waived by mutual consent of respondent and complainant.

(d) If respondents waive a hearing, and the Committee does not order a hearing on its own motion, the panel shall consider the matter on the record, which shall include all evidence submitted by the respondents and the complainant, all of which shall have been previously tendered by each party to the other.

(e) If a hearing panel is appointed, as provided in Sections 6(a) and 6(b) above, the hearing panel shall, after the hearing or upon its consideration of the record, present its recommended findings and sanctions to the full Committee, which shall make the final determination by a majority vote of those present and voting at a duly constituted meeting thereof.

Evidence and Procedure in Committee Hearings

Sec. 7. (a) The Committee staff, or the complainant, if other than a Committee, shall upon request make available to respondents and their counsel any

documentary evidence the staff intends to present at the hearing within a reasonable time before the hearing.

(b) Respondents shall submit to the Committee staff or the complainant, any documentary evidence respondents intend to present at the hearing within a reasonable time before the hearing.

(c) If a hearing is held, both the complainant and the respondent shall be entitled to be heard in person and by counsel. Formal rules of evidence shall not be applicable. Notwithstanding paragraphs (a) or (b), the parties may submit any additional documentary evidence at the hearing as the hearing panel, in its discretion, determines may be relevant and necessary for a complete record. A record of the hearing shall be kept in all cases.

Decision of the Committee

Sec. 8. (a) If the Committee determines that a violation alleged in the complaint has occurred, it shall issue a written decision which shall set forth:

(1) the act or practice which the respondent has been found to have engaged in or omitted;

(2) the rule, regulation or statutory provision which such act, practice or omission to act is deemed to violate;

(3) the basis upon which the findings are made; and

(4) the sanction imposed and the reason therefore.

(b) If the Committee determines that no violation charged in the complaint has occurred, it shall dismiss the complaint in writing.

(c) The decision of the Committee shall become final on the next business day following the expiration of a 45 calendar day period from the date of the decision, unless appealed or called for review under Article III, Section 1 of this Code.

(d) A copy of any written decision shall be sent to all respondents and the complainant named in the complaint and to each member of the Corporation with whom a respondent is presently an associated person.

Consolidation of Complaints

Sec. 9. (a) A Committee may consolidate proceedings involving two or more complaints where common questions of law or fact are involved, the evidence offered with respect to each proceeding may have a bearing on the other, and the consolidation will result in savings of time and expense. The Committee shall send written notice of the proposed consolidation to all respondents, together with copies of the complaints to be consolidated and answers of the respondents, and allow respondents 10 calendar days from the date of notification in which to submit any written objections. If objections are received, a determination shall be made by the Committee whether, in view of such, the consolidation should be effected.

(b) If the complaints sought to be consolidated were issued by more than one Committee, the Committee that proposes to take jurisdiction of the consolidated proceeding shall submit a written proposal for consolidation to the respondents and the National Business Conduct Committee. The proposal shall include copies of the relevant complaints and the answers of respondents. The respondents shall be allowed 10 calendar days from the date of notification in which to submit any written objections to the National Business Conduct Committee. If objections are received, a determination shall be made by the National Business Conduct Committee whether in view of such, the consolidation shall be effected. If the request for consolidation is granted, the Committee given jurisdiction shall send written notice of the consolidation to respondents. Respondents may submit an answer, or amend a previous answer, 10 calendar days from the date of such notice of consolidation.

Acceptance, Waiver and Consent and Summary Complaint Procedures

Sec. 10. A Committee may, prior to issuance of a complaint under Section 1 of this Article, impose disciplinary penalties pursuant to the procedures set forth under this Section 10.

Acceptance, Waiver and Consent of the Respondent

(a) If the Committee has reason to believe a violation has occurred and the member or associated person does not dispute the violation, the Committee may suggest that the member or associated person submit a letter containing an acceptance of a finding of violations, a waiver of all rights of appeal to the Board of Governors, the Securities and Exchange Commission and the courts or to otherwise challenge or contest the validity of the Order issued if the letter is accepted, and a consent to the imposition of sanctions. The letter shall describe the act or practice engaged in or omitted; the rule, regulation or statutory provision violated; and the sanction to be imposed therefor. If the Committee then concludes that the Letter of Acceptance, Waiver and Consent is appropriate and should be accepted, it shall be submitted to the National Business Conduct Committee. If the letter is accepted by the National Business Conduct Committee, it shall become final and shall constitute the complaint, answer and decision in the matter. If the letter is rejected by either Committee, any acceptances, waivers and consents contained therein shall not be considered in any further complaint action which may be taken against the member or associated person.

Summary Complaint Procedure

(b) (1) In any case in which a Committee is of the opinion that the facts are not in dispute, that the acts, practices and conduct involved constitute a violation or violations of a rule, regulation, or statutory provision and that following the complaint procedure contained in Article II, Section 1 of this Code does not appear to be appropriate, the Committee may offer the respondent an opportunity to waive a hearing and accept Summary Complaint Procedure as hereinafter set forth.

(2) Summary Complaints shall be in writing on a form to be approved by the Board of Governors and shall specify in reasonable detail the nature of the charges, the rule, regulation, or statutory provision which such act, practice or omission to act is alleged to have been violated and the sanction

deemed appropriate in the circumstances; provided, however, the sanction for all violations alleged shall not exceed censure and/or a fine of \$2,500 as to each respondent.

(3) An offer by a Committee to follow the Summary Complaint Procedure outlined in paragraphs (1) and (2) above shall include notice to the respondent:

(i) that the respondent may reject the Summary Complaint Procedure, in which case the regular complaint procedure will be followed;

(ii) that unless an acceptance of the offer is received by the Committee within 10 business days after the date of receipt of the complaint by the respondent, and unless this period is extended by the Committee, the offer will be considered as rejected by the respondent and the Committee will follow the regular complaint procedure; and

(iii) that the respondent may accept the offer by executing and returning to the Committee the number of copies of the complaint and other related documents as specified in the form together with a remittance in the amount of any fine proposed to be imposed.

(4) Acceptance by a respondent of an offer as described above shall constitute the respondent's admission of the violations, acceptance of the sanction and a waiver of all rights of appeal to the Board of Governors, the Securities and Exchange Commission and the courts or to otherwise challenge or contest the validity of the decision, and the complaint and related documents shall constitute the Committee's decision and the record in the case. Receipt of respondent's acceptance by the Committee shall conclude the proceedings as of the date the acceptance is received, without further notice to the respondent, under the conditions stated in the offer, subject to paragraphs (5) and (6).

(5) Where there is more than one respondent, and upon the rejection of such an offer by any respondent, the Committee, at its option, may terminate the proceedings as to any or all of the remaining respondents and, in the event of such termination, the Committee with jurisdiction shall file a complaint under Article II, Section 1 of this Code as to those respondents rejecting the offer and such others as are deemed necessary.

(6) The National Business Conduct Committee may institute review proceedings within 45 calendar days after receipt of respondent's acceptance by the Committee and such review shall operate as a stay of any such action. The National Business Conduct Committee may thereafter dismiss one or more charges and/or reduce the sanction or remand the matter to the Committee with instructions to institute complaint procedure under Article II, Section 1 of this Code.

(7) If it becomes necessary for the Committee having jurisdiction to file a complaint against the respondent under Article II of this Code, the respondent shall not be prejudiced in any way by the prior offer of Summary Complaint Procedure and the complaint and acceptance thereof based upon the Summary Complaint Procedure shall be of no effect and be given no consideration in any determination of the issues involved in any such complaint.

Settlement Procedure

Sec. 11. (a) A respondent in a proceeding before a Committee may at any time propose in writing an Offer of Settlement of the complaint to the Committee.

(b) Offers of Settlement must be made in conformity with the provisions of this Section and they should not be made frivolously or propose a sanction inconsistent with the seriousness of the violations to be found.

(c) Every Offer of Settlement shall be in writing and shall contain in reasonable detail:

(1) the act or practice which the member or person associated with a member is alleged to have engaged in or omitted;

(2) the rule, regulation, or statutory provision which such act, practice or omission to act is alleged to have been violated;

(3) a statement that the respondent consents to findings of fact and violations consistent with the statements contained in the Offer required by paragraphs (c)(1) and (c)(2);

(4) a proposed sanction to be imposed; and

(5) a waiver of all rights of appeal to the Board of Governors, the Securities and Exchange Commission and the courts or to otherwise challenge or contest the validity of the Order issued if the Offer of Settlement is accepted.

(d) If an Offer of Settlement is accepted by a Committee, it shall propose an Order of Acceptance of Offer of Settlement. The proposed Order shall make findings of fact, including a statement of the rule, regulation or statutory provision violated, and impose sanctions consistent with the terms of the Offer of Settlement.

(e) Before any such Order of Acceptance of Offer of Settlement shall become effective it must be submitted to and approved by the National Business Conduct Committee, which is hereby delegated authority to accept or to reject an Offer of Settlement. If the National Business Conduct Committee by a majority vote approves the Committee's Order, it shall communicate its conclusion to the Committee which shall thereafter issue such Order.

(f) The Order of Acceptance of Offer of Settlement shall constitute the Committee's decision and shall conclude the proceeding as of the date the Order is issued. If the Order includes a penalty of suspension, the suspension shall become effective on a date to be set by the President of the Association. Any other sanctions imposed shall become effective immediately.

(g) If the Offer of Settlement is rejected by a Committee or by the National Business Conduct Committee, the Offer of Settlement shall be deemed withdrawn.

(h) Where there is more than one respondent in a proceeding and one or more of the respondents submit an Offer of Settlement, the Offer may be accepted or rejected as to any one or all of the respondents submitting Offers. The

proceedings will thereafter be terminated as to those respondents whose Offers of Settlement have been accepted, but their participation may be required at any hearing. The Committee shall thereafter proceed pursuant to the regular disciplinary procedures provided for by this Code as to those respondents which did not submit Offers of Settlement.

(i) If an Offer of Settlement is not accepted and it becomes necessary for the Committee to follow the regular disciplinary procedures against the respondent, the respondent shall not be prejudiced by the prior Offer of Settlement and it shall not be given consideration in the determination of the issues involved in the pending or any other proceeding.

Complaints Directed by Board of Governors

Sec. 12. The Board of Governors shall have authority when on the basis of information and belief it is of the opinion that any act, practice or omission of any member of the Corporation or of any person associated with a member is in violation of any rule regulation or statutory provision, to file a complaint with a Committee against such member or such person associated with a member or to instruct any Committee to do so, and any such complaint shall be handled in accordance with this Article.

Complaint Docket

Sec. 13. Each Committee shall promptly notify the Surveillance Department of the Corporation of all complaints issued, and the Surveillance Department shall record all complaints so reported in the Complaint Docket. Committees shall also promptly notify the Surveillance Department of changes in the status of every complaint filed including respondents' answers, respondents' requests for or waiver of hearings, and the decision of the Committee, which notification shall also be entered in the Complaint Docket.

ARTICLE III

REVIEW OF DISCIPLINARY ACTIONS AND HEARINGS BEFORE THE BOARD OF GOVERNORS

Review by the Board of Governors

Sec. 1. (a) If a Committee shall take any disciplinary action against any member, or shall dismiss any complaint, as herein provided, such action or dismissal shall be subject to review by the Board of Governors on its own motion within 45 calendar days after the date of the decision. Any such action or dismissal shall also be subject to review upon application by any person aggrieved thereby, filed within 15 calendar days after the date of the decision. Application to the Board of Governors for review, or the institution of review by the Board of Governors on its own motion, shall operate as a stay of any such action or dismissal, until a decision is rendered by the Board of Governors upon such review as hereinafter provided.

(b) If a respondent or any aggrieved person who has made application to the Board of Governors for a review shall withdraw the appeal without a determination by the Board of Governors on the merits thereof, the Board of

Governors shall have an additional period of 45 calendar days subsequent to the withdrawal in which to determine whether it shall review the matter on its own motion.

Hearings Before the Board

Sec. 2. (a) In the case of an appeal or call for review, the complainant, if other than the Committee, or the respondent may request a hearing before a hearing panel of the Board of Governors. If a request is made, a hearing shall be granted. In the absence of a request for a hearing, the Board of Governors may have any matter set down for a hearing. A notice stating the date, time and place of the hearing shall be mailed to the complainant, if other than the Committee and respondent at least 10 calendar days before the hearing. The notice period may be waived in writing by the respondent or a shorter notice given where extraordinary circumstances require.

(b) Unless otherwise consented to by the parties, all hearings shall be held before a hearing panel appointed by the National Business Conduct Committee consisting of two or more persons, all of whom are associated with members of the Corporation, at least one of whom shall also be a current member of the Board of Governors.

(c) If a hearing is held, the hearing panel shall consider the record before the Committee and any new material submitted by the complainant and the respondent. If respondent has waived a hearing and the Board does not order a hearing on its own motion, the panel shall consider the matter on the record, which may include new evidence as long as all parties have previously been tendered the new evidence.

(d) The hearing panel shall present its recommended findings and sanctions to the National Business Conduct Committee. The National Business Conduct Committee shall make its recommended findings and sanctions to the Board of Governors which shall make the final determination.

Evidence and Procedure in Board Hearings

Sec. 3. (a) Upon request, the Corporation staff or the complainant, if other than a Committee, shall make available to respondents and their counsel any documentary evidence which was not part of the record before the Committee, within a reasonable time before the hearing.

(b) Respondents shall also make available to the Corporation staff or the complainant, any documentary evidence, which was not part of the record before the Committee, within a reasonable time before the hearing.

(c) If a hearing is held both the complainant and respondent shall be entitled to be heard in person and by counsel. Formal rules of evidence shall not be applicable. Notwithstanding paragraphs (a) or (b), the parties may submit any additional documentary evidence at the hearing as the hearing panel, in its discretion, determines may be relevant and necessary for a complete record. A record of the hearing shall be kept in all cases.

Powers of Board on Review

Sec. 4. In any proceeding to review any disciplinary action taken or dismissed by a Committee, the Board of Governors may affirm, dismiss, modify or reverse dismissals with respect to each of the Committee findings or remand the matter with appropriate instructions to the Committee. The Board of Governors may affirm, increase, or reduce any sanction, or impose any other fitting sanction.

Decision of Board

Sec. 5. (a) In any proceeding to review any disciplinary action taken by a Committee or a dismissal by a Committee if the Board of Governors determines that a violation alleged in the complaint has occurred, it shall issue a written decision which shall set forth:

- (1) the act or practice which the respondent has been found to have engaged in or omitted;
- (2) the rule, regulation, or statutory provision which such act or omission to act is deemed to violate;
- (3) the basis upon which the findings are made; and
- (4) the sanction imposed and the reason therefor.

Notification of Decision

Sec. 6. The complainant, the respondent and the member of the Corporation with whom the respondent is presently an associated person shall be promptly notified and sent a copy of any written decision rendered by the Board of Governors.

Application to SEC for Review

Sec. 7. In any case where either the complainant or the respondent feels aggrieved by any disciplinary action taken by the Board of Governors, such person may make application for review to the Securities and Exchange Commission in accordance with the Securities Exchange Act of 1934, as amended. The member of the Corporation with whom the respondent is presently an associated person shall be notified promptly of any application for review to the Securities and Exchange Commission.

ARTICLE IV

IMPOSITION OF SANCTIONS AND COSTS

Sanctions

Sec. 1. In any proceeding relating to disciplinary actions involving members and associated persons, a Committee or the Board of Governors may impose any sanction it deems appropriate as set forth in Article V, Section 1, of the Rules of Fair Practice or in the applicable By-Law or Rule of the Corporation which was the subject of the complaint.

Costs of Proceedings

Sec. 2. In any disciplinary action, the member or associated person shall bear such part of the costs of the proceedings as the Committee or Board of Governors deems fair and appropriate under the circumstances.

ARTICLE V

LIMITATION PROCEDURES UNDER ARTICLE III, SECTION 38 OF THE RULES OF FAIR PRACTICE

Board of Governors' Surveillance Committee

Sec. 1. The Board of Governors shall appoint a standing Committee of the Board to be known as the Board of Governors' Surveillance Committee which is composed of such members as are from time to time determined by the Board.

District Surveillance Committee

Sec. 2. As required to implement the provisions of this rule, each District Committee shall create a District Surveillance Committee composed of two current or former District Business Conduct Committee members; two members of the Board of Governors' Surveillance Committee, and one former member of the Board of Governors.

Written Notification

Sec. 3. If the District Surveillance Committee has reason to believe that any of the conditions specified in subsections (b) or (c) of Section 38 exist, it may exercise the authority conferred by Section 38 by issuing a notice directing the member to limit its business. Such notice shall contain a statement of the specific grounds on which such action is being taken, specify in reasonable detail the nature of the limitations being imposed and inform the member that he has an opportunity to be heard, if such request is made within three business days of receipt of the notice. The District Surveillance Committee shall also provide a similar notice in writing to a member of any revision or modification of restrictions or limitations previously imposed.

Hearing

Sec. 4. If an opportunity to be heard is requested, it shall be provided by the District Surveillance Committee within five business days of the receipt of the notice. A member requesting the opportunity to be heard shall present its reasons why the notice should be withdrawn or modified and shall be entitled to be represented by counsel. A record shall be kept of the proceeding before the District Surveillance Committee.

Decision and Effective Date

Sec. 5. (a) The District Surveillance Committee shall within five business days of a hearing issue a written decision approving or modifying the limitations specified in the notice. The decision shall also provide for an appropriate sanction to be immediately imposed for failure to comply with any limitations imposed.

(b) When an opportunity to be heard is not requested, the limitations contained in the notice shall become effective three days following receipt of the notice without any written decision unless the District Surveillance Committee decides upon a later effective date or unless the matter is reviewed by the Board of Governors, subject to the provisions of subsections (6), (7) and (8) hereof, and they shall remain in effect until such time as they are removed, revised or modified by the District Surveillance Committee.

Review by Board

Sec. 6. The written decision issued pursuant to subsection (5) shall be subject to review by the Board of Governors upon application by the member aggrieved thereby filed within five business days of the date of the decision. The decision, or the notice where no opportunity to be heard was requested before the District Surveillance Committee, shall also be subject to review by the Board of Governors on its own motion within 30 calendar days of the decision or notice. Where two members of the District Surveillance Committee disagree with the determination of the Committee, the matter will automatically be reviewed by the Board of Governors. In the case of an appeal, the member shall be given an opportunity to be heard before a hearing panel of the Board within 10 business days of the written decision. If called for review, the matter shall be heard within 30 days of such action. In any hearing before the Board, a member shall be entitled to be represented by counsel. The institution of review, whether by application or on the initiative of the Board, shall operate as a stay of the action by the District Surveillance Committee unless otherwise ordered by the Board.

Composition of Board of Governors' Hearing Panel

Sec. 7. The Board of Governors' hearing panel shall be composed of two members of the Board of Governors' Surveillance Committee and one current member of the Board.

Decision

Sec. 8. Upon consideration of the record, the Board of Governors shall in writing affirm, modify, reverse or dismiss the decision of the District Surveillance Committee or remand the matter for further proceedings consistent with its instructions. The Board shall set forth specific grounds upon which its determination is based and shall provide for an appropriate sanction to be immediately imposed for failure to comply with any limitations imposed. If a hearing is held, a decision shall issue within five business days of the hearing and the decision shall be the final action of the Board. If no hearing is requested, the matter shall be considered on the record and a decision shall be issued promptly. Any limitation imposed as a result of Board action shall become effective immediately upon issuance of its decision and shall remain in effect until such time as removed or modified by the District Surveillance Committee.

Application to Commission for Review

Sec. 9. In any case where a member feels aggrieved by any action taken or approved by the Board of Governors, such member may make application for review to the Securities and Exchange Commission in accordance with Section 19 of the Securities Exchange Act of 1934, as amended. There shall be no stay of the Board's action upon appeal to the Commission unless the Commission determines otherwise.

Successive Notices

Sec. 10. If it appears at any time to the District Surveillance Committee that, notwithstanding an effective notice or decision under subsections (3), (5) and (8) hereof, the member is still approaching financial or operational difficulty, the District Surveillance Committee may prescribe additional limitations of a member's business in which case all of the procedures specified above shall be followed prior to the implementation thereof.

Complaint by the Committee

Sec. 11. Action by the Corporation under this Article shall not foreclose action by the Corporation under any other provisions of this Code where a violation of the Rules of the Corporation may be involved.

ARTICLE VI

REVOCATION PROCEEDINGS

Purpose

Sec. 1. This Article provides procedures, in addition to those contained for the summary suspension pursuant to Article VIII of this Code of Procedure, for the Corporation to cancel or suspend the membership of a member or to bar or suspend a person from being associated with a member pursuant to Article II, Section 3, Article VI, Section 3 or Article VII, Section 2 of the By-Laws. Such actions are hereinafter referred to as "revocation proceedings."

Commencement of Revocation Proceedings

Sec. 2. (a) Should the Corporation determine to commence a revocation proceeding, it shall send notice thereof to the member or person associated with a member at least five (5) business days prior to the effective date of any action under Article II, Section 3 of the By-Laws and at least fifteen (15) days prior to the effective date of any action under Article VI, Section 3 or Article VII, Section 2 of the By-Laws.

(b) Upon written request of the member or persons associated with the member received by the Corporation prior to the expiration of the applicable notice period provided in subsection 2(a), the matter shall be presented to a hearing panel designated by the Board of Governors.

(c) A decision rendered by a hearing panel designated pursuant to subsection 2(b) shall constitute final action by the Corporation. Any cancellation, bar or suspension shall become effective on a date established by the hearing panel.

Hearings

Sec. 3. At any hearing held under this Article, a record shall be kept and the member or person associated with a member and the Corporation shall be entitled to be heard in person and be represented by counsel and to submit any relevant matter.

Decisions

Sec. 4. Following any hearing held under this Article, a written decision shall be issued setting forth the findings made and the grounds upon which that determination is based.

Other Action Not Foreclosed

Sec. 5. Action by the Corporation under this Article shall not foreclose action by the Corporation under any other provisions of this Code where a violation of the Rules of the Corporation may be involved.

ARTICLE VII

ELIGIBILITY PROCEEDINGS

Purpose

Sec. 1. This Article provides procedures for a person to become associated with a member notwithstanding the existence of a statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended, for reinstatement after a revocation proceeding pursuant to Article VI of this Code, and to obtain relief in cases of failure to meet the eligibility or qualification requirements of the Corporation's Rules and By-Laws.

Eligibility Proceedings

Sec. 2. (a) If the Corporation has reason to believe a statutory disqualification exists or there is otherwise a failure to meet the eligibility requirements of the Corporation's By-Laws, the member or broker or dealer or person shall be notified in writing of the specific eligibility deficiencies. No such notice shall be required, however, in the case of a cancellation or suspension of membership or suspension or bar of a person associated with a member pursuant to Article VI of this Code.

(b) The member or broker or dealer or person may make application to the Corporation requesting relief and shall demonstrate why the application should be granted. Should the Corporation decline to grant such request, then if requested in writing by any party, or if directed by the Corporation, a hearing shall be held before a hearing panel designated by the Board of Governors, and a record shall be kept. At the hearing the parties shall be entitled to be heard in person and be represented by counsel and to submit any relevant matter. The hearing panel shall make a recommendation as to the application which shall be forwarded to the Board of Governors together with the record.

(c) The Board of Governors shall make a written determination upon the record before it, setting forth therein the specific grounds upon which such determination is based and the conditions, if any, as to the continuance in or admission to membership it considers appropriate.

(d) The Board of Governors shall promptly notify the applicant of any action taken. When required, a notification shall be filed with the Commission.

Any applicant or person who is aggrieved by the action of the Board of Governors may make application for review of such action to the Commission.

ARTICLE VIII

SUMMARY SUSPENSION

Summary Action

Sec. 1. The Corporation may summarily:

(a) suspend a member or person associated with a member who has been and is expelled or is currently subject to a suspension from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization;

(b) suspend a member who is in such financial or operating difficulty that the Corporation determines and so notifies the Securities and Exchange Commission that the member cannot be permitted to continue to do business as a member with safety to investors, creditors, other members, or the Corporation; and

(c) limit or prohibit any person with respect to access to the NASDAQ System or other services offered by the Corporation if, in the case of a member or person associated with a member, subsection (a) or (b) applies; or, in the case of another person, if the Corporation determines that such person does not meet the qualification requirements or other prerequisites for such access and cannot be permitted to have or to continue to have such access with safety to investors, creditors, members, or the Corporation.

Written Notification

Sec. 2. Any party against whom the Corporation takes summary action pursuant to Section 1 above shall be notified promptly in writing or otherwise of such action. In the case of a person associated with a member, the member of the Corporation with which the person is presently associated shall also be notified. Such notification shall issue only after prior approval of the Executive Committee of the Board of Governors and shall contain a statement of the specific grounds on which such action is taken and provide notice that an opportunity for a hearing is afforded pursuant to the provisions of Sections 3 and 4 hereof. Such summary action shall not be conditioned upon notification but shall be effective upon the date of the written notification.

Request for Hearing

Sec. 3. Any party against whom the Corporation has taken summary action may request an opportunity for a hearing within 10 calendar days of the date of notification pursuant to Section 2 above. Such hearing shall be held within 5 calendar days of such request. A request for a hearing shall not operate as a stay of the summary action.

Hearing

Sec. 4. If a hearing is requested pursuant to Section 3 above, it shall be held before a hearing panel designated by the Board of Governors. The party against

whom the Corporation has taken summary action shall be entitled to be heard in person, to be represented by counsel and to submit any relevant matter. Counsel for the Corporation and other designated Corporation personnel may participate in the hearing and be entitled to submit any relevant matter. In any such proceeding, a record shall be kept.

Decision

Sec. 5. A written decision shall be issued by the hearing panel within 5 calendar days of the date of the hearing, and a copy shall be sent to the party against whom the Corporation has taken summary action and, in the case of a person associated with a member, the member with whom the party is presently an associated person. The decision shall contain the reasons supporting the action taken.

Review by Board

Sec. 6. (a) If the party against whom the Corporation has taken summary action does not request a hearing pursuant to Section 3, the notification of summary action shall be subject to review by the Board of Governors on its own motion within 30 calendar days of the date of the notification.

(b) If a hearing is held, the written decision issued pursuant to Section 5 shall be subject to review by the Board of Governors upon application of the party against whom the Corporation has taken summary action filed within 15 calendar days after issuance. Any such decision shall also be subject to review by the Board of Governors on its own motion within 30 calendar days after issuance.

(c) The institution of review, whether by application to, or on the initiative of, the Board shall not operate as a stay of the summary action.

Findings of Board on Review

Sec. 7. Upon consideration of the record and after further hearings as the Board of Governors shall order, the Board shall in writing affirm, modify, reverse or dismiss the decision, or remand the matter for further proceedings consistent with its instructions. The Board shall set forth specific grounds upon which its determination is based.

Application to Commission for Review

Sec. 8. Any party against whom summary action has been taken by the Board of Governors may make application for review to the Securities and Exchange Commission in accordance with Section 19 of the Securities Exchange Act of 1934, as amended.

Application to Commission for Stay of Summary Action

Sec. 9. Any party against whom summary action has been taken by the Board of Governors may apply to the Securities and Exchange Commission for a stay of such summary action as permitted by the Securities Exchange Act of 1934, as amended.

Other Action Not Foreclosed

Sec. 10. Action by the Corporation under this Article shall not foreclose action by the Corporation under any other provisions of this Code where a violation of the Rules of the Corporation may be involved.

ARTICLE IX

PROCEDURES ON GRIEVANCES CONCERNING THE NASDAQ SYSTEM

Purpose

Sec. 1. The purpose of this Article is to provide, where justified, redress for persons aggrieved by operations of the NASDAQ System and to provide procedures for the handling of qualification matters pursuant to NASDAQ rules.

Form of Application

Sec. 2. All applications shall be in writing, and shall specify in reasonable detail the nature of and basis for the redress requested. If the application consists of several allegations, each allegation shall be stated separately. All applications must be signed and shall be directed to the Corporation.

Request for Hearing

Sec. 3. Upon request, the applicant shall be granted a hearing after reasonable notice. In the absence of such request for a hearing, the Corporation may, in its discretion, have any application set down for hearing or consider the matter on the basis of the application and supporting documents.

Consideration of Applications

Sec. 4. All applications shall be considered by a hearing panel designated by the Board of Governors. The applicant shall be entitled to be heard in person and by counsel and to submit any relevant matter. In any such proceeding a record shall be kept.

Decision

Sec. 5. Decisions on applications shall be in writing and a copy sent by mail to the applicant. The hearing panel may communicate its determination to the applicant prior to the issuance of a written decision, which shall be effective as of the time of such communication. The written decision shall contain the reasons supporting the hearing panel's conclusions.

Review by Board

Sec. 6. The decision shall be subject to review by the Board of Governors on its own motion within 45 calendar days after issuance of the written decision. Any such decision shall also be subject to review upon application of any person aggrieved thereby, filed within 15 calendar days after issuance. The institution of a review, whether on application or on the initiative of the Board, shall not operate as a stay of the decision.

Findings of Board on Review

Sec. 7. Upon consideration of the record, and after such further hearings as it shall order, the Board shall affirm, modify, reverse, dismiss, or remand the decision. The Board shall set forth specific grounds upon which its determination is based.

Application to Commission for Review

Sec. 8. In any case where a person feels aggrieved by any decision of the Board of Governors taken pursuant to Section 7, the person may make application for review to the Securities and Exchange Commission in accordance with the Securities Exchange Act of 1934, as amended.

ARTICLE X

MISCELLANEOUS

Grounds of Disqualification to Participate in Proceedings

Sec. 1. No member of the Board of Governors, any Committee or any other committee or subcommittee governed by this Code shall in any manner, directly or indirectly, participate in the determination of any matter substantially affecting his interest or the interests of any person in whom he is directly or indirectly interested. In any such case the particular member shall disqualify himself, or shall be disqualified by the Chairman of any such Board or Committee.

Reports and Examination of Books and Records

Sec. 2. For the purpose of any examination, or determination as to any proceeding pursuant to this Code, any hearing panel, Committee, or the Board of Governors, or any duly authorized agent or agents of any such hearing panel, Committee or Board shall have the right to require any member or person associated with a member to report orally or in writing with regard to any examination, determination or hearing, and to examine the books and records of any member or person associated with a member.

Rulings on Procedural Matters

Sec. 3. Except as otherwise provided by this Code, the hearing panel, Committee or Board shall have discretion to make rulings on all motions and other matters arising during the course of its proceedings (including without limitation, the presence of witnesses after completion of their testimony and of other persons not parties to the proceeding) which require resolution during the proceeding.

Service of Complaints, Decisions and Other Notices

Sec. 4. Any person shall be deemed to have received notice to which he is entitled under any section of this Code by the mailing of the notice to that person at his last known address as reflected on the Corporation's records. For purposes of computing the time for any such person to take required action under this Code, 3 calendar days shall be added to the prescribed period if service is effected by mail.

Amendments to Code of Procedure

Sec. 5. This Code of Procedure may be amended by a majority vote of the Board of Governors, subject to approval by the Securities and Exchange Commission, pursuant to the Securities Exchange Act of 1934, as amended.

NASD

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

notice to members 85-28

April 18, 1985

TO: All NASD Members

RE: Collins Securities Corporation
400 Tower Building
Fourth & Center Streets
Little Rock, Arkansas

ATTN: Operations Officer, Cashier, Fail-Control Department

On April 16, 1985, the Federal District Court for the Eastern District of Arkansas appointed a Temporary Receiver for the above-captioned firm.

Members may use the "immediate close-out" procedures as provided in Section 59 (i)(2) of the NASD's Uniform Practice Code to close out open OTC contracts. Also, MSRB Rule G-12 (h)(iii) provides that members may use the above procedures to close out transactions in municipal securities.

Questions regarding the firm should be directed to:

Temporary Receiver

Harvey L. Bell, Esquire
Bell, Bilheimer & Associates, P. A.
902 West Second Street
Little Rock, Arkansas 72201
Telephone: (501) 376-1600

NASD

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

notice to members 85-29

April 19, 1985

TO: All NASD Members and Other Interested Persons

ATTN: Direct Participation Programs Department

RE: Compensation Received in Connection with Direct Participation Programs

The NASD's Direct Participation Programs and Real Estate Committees have reviewed certain information received from members and their affiliates through the review process carried out by the NASD Corporate Financing Department. The Committees reviewed the costs associated with issuing and distributing direct participation program securities, specifically, the allocation of offering costs between underwriting compensation and the issuer's organization and offering expenses. The purpose of this notice is to inform the membership and sponsors of direct participation programs of the Committees' findings and to clarify the application of NASD compensation guidelines in certain areas.

Background

On October 19, 1982, the NASD published Notice to Members 82-50, which announced the adoption of Appendix F to Article III, Section 34 of the NASD's Rules of Fair Practice. Appendix F applies to public offerings of direct participation programs and, among other things, provides that underwriting compensation from any source may not exceed Association guidelines. In addition, where a program sponsor is affiliated with an NASD member distributing the program, the issuer's organization and offering expenses payable from offering proceeds or program distributions may not exceed Association guidelines. Simultaneously, the Association published Notice to Members 82-51, which announced the Association's guidelines on underwriting compensation and organization and offering expenses referenced in Appendix F. Underwriting compensation may not exceed 10 percent of the gross proceeds of the offering, regardless of the source, with the exception that up to an additional 0.5 percent may be reimbursed to underwriters for bona fide due diligence expenses. Where a sponsor is affiliated with a distributing NASD

member, the issuer's organization and offering expenses may not exceed 15 percent of the proceeds of the offering, which includes the 10 percent underwriting compensation. Organization and offering expenses in excess of 15 percent may be paid from sources other than the program or its offering proceeds. While the 10 percent limitation on underwriting compensation is applied to all public direct participation programs, the 15 percent limitation on organization and offering expenses is only applied to sponsors that are affiliated with NASD members. Organization and offering expenses ordinarily include legal, printing, accounting and other fees of the issuer attributable to the preparation of a program for registration and subsequently offering interests to the public.

Discussion

Compensation arrangements reviewed by the Department are for the most part properly allocated between underwriting compensation and organization and offering expenses. There are four areas, however, in which the Committees believe clarification of the Association's application of Appendix F and, in some instances, the federal securities laws is required. These areas are wholesaling, due diligence reimbursement, advertising and sales literature, and retail seminars.

Wholesaling

The issues surrounding wholesaling are long-standing and have frequently arisen in the Association's review of direct participation program offerings. Where contacts with the broker-dealer community are made by bona fide employees of the issuer who do not perform wholesaling activities on a regular basis, without transaction-based compensation and incidental to their other duties and responsibilities, such persons generally are not required to register as broker-dealers. A problem arises, however, when the sponsor assigns the responsibility for contact between the issuer and the retail brokerage community to full-time specialists. The sponsor often assigns these persons geographic areas of responsibility and provides compensation in the form of salary or commissions based on the sales levels that occur within their areas of responsibility.

The information gathered by the Department has been useful in identifying when this occurs. The Department has found such wholesaling activities within both the sponsor and the general partner. In addition, a number of programs have been reviewed where a sponsor that maintains internal wholesaling capabilities has an NASD member affiliate as well. In this event, the Department found that the wholesaling expenses of the sponsor are not properly allocated by the sponsor to underwriting compensation, but are attributed solely to the sponsor's organization and offering expenses.

When the Department determines that such a wholesaling function exists within the sponsor or general partner, the Department will request that the Securities and Exchange Commission be contacted to determine whether the individuals are required to be registered as broker-dealers under the Securities Exchange Act of 1934. If the sponsor has an NASD member affiliate, the individuals will be requested to register with the member. In any event, the Department will include all salaries, expense reimbursements, bonuses and other forms of compensation associated with the wholesaling function in the 10 percent guideline on underwriting compensation.

Due Diligence

A second area needing clarification involves the proper allocation of due diligence expenses. Appendix F permits an additional 0.5 percent due diligence expense reimbursement above the 10 percent maximum on underwriting compensation. Many sponsors appear to misunderstand the activities that are properly included within the due diligence expense reimbursement. The Department observed, for example, that sales incentive vacations awarded to top producers at the close of the offering were allocated to due diligence. If this occurs, the Department will exclude such expenses from the additional 0.5 percent allowed for bona fide due diligence and reallocate such payments as incentive compensation subject to Sections 5(e) and (f) of Appendix F and the 10 percent underwriting compensation guideline.

The proper characterization of due diligence expenditures that may exceed the 10 percent limitation by 0.5 percent includes reimbursable expenses incurred by a member in affirmatively discharging its responsibility pursuant to Section 4 of Appendix F to ensure that all material facts pertaining to the program are adequately and accurately disclosed in the prospectus. If travel is necessary to discharge this obligation, it would ordinarily be undertaken by the responsible officials of the member to the partnership offices to verify the information provided to the member. Expenses associated with travel by the issuer's officials to due diligence meetings are, on the other hand, allocated to the issuer's organization and offering expenses.

Advertising and Sales Literature

A third area involves the proper characterization of the expenses of advertising materials generated to promote the sale of the sponsor's securities. Generally, sponsors wish to maintain control over the accuracy and the consistency with the prospectus of their advertising disseminated to the public. In most programs, the costs associated with creating advertising and sales promotion literature are borne by the sponsor. Therefore, the sponsor's advertising and promotional material expenses are allocated to the issuer's organization and offering expenses. However, supplemental sales literature generated by the broker-dealer with the associated costs reimbursed by the sponsor are required to be allocated to underwriting compensation and are subject to the 10 percent guideline.

Retail Seminars

The last issue involves the proper allocation of expenses for retail seminars. Generally, a sponsor's expenses for retail seminars are not included in underwriting compensation. Sponsor's expenses in this regard are normally related to officials of the sponsor appearing at seminars for the purpose of explaining the details of the program. However, any reimbursement by the sponsor of the expenses of broker-dealers for their activities at such seminars is allocated to the broker-dealer as underwriting compensation and included in the 10 percent guideline.

* * * *

The NASD hopes that this notice will aid the membership and sponsors by providing clarification of the policies of the Corporate Financing Department in its review of underwriting arrangements in direct participation program offerings. Any comments or questions regarding this notice should be directed to Richard J. Fortwengler or Larry M. Worrell of the NASD's Corporate Financing Department at (202) 728-8258.

Sincerely,

A handwritten signature in black ink, appearing to read "Frank J. Wilson", written in a cursive style.

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 85-30

April 22, 1985

TO: All NASD Members

**RE: Securities and Exchange Commission Release Announcing Shareholder
Communication Proposals**

The Securities and Exchange Commission recently issued proposals designed to clarify the obligations of brokers and issuers under its previously adopted direct communications program. The SEC had earlier mandated a program for issuers' direct communications with beneficial shareowners to go into effect on January 1, 1985.

However, on August 17, 1984, with the full support of its Advisory Committee on Shareholder Communications, the American Society of Corporate Secretaries, the American Bankers Association and the Securities Industry Association, the SEC postponed a startup of the direct communications program until January 1, 1986.

The delayed program would require brokerage firms maintaining nominee accounts to provide issuers with lists of the names, addresses and positions of the beneficial owners of their securities in those accounts. However, only those customers not objecting to disclosure would be on the lists. Issuers would have to request lists from brokers and agree to cover the firms' reasonable costs in providing these lists. The lists may only be used for mailing interim reports and incidental information to beneficial owners.

Under the rule adopted by the SEC, issuers could not use the lists for proxy solicitations.

When it authorized the program delay, the SEC agreed to propose rules clarifying the functions of brokers and issuers and ensuring effective implementation of the program. Among other things, the proposals contained in the attached release would:

- Require that brokers provide the list to issuers as often as requested rather than only once a year.

- Require that issuers request the lists from **all** brokers with customers who are beneficial owners of the issuer's securities.
- Allow issuers to send their annual reports to beneficial owners if they apprise brokers of that fact when submitting a search card for beneficial-owner information.

Broker Obligations

The proposals would require brokers to compile the list of beneficial owners whenever an issuer requests it. The rule currently requires brokers to compile the list as of the issuer's record date. If an issuer requests the list without scheduling a meeting, brokers would have to provide the list no later than 10 days after receiving the issuer's request.

Other proposals would excuse brokers from their obligation to provide the list if they do not receive assurances from the issuer of reimbursement for all reasonable expenses incurred in providing the lists. Brokers would also be excused from sending the annual report to beneficial owners if the issuer has notified the brokers that it was sending the annual report to the beneficial owners on the list.

Issuer Obligations

Under the proposals, issuers would have to request the lists from all brokers holding the issuers' securities in nominee accounts. This would prevent issuers from "cherry picking" the large firms, thereby leaving the smaller brokers with no way to recoup the costs of maintaining the required information.

Issuers may, at their option, send their annual report to the beneficial owners identified on the lists they receive from brokers. However, in such instances, the issuers are obligated to notify the brokers at the time a search card is submitted that they will mail the annual report to the beneficial owners on the list.

Reasons for Delay

In delaying its program, the SEC cited three reasons for its action:

- **Costs of implementing the program.** The securities industry estimated that the startup of the direct communications program alone would cost about \$26 million. This includes the initial survey to determine which shareholders are willing to allow their positions to be disclosed to issuers. In addition, brokers must, of course, maintain the current system for proxy distribution.

- **Possible breaches of confidentiality.** The SEC program requires that nominees furnish information on beneficial owners' positions unless those owners object to such disclosure. Because they feel that broker-dealer nominees might disclose such information by mistake, beneficial owners have suggested that they might move their accounts to banks, which are not subject to the SEC program. Broker-dealers, on the other hand, have suggested that the lists of beneficial shareholders would probably not remain confidential, and thus they would be involuntarily disclosing their customer lists.

- **Limited potential effectiveness.** A major problem with the SEC rule is that it does not affect banks. At the beginning of 1985, the shares held by bank nominees accounted for 74.7 percent of the market value of all the equity securities held by the Depository Trust Company. Thus, the SEC program would reach less than a quarter of the beneficial shareholders, and of that quarter, it

affects only the holdings of the beneficial owners who did not object to disclosure. According to a limited survey, it appears that the SEC program, if implemented, would not reach more than 15 percent of all beneficial shareowners.

Resolution of Delay

The NYSE's Ad Hoc Committee on Identification of Beneficial Owners, formed in September 1984, has largely resolved the issues of cost and confidentiality. A recent SEC-approved NYSE-rule change recommended by the Ad Hoc Committee permits brokers to assess a \$.20 per proxy surcharge for this year's annual meeting proxy solicitation to fund the program's startup costs. A second surcharge to be proposed for next year's proxy solicitation will fund the balance of the costs not covered by the first surcharge. The NASD has likewise adopted similar charges as part of its proxy rules. The Ad Hoc Committee is also addressing the issue of determining the reasonable costs for maintaining beneficial-owner lists. Rule changes in this area will be forthcoming.

To ensure standardization and confidentiality of the resulting lists of beneficial owners, the Ad Hoc Committee has selected the Independent Election Corporation of America (IECA) to serve as the intermediary between issuers and brokers in supplying lists of beneficial owners. A user board consisting of issuers, brokers and other industry representatives will govern the IECA's activities in this area.

Resolving the final reason for delay requires that Congress enact legislation allowing the SEC to regulate the proxy-processing activities of banks, associations and other entities. Legislation designed to accomplish this died in the 98th Congress. On March 20, 1985, Representatives Wirth and Rinaldo introduced in the House of Representatives the Shareholder Communications Act of 1985 (H.R. 1603). Supporters expect to reintroduce similar legislation in the Senate.

Request for Comments on These Proposals

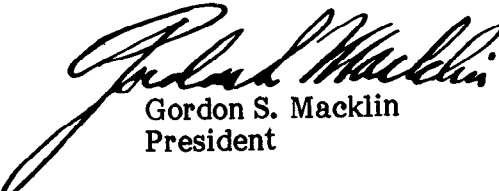
Those of you wishing to comment on these proposals should send your comments, by May 15, 1985, to:

Mr. John Wheeler
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

All comment letters should refer to File Number S7-13-85.

For your convenience, a copy of the SEC's release is enclosed with this notice. Any comments or questions regarding this notice should be directed to Thomas P. Mathers of the NASD's Communications Group at (202) 728-8267.

Sincerely,


Gordon S. Macklin
President

Attachment

**SECURITIES AND EXCHANGE
COMMISSION****17 CFR Part 240****[Release No. 34-21901; 40-14438; File No. S7-13-85]****Facilitating Shareholder
Communications****AGENCY:** Securities and Exchange Commission.**ACTION:** Proposed rules.

SUMMARY: The Securities and Exchange Commission ("Commission") is publishing for comment proposed amendments to its shareholder communications rules which govern the process by which registrants communicate with the beneficial owners of securities registered in the name of a broker or other nominee. The proposed amendments are intended to allow for the most advantageous implementation of the system of direct communication provided under those rules

DATE: Comments should be received on or before May 15, 1985.

ADDRESS: Comments should be submitted in triplicate to John Wheeler, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549. Comment letters should refer to File No. S7-13-85. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Sarah A. Miller or JoAnn L. Zuercher, (202) 272-2589, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission is publishing for comment proposed revisions to Rules 14b-1¹ and 14c-7² and a new proposed Rule 14a-13. These proposals are a direct result of the one-year deferral of the effective date (from January 1, 1985 to January 1, 1986) of Rule 14b-1(c) agreed to by industry representatives and authorized by the Commission in August 1984.³ The deferral was intended to provide more time for the determination of reasonable costs and the implementation of a system to provide registrants with security holder information in an efficient, timely and effective manner.

At the time it authorized the deferral, the Commission agreed to undertake certain steps to clarify the respective functions of brokers and registrants and to ensure the effective implementation of the system of direct communication. Accordingly, these proposed amendments delineate, in two separate rules, the respective obligations of brokers and registrants. In addition, the proposed amendments would provide, among other things, that: (1) If a registrant requests the list of non-objecting security holders, it must request the list from all brokers having customers who are beneficial owners of the registrant's securities; (2) a broker must provide the beneficial owner lists to registrants as often as they request the information, rather than only once a year; and (3) a registrant may mail its annual report to security holders to its beneficial owners so long as the registrant notifies the broker at the time it submits a search card requesting beneficial owner information.

I. Background

Rule 14b-1 was revised substantially in 1983 pursuant to recommendations of the Advisory Committee on Shareholder Communications, contained in its report, *Improving Communications Between Issuers and Beneficial Owners of Nominee Held Securities*. Paragraph (c) was adopted to provide a means of direct communication between registrants and their beneficial owners by requiring brokers to provide registrants upon request with the names, addresses and securities positions of its customers who are beneficial owners of the registrant's securities and who have not objected to such disclosure.⁴ In August 1984, the Commission deferred the effective date of paragraph (c) until January 1, 1986.⁵ Representatives from the securities industry and the registrant community agreed that during this deferral period they would develop and establish both an efficient means of furnishing beneficial owner information to registrants and an appropriate schedule of reimbursement.

In September 1984, the Ad Hoc Committee on Identification of Beneficial Owners was appointed by the New York Stock Exchange (NYSE). The Committee, composed of members of both the securities industry and registrant community, was formed to resolve the cost issues and to develop a workable and effective system that would be of maximum use to registrants and not burdensome to brokers. The Committee has now largely resolved the

problems which initially led to the deferral of the effective date of Rule 14b-1(c). First, the reimbursement of start-up costs issue has been resolved through NYSE rule changes that permit brokers to assess a \$.20 per proxy surcharge for the first annual meeting proxy solicitation occurring subsequent to adoption of the NYSE's rule changes. This surcharge, together with an additional surcharge for the next annual meeting proxy solicitation, will fund the start-up costs associated with furnishing the beneficial owner information to registrants. The second surcharge will fund the balance of the costs not funded by the first, \$.20, surcharge and will be the subject of a separate NYSE rule change. The \$.20 rule change was filed with the Commission in January 1985, published in the *Federal Register* on February 8, 1985,⁶ and approved by the Commission on March 28, 1985.⁷ It is anticipated that other self-regulatory organizations soon will adopt the surcharge as part of their proxy rules. The other cost issue—determination of reasonable costs for maintaining beneficial owner lists—is being addressed by the Ad Hoc Committee and also will be the subject of a separate NYSE rule change.

To make the system work and to ensure that registrants find the beneficial owner lists useful and meaningful, the Ad Hoc Committee also determined that an intermediary was necessary. By employing an intermediary to compile and to supply beneficial owner lists, registrants will be assured that the lists are compiled in a standardized manner. Moreover, brokers will be assured that the source of the lists will be kept confidential. In addition, economies of scale will be realized by maximizing cost savings while minimizing burdens on brokers by permitting them to delegate this function to an intermediary. The Ad Hoc Committee requested proposals and selected Independent Election Corporation of America (IECA) to serve as the intermediary between registrants and brokers in supplying lists of beneficial owners. IECA will be governed by a user board consisting of registrants, brokers and other industry representatives.

At the time of the deferral of the effective date of Rule 14b-1(c), the Commission agreed to clarify certain aspects of the shareholder communication rules and take certain additional steps which are the subject of this release.

Ultimate effectiveness and utility of the shareholder communications rules

¹ 17 CFR 240.14b-1.² 17 CFR 240.14c-7.³ Release No. 34-21339 (September 21, 1984) [49 FR 38096].⁴ Release No. 34-20021 (July 28, 1983) [48 FR 35082].⁵ Release No. 34-21339 (September 21, 1984) [49 FR 38096].⁶ Release No. 34-21702 (February 1, 1985) [50 FR 5460].⁷ Release No. 34-21900 (March 28, 1985).

will require enactment of legislation authorizing the Commission to regulate the proxy processing activities of banks, associations and other entities. During the 98th Congress, legislation, entitled the Shareholder Communications Act of 1984, was introduced in both houses of Congress. The legislation was reported out of the House Energy and Commerce Committee on August 2, 1984. No other action was taken in either the House or Senate with respect to the legislation. On March 20, 1985, Representatives Wirth and Rinaldo introduced in the House of Representatives the Shareholder Communications Act of 1985 (H.R. 1603). It is anticipated that the legislation shortly will be reintroduced in the Senate.

II. Overview of Proposals

Currently, Rule 14a-3(d) requires registrants whose securities are held by beneficial owners to take certain steps to ensure proxy solicitation material is forwarded by brokers to beneficial owners. These steps include requesting, by the use of search cards, the number of proxies and other proxy soliciting material needed by record holders to forward the material to beneficial owners. The registrant must request this information 20 calendar days prior to the record date of the annual meeting.⁸ The broker is required to respond to this request within seven business days of receipt of the request.⁹ Upon receipt of the proxy, proxy soliciting material or annual reports, the broker is required to forward these materials to its customers who are beneficial owners within five business days of receipt.¹⁰ Further, brokers are required to provide a requesting registrant with a list of its customers who are non-objecting beneficial owners of the registrant's securities. That list, which is to be compiled as of the registrant's record date for its latest annual meeting, must be provided to registrants only one time per year.

For simplicity, the Commission has set forth the registrant's obligations in proposed Rule 14a-13, and the proposed revisions to Rule 14b-1 would pertain only to brokers' obligations in connection with communicating information to beneficial owners. The system, as proposed to be changed, would require that, if the registrant requests a list of beneficial owners who do not object to the disclosure of their identity, it must make the request of all brokers having customers who are beneficial owners of the registrant's securities. Further, a registrant could

request the beneficial owner information more often than once a year and the broker would be required to comply with any such request. The lists would be compiled at least as often as the record date for the registrant's latest annual or special meeting. If no meeting is scheduled and the registrant requests a list of beneficial owners from record holders, that list would be compiled as of a date not earlier than ten business days after the broker receives the registrant's request. For example, if no annual or special meeting is scheduled and the broker receives a registrant's request for the list of beneficial owners on April 10, 1983, the list would be compiled as of a date no earlier than ten business days later or April 24, 1985. This last requirement is necessitated by the fact that brokers' back office systems do not permit the retroactive establishment of beneficial owner lists, but rather, allow those lists to be established prospectively.

The proposed amendments further provide that, if it chooses, the registrant may mail annual reports directly to beneficial owners so long as the registrant notifies the broker when making its initial request for beneficial owner information that the registrant intends to mail the annual report directly to its non-objecting beneficial owners. The registrant would notify the broker of its intention at the time it submits a search card requesting the beneficial owner information. If so notified by the registrant, a broker would have no obligation in connection with that mailing to forward the annual report to non-objecting beneficial owners but would have, of course, the obligation to forward reports to those beneficial owners who objected to the disclosure of their identities.

Finally, the proposed amendments would provide that, without assurances of reimbursement of reasonable expenses associated with satisfying its obligations with respect to communications with the beneficial owners, a broker has no obligation to perform its obligations under Rule 14b-1. The registrant would have a corresponding obligation to pay a broker's reasonable expenses associated with providing beneficial owner information.

III. Discussion of Proposals

A. Obligation of registrants in communicating with beneficial owners. Proposed Rule 14a-13, a registrant-related corollary to Rule 14b-1, delineates a registrant's obligations in communicating with its beneficial owners and would work in tandem with present Rule 14b-1.

First, provisions of present Rule 14a-3(d) would be moved to new Rule 14a-

13(a) in order to place all of the registrant-related provisions together. Paragraph (d) of Rule 14a-3(d) would become paragraph (a) of proposed Rule 14a-13 and would be amended to require registrants to request and to provide record holders with the number of copies of proxy, proxy soliciting material and annual reports to security holders necessary to supply beneficial owners. These proposed amendments recognize that record holders need not forward the annual report to those non-objecting beneficial owners with whom the registrant intends to communicate directly. Thus, if a registrant has indicated to the record holder that it wishes to communicate directly with non-objecting beneficial owners, then the record holder need only inform the registrant how many copies of the proxy soliciting material and annual reports are needed for forwarding to objecting beneficial owners. Similarly, if a registrant does not indicate that it intends to communicate directly with beneficial owners, the record holder then will inform the registrant of the number of copies needed for all beneficial owners.

Proposed paragraph (b)(1) would require a registrant to request the list of non-objecting beneficial owners from all brokers having customers who are beneficial owners of the registrant's securities. This requirement would ensure that registrants do not request the security holder lists only from the largest brokers thereby leaving the smaller brokers with no means of recouping expenses associated with maintaining the required information.

Proposed Rule 14a-13(b)(2) would continue unchanged the statement in present Rule 14b-1(c) regarding a registrant's exclusive use of the beneficial ownership lists for purposes of corporate communications. The Commission believes that this provision adequately addresses the securities industry's concerns regarding the issue of confidentiality. Moreover, the Commission notes that the identity of the individual brokers who provide the information to be compiled in the beneficial owner lists will be kept confidential by the intermediary's excision of all information identifying specific brokers.

In connection with registrants' use of beneficial owner lists for purposes of forwarding to security holders certain other corporate communications such as quarterly reports, the Commission wishes to encourage voluntary communication with security holders. In this regard, the Commission believes it would be desirable that, where registrants use the non-objecting beneficial owner lists to mail such communications directly to non-

⁸ 17 CFR 240.14a-3(d).

⁹ 17 CFR 240.14b-1(a).

¹⁰ 17 CFR 240.14b-1(b).

objecting beneficial owners, they also deliver to brokers for forwarding a sufficient number of copies of the corporate communication in order not to disadvantage those security holders who object to disclosure of their identities to registrants.

Finally, proposed paragraph (b)(3) would place on the registrant the obligation to pay the reasonable expenses of brokers associated with providing beneficial owner information.

Proposed paragraph (c) would allow registrants to mail directly the annual reports to security holders to those beneficial owners that have been identified to them. Any registrant choosing to do its own annual report mailing, however, would be required to so inform the broker at the time it submitted, pursuant to paragraph (a), a search card to the broker requesting the beneficial owner information, and, further, would have the responsibility of ensuring that the annual report precede the proxy statement.

The Commission is aware that, for reasons of economy, registrants may wish to engage in split mailing, *i.e.*, forwarding the annual report by bulk mail and mailing the proxies and other proxy soliciting material by first class mail. In this connection, questions have arisen concerning compliance with Rule 14a-3(b) which requires annual reports to accompany or precede the proxy statement.¹¹ The Commission does not wish to discourage the practice of split mailing which will result in savings to the registrant and ultimately redound to the benefit of security holders. Accordingly, compliance with the rule depends upon whether registrants take steps reasonably calculated¹² to guarantee that the annual report to security holders accompanies or precedes the proxy statement.¹³ In this connection, the Commission solicits specific comment as to whether Rule 14a-5¹⁴ should be amended to provide that when annual reports to security holders are mailed separately from proxy material, all proxy statements shall disclose the date the mailing of the

annual report to security holders was commended and shall contain instructions on how to obtain a copy of that annual report.

B. *14b-1 Obligation of registered brokers in connection with the prompt forwarding of certain communications to beneficial owners.* The Commission proposes to amend Rule 14b-1 in several respects. First, as noted above, registrant-related provisions have been moved to proposed Rule 14a-13. Second, proposed revisions to paragraph (c) relate to how often the broker's obligation to provide beneficial owner information to registrants arises. Under the present rule, a broker will be obligated to provide registrants only once a year a list of beneficial owners compiled as of the registrant's record date for its latest annual meeting of security holders.¹⁵ As proposed, a registrant could request the beneficial owner list whenever it wants and the broker, in response to that request, would respond to the request. In light of this change, paragraph (c) also would provide, in addition to stating that the list of beneficial owners is to be compiled as of the registrant's record date for its latest annual or special meeting of security holders, that if the request is not made in connection with a meeting, the list is to be compiled as of a date no earlier than ten days after receipt of the registrant's request. In connection with a broker's obligation to provide beneficial owner lists to a registrant, the Commission solicits specific comment on whether a time limit should be specified within which a broker is to provide the registrant with the requested list.

Proposed paragraph (d) contains provisions relieving a broker of his obligations in two instances. The first instance relates to reimbursement. As the rule presently stands, brokers are neither obligated to forward proxy soliciting material and annual reports to beneficial owners nor to provide registrants with beneficial owner lists without assurances of reimbursement of reasonable expenses. At present, the reimbursement provisions are placed separately in paragraphs (b) and (c). Because all obligations pursuant to the Rule relate to brokers' obligations to aid registrants to communicate with beneficial owners of their securities, the Commission proposes to place the separate reimbursement provisions in one paragraph.¹⁶ Accordingly, under proposed paragraph (d)(1), a broker's

obligations under this Rule are contingent on assurances of reimbursement from the registrant of all reasonable expenses incurred in connection with the performance of those obligations.

The second instance in which a broker would be relieved of his obligation relates to a broker's duty to deliver annual reports to security holders to beneficial owners. Proposed paragraph (d)(2) would relieve a broker of his obligation to mail the annual report to security holders identified by the broker and delivered in a list to the registrant so long as the registrant notifies the broker at the time it submits a search card, in accordance with Rule 14a-13(a), that it intends to mail the annual report directly to those beneficial owners whose identity is disclosed.

C. *14c-7 Providing copies of material for certain beneficial owners.* The Commission also proposes to amend, in several respects, Rule 14c-7, which governs the forwarding of information statements to security holders. First, obligations imposed by the Rule on the registrant would be separated into separate paragraphs similar to those contained in proposed Rule 14a-13(a). Paragraph (a) involves the registrant's obligation to inquire of record holders the number of copies of the information statement and annual report to security holders needed to forward the material to beneficial owners. Paragraph (b) concerns the registrant's obligation to supply sufficient quantities of the information statement and annual report to security holders. Paragraphs (a) and (b) and note 3 would be amended further to recognize that record holders need not forward material to those non-objecting beneficial owners with whom the registrant intends to communicate directly.

IV. Request for Comments

Any interested persons wishing to submit written comments on the proposed revisions to the shareholder communication rules, as well as on other matters that might have an impact on the proposals contained herein, are requested to do so.

The Commission also requests comment on whether the proposed revisions, if adopted, would have an adverse effect on competition or would impose a burden on competition that is neither necessary nor appropriate in furthering the purposes of the Exchange Act. Comments on this inquiry will be considered by the Commission in complying with its responsibilities under section 23(a)(2) of the Exchange Act.¹⁷

¹¹ In *Ash v. GAF Corp.*, 723 F.2d 1090, 1094 (3d Cir. 1983), the Third Circuit held that sending the annual report by third class mail 4 to 5 days prior to mailing the proxy statement by first class mail "did not reasonably guarantee that shareholders would receive the annual report at the same time or before the proxy materials. In fact, the procedure made it highly probable that shareholders would receive the annual report after they had received the proxy materials."

¹² The Commission is aware that, depending on the geographic location of specific post offices, the length of time in which it takes bulk mail to reach its intended destination may vary greatly.

¹³ Registrants who request record holders to engage in split mailing retain responsibility for ensuring compliance with Rule 14a-3(b).

¹⁴ 17 CFR 240.14a-5.

¹⁵ Release No. 34-20021 (July 23, 1983) [48 FR 35082].

¹⁶ In this regard, see discussion on pp. 4-5. *supra*, concerning the NYSE proposed rule change permitting brokers to fund start-up costs by assessing a surcharge per proxy solicitation.

¹⁷ 15 U.S.C. 78w(a)(2).

V. Statutory Basis and Text of Proposed Amendments

These amendments are being proposed pursuant to section 12, 14, 17 and 23(a) of the Securities Exchange Act of 1934.¹⁸

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements Securities.

VI. Text of Proposals

In accordance with the foregoing Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

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

§ 240.14a-3(d) [Amended]

1. By removing paragraph (d) including Notes 1 and 2 and redesignating paragraphs (e) and (f) as paragraphs (d) and (e) of § 240.14a-3(d).

2. By adding § 240.14a-13 to read as follows:

§ 240.14a-13 Obligation of registrants in communicating with beneficial owners.

(a) If the registrant knows that securities of any class entitled to vote at a meeting with respect to which the registrant intends to solicit proxies, consents or authorization are held of record by a broker, dealer, bank or voting trustee, or their nominees, the registrant shall:

(1) By first class mail or other equally prompt means, inquire of such record holder whether other persons are the beneficial owners of such securities and, if so, the number of copies of the proxy and other soliciting material necessary to supply such material to beneficial owners; and, in the case of an annual meeting at which directors are to be elected, the number of copies of the annual report to security holders necessary to supply such material to beneficial owners if such reports are to be distributed by the broker, dealer, bank, voting trustee or their nominees;

(2) Make the inquiry at least 20 calendar days prior to the record date of the meeting of security holders, or (i) if such inquiry is impracticable 20 calendar days prior to the record date of a special meeting, as many days before such meeting as is practicable or (ii) at such later time as the rules of a national securities exchange on which the class of securities in question is listed may permit for good cause shown; and

(3) Shall supply the record holders of whom the inquiry is made with additional copies of the proxy, other proxy soliciting material, and/or the

annual report to security holders if such report is to be distributed by the broker, dealer, bank, voting trustee or their nominees, in a timely manner, in such quantities, assembled in such form and at such a place, as the record holder may reasonably request in order to address and send one copy of each to each beneficial owner of securities so held and shall upon the request of such record holder, pay its reasonable expenses for completing the mailing of such material to record holders to whom the material is sent.

Note 1.— If the registrant's list of security holders indicates that some of its securities are registered in the name of a clearing agency registered pursuant to section 17A of the Act, the registrant shall make appropriate inquiry of the agency and thereafter of the participants in such agency who may hold on behalf of a beneficial owner, and shall comply with the above paragraph with respect to any such participant.

Note 2.— The attention of registrants is called to the fact that broker-dealers have an obligation pursuant to § 240.14b-1 and applicable self-regulatory requirements to obtain and forward (a) proxy soliciting materials, and (b) when requested by the registrant, annual reports to record holders, to beneficial owners to whom such brokers hold securities.

(b) Any registrant requesting pursuant to § 240.14b-1(c) a list of names, addresses and securities positions of beneficial owners of its securities who have not objected to disclosure of such information shall:

(1) Request such list from all brokers having customers who are beneficial owners of the registrant's securities;

(2) Use the information so furnished exclusively for purposes of corporate communications; and

(3) Upon the request of such brokers, pay the reasonable expenses, both direct and indirect, of providing beneficial owner information.

(c) A registrant, at its option, may mail its annual report to security holders to the beneficial owners whose identifying information is provided by brokers holders pursuant to § 240.14b-1(c), provided that such registrant notifies the brokers, at the time a search card requesting the beneficial owner information in compliance with paragraph (a) of this section is sent that the registrant will mail the annual report to security holders to the beneficial owners so identified.

3. By revising § 240.14b-1 to read as follows:

§ 240.14b-1 Obligation of registered brokers in connection with the prompt forwarding of certain communications to beneficial owners.

A broker registered under section 15 of the Act shall:

(a) Respond no later than seven business days after receipt of an inquiry made in accordance with § 240.14a-13(a) by or on behalf of a registrant soliciting proxies, consents or authorization by indicating, by means of a search card or otherwise, the approximate number of its customers who are beneficial owners of the registrant's securities that are held of record by the broker or its nominees;

(b) Upon receipt of the proxy, other proxy soliciting material, and/or annual reports to security holders, forward such materials to its customers who are beneficial owners of the registrant's securities no later than five business days after the receipt of the proxy material or annual reports; and

(c) Provide the registrant, upon its request, with the names, addresses and securities positions, compiled at least as often as of the registrant's record date for its latest annual or special meeting of security holders, or, if not in connection with a meeting, no earlier than ten business days after receipt of the registrant's request of its customers who are beneficial owners of the registrant's securities and who have not objected to disclosure of such information.

(d) A broker need not satisfy (1) its obligations under this section if a registrant does not provide assurance of reimbursement of the broker's reasonable expenses, both direct and indirect, incurred in connection with performing the obligations imposed by this section; or (2) its obligation under paragraph (b) of this section to forward annual reports to beneficial owners if a registrant notifies the broker pursuant to § 240.14a-13(c) that the registrant will mail the annual report to non-objecting beneficial owners, identified by the broker and delivered in a list to the registrant pursuant to paragraph (c) of this section.

4. By revising § 240.14c-7 to read as follows:

§ 240.14c-7 Providing copies of material for certain beneficial owners.

If the registrant knows that securities of any class entitled to vote at a meeting are held of record by a broker, dealer, bank or voting trustee, or their nominees, the registrant shall:

(a) Inquire of such record holder whether other persons are the beneficial owners of such securities and, if so, the number of copies of the information statement necessary to supply such material to beneficial owners and, in the case of an annual meeting at which directors are to be elected, the number of copies of the annual report to security holders, necessary to supply such material to such beneficial owners for whom proxy material has not been and

¹⁸ 15 U.S.C. 78f, 78n, 78g, and 78w(a).

is not to be made available if such reports are to be distributed by the brokers, dealer, bank, voting trustee or their nominees; and

(b) Supply such record holder with additional copies of the information statement and the annual report to security holders, if such report is to be distributed by the broker, dealer, bank, voting trustee or their nominees, in such quantities, assembled in such form and at such a place, as the record holder may reasonably request in order to address and send one copy of each to each beneficial owner of securities so held and shall, upon the request of such record holder, pay its reasonable expenses for completing the mailing of such material to security holders to whom the material is sent.

Note 1.—If the registrant's list of security holders indicates that some of its securities are registered in the name of "Cede & Co.", a nominee for the Depository Trust Company, or in the name of a nominee for any central certificate depository system, a registrant shall make appropriate inquiry of the central depository system and thereafter of the participants in such a system whom may hold on behalf of a beneficial owner, and to comply with the above rule with respect to any such participant.

Note 2.—The requirement for sending an annual report to security holders of record having the same address will be satisfied by sending a least one report to a holder of record at that address provided that those holders of record to whom a report is not sent agree thereto in writing. This procedure is not available to registrants, however, where banks, broker-dealers and other persons hold securities in nominee accounts or "street names" on behalf of beneficial owners, and such persons are not relieved of any obligation to obtain or send such annual report to the beneficial owners.

Note 3.—The attention of registrants is called to the fact that brokers have an obligation pursuant to § 240.14b-1 and applicable self-regulatory requirements to obtain and forward, in a timely manner, (a) information statements, and (b) when requested by the registrant, annual reports to

security holders to beneficial owners for whom such brokers hold securities.

(Secs. 3, 12, 14, 15(d), 17, 23(a), 48 Stat. 882, 892, 894, 895, 897, 901; secs. 6, 7, 8, 10, 19a, 48 Stat. 906, 908; sec. 203(a), 49 Stat. 704; secs. 5, 52 Stat. 1078; sec. 301, 54 Stat. 857; secs. 8, 202, 68 Stat. 685, 686; secs. 3, 4, 5, 6, 10, 78 Stat. 565-68, 569, 570-74, 580; sec. 1, 79 Stat. 1051; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3-5, 28c, 84 Stat. 1435, 1497; sec 105(b), 88 Stat. 1503; secs. 8, 9, 10, 11, 14, 18, 89 Stat. 117, 118, 119, 121, 137, 155; 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 78c, 78f, 78m, 78n, 78g, 78w(a))

By the Commission.

Shirley E. Hollis,
Assistant Secretary.

March 28, 1985.

Securities and Exchange Commission

Regulatory Flexibility Act Certification

I, John S.R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b), that proposed Rules 14a-13 and proposed amendments to Rule 14b-1 and 14c-7, if promulgated, will not have a significant impact on a substantial number of small entities. The reasons for this certification are as follows: Proposed Rule 14a-13 provides guidance to, and establishes obligations of, registrants who wish to communicate directly with beneficial owners. Proposed Rule 14a-13(a), (present Rule 14a-13(d)), and Rule 14c-7 require a registrant to inquire of its record holders the number of proxies, other proxy soliciting material, or information statements necessary to forward to beneficial owners and to supply its record holders with the appropriate number of copies. This amendment neither increases nor decreases the cost or burden on a small entity registrant associated with complying with these obligations. Compliance with Rule 14a-13 (b) and (c) is voluntary in the sense that only registrants who choose to communicate directly with beneficial

owners need comply with the Rule's requirements to request security holder lists from all brokers and to pay the reasonable expenses of brokers associated with providing beneficial owner lists. Accordingly, only those small entities who wish to communicate directly with their beneficial owners need incur the direct costs associated with Rule 14a-13 (b) and (c). Small entity registrants will be required, however, to reimburse brokers for start-up costs associated with furnishing the beneficial owner information, at the rate of \$.20 per proxy for this year's annual proxy solicitation and at a rate sufficient to cover the remaining start-up costs for next year's annual meeting proxy solicitation.

Rule 14b-1 establishes the obligations of brokers in connection with forwarding communications to beneficial owners. Proposed amendments to paragraph (c) would require a broker, at the registrant's request, to compile the list of beneficial owners more often than one time per year. This amendment will impose no additional cost on small entities. Proposed paragraph (d) provides that a broker's performance of obligations imposed by the Rule is contingent on assurances of reimbursement from the registrant of all reasonable expenses incurred in connection with performing the obligations imposed by the Rule. Proposed paragraph (d) which also specifies that a broker has no obligation to mail the annual report to security holders if the registrant notifies the broker that it intends to mail the annual report directly to those beneficial owners whose identity is disclosed to the registrant, will impose no additional cost on small brokers subject to the Rule.

Dated: March 28, 1985.

John S.R. Shad,
Chairman.

[FR Doc. 85-7954 Filed 4-4-85; 8:45 am]

BILLING CODE 8010-01-M

NASD

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

notice to members 85-31

April 29, 1985

TO: All NASD Members and Level 2 and Level 3 Subscribers

RE: NASDAQ National Market System Grows to 1,940 Securities With 82 Voluntary Additions on May 7, 1985, and Six Mandatory Inclusions on May 14, 1985

On Tuesday, May 7, 1985, 82 issues are scheduled to join the NASDAQ National Market System bringing the total number of issues in NASDAQ/NMS to 1,934. These 82 issues, which will begin trading under real-time trade reporting, are entering the NASDAQ/NMS pursuant to the Securities and Exchange Commission's criteria for voluntary designation.

The 82 issues scheduled to join NASDAQ/NMS on Tuesday, May 7, 1985, are:

Symbol	Company Name	Location
ACMT	ACMAT Corporation	East Hartford, CT
ADIA	ADIA Services, Inc.	Menlo Park, CA
AVSN	Activision, Inc.	Mountain View, CA
ASMIF	Advanced Semiconductor Materials International NV	Bilthoven, Netherlands
ALGA	Alpine Group, Inc. (The)	New York, NY
ECOL	American Ecology Corporation	Agoura Hills, CA
ANHC	American National Holding Company	Kalamazoo, MI
AUML	Automated Medical Laboratories, Inc.	Hialeah, FL
AUTR	Autotrol Corporation	Milwaukee, WI
BIOW	Banks of Iowa, Inc.	Des Moines, IA
BERK	Berkline Corporation (The)	Morristown, TN
BIRT	Birther Corporation (The)	El Monte, CA
BOOL	Boole & Babbage, Inc.	Sunnyvale, CA
BANQ	Burritt InterFinancial Bancorporation	New Britain, CT
CASC	Cascade Corporation	Portland, OR
CJER	Central Jersey Bank & Trust Company	Freehold Township, NJ

Symbol	Company Name	Location
CAKE	Charlotte Charles, Inc.	Chicago, IL
CNCL	Commercial National Corporation	Shreveport, LA
COMW	Commonwealth Savings & Loan Association F.A.	Fort Lauderdale, FL
CGIC	Continental General Insurance Company	Omaha, NE
DNNR	Danners, Inc.	Indianapolis, IN
DMGIF	Dumagami Mines Limited	Ontario, Canada
EPSC	EPSCO, Incorporated	Westwood, MA
ENDLZ	Endo-Lase Inc., Warrants	New York, NY
EBNC	Equitable Bancorporation	Baltimore, MD
FIAMA	First American Bank and Trust, Class A	North Palm Beach, FL
FFKZ	First Federal Savings & Loan Association of Kalamazoo	Kalamazoo, MI
FTSC	First Federal Savings & Loan Association of South Carolina	Greenville, SC
FMBC	First Michigan Bank Corporation	Zeeland, MI
FMSA	First Mutual Savings Association of Florida	Pensacola, FL
FHIF	Florifax International, Inc.	Tulsa, OK
FRDM	Freedom Savings and Loan Association	Tampa, FL
GMFD	Germania, F.A.	Alton, IL
GTAM	Great American Corporation	Baton Rouge, LA
GPCCK	Guardian Packaging Corporation	Newark, CA
HHOT	H & H Oil Tool, Inc.	Santa Paula, CA
IFII	Indiana Financial Investors, Inc.	Indianapolis, IN
IWTR	Indianapolis Water Company	Indianapolis, IN
IINT	Information International, Inc.	Culver City, CA
INEI	Insituform East, Incorporated	Landover, MD
INSUA	Insituform of North America, Inc., Class A	Memphis, TN
INRD	Interactive Radiation, Inc.	Northvale, NJ
JUDY	Judy's Inc.	Van Nuys, CA
KENN	Kennington Ltd., Inc.	Los Angeles, CA
KLOS	Kloss Video Corporation	Cambridge, MA
LCSI	LCS Industries, Inc.	Clifton, NJ
LSCO	LESCO, Inc.	Rocky River, OH
LMAN	Lieberman Enterprises Incorporated	Minneapolis, MN
MARC	M/A/R/C Inc.	Dallas, TX
MPSB	MPS Bancorp, Inc.	Mount Prospect, IL

Symbol	Company Name	Location
MFCO	Microwave Filter Company, Inc.	East Syracuse, NY
MSEX	Middlesex Water Company	Iselin, NJ
MCAP	Midland Capital Corporation	New York, NY
NHMO	National HMO Corporation	Melbourne, FL
OGLE	Oglebay Norton Company	Cleveland, OH
PTCS	PT Components, Inc.	Indianapolis, IN
PEXPP	People Express Airlines, Inc., Series A Preferred	Newark, NJ
PTCO	Petroleum Equipment Tools Co.	Houston, TX
PSBF	Pioneer Savings Bank, F.S.B.	Clearwater, FL
PBAN	Popular Bancshares Corporation	Miami, FL
PFCO	Preferred Financial Corporation	Denver, CO
PSLA	Preferred Savings and Loan Association, Inc.	High Point, NC
PULLW	Pullman Company (The), Warrants	Princeton, NJ
QTEC	QuesTech, Inc.	McLean, VA
RIHT	RIHT Financial Corporation	Providence, RI
RMPO	Ramapo Financial Corporation	Wayne, NJ
STJO	St. Joseph Bancorporation, Inc.	South Bend, IN
SAXO	Saxon Oil Company	Dallas, TX
SNEL	Snelling and Snelling, Inc.	Sarasota, FL
STBN	Southern Bancorporation, Inc.	Greenville, SC
SWEL	Southwestern Electric Service Company	Dallas, TX
SMFG	Stearns Manufacturing Company	St. Cloud, MN
SCAF	Surgical Care Affiliates, Inc.	Nashville, TN
TWBC	TransWorld Bancorp	Sherman Oaks, CA
TRILF	Trilogy Limited	Cupertino, CA
UBKR	United Bankers, Inc.	Waco, TX
WGHT	Weigh-Tronix, Inc.	Fairmont, MN
WCCC	Western Commercial	Fresno, CA
WOLA	Wolverine Technologies Inc.	Lincoln Park, MI
WRIT	William E. Wright Company	West Warren, MA
ZNAT	Zenith National Insurance Corp.	Encino, CA
ZCAD	Zycad Corporation	Arden Hills, MN

Additionally, the following six securities will enter the NASDAQ/NMS under the mandatory Tier 1 criteria on May 14, 1985:

Symbol	Company Name	Location
ASTA	AST Research, Inc.	Irvine, CA
BLII	Britton Lee, Inc.	Los Gatos, CA

CANNY	Canon, Inc.	Tokyo, Japan
NIPNY	NEC Corporation	Tokyo, Japan
SPCO	Software Publishing Corporation	Mountain View, CA
SMBX	Symbolics, Inc.	Cambridge, MA

The following changes to the list of NASDAQ/NMS securities occurred since April 3, 1985.

NASDAQ/NMS Symbol And/Or Name Changes

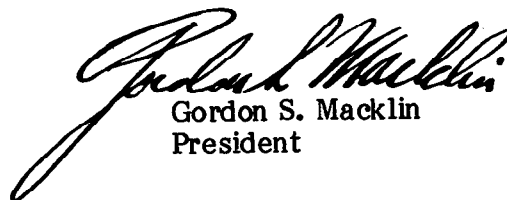
<u>New/Old Symbol</u>	<u>New/Old Security Name</u>	<u>Date of Change</u>
TLMTB/TLMT	Telemation, Inc., Class B/ Telemation, Inc.	4/04/85
ADCT/MGNE	ADC Telecommunications, Inc./ Magnetic Controls Company	4/08/85
CMRK/CMRK	Caremark, Inc./Home Health Care of America, Inc.	4/12/85
DIGI/DIGI	DSC Communications Corporation/Digital Switch Corporation	4/23/85
FTNC/BGBT	First National Corporation (Ohio)/Big Bite, Inc.	4/24/85

NASDAQ/NMS Deletions

<u>Symbol</u>	<u>Security Name</u>	<u>Date</u>
LFSL	Liberty Federal Savings & Loan Association	4/03/85
KOSSQ	Koss Corporation	4/08/85
GHOM	General Homes Corporation	4/09/85
MACG	MacGregor Sporting Goods, Inc.	4/16/85
AMLT	Armel, Inc.	4/16/85
WCAS	Western Casualty & Surety Co.	4/17/85
HMOH	HealthAmerica Corporation	4/17/85
GBAYA	Greate Bay Casino Corporation, Class A	4/18/85
BFXCE	BFI Communications, Inc.	4/29/85
GENA	General Automation, Inc.	4/29/85

Any questions regarding this notice should be directed to Donald Bosis, Assistant Director, NASDAQ Operations, at (202) 728-8043. Questions pertaining to trade reporting rules should be directed to Steve Hickman, Market Surveillance, at (202) 728-8202.

Sincerely,


Gordon S. Macklin
President

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1755 K STREET, N.W. WASHINGTON, D.C. 20007-2070

notice to members 85-32

April 30, 1985

TO: All NASD Members and Other Interested Persons

RE: Payment for Order Flow

It has come to the NASD's attention that some members are engaging in a practice whereby market making or wholesale dealers pay retail firms to direct those firms' customer orders to the market maker. The Board of Governors has established a special subcommittee of the National Business Conduct Committee to study potential problems related to these arrangements. That subcommittee is continuing its study, but on the basis of the analysis thus far, the Board of Governors has concluded that members should be alerted to two important areas: the requirement for firms to disclose fully all compensation received in connection with payment arrangements, and the requirement for firms to assure best execution of trades processed under these arrangements. These issues are discussed below.

Disclosure of Compensation

Rule 10b-10 ^{1/} under the Securities Exchange Act of 1934 prescribes information that a broker or dealer must disclose to its customer on the customer's confirmation. The rule requires that the broker-dealer disclose to the customer, among other things:

... the amount of any remuneration received or to be received by him from [his] customer in connection with the transaction ...
and... the source and amount of any other remuneration received or to be received by him in connection with the transaction ... ^{2/}

The rule provides, however, that in the case of ordinary secondary market trades, the confirmation can simply state whether other remuneration has been or will be received and that the source and amount of this remuneration will be

^{1/} 17 CFR §240.10b-10.

^{2/} Rule 10b-10(a)(7), 17 CFR §240.10b-10(a)(7).

furnished upon written request. In the context of payments for order flow, therefore, firms receiving compensation from market makers should disclose that they are receiving "other remuneration" in connection with the transaction. It appears Rule 10b-10 does not require disclosure on the confirmation of the source and amount of this remuneration, but permits that information to be furnished upon request. ^{3/}

Under Rule 10b-10 therefore, payments received by a retail firm from a market maker in return for their directing order flow to the market maker should be considered additional compensation received in connection with each transaction. Any firm receiving such compensation should disclose information on the source and amount of the compensation in an appropriate manner. Firms may wish to consult with their counsel to determine the manner in which this disclosure requirement should be satisfied.

Best Execution

The Interpretation of the Board of Governors on Execution of Retail Transactions, ^{4/} the "Best Execution Interpretation," requires that:

[I]n any transaction for or with a customer, a member and persons associated with a member shall . . . buy or sell . . . so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

This requirement is clearly applicable to situations in which firms direct all of their order flow to a particular dealer. Although examinations by the NASD indicate that firms that have entered into agreements for the payment for order flow are obtaining the best execution of their customers' transactions, it is important for all firms to assure that they continue to obtain the best execution of trades subject to these arrangements. This area will continue to be reviewed by NASD examiners during on-site examinations to ensure ongoing compliance.

As noted earlier, the NASD subcommittee reviewing arrangements for the payment for order flow has not yet concluded its study and may issue additional recommendations with respect to these arrangements.

^{3/} Article III, Section 12 of the NASD Rules of Fair Practice contains requirements that are basically similar to those in Rule 10b-10. Section 12 specifically states that a member:

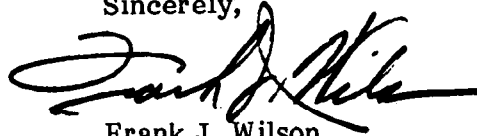
. . . shall give or send to [its] customer written notification disclosing . . . the source and amount of any commissions or other remuneration received or to be received by such member in connection with the transaction.

The NASD Ad Hoc Committee on Rule and By-Law Amendments has recommended that Section 12 be rescinded as redundant to Rule 10b-10, and that recommendation will be published for comment shortly.

^{4/} NASD Manual (CCH) p. 2035.

Questions or comments regarding this notice may be directed to John E. Pinto, NASD Surveillance Department, (202) 728-8233 or Dennis C. Hensley, NASD General Counsel's Office, (202) 728-8245.

Sincerely,

A handwritten signature in black ink, appearing to read "Frank J. Wilson", with a stylized flourish extending to the right.

Frank J. Wilson
Executive Vice President
and General Counsel