

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 55

Suggested Routing:*

- | | | | |
|---|--|---|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional | <input checked="" type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research |
| <input type="checkbox"/> Corporate Finance | <input type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Government | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Amendments Adopted — Sharing in Customer Accounts

EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved amendments to Article III, Section 19(f) of the NASD Rules of Fair Practice governing sharing in customer accounts by members and by

persons associated with members.

The amendment will permit performance-based fees under certain circumstances. The text of the amendment follows this notice.

BACKGROUND

The SEC recently approved amendments to Article III, Section 19(f) of the NASD Rules of Fair Practice (see SEC Release No. 34-25736, dated May 23, 1988) that would allow performance-based fees under certain circumstances. Section 19(f) generally prohibits members or persons associated with members from sharing in the profits or losses in customer accounts other than in direct proportion to the amount invested. The amendments would permit performance-based compensation under circumstances similar to those enumerated in Rule 205-3 of the Investment Advisers Act of 1940.

EXPLANATION OF AMENDMENTS

The amendments will allow members or persons associated with members to receive compensation based on a share of profits or gains in an account when:

1. Written authorization is obtained from the member carrying the client's account.
2. The customer meets stated minimum net-

worth or account investment-size requirements.

3. There is a reasonable belief that the customer understands the compensation method and its risks.

4. The arrangement is in writing.

5. The agreement was reached through "arm's length" negotiation.

6. The arrangement takes into account both gains and losses over at least a one-year period.

7. The member has disclosed all material information relating to the arrangement.

Members are cautioned, however, that it is the position of the SEC's Division of Investment Management that compensation received by a member or person associated with a member under this rule would constitute "special compensation" for purposes of the exception to the definition of "investment adviser" in Section 202(a)(11)(C) of the Investment Advisers Act of 1940. This would limit the availability of the broker-dealer exemption from investment adviser registration. In addition, any member or person associated with a member required to be registered under the Ad-

visers Act, or state law, who receives compensation based on a share of profits or capital appreciation of a customer's account must comply with Section 205(1) and Rule 205-3 under the Advisers Act, which set forth the terms upon which such compensation may be received or applicable state law with respect to such compensation. (See SEC Release 34-24355, dated April 16, 1987.)

The NASD rule, while not identical to Rule 205-3 under the Advisers Act, uses the same basic criteria as that rule. However, Rule 205-3 in some respects imposes requirements that go beyond those of amended Section 19(f). Firms and persons associated with members who are in compliance with the current provisions of Rule 205-3 would also generally be in compliance with the provisions of Section 19(f). Questions about this notice can be directed to T. Grant Callery, NASD Associate General Counsel, at (202) 728-8285.

**PROPOSED AMENDMENTS TO
ARTICLE III, SECTION 19(f) OF THE
NASD RULES OF FAIR PRACTICE**

(New language underlined; deleted language in brackets.)

Customers' Securities or Funds

⋮

Sharing in accounts; extent permissible

(f) (1)(A) Except as provided in Subsection (f)(2) no member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member [unless]; provided, however, that a member or person associated with a member may share in the profits or losses in such an account if (i) such member or person associated with a member obtains prior written authorization from the member carrying the account; and (ii) the member or person associated with a member shares in the profits or losses in the account only in direct proportion to the financial contributions made to such account by either the member or person associated with a member.

(B) Exempt from the direct proportionate share limitation of subsection (f)(1)(A)(ii) are accounts of the immediate family of such member or person associated with a member. For purposes of this section, the term "immediate family" shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the member or person associated with a member otherwise contributes directly or indirectly.

(2) Notwithstanding the prohibition of subsection (f)(1), a member or person associated with a member may receive compensation based on a share in profits or gains in an account if all of the following conditions are satisfied:¹

(A) The member or person associated with a member seeking such compensation obtains prior written authorization from the member carrying the account;

(B) The customer has at the time the account is opened either a net worth which the member or person associated with a member reasonably believes to be not less than \$100,000, or the minimum amount invested in the account is not less than \$500,000;

(C) The member or person associated with a member reasonably believes the customer is able to understand the proposed method of compensation and its risks prior to entering into the arrangement;

(D) The compensation arrangement is set forth in a written agreement executed by the customer and the member;

(E) The member or person associated with a member reasonably believes, immediately prior to entering into the arrangement, that the agreement represents an arm's-length arrangement between the parties;

(F) The compensation formula takes into account both gains and losses realized or accrued in the account over a period of at least one year; and

(G) The member has disclosed to the customer all material information relating to the arrangement including the method of compensation and potential conflicts of interest which may result from the compensation formula.

¹ It is the position of the Division of Investment Management of the Securities and Exchange Commission that compensation received by a member or person associated with a member under this rule would constitute "special compensation" for purposes of the exception to the definition of "investment advisor" in Section 202(a)(11)(C) of the Investment Advisers Act of 1940 (Advisers Act). Any member or person associated with a member, required to be registered under the Advisers Act, or state law, who receives compensation based on a share of profits or capital appreciation of a customer's account must comply with Section 205(1) and Rule 205-3 under the Advisers Act, or applicable state law, with respect to such compensation. (SEC Release 34-24355, 52 Fed. Reg. 13778, April 24, 1987).

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 56

Suggested Routing:*

- | | | | |
|--|--|--|------------------------------------|
| <input type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research |
| <input type="checkbox"/> Corporate Finance | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Government | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Securities | <input type="checkbox"/> Municipal | <input checked="" type="checkbox"/> Registration | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Revisions to Form BD; State Pilot for Broker-Dealer Phase of CRD

EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved two revisions to Form BD, the *Uniform Registration Application for Broker-Dealers*, under the Securities Exchange Act of 1934. These revisions, which are effective August 1, 1988, include an additional paragraph on the execution page of Form BD providing for an explicit consent to service of process for actions brought by the SEC, self-regulatory organizations (SROs), or the Securities Investors Protection Corporation (SIPC), as well as a requirement for disclosure of the broker-dealer's fiscal year.

Members are not required to submit a special amendment filing of the new version of the form (Form BD, revised 7/88) as a result of these changes. All future filings, however, must be made on the revised form.

In preparation for state entry into the broker-dealer phase of the Central Registration Depository (CRD), the NASD is introducing amended system software on a pilot basis. The focus of this pilot software is directed to state users of the system. However, NASD members will notice minor revisions to their CRD status reports.

BACKGROUND INFORMATION

The SEC recently adopted an amendment to Form BD, the uniform registration application that is filed by a broker-dealer to become registered or to amend an existing application, under the Securities Exchange Act of 1934. The amendment provides for consent from the applicant that service of any civil action brought by or notice of any proceeding before the SEC or any self-regulatory organization, or application for protective decree filed by SIPC, may be given to the applicant's contact employee at the applicant's main address as identified in Items 1G and 1E on Form BD.

This revision addresses the SEC's concern for consent language relating to the SEC and SROs, as well as SIPC's difficulties in obtaining adequate service of process in applications for protective decrees for broker-dealers that failed financially.

A second revision to Form BD incorporates a request from the North American Securities Administrators Association (NASAA). At its spring meeting in April 1988, the NASAA membership approved an amendment to Form BD requiring fiscal-year disclosure. Many states require information concerning an applicant's fiscal year and it

was believed that Form BD is the most effective means of obtaining this information. To address state needs, the SEC is also amending Item 3 on Form BD to require an applicant to disclose its fiscal year-end.

The SEC adoption of these amendments is further detailed in SEC Release No. 34-25806.

FILING REQUIREMENTS

Neither the SEC nor the NASD will require existing broker-dealers to file amendments to their Form BDs as a result of these changes. Members will be required to provide the consent and fiscal year-end only when Form BD is next amended for some other reason.

A copy of the revised (7/88) Form BD is included with this notice. Members are urged to replace existing supplies of Form BD with the new version to avoid use of the obsolete form. Supplies of the revised Form BD may be ordered through NASD Information Services at (301) 738-6500.

BROKER-DEALER PHASE OF CRD

In preparation for state participation in the broker-dealer phase of CRD, the NASD is introducing new system software on a pilot basis to assist states in training prior to the full implementation of this phase of the system.

Phase I of the system, begun in 1981, provided for the centralized processing of Forms U-4 and U-5 for associated persons of NASD member firms. Phase II, which will begin in September 1988, will enable the NASD to centrally process

Form BD, amendments to Form BD, and Form BDW, the uniform document used to terminate the registration of a broker-dealer.

The introduction of this pilot program, which will be implemented in early August, will result in only minor changes to the broker-dealer status reports generated by the system.

The most significant change will be the introduction of new edits for branch offices. Status reports indicating these edits will be generated when the following conditions are present: the branch office address or effective date is missing or incomplete; the branch manager is not properly registered; the manager does not maintain an active registration in the state where the branch is located; or, the firm is not registered in the state where the branch is located.

The NASD has maintained the broker-dealer data base since January 1986, so the implementation of the broker-dealer phase of the system will not result in additional filing requirements; but it will reduce the volume of amendment mailings due to the centralized filing with the CRD on behalf of the NASD and the states.

Additional information regarding state participation in the September implementation of the broker-dealer phase of CRD will be published as it develops.

Questions concerning this notice can be directed to either Chris Goodwin, Assistant Director, or Maudese King, Manager, NASD Member Firm Registration Services, at (301) 738-6717.

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 57

Suggested Routing:*

Senior Management
 Corporate Finance
 Government Securities

Institutional
 Internal Audit
 Legal & Compliance
 Municipal

Mutual Fund
 Operations
 Options
 Registration

Research
 Syndicate
 Trading
 Training

*These are suggested departments only. Others may be appropriate for your firm.

Subject: NASDAQ National Market System Additions as of July 22, 1988.

As of July 22, 1988, the following 30 issues joined the NASDAQ National Market System, bringing the total number of issues in NASDAQ/NMS to 2,932:

Symbol	Company	Entry Date	SOES Execution Level
CLDR	Cliffs Drilling Company	6/15/88	500
LFSA	First Federal Savings & Loan Association of Lenawee County	6/15/88	500
HVDK	Harvard Knitwear, Inc.	6/16/88	500
DELL	Dell Computer Corporation	6/22/88	1000
INDX	Index Technology Corporation	6/23/88	1000
MIND	Mindscape, Inc.	6/23/88	1000
EWSCA	E. W. Scripps Company (The) (CI A)	6/29/88	500
CNCD	Concorde Career Colleges, Inc.	6/30/88	1000
DEMP	Drug Emporium, Inc.	6/30/88	1000
NOVXM	Nova Pharmaceutical Corporation (CI C Wts)	7/1/88	500
NOVXL	Nova Pharmaceutical Corporation (CI D Wts)	7/1/88	500
KOSM	Cascade International, Inc.	7/5/88	500
HFSA	Home Federal Savings Bank	7/5/88	500
PACE	Pacesetter Homes, Inc.	7/5/88	200
SJNB	SJNB Financial Corp.	7/5/88	200
TMSTA	Thomaston Mills, Inc. (CI A)	7/5/88	200
TMSTB	Thomaston Mills, Inc. (CI B)	7/5/88	200
PBCT	People's Bank	7/6/88	1000
NHLI	National Health Laboratories, Inc.	7/7/88	1000
TRIAP	Triangle Industries, Inc. (Pfd)	7/11/88	200
LENS	Concord Camera Corp.	7/12/88	500
EAFC	Eastland Financial Corp.	7/12/88	1000
RATNY	Ratners Group, plc.	7/13/88	1000
BBGS	Babbage's, Inc.	7/15/88	500
EBCI	Eagle Bancorp, Inc.	7/18/88	500

Notice to Members 88-57

RICE	American Rice, Inc.	7/19/88	500
ICOC	ICO, Inc.	7/19/88	200
JFFN	Jefferson Bank	7/19/88	500
PTNM	Putnam Trust Company of Greenwich (The)	7/19/88	200
TUSC	Tuscarora Plastics, Inc.	7/21/88	500

NASDAQ/NMS Pending Additions

The following issues have filed for inclusion in NASDAQ/NMS upon effectiveness of their registration statements with the SEC or other appropriate regulatory authority. Their inclusion may commence prior to the next regularly scheduled phase-in date.

Symbol	Company	Location	SOES Execution Level
CFED	Charter Federal Savings Bank	Randolph, NJ	500
ECGI	Environmental Control Group, Inc.	Maple Shade, NJ	1000
HAMS	Smithfield Companies, Inc. (The)	Smithfield, VA	1000
SLTN	Solectron Corporation	San Jose, CA	1000
UTRX	Unitronix Corporation	Piscataway, NJ	500
WSBX	Washington Savings Bank, FSB	Waldorf, MD	500
WILFP	Wilson Foods Corporation (Pfd)	Oklahoma City, OK	1000

NASDAQ/NMS Symbol and/or Name Changes

The following changes to the list of NASDAQ/NMS securities occurred since June 13, 1988.

New/Old Symbol	New/Old Security	Date of Change
FSPG/FSPG	First Home Savings Bank, S.L.A./ First Savings & Loan Association of Penns Grove	6/20/88
PHBK/PHBK	Peoples Heritage Financial Group, Inc./ Peoples Heritage Savings Bank	6/20/88
USGL/SSMC	U.S. Gold Corporation/Silver State Mining Corp.	6/23/88
SWARA/SWAR	Schwartz Brothers, Inc. (Cl A)/Schwartz Brothers, Inc.	6/24/88
WSMCA/WTLCA	WestMarc Communications, Inc. (Cl A)/ Western Tele-Communications, Inc. (Cl A)	6/24/88
CODNW/CODNW	Codenoll Technology Corporation (9/10/89 Wts)/ Codennoll Technology Corporation (9/10/88 Wts)	6/29/88
HARVY/HARVY	Harvard Group, PLC/Harvard Securities Group, plc	6/29/88
RTII/RTCH	RTI, Inc./Radiation Technology Inc.	6/29/88
INRD/INRD	INRAD, Inc./Interactive Radiation, Inc.	6/30/88
BCNJ/NJSB	Bancorp New Jersey, Inc./New Jersey Savings Bank	7/1/88
BGEN/BGENF	Biogen, Inc./Biogen, NV	7/1/88
FCFI/CFSD	First Capitol Financial Corp./ Capitol Federal Savings & Loan Association of Denver	7/1/88
FFCH/FFCH	First Financial Holdings, Inc./ First Federal Savings & Loan Association of Charleston	7/1/88
CSESF/CLSIF	Connaught Biosciences, Inc./CDC Life Sciences, Inc.	7/5/88
SFFD/SFFD	SFFed Corp./ San Francisco Federal Savings & Loan Association	7/5/88
XTON/VTEK	Executone Information Systems, Inc./ Vodavi Technology Corp.	7/8/88

Notice to Members 88-57

TRIA/CJIA	Triangle Industries, Inc. (CI A)/CJI Industries, Inc. (CI A)	7/11/88
IMMCW/IMMCW	International Mobile Machines Corporation (8/5/89 Wts)/ International Mobile Machine Corporation (8/5/88 Wts)	7/11/88
NHDI/NHRD	NHD Stores, Inc./National Hardgoods Distributors, Inc.	7/13/88
CJSB/CJSL	Central Jersey Savings Bank, SLA/ Central Jersey Savings & Loan Association	7/14/88
UNSA/UNSA	United Financial Corp. of South Carolina, Inc./ United Savings & Loan Association	7/19/88
ACXM/CCXN	Acxiom Corporation/CCX Network, Inc.	7/21/88
WSMP/WSMP	WSMP, Inc./Western Steer - Mom 'N' Pop's, Inc.	7/21/88

NASDAQ/NMS Deletions

Symbol	Security	Date
ICLB	International Clinical Laboratories, Inc.	6/14/88
LNBK	Lane Financial, Inc.	6/14/88
AMSH	American Shared Hospital Services	6/16/88
OSTNN	Old Stone Corporation (Ser C Pfd)	6/16/88
UNGR	Ungermann-Bass, Inc.	6/16/88
IGEN	IGI, Inc.	6/20/88
LTLE	Arthur D. Little, Inc.	6/20/88
SALNW	Sahlen and Associates, Inc. (Wts)	6/20/88
SCNN	Scantron Corporation	6/20/88
TMCIW	T.M. Communications, Inc. (Wts)	6/20/88
TOWR	Tower Federal Savings Bank	6/20/88
ATMI	ATI Medical, Inc.	6/23/88
PHCC	Preferred Health Care Ltd.	6/23/88
DXTKZ	Diagnostek, Inc. (CI B Wts)	6/24/88
UBTC	University Bank, National Association	6/27/88
ATRN	Austron, Inc.	6/27/88
BIMD	ICN Biomedicals, Inc.	6/27/88
MUXVF	Musto Explorations Limited	6/28/88
IDEL	Ideal School Supply Corp.	6/29/88
MTCH	MTech Corp.	6/29/88
OMBK	Omnibank of Connecticut, Inc.	6/29/88
DCPY	Datacopy Corp.	7/1/88
FHVN	Fairhaven Savings Bank	7/1/88
FFBN	First Federal Bank, FSB	7/1/88
KEII	Keithley Instruments, Inc.	7/1/88
LCNAF	Lacana Mining Corp.	7/1/88
DSLTT	Diamond Crystal Salt Co.	7/5/88
DUSA	Dryclean USA, Inc.	7/5/88
ITELO	IteI Corporation (CI B Pfd)	7/5/88
MBSB	Mt. Baker, A Savings Bank	7/5/88
SOLI	Solitec, Inc.	7/6/88
ENZO	Enzo Biochem, Inc.	7/8/88
ISOE	ISOETEC Corporation	7/8/88
LNER	Linear Films, Inc.	7/8/88
VRTX	Vortec Corporation	7/8/88
CITR	Citytrust Bancorp, Inc.	7/11/88
MMAC	Merrimac Industries, Inc.	7/11/88
PACR	Pacer Corporation	7/11/88

Notice to Members 88-57

CSAR	Calstar, Inc.	7/13/88
DCOR	Decor Corporation	7/13/88
DEWY	Dewey Electronics Corp.	7/13/88
MFCO	Microwave Filter Company	7/13/88
MIDD	Middleby Corporation	7/13/88
PCRO	Philip Crosby Associates, Inc.	7/13/88
FPBTW	Fountain Powerboat Industries, Inc. (Wts)	7/14/88
COIL	Crystal Oil Company	7/15/88
DPCZ	Diagnostic Products, Inc.	7/15/88
CCCOA	Century Communications Corp. (Cl A)	7/18/88
CMPH	Comprehensive Care Corp.	7/18/88
ACST	Amcast Industries Corporation	7/20/88
HOOP	Hooper Holmes, Inc.	7/20/88
DNIC	Diasonics, Inc.	7/21/88
JSON	Josephson International, Inc.	7/21/88

Questions regarding this notice can be directed to Kit Milholland, Senior Analyst, NASDAQ Operations, at (202) 728-8281. Questions pertaining to trade-reporting rules can be directed to Leon Bastien, Assistant Director, NASD Market Surveillance, at (202) 728-8192.

NASDAQ and NASDAQ/NMS are registered trademarks and service marks of the
National Association of Securities Dealers, Inc.

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 58

Suggested Routing:*

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Internal Audit
- Legal & Compliance
- Municipal

- Mutual Fund
- Operations
- Options
- Registration

- Research
- Syndicate
- Trading
- Training

*These are suggested departments only. Others may be appropriate for your firm.

Subject: September First-Saturday Exam Session Changed

The first-Saturday exam session date for September has been *changed to August 27, 1988*, for all test centers because of the Labor Day holiday, which falls during the first weekend of the month. Requests for appointments for the August 27

session must be received *no later than August 17* (the eighth business day prior to the session).

The August, October, and November exam sessions are still scheduled for the first Saturday of those months.

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 59

Suggested Routing:*

- | | | | |
|---|---|---|--|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research |
| <input type="checkbox"/> Corporate Finance | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Government | <input type="checkbox"/> Legal & Compliance | <input checked="" type="checkbox"/> Options | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Securities | <input checked="" type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Labor Day Trade Date--Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Monday, September 5, 1988, in observance of Labor Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule.

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

Questions regarding the application of these settlement dates to a particular situation can be directed to the NASD Uniform Practice Department at (212) 858-4341.

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

Trade Date	Settlement Date	Regulation T Date*
August 26	September 2	September 7
29	6	8
30	7	9
31	8	12
September 1	9	13
2	12	14
5	Markets Closed	—
6	13	15

*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Regulation T Date."

Notice To Members

National Association of Securities Dealers, Inc.

August 1988

Number 88 - 60

Suggested Routing:*

- | | | | |
|---|---|--|--|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input checked="" type="checkbox"/> Research |
| <input type="checkbox"/> Corporate Finance | <input type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Government | <input type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Quarterly Check List of NASD Notices to Members

The following NASD Notices to Members were issued during the second quarter of 1988. Requests for copies of notices should be *accompanied by a self-addressed mailing label* and sent to: NASD Administrative Services, 1735 K Street, N.W., Washington, D.C. 20006-1506.

Notice	Date	Topic			
88-26	4/12	Request for Comments on Proposed Amendments to Appendix A to Article III, Section 30 of the NASD Rules of Fair Practice	88-32	5/10	the Proposed Government Securities Rules: Removal of Fine Limitations
88-27	4/13	NASDAQ National Market System Totals 2,994 Securities With 11 Additions on April 19, 1988	88-33	5/12	Amendment to the NASD Board of Governors' Corporate Financing Interpretation Regarding Public Offerings When Proceeds Are Directed to NASD Members
88-28	4/15	Quarterly Check List of NASD Notices to Members	88-34	5/12	Adoption of Amendments to Schedule E to the NASD By-Laws, Effective Immediately
88-29	4/28	Proposed New Section 3 to Article VII and Amendment to Article XI, Section 4 of the NASD By-Laws Concerning Emergency Authority Of the NASD Board of Governors	88-35	5/12	Adoption of New Section 67 of the NASD Uniform Practice Code Regarding Delayed Closings, Effective June 12, 1988
88-30	4/28	NASDAQ National Market System Totals 2,976 Securities With Two Additions on May 3, 1988	88-36	5/19	NASDAQ National Market System Totals 2,945 Securities With Seven Additions on May 17, 1988
88-31	5/4	Proposed Amendments to Article V, Section 1 of the NASD Rules of Fair Practice and Section 12(2) of	88-37	5/26	Memorial Day Trade Date—Settlement Date Schedule
			88-38	5/31	SIPC Trustee Appointed: Omni Mutual, Inc., Two Wall Street, New York, New York 10005
			88-39	6/1	SEC Approves New Category of Limited Representative Registration—Corporate Securities Examinations (Series 62); Study Outline Available
					NASDAQ National Market System

NASD Notice to Members 88-60

		Totals 2,950 Securities With 10 Additions on June 7, 1988	88-42	6/17	NASDAQ National Market System Advances to 2,954 Securities With 14 Additions on June 21, 1988
88-40	6/1	Adoption of New Schedule H to the NASD By-Laws and Proposed Amendment to Article III, Section 21 Of the NASD Rules of Fair Practice	88-43	6/22	Adoption of Amendments to the Rules of Practice and Procedures For the NASD Small Order Execution System And to Schedule D to The NASD By-Laws, Effective June 30, 1988
88-41	6/7	Independence Day Trade Date-Settlement Date Schedule			

© National Association of Securities Dealers, Inc., 1988.
NASDAQ and NASDAQ/NMS are registered trademarks and service marks of the
National Association of Securities Dealers, Inc.

Notice To Members

National Association of Securities Dealers, Inc.

August 25, 1988 – Supplement

Number 88 - 61

Suggested Routing:*

Senior Management
 Corporate Finance
 Government
 Securities

Institutional
 Internal Audit
 Legal & Compliance
 Municipal

Mutual Fund
 Operations
 Options
 Registration

Research
 Syndicate
 Trading
 Training

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Interpretations – Effective Immediately – of SOES Rules Regarding Compliance With Maximum Order Size Restrictions.

EXECUTIVE SUMMARY

The Small Order Execution System (SOES) was created to allow public customers to enter orders of limited size into the NASDAQ System for immediate execution at the best available price. Section 3(c) of the SOES Rules states that, "Agency orders in excess of the maximum order size may not be divided into smaller parts for purposes of meeting the size requirements for orders entered into SOES."

In light of certain order aggregation practices by associated persons and by customers who control several accounts, the NASD has adopted interpretations of SOES Rules to clarify the intent of the rules. These interpretations are effective immediately.

Where a single investment decision has been made involving the purchase or sale of more than the maximum order size, the order cannot be executed through SOES. Trades entered within any five-minute period in accounts controlled by an associated person or customer will be presumed to be based on a single investment decision.

For purposes of SOES Rules, an order will not be considered an order from a public customer if it is for an account of a person associated with a member firm who has physical access to a terminal capable of entering orders into SOES or if it is for an account of a member of the "immediate family" of the associated person.

BACKGROUND

In 1984, the NASD implemented the Small Order Execution System (SOES) to enable public customers to have their orders of limited size entered into the NASDAQ System for immediate execution at the best available price. SOES was designed exclusively for individual retail customer

orders restricted to a maximum size. Accordingly, the SOES rules prohibit any practice designed to circumvent the SOES execution size limits, including breaking up larger orders for execution in SOES. The NASD Market Surveillance Committee has taken several disciplinary actions against firms and individuals for such conduct. SOES

rules also restrict its use to agency orders of public customers, not principal trades by dealers. Disciplinary actions have also been taken against firms entering professional, proprietary orders through the system.

After the market break of October 1987, SOES was upgraded to enhance the quality of service and access provided to individual customers. Participation in SOES became mandatory for all market makers in NASDAQ National Market System securities. Such market makers are committed to executions for at least five times the maximum order size in every security for which they are making markets if their quotes are the inside market or the orders are preferenced to them. NASDAQ market makers are also now subject to a 20-business-day penalty for any unexcused withdrawal from NASDAQ. All of these changes were made to enhance SOES as a system designed to serve individual customers entering small orders.

As a result of the system's enhancements and the increased commitment of market makers to SOES, the NASD has carefully monitored the utilization of SOES since the June 30, 1988 effective date of mandatory SOES participation. It appears that the SOES size limitations are being circumvented by the entry of a group or series of orders which individually may appear to be SOES eligible but are the result of one investment decision. These orders are generally entered in the form of a group or series of transactions for one or more accounts that are related or controlled by a person associated with a member firm or by a customer, and therefore should be aggregated for purposes of determining compliance with SOES size limitations.

The NASD is issuing this interpretation of the SOES Rules of Practice and Procedures to clarify how those rules apply to these practices.

INTERPRETATIONS OF SOES RULES

Aggregation of Transactions in Related Accounts –
Section c) 3) C) of the SOES Rules provides:

Only agency orders no larger than the maximum order size, as defined herein, received from public customers may be entered by a SOES Order Entry Firm in to SOES for execution against a SOES Market Maker. Agency orders in excess of the maximum order size may not be divided into smaller parts for purposes of meeting the size requirements for orders entered in to SOES.

Section a) 7) of the SOES Rules defines "maximum order size" for SOES as:

the maximum size of individual orders for a security that may be entered into or executed through SOES.¹

Since the initiation of SOES, the NASD has interpreted the above-cited provisions as preventing a firm or customer from breaking up an order too large for SOES into a series of smaller orders executed through the system. Thus, where a single investment decision has been made involving the purchase or sale of more than the maximum order size, the order cannot be executed through SOES.

The recent development of certain aggregation practices by associated persons and customers who control several accounts makes it necessary to clarify the application of the SOES rules to these new situations. In some cases, an associated person or customer controlling several accounts may, after making one investment decision, simultaneously place a group of maximum-size orders, one for each controlled account. Associated persons have been accepting these orders and entering them into SOES as a series of SOES-eligible transactions. In other cases, customers or associated persons have executed a series of orders in their personal accounts based on one investment decision. These practices violate the intent underlying the SOES Rules.

For purposes of the SOES rules, orders that are based on a single investment decision and that are entered by a SOES order entry firm for accounts under the control of an associated person or public customer will be deemed to constitute a single order and will be aggregated for determining compliance with the SOES order size limits. Trades entered within any five-minute period in accounts controlled by an associated person or customer will be presumed to be based on a single investment decision. An associated person or customer will be deemed to control an account if he exercises discretion over the account or has been granted a power of attorney to execute transactions in the account, or if the account is his personal account or, in the case of an associated person, the account of a member of his "immediate family" as that term is defined in the NASD Free-Riding Interpretation.

Restriction to Public Customer Orders –
The restriction in the SOES Rules that permits the system to be used only for agency orders of public

customers is intended to preclude use by firms for their proprietary trading or for similar types of activity by professionals trading for their own accounts. It would change the character of SOES as a system designed exclusively for individual investors' small orders to permit professional trading activity to occur in the system.

To assure that SOES is utilized only for orders of public customers and not for orders for firms' accounts or accounts of professional trading personnel, the NASD is clarifying what constitutes an order from a public customer.

For purposes of the SOES Rules, an order will not be considered an order from a public customer if it is for any account of a person associated with a member firm who has physical access to a terminal capable of entering orders in to SOES or for any account of a member of the "immediate family" of such associated person, as that term is defined in the NASD Free-Riding Interpretation.²

The NASD believes these clarifying interpretations of the SOES Rules will assure the continued integrity of the Small Order Execution System as a premier order execution system for public customers.

Activity of members inconsistent with the

provisions of this Interpretation shall, in addition to violating the referenced SOES rules, violate Article III, Section 1 of the NASD Rules of Fair Practice.

This Interpretation shall be effective immediately.

Any questions regarding this notice may be directed to Dennis Hensley (202) 728-8245, James M. Cangiano (202) 728-8186, or Laura R. Singer (202) 728-8204.

¹ The maximum size for each security is published from time to time by the NASD. See, for example, NASD Notice to Members 88-43 (June 22, 1988) in which levels of 1,000, 500, and 200 shares were established.

² See Interpretation of the Board of Governors – Free-Riding and Withholding under Article III, Section 1 of the NASD Rules of Fair Practice, NASD Manual (CCH), pages 2041, 2045. The Free-Riding Interpretation defines "immediate family as including parents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children.