

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 81

Suggested Routing:*

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

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

Subject: Broker-Dealer and Agent Renewals for 1988-89; Status of CRD Phase II Implementation

EXECUTIVE SUMMARY

The 1988-89 NASD broker-dealer and agent registration renewal cycle will begin in early November. This program allows for simplification of the renewal process through the payment of one invoice amount that will include fees for NASD personnel assessments, NASD branch office fees, New York Stock Exchange (NYSE) and American Stock Exchange (Amex) maintenance fees, state agent renewal fees, and state broker-dealer renewal fees. Members are urged to read the following Notice and the instruction materials included in the forthcoming invoice package to ensure continued eligibility to do business in the relevant states effective January 1, 1989.

The implementation date for Phase II of CRD, the processing of Form BD on behalf of the system's regulatory participants, is February 1, 1989.

INITIAL RENEWAL INVOICES

On or around November 10, 1988, initial renewal invoices will be mailed to all member

firms. The invoices will include fees for NASD personnel assessments, NASD branch office fees, New York Stock Exchange (NYSE) and American Stock Exchange (Amex) maintenance fees, state agent renewal fees, and state broker-dealer renewal fees. Full payment of the November invoice must be received by the NASD no later than **December 16, 1988**.

This year's NASD personnel assessment will cost \$10 per person with a 50 percent discount resulting in a \$5 fee per registered person. NASD branch office fees remain \$50 per branch office. All NASD branch offices listed as active on Schedule E of a firm's Form BD as of September 30, 1988, will be assessed.

Agent renewal fees for NYSE, Amex, and state affiliations will be listed in a table enclosed with each invoice. The table includes a list of state broker-dealer renewal fees for states that are participating in this year's broker-dealer renewal program. NYSE and Amex maintenance fees—collected by the NASD for firms that are registered with NYSE/Amex as well as the NASD—are based on the number of NYSE and Amex registered personnel employed by the member.

If a state is not participating in this year's broker-dealer renewal program, members registered in that state must contact the state

directly to assure compliance with renewal requirements. In addition, some participating states may require steps beyond the payment of renewal fees to complete the broker-dealer renewal process. Members should contact states directly for further information on state renewal requirements.

Payment of the initial invoice should be in the form of a check drawn on the member firm's bank account. Please submit the check with the top portion of the invoice and mail it in the return envelope provided with the invoice. To ensure prompt processing, the renewal invoice payment should not be included with other forms or fee submissions. Members should be aware that failure to return payment to the NASD by December 16, 1988, will mean a loss of eligibility to do business in the relevant states effective January 1, 1989.

FILING FORM U5

Members may wish to avoid unwanted renewals by filing Form U5 for agent terminations in one or more affiliations. Because of the increased convenience and flexibility reported by members who used predated Form U5 for last year's renewal, the NASD will process predated agent terminations again this year. From November 1 to December 16, the NASD will accept and process Forms U5 (both partial and full terminations) with predated dates of termination. Under this procedure, if the Form U5 indicates a termination date of December 31, 1988, an agent may continue doing business in a jurisdiction until the end of the calendar year without being assessed renewal fees for that jurisdiction. Please ensure that Forms U5 are filed by the renewal deadline date of December 16, 1988. Also, predated Forms U5 cannot be processed if the date of termination indicated is January 1, 1989, or thereafter.

Members should exercise care when submitting predated Forms U5. The NASD will process these forms as they are received, but cannot withdraw a predated termination once processed. To withdraw a predated termination, a member would have to file a new Form U4 subsequent to the termination date. Members would still be obligated to update the Form U5 with any disciplinary information received subsequent to the filing of the Form U5.

FILING FORM BDW

Procedures regarding the filing for Form BDW to terminate broker-dealer registration in one

or more affiliations will differ slightly from past years. Although the Central Registration Depository (CRD) Phase II program is not yet implemented, firms requesting terminations (either full or state only) will be able to file their Form BDW with the CRD in order to avoid the assessment of renewal fees in those states that are designated on the Form BDW. To effect termination in those designated states, firms also will have to comply with state requirements and file the Form BDW directly with the state, unless the state has instructed otherwise.

The deadline for receipt of Forms BDW by the CRD for firms desiring to terminate in a state before year end 1988 is **December 16, 1988**. Predated Form BDW will be accepted and processed in the same manner as predated Form U5.

REMOVING OPEN REGISTRATIONS

For the second year, the NASD will include in the initial invoice package a roster of firm agents whose NASD registration is either terminated or purged but who have approved registrations with states. This roster should aid in the reconciliation of personnel registrations prior to year's end. Firms may terminate obsolete state registrations through the submission of a Form U5 or reinstate NASD licenses through the filing of a Page 1 of Form U4. No roster will be included if a firm does not have agents within this category.

BILLING CODE BREAKDOWN

This year's final invoice package will again include a breakdown of fees assessed by billing code for firms that use billing codes in the registration process. This breakdown will aid the firm in its internal research and allocation of fees.

FINAL ADJUSTED INVOICES

On or about January 13, 1989, the NASD will mail final adjusted invoices to members. These invoices will reflect the final status of firm and agent registrations as of December 31, 1988. Any adjustments in fees owed, as a result of registration terminations or approvals subsequent to the initial invoice mailing, will be made in this final reconciled invoice. If a member has more agents registered at year end than on the November invoice date, additional fees will be assessed. If a member has fewer registered personnel at year end than in November, a credit will be issued.

Included with this adjusted invoice will be the member renewal rosters, which will list all renewed personnel registered with the NASD, NYSE, Amex, and each state. Personnel whose registration is approved in any of these jurisdictions during November and December will automatically be included in this roster, while registrations that are pending approval or are deficient at year end **will not be included** in the renewal process. Firms also will receive an NASD branch office roster that lists all branches for which they have been assessed.

Firms then will have a two-month period in which to reconcile any discrepancies on the rosters. All jurisdictions should be contacted directly in writing. Specific information and instructions concerning the final adjusted invoice package will appear in the January 1989 Notices to Members, as well as on the inside cover of the renewal roster.

STATUS OF CRD PHASE II

Phase II of CRD, the processing of Form BD on behalf of the system's regulatory participants, originally was targeted for implementation on November 1, 1988. However, because of industry

recommendations, the date for system implementation has been postponed until February 1, 1989.

During the Fall Conference of the North American Securities Administrators Association (NASAA), held October 8-13, 1988, industry representatives voiced concern over the proposed November start-up date for Phase II. The concern centered around the short notice provided to the industry of the revised filing requirements and the implementation of a new program during the year-end renewal period. NASAA was receptive to the industry comments and has postponed the implementation date until February 1, 1989. It chose this date to avoid conflicts with the annual renewal process and to give all parties adequate time to prepare.

During this interim period, the system will continue to operate in a pilot phase that provides Form BD data to the states. Notice will be provided regarding the revised filing requirements for the participating states in advance of the February 1, 1989, implementation date.

Questions concerning this notice may be directed to NASD Information Services at (301) 738-6500.

Notice To Members

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Subject: Veteran's Day and Thanksgiving Day Trade Date-Settlement Date Schedules

The schedule of trade dates/settlement dates below reflects the observance by the financial community of Veteran's Day and Thanksgiving Day.

On Friday, November 11, the NASDAQ System and the exchange markets will be open for trading. But, it will not be a settlement date since many of the nation's leading banking institutions will be closed in observance of Veteran's Day.

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

Trade Date	Settlement Date	Regulation-T Date ¹
November 3	10	14
4	14	15
7	15	16
8	16	17
9	17	18
10	18	21
11	18	22
14	21	23
15	22	25
16	23	28
17	25	29
18	28	30
21	29	December 1
22	30	2
23	December 1	5
24	Market Closed	—
25	2	6

All securities markets will be closed on Thursday, November 24, in observance of Thanksgiving Day.

Note: November 11, 1988, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Transactions made on Friday, November 11, will be combined with transactions made on the previous day, November 10, for settlement on November 18. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, buy-ins, and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

These 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 may be directed to the NASD Uniform Practice Department at (212) 858-4341.

¹ 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 business days of the date of purchase, or, pursuant to Section 220.8(d)(1), apply 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

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- Senior Management
- Corporate Finance
- Government Securities
- Institutional

- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Systems
- Trading
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**Subject: Amendment to Article III, Section 21 of the NASD Rules of Fair Practice
Re: Marking Customer Order Tickets — Effective Immediately**

EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved an amendment to Article III, Section 21 of the NASD Rules of Fair Practice to require the marking of customer order tickets for each transaction in a non-NASDAQ security to reflect the dealers contacted by members and the quotations received to determine the best interdealer market as required by an amendment to the NASD's "Best Execution Interpretation" (the Interpretation). The text of the amendment follows this notice.

BACKGROUND

On May 2, 1988, the SEC approved proposed rule changes providing for new Schedule H to the NASD By-Laws (Schedule H). The rule amendments establish an electronic system of mandatory price and volume reporting for over-the-counter (OTC) securities that are not part of the National Association of Securities Dealers Automated Quotations (NASDAQ) System.¹ In part, the rule changes also amend the Interpretation of the

Board of Governors Execution of Retail Transactions in the Over-the-Counter Market (the Interpretation) by adding a new paragraph (D) that requires members to contact and obtain quotations from a minimum of three dealers (or all dealers in a security for which there are three or less) prior to executing any transaction on behalf of a customer in a non-NASDAQ OTC security.

On June 1, 1988, the NASD issued Notice to Members 88-40 to announce the adoption of Schedule H and to solicit a membership vote on a proposed amendment to Article III, Section 21 of the NASD Rules of Fair Practice on the "Marking of Customer Order Tickets." The membership approved the proposed rule amendment and the SEC approved the amendment on August 1, 1988.²

EXPLANATION OF AMENDMENT

The amendment to Article III, Section 21 added to the rule a new paragraph (b), which requires that a person associated with a member note on the order ticket for each transaction in a non-NASDAQ OTC security the identities of the dealers contacted and the quotations received to determine the best interdealer market. This change complements the amendment to the Interpretation and will enable the Association to determine compliance with that change.

The amendments to Article III, Section 21 and the Interpretation do not result in a change to the NASD's markup policy set forth in the NASD Manual as an Interpretation to Article III, Section 4 of the NASD Rules of Fair Practice (NASD Markup Policy) and compliance with the new amendments will not necessarily assure compliance with the NASD Markup Policy.³ Thus, under the new amendments, contacting three dealers that may quote prices substantially higher than the prevailing market price as determined by the standards established under the NASD Markup Policy will not permit the member to mark up a security based on those quotations.

In addition, both the amendment to the Interpretation and the new amendment to Article III, Section 21 requiring the marking of customer order tickets must be read in conjunction with the price- and volume-reporting provisions for non-NASDAQ OTC securities under Schedule H. Under these regulatory provisions, responsibility for reporting price and volume for trades in non-NASDAQ OTC securities rests with the **executing broker-dealer**.

Thus, where an introducing firm is **executing** trades in non-NASDAQ OTC securities, the introducing firm is responsible for reporting the price and volume of the transactions and marking the order tickets to reflect the dealers contacted. Where an introducing firm only passes an order on to another firm that executes the order, the executing firm, and not the introducing firm, is responsible for the reporting and marking of the order ticket.

Questions regarding this notice can be directed to Elizabeth Wollin, Assistant Director, Automated Reports, at (301) 728-6887, or Eneida Rosa, Assistant General Counsel, NASD Office of General Counsel, at (202) 728-8284.

AMENDMENT TO ARTICLE III, SECTION 21 OF THE NASD RULES OF FAIR PRACTICE

Books and Records

Section 21

(Note: New language is underlined.)

(b) Marking of Customer Order Tickets

(i) A person associated with a member shall indicate on the memorandum for the sale of any security whether the order is "long" or "short," except that this requirement shall not apply to transactions in corporate debt securities. An order may be marked "long" if (1) the customer's account is long the security involved or (2) the customer agrees to deliver the security as soon as possible without undue inconvenience or expense.

(ii) A person associated with a member shall indicate on the memorandum for each transaction in a non-NASDAQ security, as that term is defined in Schedule H to the NASD By-Laws, the name of each dealer contacted and the quotations received to determine the best interdealer market.

¹Members' obligations under this new upgrading system are set forth in Notice to Members 88-54 (July 1988).

²Securities Exchange Act Release No. 34-25952, August 1, 1988.

³NASD Manual (CCH), pp. 2054-2058.

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Subject: SEC Approval of Amendments to NASD Rules of Fair Practice and Conforming Amendments to the By-Laws Re: Supervisory Practices and Definitions of Branch Office and Office of Supervisory Jurisdiction

EXECUTIVE SUMMARY

On October 13, 1988, the Securities and Exchange Commission approved amendments to Article III, Section 27 of the Rules of Fair Practice and conforming amendments to Article I of the By-Laws and Schedule C to the By-Laws. The amendments to Article III, Section 27 (1) prescribe specific supervisory practices and procedures for all member firms and (2) revise the definitions of branch office and office of supervisory jurisdiction.

The conforming amendment amends the present text in the By-Laws to delete the substantive definition and instead references the definition set forth in Article III, Section 27. In addition, Schedule C to the By-Laws is amended to delete from an Explanation of the Board of Governors certain text pertaining to the definitions of office of supervisory jurisdiction and branch office. The texts of the amendments are attached.

BACKGROUND

In recent years, the NASD has become increasingly concerned that many persons associated with NASD members are engaging in the offer and sale of securities to the public without adequate on-going supervision. In particular, the potential for significant regulatory problems exists when registered representatives conduct business at locations that are not subject to regular examination by the member and operate without direct oversight of qualified supervisory personnel.

The NASD also has considered whether certain aspects of a firm's business should be subject

to on-site supervision by a registered principal so that the member can properly discharge its regulatory obligations. Further, the NASD has from time to time considered whether the definition of "branch office" in the By-Laws should be revised.

In connection with its review, the NASD, on February 9, 1988, issued Notice to Members 88-11, which requested comments on proposed amendments to Article III, Section 27 of the Rules of Fair Practice that set forth specific minimum requirements for supervisory practices and procedures for NASD members. After reviewing

the comment letters, the NASD then published Notice to Members 88-44, requesting a member vote on proposed amendments substantially similar to those set forth in Notice to Members 88-11. The membership voted to approve the proposed amendments, and they were filed with the Securities and Exchange Commission. The Commission approved the amendments on October 13, 1988.

EXPLANATION

Amendments to Supervision Rules

The amendments substantially expand the specificity of Article III, Section 27 of the NASD Rules of Fair Practice with respect to a member's supervisory obligations. The NASD believes the new provisions will assist members in ensuring compliance with applicable laws, regulations, and rules by requiring that firms review their businesses and construct and document a supervisory system that is reasonably designed to achieve compliance with the securities laws and regulations and NASD rules applicable to the various areas of business in which NASD members are engaged.

The amendments also contain certain minimum required supervisory procedures and practices that the NASD believes to be necessary in any firm, regardless of size or type, in order to supervise adequately an investment banking and/or securities business.

The amendments require each firm to establish and maintain supervisory procedures and practices that provide for, at a minimum, the following:

(1) Establishment and maintenance of written supervisory and review procedures as specified in the proposed amendments;

(2) Designation of appropriately registered principals for each type of business in which the firm engages to carry out the firm's supervisory obligations;

(3) Designation as an OSJ for each location that meets the OSJ definition and any other locations for which such designation is appropriate to enable the firm to supervise properly, viewed in light of certain factors enumerated in the proposed amendments;

(4) Designation of one or more appropriately registered principal(s) in each OSJ, including the main office, and one or more appropriately registered representative(s) or principal(s) in each branch office to carry out the supervisory respon-

sibilities and activities assigned to that office by the member;

(5) Assignment of each registered person to a supervisor;

(6) Reasonable efforts to ensure that all supervisory personnel are properly qualified;

(7) Participation of each registered representative, individually or collectively and not less than annually, at an interview or meeting at which compliance matters relevant to the activities of such representative(s) are discussed;

(8) Designation and identification to the NASD of one or more principals who shall review the firm's supervisory practices and procedures and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations and with the rules of the NASD; and

(9) Establishment of a schedule for examining the firm's branch offices that takes into account the nature of the activity, volume of business, and number of persons at each office.

The amendments require that each firm maintain written supervisory procedures that describe the supervisory system implemented according to the above requirements and that list the titles, registration status, and locations of the required supervisory personnel and the specific responsibilities assigned to each. A copy of the member's supervisory procedures, or the relevant parts thereof, will be required to be kept and maintained at each OSJ and at each other location where supervisory activities are conducted on behalf of the member. The member will be required to amend its written supervisory procedures, as appropriate, within a reasonable time after changes occur in applicable laws, regulations, and rules, and as changes occur in the firm's supervisory system, and to communicate these changes throughout its organization.

Members also will be required to conduct a review, at least annually, of the business in which it engages for purposes of detecting and preventing violations of, and to ensure compliance with, applicable laws, regulations, and rules. At a minimum, this will include the periodic examination of customer accounts to detect and prevent irregularities and abuses, an annual inspection of each OSJ, and the inspection of branch offices in accordance with a schedule to be set forth in the

member's supervisory procedures. The member will be required to retain a written record of the dates upon which each inspection and review was conducted.

Amendments to Definitions of "Office of Supervisory Jurisdiction" and "Branch Office"

An "office of supervisory jurisdiction" (OSJ) is currently defined in Article III, Section 27 of the NASD Rules of Fair Practice as ". . . any office designated as directly responsible for the review of the activities of registered representatives or associated persons in such office and/or any other offices of the member." Under the amendments, an OSJ is any business location of a member firm at which *one or more* of the following functions take place:

- (1) Order execution and/or market making;
- (2) Structuring of public offerings or private placements;
- (3) Maintaining custody of customers' funds and/or securities;
- (4) Final acceptance (approval) of new accounts on behalf of the member;
- (5) Review and endorsement of customer orders pursuant to the provisions of proposed Article III, Section 27(d);
- (6) Final approval of advertising or sales literature for use by persons associated with the member, pursuant to Article III, Section 35(b)(1) of the Rules of Fair Practice; or
- (7) Responsibility for supervising the activities of persons associated with the member at one or more other offices of the member.

The term "branch office" is currently defined in Article I, Section (c) of the NASD By-Laws as ". . . an office which is owned or controlled by a member, and which is engaged in the investment banking or securities business." An Explanation of the Board of Governors in Schedule C to the NASD By-Laws reiterates this definition and also provides that a place of business of a person associated with a member is considered a branch office if the member (1) directly or indirectly contributes a substantial portion of the operating expenses of such place of business; and/or (2) authorizes a listing in any publication or other media, including a professional dealers digest or

telephone directory, that designates a place as an office or if the member designates any such place as an office to another organization.

The amendment redefines "branch office" as any business location of the member identified to the public or customers by any means as a location at which the investment banking or securities business is conducted on behalf of the member, excluding any location identified solely in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the office of the member responsible for supervising the activities of the identified location.

Conforming Amendment to By-Laws

Article I of the NASD By-Laws sets forth certain definitions applicable to terms used in the By-Laws and the Rules of Fair Practice. Section (c) defines branch office. Because branch office is now defined in Article III, Section 27(f)(2), the substantive definition is deleted from the By-Laws provisions, and a reference to Article III, Section 27 of the Rules is substituted.

Amendment to Schedule C to the By-Laws

An Explanation of the Board of Governors set forth at Schedule C to the By-Laws contains material pertaining to the distinction between an office of supervisory jurisdiction and a branch office and to the definition of a branch office. This material has been deleted because the text is inconsistent with the amended Article III, Section 27.

Effective Date

As stated in Notice to Members 88-44, the Board of Governors has determined that it is appropriate to provide members with a six-month period following SEC approval to bring their supervisory practices and procedures into compliance with the new rules. The amendments will therefore take effect April 13, 1989.

The texts of the new rule and of the By-Law and Schedule C amendments are attached. The existing provisions of Section 27, with the exception of paragraph (e), are deleted.

Questions concerning this notice can be directed to Dennis C. Hensley, NASD, Deputy General Counsel, at (202) 728-8245, or Jacqueline D. Whelan, Senior Attorney, Office of the General Counsel, at (202) 728-8270.

ARTICLE III, SECTION 27 - RULES OF FAIR PRACTICE

Sec. 27.

Supervisory System

(a) Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the rules of this Association. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by paragraphs (b) and (c) of this Section.

(2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker-dealer is required.

(3) The designation as an office of supervisory jurisdiction (OSJ) of each location that meets the definition contained in paragraph (f) of this Section. Each member shall also designate such other OSJs as it determines to be necessary in order to supervise its registered representatives and associated persons in accordance with the standards set forth in this Section 27, taking into consideration the following factors:

(i) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;

(ii) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;

(iii) whether the location is geographically distant from another OSJ of the firm;

(iv) whether the member's registered persons are geographically dispersed; and

(v) whether the securities activities at such location are diverse and/or complex.

(4) The designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.

(5) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.

(6) Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities.

(7) The participation of each registered representative, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the member at which compliance matters relevant to the activities of the representative(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative's(') place of business.

(8) Each member shall designate and specifically identify to the Association one or more principals who shall review the supervisory system, procedures, and inspections implemented by the member as required by this Section and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations, and with the rules of this Association.

Written Procedures

(b)(1) Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of this Association.

(b)(2) The member's written supervisory

procedures shall set forth the supervisory system established by the member pursuant to Section 27(a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the rules of this Association. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(b)(3) A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the rules of this Association, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

Internal Inspections

(c) Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with the rules of this Association. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected according to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and

the number of associated persons assigned to the location. Each member shall retain a written record of the dates upon which each review and inspection is conducted.

Written Approval

(d) Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction.

Qualifications Investigated

(e) Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association.

Definitions

(f)(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

- (i) order execution and/or market making;
- (ii) structuring of public offerings or private placements;
- (iii) maintaining custody of customers' funds and/or securities;
- (iv) final acceptance (approval) of new accounts on behalf of the member;
- (v) review and endorsement of customer orders, pursuant to paragraph (d) above;
- (vi) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Article III, Section 35(b)(1) of the Rules of Fair Practice; or
- (vii) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(f)(2) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding any location identified solely in a telephone directory line listing or on a business

card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised.

AMENDMENTS TO ARTICLE I— NASD BY-LAWS

(Note: Deleted language is in brackets; new language is underlined.)

When used in these By-Laws, and any rules of the Corporation, unless the context otherwise requires, the term:

(a) - (b) No change;

(c) "branch office" means an office [located in the United States which is owned or controlled by a member, and which is engaged in the investment banking or securities business;] defined as a branch office in Article III, Section 27 of the Rules of Fair Practice;

(d) - (o) No change.

AMENDMENTS TO SCHEDULE C TO THE NASD BY-LAWS

Explanation of the Board of Governors

[Distinction Between Branch Office and Office of Supervisory Jurisdiction;] Appointment of Executive Representative; [Standards for Determining Branch Offices].

[The term "office of supervisory jurisdiction" defined in Section 27 of Article III of the Rules of Fair Practice means any office designated by the member in its memorandum of supervisory procedures, established pursuant to Article III, Section 27 of the Rules. Such office shall be directly responsible for the review of the activities of Registered Representatives and persons associated with the member in that office and/or in other offices of the member.]

The term "executive representative" as found in Section 3 of Article III of the By-Laws means that person designated by the member to represent, vote and act for the member in all the affairs of the Corporation. Pursuant to the provisions of Section 8 of Article III of the By-Laws, every member who maintains a registered branch office in a district of the Corporation other than the one in which its main office is located, is entitled to one vote on all matters pertaining solely to the district in which such registered branch office is located, including

the election of members of the Board of Governors from such district. Should a member maintain more than one branch office in a district, it is entitled to only one vote in that district. Therefore, each member shall designate one executive representative and shall designate one "district executive representative" for each district other than the one in which the main office is located in which the member maintains a registered branch office.

[The term "branch office" defined in Article I of the By-Laws means any office, including a corporate subsidiary of a member, located in the United States and other than the main office which is owned or controlled by a member and engaged in the investment banking or securities business.]

Each member is under a duty to insure that its membership application with the Corporation is kept current at all times by supplementary amendments to its original application and that any offices other than the main office are properly designated and registered, if required, with the Corporation. [Each member must also determine in light of the requirements of Article III, Section 27 of the Rules of Fair Practice, the form of its written supervisory procedures, and, accordingly, which offices are to be designated as offices of supervisory jurisdiction responsible for carrying out the written procedures.]

Each member must designate to the Association those offices of supervisory jurisdiction, including the main office, and must register those offices which are deemed to be branch offices in accordance with the standards [found hereafter] set forth in Article III, Section 27 of the Rules of Fair Practice. [A branch office would be considered an office of supervisory jurisdiction only if designated as such and only if specified supervisory activities are assigned to it under the member's written procedures. Members should note that the term "branch office" of itself does not carry any implication that the branch office personnel are required to perform any supervisory function. The term "branch office" is merely to designate and identify for registration purposes the various offices of a member other than the main office and as such are required to be registered and as to which a registration fee should be paid. If an office falls within the definition of both an office of supervisory jurisdiction and a branch office, it must be designated to the Corporation in each category, and it must be registered as a branch of-

office, and the applicable registration fee for a branch office must be paid.

In determining whether an office or the activities of a person associated with a member in an area constitutes a branch office of a member, the following standards shall be used:

1. It shall be considered a branch office if the member directly or indirectly contributes a substantial portion of the operating expenses of any place used by a person associated with a member who is engaged in the investment banking or securities business, whether it be

commercial office space or a residence. Operating expenses, for the purposes of the

standard, shall include items normally associated with the cost of operating the business such as rent and taxes.

2. It shall be considered a branch office if the member authorizes a listing in any publication or any other media, including a professional dealer's digest or a telephone directory, which listing designates a place as an office or if the member designates any such place with an organization as an office.]

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 85

Suggested Routing:*

- Senior Management
- Corporate Finance
- Government Securities
- Institutional

- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Systems
- Trading
- Training

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

Subject: Securities and Exchange Commission Decision Re: Handling Customers' Limit Orders

EXECUTIVE SUMMARY

The Securities and Exchange Commission has affirmed a finding by the NASD Board of Governors that a member firm, by accepting a customer's limit order, had an obligation to give that order priority over its own proprietary position unless it had previously arrived at a different understanding with the customer.

BACKGROUND

The Securities and Exchange Commission has issued a decision In the Matter of the Application of E.F. Hutton & Company, Inc., n/k/a Shearson Lehman Hutton, Inc., (Securities Exchange Act Release No. 25587) in which the Commission affirmed findings by the NASD Board of Governors that Hutton had failed to properly carry out its obligations to its customer in the manner in which the firm handled the customer's limit order.

The facts of the case were that a customer of the firm had placed an open limit order to sell 5,000 shares of an over-the-counter security at a price of 17 1/8. The firm accepted the order at a

time when it was a registered market maker in the security with quotes in the NASDAQ System of 17 bid, 17 1/2 asked. While holding the customer's order, the firm sold shares from its inventory at prices higher than the 17 1/8 price sought by the customer.

The Commission affirmed the NASD's conclusion that, by accepting the customer's limit order, the firm had an obligation to give that order priority over its own proprietary position unless it had previously arrived at a different understanding with the customer. Since no such understanding had been reached in this case, the NASD and the Commission concluded that the firm did not fulfill its obligations to the customer and that such activity constituted a violation of Article III, Section 1 of the NASD Rules of Fair Practice. The Commission found "[i]t is hornbook law that, absent disclosure and a contrary agreement, a fiduciary cannot compete with his beneficiary with respect to the subject matter of their relationship."¹ The Commission concluded that the practice at issue affected the fundamentals of the broker-dealer customer relationship in that the firm was, in effect, competing with the customer with respect to the subject matter for their relationship — the execution of the order.

This matter is currently on appeal before the United States Court of Appeals for the District of Columbia Circuit.

Questions regarding this notice may be directed to Dennis C. Hensley, Vice President and Deputy General Counsel, at (202) 728-8245, or

T. Grant Callery, Associate General Counsel, at (202) 728-8285

¹Securities and Exchange Act Release 25587 (July 6, 1988) p. 6. Footnote omitted.

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 86

Suggested Routing:*

- Senior Management
- Corporate Finance
- Government Securities
- Institutional

- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Systems
- Trading
- Training

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

Subject: Approval and Immediate Effectiveness of Article III, Section 43 of the NASD Rules of Fair Practice Regarding Outside Business Activities

EXECUTIVE SUMMARY

The SEC has approved new Section 43 to Article III of the NASD Rules of Fair Practice. The new section prohibits all persons associated with a member in any registered capacity from accepting employment or compensation from any other person as a result of business activity outside the scope of the employment relationship with a member unless prompt written notice to the member firm is provided. This provision does not apply to compensation from passive investments and activities subject to the requirements of Article III, Section 40 of the Rules of Fair Practice. The text of the rule follows this notice.

BACKGROUND

On October 13, 1988, the Securities and Exchange Commission (SEC) approved new Section 43 to Article III of the NASD Rules of Fair Practice (see SEC Release No. 34-26178 (dated October 13, 1988)). The section is intended to improve the supervision of registered personnel by providing information to member firms con-

cerning outside business activities of their representatives.

On January 14, 1988, the NASD issued Notice to Members 88-5, which solicited comments on a proposed NASD Rule of Fair Practice prohibiting any person associated with a member firm from being employed by, or accepting compensation from, any other person based on any business activity outside the scope of the employment relationship with a member firm, unless such person had provided prior written notice to that firm.

When requesting comments concerning the proposed rule, the NASD Board of Governors observed that the expansion of the financial services industry had provided increased business opportunities for persons associated with a member firm, both within the scope of their employment with a member and otherwise. The Board noted that, in recent disciplinary cases, prior notice to a member firm of an associated person's outside business activities might have prevented harm to the investing public or the firm's entanglement in legal difficulties.

The Board further observed that the internal rules of many member firms already included limitations on outside business activities and notification requirements, and that both the

New York Stock Exchange and the American Stock Exchange require associated persons of member firms to notify their firms of outside business activities.¹ The Board concluded that it was appropriate for member firms to receive prompt notification of all outside business activities of their associated persons so that the member's objections, if any, to such activities could be raised at a meaningful time and so that appropriate supervision could be exercised as necessary under applicable law.

After reviewing comments submitted by the membership, the NASD Board concluded that the proposed rule should be adopted with certain modifications limiting the rule's application to persons associated with a member in a registered capacity and exempting passive investments and activities subject to the requirements of Article III, Section 40 of the NASD Rules of Fair Practice from the proposed rule's notice requirements. The Board determined that prompt, rather than prior, notice should be required under the proposed rule, and that the form of the written notice should be determined by the employer-member and could therefore include using Form U-4. The proposed rule, as modified, was approved after a member vote (see Notice to Members 88-45 dated July 1, 1988) and was filed with the SEC on July 27, 1988.

Questions concerning this notice can be directed to Norman Sue, Jr., Senior Attorney, Office of the General Counsel, at (202) 728-8117

OUTSIDE BUSINESS ACTIVITIES

Sec. 43. No person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member. Such notice shall be in the form required by the member. Activities subject to the requirements of Article III, Section 40 of the Rules of Fair Practice shall be exempted from this requirement.

¹New York Stock Exchange Rule 346(b), (c), and Supplementary Material .10; American Stock Exchange Rule 342(a), (b), and Commentary .20. Both organizations also require persons in supervisory positions to devote their entire time during business hours to the business of their firms and allow such persons to obtain permission from the exchange to devote less than full time to the business of their firm when it will not impair the protection of investors or the public interest.

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 87**Suggested Routing:***

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

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

REQUEST FOR COMMENTS

Subject: Proposed Amendment Re: Predispute Arbitration Clauses in Customer Agreements; Last Date for Comment: December 1, 1988

EXECUTIVE SUMMARY

The NASD requests comments on a proposed amendment to Article III, Section 21 of the NASD Rules of Fair Practice. The amendment would require each member using a predispute arbitration clause in a customer agreement to highlight that clause and to include similarly highlighted disclosures concerning the nature of arbitration and the waiver of the customer's right to litigate disputes arising under the agreement.

The amendment also would prohibit the use in any agreement of any language that limits or contradicts the arbitration rules of

any self-regulatory organization, limits the ability of a party to file a claim in arbitration, or limits the ability of the arbitrators to make an award under the arbitration rules of a self-regulatory organization and applicable law.

The NASD Board of Governors believes this amendment is appropriate to provide customers with effective disclosure of the meaning and effect of predispute arbitration clauses and to maintain the integrity of the arbitration process.

The text of the proposed amendment follows this notice.

BACKGROUND AND ANALYSIS

In keeping with its support for the continued improvement of securities industry arbitration as a fair, expeditious, and economical means for the resolution of disputes, the Board of Governors has responded to suggestions of the Securities and Exchange Commission and others seeking more explicit disclosure of the existence and meaning of

predispute arbitration clauses in customer agreements.

The Board of Governors believes that in order to provide clear and informative disclosure of the existence and meaning of predispute arbitration clauses, investors should be placed on appropriate notice of the fact they are making an important election to which they will be bound.

Therefore, the Board is soliciting comment on a proposed amendment to Article III, Section 21 of the NASD Rules of Fair Practice recommended by the NASD's National Arbitration Committee. The amendment would apply to any member using a predispute arbitration clause in new agreements signed by an existing or new customer on or after the effective date of the proposed amendment. As proposed, the amendment would require each member using a predispute arbitration clause in a customer agreement to highlight that clause and to include similarly highlighted disclosures concerning the nature of arbitration and the waiver of the customer's right to litigate disputes arising under the agreement. The amendment also would prohibit the use in any agreement of any language that limits or contradicts the arbitration rules of any self-regulatory organization, limits the ability of a party to file a claim in arbitration, or limits the ability of arbitrators to make an award under the arbitration rules of a self-regulatory organization and applicable law.

The proposed amendment sets forth five affirmative statements (proposed Section 21(f)(1)(i)-(v)), that generally describe the effect of entering into a binding predispute arbitration agreement. In addition, the proposed amendment would require that, immediately preceding the signature line in a customer agreement, a statement appear that the agreement contains a predispute arbitration clause. This statement would be initialed by the customer, and a copy of the entire agreement containing a predispute arbitration clause would be given to the customer, who would acknowledge receipt.

The Board specifically seeks comment as to whether a customer's refusal or failure to initial this statement or acknowledge receipt would tend to affect the validity of the entire customer agreement or should result in a violation of Article III, Section 21 of the NASD Rules of Fair Practice.

The Board also solicits comments concerning proposed Section 21(f)(4), which would prohibit members from including in customer contracts any condition that purports to limit or contradict the arbitration rules of any self-regulatory organization, limits the ability of a party to file any claim in arbitration, or limits the ability of an arbitrator or arbitrators to make an award under such rules and applicable law. In considering the foregoing

proposed amendment, the Board of Governors determined that members should be permitted to include additional language in their disclosures concerning predispute arbitration agreements pointing out the advantages of arbitration and the fact that arbitration is favored by both federal and state law. The Board seeks comment concerning the most appropriate means for effecting and/or limiting such representations, whether by uniform rule or otherwise.

The NASD encourages all members and other interested persons to comment on the proposed amendment. Comments should be directed to:

Mr. Lynn Nellius, Secretary
National Association of Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Comments must be received no later than December 1, 1988. Comments received by this date will be considered by the NASD's National Arbitration Committee and the NASD Board of Governors. If the proposed amendment is approved by the Board, it will be submitted to the membership for a vote. If approved by the membership, the amendment must be filed with and approved by the Securities and Exchange Commission before becoming effective.

Questions concerning this notice may be directed to Norman Sue, Jr., Senior Attorney, NASD Office of General Counsel, at (202) 728-8117.

PROPOSED AMENDMENT TO ARTICLE III, SECTION 21 OF THE NASD RULES OF FAIR PRACTICE

(Note: New language is underlined.)

Books and Records

Section 21

Requirements Concerning Predispute Arbitration Agreements With Customers

(f)(1) No member shall execute an agreement with a customer containing a predispute arbitration clause unless such clause is highlighted and contains the following disclosure language

which shall also be highlighted:

(i) Arbitration is final and binding on the parties.

(ii) The parties are waiving their right to seek remedies in court, including the right to jury trial.

(iii) Pre-arbitration discovery is generally more limited than and different from court proceedings.

(iv) The arbitrator's award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited.

(v) The panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry.

(2) Immediately preceding the signature line, there shall be a statement initialed by the customer acknowledging that the agreement contains a predispute arbitration clause.

(3) A copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(4) No agreement shall include any condition which limits or contradicts the arbitration rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make an award under such rules and applicable law.

(5) The requirements of this subsection (f) shall apply only to new agreements signed by an existing or new customer of a member after (effective date).

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 88

Suggested Routing:*

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

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

Subject: Amendment to Section 34, of the NASD Rules of Fair Practice
Re: Prohibition on Non-Cash Sales Incentives in Public Offerings
Effective January 1, 1989

EXECUTIVE SUMMARY

The Securities and Exchange Commission has approved amendments to Appendix F under Article III, Section 34 of the Rules of Fair Practice ("Appendix F") and the Interpretation of the Board of Governors Review of Corporate Financing, pursuant to Article III, Section 1 of the Rules of Fair Practice (the "Interpretation"). The amendments, which become effective January 1, 1989, prohibit members from accepting non-cash sales incentives in connection with the sale of public direct participation programs, corporate debt and equity offerings, and real estate investment trusts. The text of the amendments are attached.

BACKGROUND

The amendments to Appendix F and the Interpretation prohibiting non-cash sales incentives in public offerings are the result of the NASD's long-standing concern about the use of incentives as sales compensation. Sales incentives typically are

offered to registered representatives of member firms based on their sales of public direct participation programs or real estate investment trusts. Non-cash incentives usually take the form of trips to vacation resorts or the selection of luxury merchandise.

The NASD believes that the ability of members to supervise their registered representatives is severely impacted when an outside entity such as a direct participation program sponsor or real estate investment trust offers and provides non-cash incentives to a member's retail sales force. This is particularly true when direct appeals promoting incentives are made to registered representatives, making it difficult for members to adequately control the participation of their registered representatives in non-cash incentive programs.

Since incentive programs appear to have become more prevalent and more aggressive, the NASD determined that attempts to control sales incentives, short of a prohibition, would not be effective. These amendments, by prohibiting the receipt of non-cash sales incentives and clarifying the procedures for the receipt of cash compensation, strengthen the ability of member firms to supervise their associated persons.

The NASD has determined not to prohibit

members from establishing in-house non-cash sales incentive programs where the programs are funded entirely by the member and offered only to registered representatives associated with that member. The NASD believes that it is the influence of outside entities on the member's sales force that has the effect of undermining the member's ability to supervise. With an in-house incentive program, the member has control over the suitability of the particular program, is responsible for the sales methods used to sell an offering, and is in a position to exercise control over its registered representatives.

EXPLANATION OF AMENDMENTS

The amendment to Subsection 5(e) of Appendix F addresses the receipt of non-cash compensation and prohibits any member or person associated with a member from accepting any non-cash compensation or sales incentive (such as travel bonuses, prizes, and awards) offered or provided by any sponsor, affiliate of a sponsor, or direct participation program, including specifically sponsors affiliated with the member.

However, in order to provide for the receipt of small, souvenir-type incentive items by members and associated persons, the amendment permits the acceptance of non-cash incentive items offered directly by a sponsor, affiliate of a sponsor or program where (1) the aggregate value of all such items provided to each associated person during any year does not exceed \$50; (2) the value of all such items made available in connection with a public offering is included as underwriting compensation subject to the NASD's underwriting compensation guidelines; and (3) the proposed payment or transfer of all such incentive items is disclosed in the prospectus or similar offering document.

With respect to a member's own in-house incentive program, the amendment to Subsection 5(e) permits a member to provide non-cash compensation or sales incentive items to its associated persons only where no sponsor, affiliate of a sponsor, or direct participation program directly or indirectly participates in or contributes to providing such non-cash compensation.

A sponsor, affiliate of a sponsor, or program would be deemed to be "participating" in an in-house program if it assists in the selection of or arrangements for any trip or merchandise item

provided to the associated persons of a member. Similarly, a sponsor, affiliate of a sponsor, or program would be deemed to be "contributing" to an in-house incentive program if it directly or indirectly provides monetary support to such program. Sponsors affiliated with members, as well as independent sponsors, are equally subject to the prohibition on directly or indirectly funding or providing non-cash compensation to associated persons of members.

Subsection 5(f) of Appendix F, as amended, is applicable to the acceptance of cash compensation by members, subject to the limitations on the receipt of direct or indirect non-cash compensation in Subsection 5(e). Under the new amendment, a member may accept cash compensation only if: (1) the compensation is paid directly to the member and any distribution to the member's associated persons is controlled solely by the member; (2) the value of all compensation is included as underwriting compensation subject to the NASD's limits on maximum underwriting compensation; (3) the payment of the compensation is disclosed in the prospectus or similar offering document; (4) the compensation is recorded on the member's books and records as compensation received in connection with a public offering; and (5) the compensation is not directly or indirectly related to any non-cash compensation or sales incentive provided by a member to its associated persons.

These provisions are intended to clarify the fact that a member is permitted to use any cash compensation it may receive to defray the expenses of internal non-cash sales incentive programs, but that affiliated and non-affiliated sponsors may not offer and that affiliated and non-affiliated members may not accept participation in or contribution to such internal non-cash incentive programs. In other words, in-house incentive programs are permitted only when funded entirely by the member's own funds, the receipt of which was not directly or indirectly linked to an in-house incentive program.

The amendment to the Interpretation is applicable to corporate debt and equity offerings, including real estate investment trusts. The amendment imposes the same prohibition as the amendment to Appendix F on members or persons associated with members from accepting, directly or indirectly, any non-cash sales compensation or

sales incentive item (including, but not limited to, travel bonuses, prizes, and awards) valued in excess of \$50 per person per issuer annually. As in the case of a direct participation program, a member is permitted to provide non-cash sales incentive items to its associated persons provided that no issuer, affiliate of an issuer, including an affiliate of the member, directly or indirectly participates in or contributes to providing such non-cash sales incentives.

EFFECTIVE DATE

The amendments to Appendix F and the Interpretation will become effective January 1, 1989. Most currently operating non-cash sales incentive programs have qualifying periods that coincide with the calendar year; therefore, the last day that sales may be applied to a current incentive program will be December 31, 1988. However, during calendar year 1989, members and their associated persons will be permitted to receive non-cash incentives earned prior to January 1, 1989, provided that the incentive program has been approved by the NASD's Corporate Financing Department and is in compliance with the current requirements of Subsection 5(f) of Appendix F.

Questions regarding this notice can be directed to either Richard J. Fortwengler, Assistant Director, or Ms. Allyn M. O'Connor, Supervisor, NASD Corporate Financing Department, at (202) 728-8258.

AMENDMENT TO APPENDIX F UNDER ARTICLE III, SECTION 34 OF THE RULES OF FAIR PRACTICE

(Note: New language is underlined; deleted language is in brackets.)

Sec. 5

Organization and Offering Expenses

e) No [sponsor, affiliate of a sponsor (other than a member dealing with persons associated with that member), or program] member or person associated with a member shall directly or indirectly accept [provide] any non-cash compensation or sales incentive item [,] including, but not limited to, travel bonuses, prizes, and awards offered or provided to such member or its associated persons by any sponsor, affiliate of a sponsor or program. Notwithstanding the foregoing, a member may provide non-

cash compensation or sales incentive items to its associated persons provided that no sponsor, affiliate of a sponsor or program, including specifically an affiliate of the member, directly or indirectly participates in or contributes to providing such non-cash compensation. Further, this section shall not prohibit [directly to] a person associated with a member from accepting any non-cash sales incentive item offered directly to that person by a sponsor, affiliate of a sponsor or program [unless] where:

1) the aggregate value of all such items [to be received] paid by any sponsor or affiliate of a sponsor to each associated person during any year does not exceed \$50;

(2) the value of all such items to be made available in connection with an offering is included as compensation to be received in connection with the offering for purposes of subsection (b) of this section; and

(3) the proposed payment or transfer of all such items [to be made available in connection with any offering] is disclosed in the prospectus or similar offering document.

(f) Subject to the limitations on direct and indirect non-cash compensation provided under subsection (e) of this section, [N]no [sponsor, affiliate of a sponsor, or program shall provide compensation to a] member [in the form of sales incentives or bonuses] shall accept any cash compensation unless all of the following conditions are satisfied:

(1) all [sales incentives and bonuses are] compensation is paid directly to the member in cash and the distribution, if any, of [incentives or bonuses] all compensation to the member's associated persons is controlled solely by the member;

(2) the value of all [incentives or bonuses] compensation to be [made available] paid in connection with an offering is included as compensation to be received in connection with the offering for purposes of subsection (b) of this section;

(3) arrangements relating to the proposed payment of all [incentives or bonuses] compensation are disclosed in the prospectus or similar offering document; [and]

(4) the value of all [incentives and bonuses] compensation paid in connection with an

offering is reflected on the books and records of the recipient member as compensation received in connection with the offering; and
(5) no compensation paid in connection with an offering is directly or indirectly related to any non-cash compensation or sales incentive items provided by the member to its associated persons.

**AMENDMENT TO THE
INTERPRETATION OF THE BOARD OF
GOVERNORS-REVIEW OF
CORPORATE FINANCING, ARTICLE
III, SECTION 1 OF THE RULES OF
FAIR PRACTICE**

(Note: New language is underlined and follows paragraph on "Overallocation Options" under "Arrangement Factors" section of Corporate Financing Interpretation on page 2033 of the NASD Manual.)

Sales Incentives

When proposed in connection with the distribution of a public offering of securities, it shall be an unfair and unreasonable arrangement for a member or person associated with a member to accept, directly or indirectly, any non-cash sales incentive item, including but not limited to travel bonuses, prizes and awards, from an issuer or affiliate of an issuer in excess of \$50 per person per issuer annually. Notwithstanding the foregoing, a member may provide non-cash sales incentive items to its associated persons provided that no issuer, affiliate of the issuer, including specifically an affiliate of the member, directly or indirectly participates in or contributes to providing such non-cash sales incentive.

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 89

Suggested Routing:*

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

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

Subject: Amendment to Schedule E of the NASD By-Laws Re: Definition of Qualified Independent Underwriter — Effective December 1, 1988

EXECUTIVE SUMMARY

The SEC has approved an amendment to the definition of qualified independent underwriter contained in Section 2(l) of Schedule E to the NASD By-Laws. The amendment, which becomes effective December 1, 1988, precludes a member from acting as a qualified independent underwriter if any of its associated persons having supervisory responsibility for organizing, structuring, or performing due diligence with respect to corporate public offerings of securities have within the previous five-year period been convicted or enjoined or have been the subject of dis-

ciplinary action by the NASD, the SEC or any self-regulatory organization for distribution-related activities resulting in a suspension or bar from a self-regulatory organization.

Additionally, the amendments would require a qualified independent underwriter to have experience in managing or co-managing public offerings of a size and type similar to the proposed offering. They also would restrict the qualified independent underwriter's direct or indirect ownership of the issuer's equity securities. The text of the amendment is attached.

BACKGROUND

The Securities and Exchange Commission approved an amendment to Schedule E to the NASD By-Laws regarding the definition of qualified independent underwriter. The amendment to the definition is intended to clarify and enhance the current criteria and to ensure that the purposes of Schedule E will be achieved.

Schedule E contains a number of requirements intended to address conflicts of interest experienced by a member that engages in a public

offering of its own securities or the securities of the member's parent or affiliate. One of the major conflicts arises when a member participates in establishing the public offering price of the securities and conducts due diligence with respect to the registration statement. Schedule E addresses these conflicts by requiring that a member, independent of the issuer, with a background in underwriting, a track record of profitable operations, and experienced management conducts due diligence, participates in the preparation of the

registration statement and offering documents, and provides an opinion on the price of an equity issue or the yield of a debt issue. Such member is termed a qualified independent underwriter and must satisfy the objective criteria contained within the definition of that term in Section 2(1) of Schedule E.

The Corporate Financing Committee and the Board of Governors have determined that it is necessary to amend the current criteria to ensure that the purposes of Schedule E will be achieved. Therefore, Schedule E has been amended to enhance and clarify the existing experience requirement contained in Subsection 2(1)(4) of Schedule E, specify the level at which a member's direct or indirect ownership of the issuer's equity securities would disqualify the member from acting as a qualified independent underwriter and to add restrictions that would disqualify members because of disciplinary histories of certain of their associated persons.

EXPERIENCE REQUIREMENT

Prior to the amendment, Section 2(1)(4) stated that a qualified independent underwriter must be actively engaged in the underwriting of public offerings for at least the five-year period immediately preceding the filing of the registration statement. The NASD believes that the phrase "actively engaged in the underwriting of public offerings" should be amended to ensure that the qualified independent underwriter is sufficiently experienced to perform the due diligence and pricing functions with respect to the proposed public offering. Therefore, the Section has been amended to require that the member have experience in "managing or co-managing" public offerings of a "size and type similar to the proposed offering." The requirement that the qualified independent underwriter have managed or co-managed public offerings ensures that the member has had previous experience in performing the functions of due diligence and pricing that are functions traditionally fulfilled by managers and co-managers.

This requirement is coupled with the requirement that the member also have experience in offerings which are of similar size and type. The similar size and type requirement is intended to prevent, for example, a member with experience as an underwriter of small equity offerings from acting as a qualified independent underwriter for a large firm-commitment offering of high-risk, high-yield debt. As a result, subprovisions (a) and (b) of

Section 2(1)(4) include specific parameters relating to the size and type of previous offerings managed or co-managed by the member. In debt offerings, the member must have managed or co-managed other debt offerings, each with gross proceeds of not less than 25 percent of the gross proceeds of the proposed offering. In equity offerings, the member must have managed or co-managed other equity offerings, each with gross proceeds of not less than 50 percent of the gross proceeds of the proposed offering. In addition, if the member has acted as manager or co-manager of public offerings, each with gross proceeds of at least \$50 million, it is believed that managing such offerings demonstrates due diligence and pricing experience that qualifies the member for any type or size offering.

The experience requirement also contains alternative criteria that would permit a member to demonstrate that it has acquired the requisite experience through means other than acting as a manager or co-manager. The Association does not wish to preclude members from acting as qualified independent underwriters if they have extensive experience in performing due diligence and rendering fairness opinions in connection with corporate financing activities such as mergers and acquisitions but have no comparable experience as a manager or co-manager. Therefore, a member can satisfy the requirements if it can demonstrate that it has experience within the previous five years involving the pricing and due diligence functions that is comparable to the experience of a manager or co-manager of public offerings of securities of the size set forth in the first three criteria.

DISCIPLINARY HISTORY REQUIREMENTS

The amendment adopts a new Subsection 5 to Section 2(1) of Schedule E. The new Subsection precludes a member from acting as a qualified independent underwriter if any person associated with the member in a supervisory capacity responsible for structuring corporate public offerings or conducting due diligence has been convicted, enjoined, suspended, or barred within the previous five years for a violation of federal, state, or self-regulatory organization anti-fraud rules in connection with the distribution of securities.

Subsection (a) would disqualify a member if any of the supervisory personnel referred to above have been convicted within five years prior to the filing of the registration statement of a violation of

the anti-fraud provisions of federal or state laws or rules or regulations promulgated thereunder in connection with the distribution of a registered or unregistered offering of securities. Subsection (b) would disqualify a member if any of such supervisory personnel have been subject to any order, judgment, or decree of any court entered within five years prior to the filing of the registration statement, and if the order, judgment, or decree permanently enjoins or restrains such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of federal or state securities laws or any rules or regulations promulgated thereunder in connection with the distribution of a registered or unregistered offering of securities. Subsection (c) would disqualify a member if any of such supervisory personnel have been suspended or barred from association with any member by an order or decision of the Securities and Exchange Commission, any state, the NASD, or any self-regulatory organization within five years prior to the filing of the registration statement for any conduct or practice found to be in violation of the anti-fraud provisions of federal or state laws or rules or regulations promulgated thereunder or the anti-fraud rules of any self-regulatory organization in connection with the distribution of a registered or unregistered offering of securities.

EQUITY OWNERSHIP

The amendment redesignates present Subsection 5 as new Subsection 6, which restricts to less than 5 percent the beneficial ownership of the outstanding voting securities of a corporate issuer or partnership issuer by the qualified independent underwriter. Previously, Section 2(1)(5) provided that the qualified independent underwriter could not be an "affiliate" of the issuer. The definition of affiliate as contained in Section 2(a) of Schedule E involves the concept of control of the issuer and presumes affiliation when a member owns at least 10 percent of the voting stock of the issuer. Therefore, under the provisions of the old section, a qualified independent underwriter could, for example, own 8 percent of the outstanding securities of the issuer and meet the criteria of a qualified independent underwriter. The NASD determined that the affiliation standard did not provide for sufficient objectivity. The amendment provides that a member may not beneficially own 5 percent or

more of the outstanding voting securities of a corporate issuer or beneficially own a partnership interest in 5 percent or more of the distributable profits or losses of an issuer which is a partnership.

EFFECTIVE DATE

The amendment becomes effective December 1, 1988. Therefore, all offerings declared effective by the SEC, or if SEC-exempt, by another reviewing regulatory authority on or after December 1, 1988, are required to comply with the new definition of qualified independent underwriter.

Questions regarding this notice should be directed to Charles L. Bennett, Assistant Director, NASD Corporate Financing Department at (202) 728-8258.

AMENDMENT TO SCHEDULE E TO THE BYLAWS

(Note: New language is underlined.)

Section 2 — Definitions

(1) Qualified independent underwriter — a member which:

(4) has actively engaged in the underwriting of public offerings of securities of a similar size and type for at least the five-year period immediately preceding the filing of the registration statement. For purposes of this section, the above requirement shall be satisfied if the member:

(a) with respect to a proposed debt offering, has acted as manager or co-manager of public offerings of debt securities within the previous five years, including offerings each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering,

(b) with respect to a proposed equity offering, has acted as manager or co-manager of public offerings of equity securities (or of securities convertible into equity securities) within the previous five years, including offerings each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering, or

(c) has acted as manager or co-manager of public offerings of securities within the previous five years, including offerings each with gross proceeds of not less than \$50 million, or

d) demonstrates that it has acquired experience within the previous five years involving the pricing and due diligence functions comparable to that of a manager or co-manager of public offerings of securities in the above amounts;

(5) no person associated with the member in a supervisory capacity responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(a) has been convicted within five years prior to the filing of the registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with the distribution of a registered or unregistered offering of securities;

(b) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within five years prior to the filing of the registration statement permanently enjoining or restraining such person from

engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with the distribution of a registered or unregistered offering of securities; or

(c) has been suspended or barred from association with any member by an order or decision of the Securities and Exchange Commission, any state, the Corporation or any other self-regulatory organization within five years prior to the filing of the registration statement for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with the distribution of a registered or unregistered offering of securities; or

(6)[(5)] is not an affiliate of the entity issuing securities pursuant to Section 3 of this Schedule and does not beneficially own five percent or more of the outstanding voting securities of such entity which is a corporation or beneficially own a partnership interest in five percent or more of the distributable profits or losses of such entity which is a partnership; and

(7)[(6)] (No change)

Notice To Members

National Association of Securities Dealers, Inc.

November 1988

Number 88 - 90

Suggested Routing:*

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

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

REQUEST FOR COMMENTS

Subject: Proposed Rule Amendment, By-Laws Amendments Under Schedule C
Re: Training, Qualification, and Registration of Representatives and Principals;
Last Date for Comments: December 1, 1988

EXECUTIVE SUMMARY

The NASD requests comments on the following:

A proposed amendment to Article III, Section 27 of the Rules of Fair Practice that would require members to provide for the appropriate training of persons initially applying for registration and to take reasonable steps to maintain the knowledge of its registered persons with respect to the products and services such persons offer to the public.

Proposed amendments to Schedule C to the By-Laws that would require members to submit applications for and maintain the

registrations of only such persons who intend to engage or are engaged in the investment banking or securities business for the member and that would establish waiting periods between attempts to pass qualification examinations.

In addition, the NASD wishes to inform the membership of a policy change that substantially restricts the grounds on which requests for qualification examination waivers will be reviewed. The texts of the proposed amendments are attached. Comments must be received by December 1, 1988.

BACKGROUND

In response to certain recommendations of the NASD Regulatory Review Task Force, the Qualifications Committee of the NASD Board of Governors has undertaken to review the NASD qualification system and to consider additional means to maintain an appropriate level of knowledge and professionalism for persons as-

sociated with NASD members. This review will not only address the adequacy of existing NASD qualifications standards, but also will consider issues relating to the need to afford reasonable assurance to the investing public that registered persons remain knowledgeable about products and services available to investors, as well as applicable rules, regulations, and policies governing

the investment banking and securities business.

Although the review is ongoing, the Board of Governors has determined at this time to publish for comment proposals that address certain issues associated with the training, qualifications, and registration of representatives and principals.

SUPERVISION AND TRAINING

The NASD proposes to amend Article III, Section 27 of the Rules of Fair Practice, which sets forth supervisory standards applicable to NASD members,¹ to require that a member's supervisory practices and procedures include provisions for (1) the training of applicants at the time of application for registration and (2) taking reasonable steps to maintain registered persons' knowledge with respect to the products and services offered to the public.

The NASD believes that the initial training and continued competency of registered personnel is integrally linked to supervision in a complex and changing industry and that it is appropriate to require members to incorporate these responsibilities into their supervisory systems. The proposed amendment is drafted to allow a member flexibility in determining the means most appropriate to its operations in discharging this responsibility, including the use of training products and services of other organizations.

SCHEDULE C AMENDMENTS

Registration of Associated Persons

The NASD proposes to amend Part II, Section (1)(a) and Part III, Section (1)(a) of Schedule C to the By-Laws to require that members register only persons who are engaged or will engage in the investment banking or securities business on behalf of the member in the capacities of principal and representative. The proposed amendment would specifically prohibit members from maintaining registrations for persons who no longer function as principals or representatives of the firm and who no longer are active in the member's investment banking or securities business, or who wish to avoid the re-examination requirement applicable to persons who are not registered for more than two years.

Members also would be prohibited from sponsoring an application for registration where there is no intent to maintain the applicant's employment with the member after examination. The NASD believes this amendment is fully consis-

tent with the historic intent of the qualification and registration program and that the proposed amendment is necessary to prevent such unacceptable practices as "parking" registrations and using NASD membership to gain a competitive advantage in operating a commercial training business.

Waiting Periods Between Attempts on Qualification Examinations

The NASD also proposes to amend Part VI of Schedule C to the By-Laws to establish waiting periods between attempts to pass NASD qualification examinations. Waiting periods were in effect in the NASD qualification program until 1979 and now are used in connection with the qualification examinations of the Municipal Securities Rulemaking Board (MSRB). The extensive automation of the registration and qualification process has made it possible for applicants to make multiple attempts to pass examinations in rapid succession, often within very brief periods.

The NASD believes this practice promotes "test learning" rather than a proper understanding of the substantive material covered in the various qualification examinations. The proposed waiting periods are intended to encourage a more professional approach to the examination process and to the training of applicants, as well as to protect the integrity of the qualification examinations. In the interest of uniformity, the proposed waiting periods are the same as those prescribed by the MSRB — 30 days between the first and second attempts, 30 days between the second and third attempts, and six months after the third and all subsequent attempts.

EXAMINATION WAIVER POLICY

Part VI, Section (5) of Schedule C to the By-Laws permits the waiver of a qualification examination and reads as follows:

"(5) The President of the Corporation may, in exceptional cases and where good cause is shown, waive the applicable Qualification Examination upon written request by the member and accept other standards as evidence of an applicant's qualifications for registration. Advanced age, physical infirmity or experience in fields ancillary to the investment banking or securities business will not individually of themselves constitute sufficient grounds to waive a Qualification Examination."

The number of waiver requests has increased

significantly in recent years at a time when the securities business and, consequently, the NASD's qualification program have become more complex. Waiver requests now are reviewed under guidelines, developed by the Qualifications Committee and approved by the Board, which focus primarily upon the applicant's experience in fields related to the securities business. The NASD has become concerned that this process no longer is consistent with the best interests of the securities industry or the investing public. The purpose of the qualification examinations is to provide an objective and quantifiable measure of minimum applicant competency.

The NASD believes the examinations do not pose an unreasonable barrier to registration to any class of applicants. Thus, the NASD has determined that the examination should be a prerequisite for all applicants, with exceptions granted only in highly unusual circumstances. As a consequence, waiver requests based only on ancillary experience, such as investment management, or advisory services, will be routinely denied. This policy will be applied to both initial examination waiver requests and requests to waive the re-examination requirements of Part II, Section 1(c) and Part III, Section 1(c) of Schedule C.

It should be noted that this policy would not affect a person whose registration in a particular capacity may be wrongly terminated due, for example, to an incorrectly completed Form U-4, provided that such person's continuous activity in the registrable function can be documented by a member.

The NASD encourages all members and interested parties to comment on the proposed amendments. Comments should be directed to:

Mr. Lynn Nellius, Secretary
National Association of Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Comments must be received no later than **December 1, 1988**. Comments received by this date will be considered by the NASD Qualifications Committee and by the NASD Board of Governors. Any changes to the NASD Rules of Fair Practice must be voted on by the membership and filed with, and approved by, the Securities and Exchange Commission before becoming effective.

Any changes to Schedule C to the By-Laws must be filed with, and approved by, the SEC before becoming effective.

Questions concerning this notice can be directed to Frank McAuliffe, Vice President, NASD Qualifications, at (301) 590-6694, or Jacqueline D. Whelan, Senior Attorney, NASD Office of General Counsel, at (202) 728-8270.

PROPOSED AMENDMENTS TO ARTICLE III, SECTION 27 OF THE NASD RULES OF FAIR PRACTICE

(Note: Proposed additional language is underlined.)
Section 27

Supervisory System

(a) Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with the rules of this Association. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(7) The training of persons applying for general or limited registration consistent with the qualification requirements of the NASD and other applicable securities self-regulatory organizations and reasonable steps to maintain levels of knowledge of registered persons with respect to the products and services such persons offer to the public.

(Subsequent sections to be renumbered consecutively.)

PROPOSED AMENDMENTS TO SCHEDULE C OF THE BY-LAWS

(Note: New language is underlined; deleted language is in brackets.)

II

REGISTRATION OF PRINCIPALS

(1) Registration Requirements

(a) All Principals Must be Registered — All persons [associated] engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such with the Corporation in the category of registration appropriate to the function to be

performed as specified in Part II, Section (2) hereof. Before their registrations can become effective, they shall pass a Qualification Examination for Principals appropriate to the category of registration as specified by the Board of Governors. A member shall not maintain a principal registration with the Corporation for any person who is no longer active in the member's investment banking or securities business in a principal capacity or for any person where the sole purpose of the registration is to avoid the examination requirement prescribed in Section (1)(c) hereof. A member shall make application for the registration of any person as principal where there is no intent to employ such person in the member's investment banking or securities business after the examination.

III

REGISTRATION OF REPRESENTATIVES

(1) Registration Requirement

(a) All Representatives Must be Registered — All persons [associated] engaged or to be engaged in the investment banking or securities business of a member who are to function as representatives shall be registered as such with the Corporation in the category of registration appropriate to the function to be performed as specified in Part III, Section (2) hereof. Before their registrations can become effective, they shall pass a Qualification Examination for Representatives appropriate to the category of registration as specified by the Board of Governors. A member shall not maintain a representative registration with the Corporation for any person

who is no longer active in the member's investment banking or securities business in a representative capacity or for any person where the sole purpose of the registration is to avoid the examination requirement prescribed in Section (1)(c) hereof. A member shall not make application for the registration of any person as a representative where there is no intent to employ such person in the member's investment banking or securities business after the examination.

VI

QUALIFICATION EXAMINATIONS AND WAIVER OF REQUIREMENTS

(6) Any person associated with a member who fails to pass a qualification examination prescribed by the Corporation shall be permitted to take the examination again after a period of 30 calendar days has elapsed from the date of the prior examination, except that any person who fails to pass an examination three or more times in succession shall be prohibited from again taking such examination until a period of six months has elapsed from the date of such person's last attempt to pass the examination.

¹On August 1, 1988, the NASD membership approved substantial changes in the provisions of Article III, Section 27. These changes, which were approved by the Securities and Exchange Commission on October 13, 1988, will become effective April 13, 1989. See Notice to Members 88-84, dated November 1, 1988. The proposals set forth herein would amend Article III, Section 27 as it will be in effect as of April 13, 1989, and would take effect at that time.