

Notice To Members

National Association of Securities Dealers, Inc.

December 1988

Number 88 - 95

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 type="checkbox"/> Registration | <input checked="" 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: SEC Approval of Amendment to NASD Rules of Fair Practice Re: Prompt Payment for Investment Company Shares — Effective Date: January 1, 1989

EXECUTIVE SUMMARY

The Securities and Exchange Commission recently approved an amendment to Article III, Section 26 of the NASD Rules of Fair Practice. This amendment, which replaces the Interpretation of the Board of Governors Relating to Prompt Payment by members for shares of investment companies, establishes time frames within which members must transfer payment for investment company shares to investment companies or their agents. The text of the amendment follows this notice.

BACKGROUND

On October 31, 1988, the SEC approved a proposed rule change providing for a new paragraph (m) to Article III, Section 26 of the NASD Rules of Fair Practice. Since 1955, prompt payment by NASD members for investment company shares that they had sold to customers has been governed by the NASD Board of Governors Prompt Payment Interpretation. That interpretation did not, however, include a definition of the term "prompt payment." That interpretation has been

rescinded and replaced by the new paragraph (m) to Section 26. The amendment, as approved by the Commission, was adopted pursuant to member vote, which was solicited in Notice to Members 87-44.

EXPLANATION OF AMENDMENT

New Section 26(m) defines the term "prompt payment" in two sets of circumstances.

(1) The new rule will require members, including underwriters, who engage in direct retail transactions with customers to transmit payments that are received from their customers to investment companies or their agents by the later of the trade date plus five business days or the end of one business day following receipt of the customer's payment for such shares.

(2) The second paragraph of the rule requires members that are underwriters and that engage in wholesale transactions with other members to transmit payments received from such members to the funds or their agents by the end of two business days following the receipt of such funds.

Effective Date

In order to facilitate changes in internal firm procedures that will be required by this rule, the NASD has determined that the rule will become

effective January 1, 1989. The text of the new rule is attached. Questions concerning this notice can be directed to A. John Taylor, Vice President, Investment Companies/Variable Contracts, NASD, at (202) 728-8328.

**AMENDMENT TO NASD RULES OF
FAIR PRACTICE**
Investment Companies

Sec. 26

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Prompt Payment for Investment Company Shares

m (1) Members (including underwriters) that engage in direct retail transactions for investment company shares shall transmit payments

received from customers for such shares, which such members have sold to customers, to payees (i.e., underwriters, investment companies, or their designated agents) by (1) the end of the fifth business day following receipt of a customer's order to purchase such shares or by (2) the end of one business day following receipt of a customer's payment for such shares, whichever is the later date.

(2) Members that are underwriters and that engage in wholesale transactions for investment company shares shall transmit payments for investment company shares, which such members have received from other members, to investment company issuers or their designated agents by the end of two business days following receipt of such payments.

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**Subject: SEC Approval of Amendments to NASD By-Laws and Rules of Fair Practice
And New Government Securities Rules**

EXECUTIVE SUMMARY

On November 2, 1988, the Securities and Exchange Commission approved amendments to the NASD By-Laws and Rules of Fair Practice and new Government Securities Rules designed to permit the NASD to carry out its regulatory responsibilities under the Government Securities Act of 1986. Included among these rules is a Government Securities Advertising Rule.

This rule will require members to file advertising relating to government securities with the NASD. This requirement will be implemented as

of January 1, 1989.

The Government Securities Act provides for the regulation of government securities activities by brokers and dealers and creates a new section 15C of the Securities Exchange Act of 1934 that requires SEC registration and either NASD or exchange membership for government securities brokers and dealers. The text of the proposed amendments follows this notice.

BACKGROUND

Public Law 99-571 (the "Government Securities Act of 1986"), enacted by Congress in October 1986, amended the Securities Exchange Act of 1934 (1934 Act) by adding a new Section 15C that requires registration of government securities brokers and dealers and provides for adoption of rules for such brokers and dealers by the Treasury Department. In addition, the Government Securities Act amended Section 15A(f) of the 1934 Act to provide the NASD with the authority to adopt and implement rules applicable to its members; to enforce compliance with the

provisions of the Government Securities Act and rules and regulations adopted thereunder; to discipline members for violations of the Government Securities Act and rules; to examine members' books and records; and to implement the provisions of the 1934 Act relating to denial of membership, or association with members, or persons or entities subject to statutory disqualification. In addition, the Government Securities Act provided the NASD with the authority to adopt rules to prohibit fraudulent, misleading, deceptive, and false advertising of government securities.

A proposed amendment to Article III, Section

35 of the NASD Rules of Fair Practice, relating to advertising, was circulated for member comment in Notice to Members 87-24, dated April 14, 1987. These amendments have been incorporated into the Government Securities Rules. The remainder of the rule proposals relating to government securities activities of NASD member firms were circulated for member comment in Notice to Members 87-53, dated August 12, 1987. Notice to Members 88-1 solicited member votes on the proposals, which were approved by the membership and filed with the Securities and Exchange Commission. The Commission approved the amendments on November 2, 1988.

EXPLANATION

The amendments and new rules provide the NASD with the ability to carry out its responsibilities under the Government Securities Act. These amendments are divided into four parts:

- Amendments to the NASD By-Laws.
- Amendments to Schedule C of the NASD By-Laws regarding registration of individuals.
- An amendment to Article I, Section 5 of the NASD Rules of Fair Practice.
- A rule package designated as "Government Securities Rules" which provides substantive rules governing the activities of government securities brokers and dealers."

NASD By-Laws

These amendments incorporate into existing By-Law provisions appropriate references to government securities brokers and dealers or to the rules of the Treasury Department.

Substantive changes to the By-Laws include a new Section 8 to Article VII that allows the Board of Governors to adopt government securities rules subject to member vote and a new Section 6 to Article XVI that applies to limitations of powers. New Section 6 states that the By-Law provisions governing qualifications of members and rulemaking authority conferred upon the NASD shall not be inconsistent with the Government Securities Act. This provision is similar to an existing provision in the By-Laws relating to municipal securities brokers and dealers.

The amendments also contain changes to Article II, Section 4 of the By-Laws that define the term "disqualification." These changes generally

conform the NASD definition to the definition in the 1934 Act.

Schedule C to the NASD By-Laws

The amendments to Schedule C of the By-Laws add a new Part X. This section defines government securities principals and representatives. It also requires registration of government securities principals and representatives, and exempts from registration persons serving in an exclusively clerical or ministerial capacity. The definitions of the categories of individuals required to be registered either as principals or representatives track the provisions of Section 400.3(c) of the Treasury regulations. Such registration is required to provide the NASD with the information needed to make a determination of potential statutory disqualification and identify a firm's principals for purposes of contact with and examination of the firm.

NASD Rules of Fair Practice

The amendment to Article I, Section 5 of the Rules of Fair Practice is intended to clarify that the applicable Rules of Fair Practice do not apply to members that are registered with the SEC under Section 15C as sole government securities brokers or dealers. The provisions of the Rules of Fair Practice will, of course, remain fully applicable to members registered under Section 15(b) of the 1934 Act.

Government Securities Rules

The remaining provisions of the proposed rule package are designated as "Government Securities Rules." These rules are substantially parallel to the NASD Rules of Fair Practice in areas in which such rules are consistent with NASD obligations under the provisions of Section 15A(f) of the 1934 Act.

The proposed rules include provisions relating to the maintenance of books and records, supervisory procedures, and regulation of activities of members that are experiencing financial or operational difficulties or that are changing their exemptive status under the customer protection provisions applicable to government securities brokers and dealers. In addition, these rules contain a government securities advertising rule which imposes a requirement that government security advertising be filed with the NASD Advertising Department. The rules also provide the framework

for the NASD to bring disciplinary actions pursuant to the NASD Code of Procedure.

EFFECTIVE DATE

The amendments became effective upon approval by the Securities and Exchange Commission on November 2, 1988. With respect to the filing requirement for advertising, however, the NASD has determined that such filings should commence as of January 1, 1989.

Questions concerning this notice can be directed to T. Grant Callery, NASD Associate General Counsel, at (202) 728-8285. Questions relating to the advertising rule may be directed to R. Clark Hooper, Director, NASD Advertising Department, at (202) 728-8330.

Questions relating to financial responsibility aspects of the rules may be directed to Walter J. Robertson, Associate Director, Financial Responsibility, at (202) 728-8236.

NASD BY-LAWS

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

ARTICLE I

Definitions

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

- (a) "Act" means the Securities Exchange Act of 1934 as amended;
- (b) "bank" means (1) a banking institution organized under the laws of the United States, (2) a member bank of the Federal Reserve System, (3) any other banking institution, whether incorporated or not, doing business under the laws of any state or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks and which is supervised and examined by a State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of the Act, and (4) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (1), (2) or (3) of this subsection;
- (c) "branch office" means an office which is owned or controlled by a member, and which is engaged in the investment banking or securities business;

- (d) "broker" means any individual, corporation, partnership, association, joint stock company, business trust, unincorporated organization or other legal entity engaged in the business of effecting transactions in securities for the account of others, but does not include a bank;
- (e) "Commission" means the Securities and Exchange Commission;
- (f) "Corporation" means the National Association of Securities Dealers, Inc.;
- (g) "dealer" means any individual, corporation, partnership, association, joint stock company, business trust, unincorporated organization or other legal entity engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business;
- (h) "investment banking or securities business" means the business, carried on by a broker, dealer, [or] municipal securities dealer (other than a bank or department or division of a bank), or government securities broker or dealer of underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others;
- (i) "member" means any broker or dealer admitted to membership in the Corporation;
- (j) "municipal securities" means securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond as defined by Section 3(a)(29) of the Act;
- (k) "municipal securities dealer" means any person, except a bank or department or division of a bank, engaged in the business of buying and selling municipal securities for his own account, through a broker or otherwise, but does not include any person insofar as he buys or sells securities for his own account either individually or in some fiduciary capacity but not as a part of a regular business;
- (l) "municipal securities broker" means a

broker, except a bank or department or division of a bank, engaged in the business of effecting transactions in municipal securities for the account of others;

(m) "person associated with a member" or "associated person of a member" means every sole proprietor, partner, officer, director, or branch manager of any member, or any natural person occupying a similar status or performing similar functions, or any natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by such member, whether or not any such person is registered or exempt from registration with the Corporation pursuant to these By-Laws;

(n) "registered broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer" means any broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer which is registered with the Commission under the Act;

(o) "rules of the Corporation" means all rules of the Corporation including the Certificate of Incorporation, By-Laws, Rules of Fair Practice, Government Securities Rules, Code of Procedure, Uniform Practice Code, and any Interpretations thereunder.

(p) "government securities broker" shall have the same meaning as in Section 3(a)(43) of the Act except that it shall not include financial institutions as defined in Section 3(a)(46) of the Act.

(q) "government securities dealer" shall have the same meaning as in Section 3(a)(44) of the Act except that it shall not include financial institutions as defined in Section 3(a)(46) of the Act.

ARTICLE II

Qualifications of Members and Associated Persons

Persons Eligible to Become Members and Associated Persons of Members

Sec. 1. (a) Any registered broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer authorized to transact, and whose regular course of business consists in actually transacting, any branch of the investment banking or securities business in the United States, under the laws of the United

States, shall be eligible for membership in the Corporation, except such registered brokers, dealers, [or] municipal securities brokers or dealers, or government securities brokers or dealers which are excluded under the provisions of Sections 3(a) or (b) of this Article.

(b) Any person shall be eligible to become an associated person of a member, except such persons who are excluded under the provisions of Section 3(b) of this Article.

Authority of Board to Adopt Qualification Requirement

Sec. 2. (a) The Board of Governors shall have authority to adopt rules and regulations applicable to applicants for membership, members and persons associated with applicants or members establishing specified and appropriate standards with respect to the training, experience, competence and such other qualifications as the Board of Governors finds necessary or desirable, and in the case of an applicant for membership or a member, standards of financial responsibility or operational capability.

(b) In establishing and applying such standards, the Board of Governors may classify members and persons associated with such members, taking into account relevant matters, including the nature, extent and type of business being conducted and of securities sold, dealt in, or otherwise handled. The Board of Governors may specify that all or any portion of such standards shall be applicable to any such class and may require the persons in any such class to be registered with the Corporation.

(c) The Board of Governors may from time to time make changes in such rules, regulations and standards as it deems necessary or appropriate. Neither the adoption nor any change in such standards need be submitted to the membership for approval and such rules, regulations and standards as adopted or amended shall become effective at such time as the Board of Governors may prescribe.

Ineligibility of Certain Persons for Membership or Association

Sec. 3. (a) No registered broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer shall be admitted to membership, and no member shall be continued

in membership, if such broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer, or member fails or ceases to satisfy the qualification requirements under Section 2 of this Article, if applicable, or if such broker, dealer, municipal securities broker or dealer or government securities broker or dealer, or member is or becomes subject to a disqualification under Section 4 of this Article.

(b) No person shall become associated with a member, or continue to be associated with a member, or transfer association to another member, if such person fails or ceases to satisfy the qualification requirements under Section 2 of this Article if applicable, or if such person is or becomes subject to a disqualification under Section 4 of this Article; and no broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer shall be admitted to membership, and no member shall be continued in membership if any person associated with it is ineligible to be an associated person under this subsection.

(c) If it deems it appropriate, the Board of Governors, upon notice and opportunity for a hearing, may cancel the membership of a member if it becomes ineligible for continuance in membership under subsection (a) hereof, may suspend or bar a person from continuing to be associated with any member if such person is or becomes ineligible for association under subsection (b) hereof, and may cancel the membership of any member who continues to be associated with any such ineligible person.

(d) Any broker, dealer, [or] municipal securities broker, or government securities broker or dealer which is ineligible for admission into membership, or any member which is ineligible for continuance in membership, may file with the Board of Governors an application requesting relief from the ineligibility, pursuant to procedures adopted by the Board of Governors and contained in the Corporation's Code of Procedure. The Board of Governors may, in its discretion, approve the admission or continuance of an applicant or member, or the association of any person, if the Board determines that such approval is consistent with the public interest and the protection of investors. Any

approval hereunder may be granted unconditionally or on such terms and conditions as the Board considers necessary or appropriate. In the exercise of the authority granted hereunder, the Board of Governors may:

(1) conduct such inquiry or investigation into the relevant facts and circumstances as it, in its discretion, considers necessary to its determination, which, in addition to the background and circumstances giving rise to the failure to qualify or disqualification may include the proposed or present business of an applicant for membership or of a member and the conditions of association of any prospective or presently associated person, among other matters;

(2) permit, in limited types of situations, a membership or association with a member pending completion of its inquiry or investigation, and its final determination, based upon a consideration of relevant factors, and may classify situations taking into account the status of brokers, dealers, [and] municipal securities brokers and dealers and government securities brokers and dealers as applicants or existing members and of persons as prospective or presently associated persons of members; the type of disqualification or failure to qualify; whether a member or associated person has been the subject of a previous approval and the terms and conditions thereof; and any other relevant factors; and

(3) delegate any of its functions and authority under this subsection (d) to appropriate committees of the Corporation or to Corporation staff members.

(e) An application filed under subsection (d) hereof shall not foreclose any action which the Board of Governors is authorized to take under subsection (c) hereof until approval has been granted.

(f) Approval by the Board of Governors of an application made under subsection (d) shall be subject to whatever further action the Commission may take pursuant to authority granted to the Commission under the Act.

Definition of Disqualification

Sec. 4. A person is subject to a "disqualifica-

tion" with respect to membership, or association with a member, if such person:

Commission and Self-Regulatory Organization Disciplinary Sanctions

(a) has been and is expelled or suspended from membership or participation in, or barred or suspended from being associated with a member of, any self-regulatory organization[;], contract market designated pursuant to Section 5 of the Commodity Exchange Act, or futures association, registered under Section 17 of such Act, or has been denied trading privileges on any such contract market;

(b) is subject to an order of the Commission or other appropriate regulatory agency denying, suspending for a period not exceeding twelve months, or revoking its registration as a broker, dealer, [or] municipal securities dealer (including a bank or department or division of a bank), or government securities broker or dealer, or barring or suspending him from being associated with a broker, dealer, [or] municipal securities dealer (including a bank or department or division of a bank), or government securities broker or dealer[;], or is subject to an order of the Commodity Futures Trading Commission denying, suspending, or revoking his registration under the Commodity Exchange Act;

(c) by his conduct while associated with a broker, dealer, [or] municipal securities dealer (including a bank or department or division of a bank), or government securities broker or dealer, or while associated with an entity or person required to be registered under the Commodity Exchange Act has been found to be a cause of any effective suspension, expulsion or order of the character described in subsections (a) or (b) of this Section.

(d) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person described in subsections (a), (b), or (c) of this Section.

Misstatements

(e) has willfully made or caused to be made in any application for membership in [the Corporation] a self-regulatory organization or to become associated with a member of [the Corporation] a self-regulatory organization, or in any report

required to be filed with [the Corporation] a self-regulatory organization, or in any proceeding before [the Corporation] a self-regulatory organization, any statement which was at the time, and in light of the circumstances under which it was made, false, or misleading with respect to any material fact, or has omitted to state in any such application, report or proceeding any material fact which is required to be stated therein;

Convictions

(f) has been convicted within ten years preceding the filing of any application for membership in the Corporation, or to become associated with a member of the Corporation, or at any time thereafter, of any felony or misdemeanor which:

(1) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense;

(2) arises out of the conduct of the business of a broker, dealer, municipal securities dealer or government securities broker or dealer, investment adviser, bank insurance company, [or] fiduciary, or any entity or person required to be registered under the Commodity Exchange Act;

(3) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or

(4) involves the violation of Sections 152, 1341, 1342, or 1343 or Chapters 25 or 47 of Title 18, United States Code; or

Injunctions

(g) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, [or] entity or person required to be registered under the Commodity Exchange Act, municipal securities dealer (including a bank or department or division of a bank) or government securities broker or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or

continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

**ARTICLE III
Membership**

Application for Membership

Sec. 1. (a) Application for membership in the Corporation, properly signed by the applicant, shall be made to the Corporation, on the form to be prescribed by the Corporation, and shall contain:

(1) an acceptance of and an agreement to abide by, comply with, and adhere to, all the provisions, conditions, and covenants of the Certificate of Incorporation, the By-Laws, the rules and regulations of the Corporation as they are or may from time to time be adopted, changed or amended, and all rulings, orders, directions and decisions of, and sanctions imposed by, the Board of Governors or any duly authorized committee, the provisions of the federal securities laws, including the rules and regulations adopted thereunder, [and] including [and] the rules of the Municipal Securities Rulemaking Board[,] and the Treasury Department, provided, however, that such an agreement shall not be construed as a waiver by the applicant of any right to appeal as provided in the Act;

(2) an agreement to pay such dues, assessments, and other charges in the manner and amount as shall from time to time be fixed by the Board of Governors pursuant to these By-Laws;

(3) an agreement that neither the Corporation, nor any officer or employee thereof, nor any member of the Board of Governors or of any district or other committee, shall be liable, except for willful malfeasance, to the applicant or to any member of the Corporation or to any other person, for any action taken by such officer or member of the Board of Governors or of any district or other committee, in his official capacity, or by any employee of the Corporation while acting within the scope of his employment or under instruction of any officer, board, or committee of the Corporation, in connection with the administration or enforcement of

any of the provisions of the rules of the Corporation as they are or may from time to time be adopted, or amended, or any ruling, order, directive, decision of, or penalty imposed by the Board of Governors or any duly authorized committee, the provisions of the federal securities laws, including the rules and regulations adopted thereunder, including [and] the rules of the Municipal Securities Rulemaking Board and the Treasury Department; and

(4) such other reasonable information with respect to the applicant as the Board of Governors may require.

(b) Any application received by the Corporation shall be referred to the District Committee of the district in which the applicant has his principal place of business, and if a majority of the members of such District Committee determine that the applicant has satisfied all of the admission requirements of the By-Laws, it shall recommend the applicant's admission to membership and promptly notify the Secretary of the Corporation of such recommendation.

(c) If a majority of the members of such District Committee determine that the applicant fails to satisfy all of the admission requirements of the By-Laws, it shall promptly notify the Secretary of the Corporation who shall thereafter take appropriate action as of the date when posted to the membership roll.

(d) Each member shall ensure that its membership application with the Corporation is kept current at all times by supplementary amendments to the original application.

Similarity of Membership

Sec. 2. No change.

Executive Representative

Sec. 3. No change.

Membership Roll

Sec. 4. No change.

Resignation of Members

Sec. 5. No change.

Transfer and Termination of Membership

Sec. 6. No change.

Registration of Branch Offices

Sec. 7. No change.

Vote of Branch Offices

Sec. 8. No change.

District Committees' Right to Classify Branches

Sec. 9. No change.

ARTICLE IV

**Registered Representatives and Associated Persons
Qualification Requirements**

Sec. 1. No member shall permit any person associated with such member to engage in the investment banking or securities business unless the member determines that such person has complied with the applicable provisions under Article II of the By-Laws.

Application for Registration

Sec. 2. (a) Application by any person for registration with the Corporation, properly signed by the applicant, shall be made to the Corporation, on the form to be prescribed by the Board of Governors and shall contain:

(1) an acceptance of and an agreement to comply with all the provisions of the rules of the Corporation as they are or may from time to time be adopted or amended, all rulings, orders, directions and decisions of, and penalties imposed by, the Board of Governors or any duly authorized committee, the provisions of the federal securities laws, including the rules and regulations adopted thereunder[, and] including the rules of the Municipal Securities Rulemaking Board and the Treasury Department, provided, however, that such an agreement shall not be construed as a waiver by the applicant of any right to appeal as provided in the Act;

(2) an agreement that neither the Corporation, nor any officer or employee thereof, nor any member of the Board of Governors or of any District or other Committee, shall be liable except for willful malfeasance, to the applicant or to any member of the Corporation or to any other person, for any action taken by such officer, member of the Board of Governors or of any District or other Committee in his official capacity, or by any employee of the Corporation while acting within the scope of his employment, or under instruction of any officer, board or committee of the Corporation, in connection with the administration or enforcement of any of the provisions of the By-Laws, any rules of the Corporation as they are or may from time to

time be adopted or amended, any ruling, order, direction, decision of, or penalty imposed by, the Board of Governors or any duly authorized committee, the provisions of the federal securities laws, including the rules and regulations adopted thereunder, [or] including the rules of the Municipal Securities Rulemaking Board and the rules of the Treasury Department; and

(3) such other reasonable information with respect to the applicant as the Corporation may require.

(b) The Corporation shall not approve an application for registration of any person who is not eligible to be an associated person of a member under the provisions of Section 3(b) of Article II of these By-Laws.

(c) Every application for registration filed with the Corporation shall be kept current at all times by supplementary amendments to the original application.

Notification by Member to Corporation of Termination

Sec. 3. Following the termination of the association with a member of a person who is registered with it, such member shall promptly, but in no event later than thirty (30) calendar days after such termination, give written notice to the Association on a form designated by the Board of Governors of the termination of such association. A member who does not submit such notification in writing within the time period prescribed shall be assessed a late filing fee as specified by the Board of Governors. Termination of registration of such person associated with a member shall not take effect so long as any complaint or action is pending against a member and to which complaint or action such person associated with a member is also a respondent, or so long as any complaint or action is pending against such person individually or so long as any examination of the member or person associated with such member is in process. The Corporation, however, may in its discretion declare the termination effective at any time.

Retention of Jurisdiction

Sec. 4. A person whose association with a

member has been terminated and is no longer associated with any member of the Corporation shall continue to be subject to the filing of a complaint under the Code of Procedure based upon conduct which commenced prior to the termination, but any such complaint shall be filed within one (1) year after the effective date of termination of registration pursuant to Section 3 above or, in the case of an unregistered person, within one (1) year after the date upon which such person ceased to be associated with the member.

**ARTICLE V
Affiliates**

No change.

ARTICLE VI

Dues, Assessments and Other Charges

No change.

ARTICLE VII

Board of Governors

Powers and Authority of Board of Governors

Sec. 1. (a) The Board of Governors shall be the governing body of the Corporation and, except as otherwise provided by these By-Laws, shall be vested with all powers necessary for the management and administration of the affairs of the Corporation and the promotion of the Corporation's welfare, objects and purposes. In the exercise of such powers, the Board of Governors shall have the authority to:

- (1) adopt for submission to the membership, as hereinafter provided, such By-Laws, Rules of Fair Practice and changes or additions thereto as it deems necessary or appropriate;
- (2) make such regulations, issue such orders, resolutions, interpretations, including interpretations of the Rules of Fair Practice, and directions, and make such decisions as it deems necessary or appropriate;
- (3) prescribe a code of arbitration procedure providing for the required or voluntary arbitration of controversies between members and between members and customers or others as it shall deem necessary or appropriate and neither the adoption nor any amendments to the code need be submitted to the membership for approval and the code and any amendments thereto shall become

effective as the Board of Governors may prescribe;

(4) establish rules and procedures to be followed by members in connection with the distribution of securities issued by member and affiliates thereof, and neither the adoption nor any amendments to such rules and procedures need be submitted to the membership for approval and such rules and procedures and any amendments thereto shall become effective as the Board of Governors may prescribe;

(5) require all over-the-counter transactions in securities between members, other than transactions in exempted securities, to be cleared and settled through the facilities of clearing agency registered with the Commission pursuant to the Act, which clears and settles such over-the-counter transactions in securities;

(6) organize and operate automated system to provide qualified subscribers with securities information and automated services. The systems may be organized and operated by a division or subsidiary component of the Corporation or by one or more independent firms under contract with the Corporation as the Board of Governors may deem necessary or appropriate. The Board of Governors may adopt rules of such automated systems, establish reasonable qualifications and classifications for members and other subscribers, provide qualification standards for securities included in such systems, require members to report prompt information in connection with securities included in such systems, and establish charges to be collected from subscribers and others. The Board of Governors shall have power to adopt, amend, supplement or modify such rules, qualifications, classifications, standards and charges from time to time without recourse to the membership for approval, and such rules, qualifications, classifications, standards and charges shall become effective as the Board of Governors may prescribe;

(7) engage in any activities or conduct necessary or appropriate to carry out the Corporation's purposes under its Certificate of

Incorporation and the federal securities laws; and

(8) (i) adopt for submission to the membership such rules as the Board of Governors deems appropriate to implement the provisions of the Act as amended by the Government Securities Act of 1986 and the rules and regulations promulgated thereunder, and (ii) make such regulations, issue such orders, resolutions, interpretations, including interpretations of the rules adopted pursuant to this Section, and directions, and make such decisions as it deems necessary or appropriate.

(b) In the event of the refusal, failure, neglect or inability of any member of the Board of Governors to discharge his duties, or for any cause affecting the best interests of the Corporation the sufficiency of which the Board of Governors shall be the sole judge, the Board shall have the power, by the affirmative vote of two-thirds of the Governors then in office, to remove such member and declare his position vacant and that it shall be filled in accordance with the provisions of Section 6 of this Article.

Authority to Suspend for Failure to Submit Required Information

Sec. 2. No change.

Composition of Board

Sec. 3. No change.

Term of Office of Governors

Sec. 4. No change.

Succession to Office

Sec. 5. No change.

Election of Board Members

Sec. 6. No change.

Filling of Vacancies on Board

Sec. 7. No change.

Meetings of Board

Sec. 8. No change.

Offices of Corporation
Sec. 9. No change.

ARTICLE VIII
District Committees

No change.

ARTICLE IX
Nominating Committees

No change.

ARTICLE X
Officers and Employees

No change.

ARTICLE XI
Committees

No change.

ARTICLE XII
Rules of Fair Practice

No change.

ARTICLE XIII
Disciplinary Proceedings

No change.

ARTICLE XIV

Power of Board to Prescribe Sanctions

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

(a) breach by a member or a person associated with a member of any covenant with the Corporation or its members;

(b) violation by a member or a person associated with a member of any of the terms, conditions, covenants, and provisions of the rules of the Corporation, the federal securities

laws, including the rules and regulations adopted thereunder, [and] including rules of the Municipal Securities Rulemaking Board and the rules of the Treasury Department;

(c) failure by a member or person associated with a member to submit a dispute for arbitration under the Code of Arbitration Procedure ("Code") as required by the Code, or to fail to appear or to produce any document in their possession or control as directed pursuant to provisions of the Code, or to fail to honor an award of arbitrators properly rendered pursuant to the Code where a timely motion has not been made to vacate or modify such award pursuant to applicable law;

(d) refusal by a member or person associated with a member to abide by an official ruling of the Board of Governors or Uniform Practice Committee acting within its appropriate authority, with respect to any transaction which is subject to the Uniform Practice Code; or

(e) failure by a member or a person associated with a member to adhere to any ruling, order, direction or decision of, or to pay any penalty, fine or costs imposed by the Board of Governors or any District Business Conduct Committee.

ARTICLE XV

Uniform Practice Code

No change.

ARTICLE XVI

Limitation of Powers

Prohibitions

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

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

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

Use of Name of Corporation by Members

Sec. 2. No member shall use the name of the

Corporation except to the extent that may be authorized by the Board of Governors.

Unauthorized Expenditures

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

Conflicts of Interest

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

Municipal Securities

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

Government Securities

Sec. 6. The provisions of the By-Laws governing qualifications of members and persons associated with members and conferring rulemaking authority upon the Board of Governors shall not be applicable to the government securities activities of members or persons associated with members to the extent that the application of such provisions or authority would be inconsistent with Section 15A(f) of the Act.

ARTICLE XVII

Procedure for Adopting Amendments to By-Laws

No change.

**ARTICLE XVIII
Corporate Seal**

No change.

**ARTICLE XIX
Checks**

No change.

**ARTICLE XX
Annual Financial Statement**

No change.

SCHEDULE C TO THE NASD BY-LAWS

V

**PERSONS EXEMPT FROM
REGISTRATION**

(1) The following persons associated with a member are not required to be registered with the Corporation:

(a)-(c)

No change.

(d) persons associated with a member whose functions are related solely and exclusively to:

(i)

No change.

(ii) transactions in exempted securities, except as provided in Part X hereof, or

(iii)

No change.

X

**REGISTRATION OF GOVERNMENT
SECURITIES PRINCIPALS AND
REPRESENTATIVES**

1. Registration of Principals. All persons associated with a member not previously registered as a principal who are to function as government securities principals shall be registered as such with the Corporation.

(a) Definition of Government Securities Principal — Persons associated with a member who are:

(1) engaged in the management or supervision of the member's government securities business, including:

(i) underwriting, trading or sales of government securities;

(ii) financial advisory or consultant services for issuers in connection with the

issuance of government securities;

(iii) research or investment advice, other than general economic information or advice, with respect to government securities in connection with the activities described in (i) and (ii) above;

(iv) activities other than those specifically mentioned that involve communication, directly or indirectly, with public investors in government securities in connection with the activities described in (i) and (ii) above;
or

(2) are responsible for supervision of:

(i) the processing and clearance activities with respect to government securities; or

(ii) the maintenance of records involving any of the activities described in (a)(1) above;

are designated as principals.

(b) Notification of Principal Status — A member shall promptly notify the Corporation of the assumption of principal status by an individual not previously registered as a principal with the member on the form designated by the Board of Governors accompanied by the applicable fees.

2. Registration of Representatives. All persons associated with a member who are to function as government securities representatives who have not previously been registered shall be registered as such with the Corporation.

(a) Definition of Representative — Persons associated with a member, including assistant officers other than principals, who are engaged in the government securities business for the member including:

(i) underwriting, trading or sales of government securities;

(ii) financial advisory or consultant services for issuers in connection with the issuance of government securities;

(iii) research or investment advice, other than general economic information or advice, with respect to government securities in connection with the activities described in paragraphs (i) and (ii) above;

(iv) activities other than those specifically mentioned that involve communication, directly or indirectly, with public investors in government securities in connection with the activities described in paragraphs (i) and (ii) above;

are designated as representatives.

(b) Notification of Representative Status —

A member shall promptly notify the Corporation of the assumption by an individual not previously registered with the member of representative status on the form designated by the Board of Governors accompanied by the applicable fees.

3. Persons Exempt From Registration. Persons associated with a member whose functions are exclusively clerical or ministerial are not required to register with the Corporation.

PROPOSED AMENDMENT TO NASD RULES OF FAIR PRACTICE

(Note: New language is underlined.)

ARTICLE I

Adoption and Application

Applicability

Sec. 5. (a) These Rules of Fair Practice shall apply to all members and persons associated with a member, other than those members registered with the Securities and Exchange Commission solely under the provisions of Section 15C of the Act and persons associated with such members. Persons associated with a member shall have the same duties and obligations as a member under these Rules of Fair Practice.

(The remainder of Section 5 remains unchanged.)

GOVERNMENT SECURITIES RULES

Adoption of Rules

Sec. 1. The following provisions are adopted pursuant to Article VII, Section 1(a)(8) of the NASD By-Laws and Section 15A(f)(2) of the Securities Exchange Act of 1934.

Applicability

Sec. 2. (a) These rules shall apply to the government securities business of all members and persons associated with a member in order to implement and enforce the provisions of the

Securities Exchange Act of 1934 and the rules promulgated thereunder including the rules of the Treasury Department. Unless otherwise indicated herein, the requirements of these rules are in addition to those contained in the Rules of Fair Practice for members that are subject to the provisions of the Rules of Fair Practice. Persons associated with a member shall have the same duties and obligations as a member under these rules.

(b) A member or person associated with a member, who has been expelled, cancelled, or revoked from membership or from registration or who has been barred from being associated with all members, shall cease to have any privileges of membership or registration. A member or person associated with a member who has been suspended from membership or registration shall also cease to have any privileges of membership or registration other than those under the Code of Procedure or insurance programs sponsored by the Corporation. In neither case shall such a member or person associated with a member be entitled to recover any admission fees, dues, assessments, or other charges paid to the Corporation.

(c) A member or person associated with a member who has been suspended from membership or from registration shall have all of the obligations imposed by the By-Laws, these rules, and other regulations of the Corporation.

Definitions in By-Laws and Rules of Fair Practice

Sec. 3. Unless the context otherwise requires, or unless defined in these rules, terms used in the rules and provisions hereby adopted, if defined in the By-Laws or Rules of Fair Practice shall have the meaning as defined therein.

Books and Records

Sec. 4.

Requirements

(a) Each member shall keep and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations, and statements of policy promulgated thereunder and with the rules of this Association.

Information on accounts

(b) Each member shall maintain accounts of customers in such form and manner as to show

the following information: name, address, and whether the customer is legally of age; signature of the registered representative introducing the accounts and signature of the member or the partner, officer, or manager accepting the account for the member. If the customer is associated with or employed by another member, this fact must be noted. In discretionary accounts, the member shall also record the age or approximate age and occupation of the customer as well as the signature of each person authorized to exercise discretion in such account.

Record of written complaints

(c) Each member shall keep and preserve either a separate file of all written complaints of customers and action taken by the member, if any, or a separate record of such complaints and a clear reference to the files containing the correspondence connected with such complaint.

"Complaint" defined

(d) A "complaint" shall be deemed to mean any written statement of a customer or any person acting on behalf of a customer alleging a grievance involving the activities of those persons under the control of the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.

Supervision

Sec. 5.

Written procedures

(a) Each member shall establish, maintain, and enforce written procedures that will enable it to supervise properly the activities of each registered representative and associated person to ensure compliance with the applicable provisions of the Securities Exchange Act of 1934, rules, regulations, and statements of policy promulgated thereunder including the rules of the Treasury Department, and with the applicable rules of this Association.

Responsibility of member

(b) Final responsibility for proper supervision shall rest with the member. The member shall designate a partner, officer, or manager to carry out the written supervisory procedures. A copy of such procedures shall be kept in each

office of the member.

Eligibility investigated

(c) Each member shall have the responsibility and the duty to ascertain by investigation the absence of any statutory disqualification as that term is defined under Section 3(a)(39) or 15C(c) of the Securities Exchange Act of 1934 and that any application for registration by an associated person is complete and accurate.

Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties

Sec. 6. (a) Application — For the purposes of this rule, the term "member" shall be limited to any member of the Association registered with the Securities and Exchange Commission pursuant to Section 15C of the Securities Exchange Act of 1934 that is not designated to another self-regulatory organization by the Securities and Exchange Commission for financial responsibility pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17d-1 thereunder. Further, the term shall not be applicable to any member that is subject to Section 402.2(c) of the rules of the Treasury Department.

(b) A member, when so directed by the Association, shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist, or have existed, for more than fifteen (15) consecutive business days:

(A) A firm's liquid capital is less than 150 percent of the total haircuts or such greater percentage thereof as may from time to time be prescribed by the Association.

(B) A firm's liquid capital minus total haircuts is less than 150 percent of its minimum dollar capital requirement.

(C) The deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1).

(2) The Association restricts the member for any other financial or operational reason.

(c) A member, when so directed by the Association, shall forthwith reduce its business:

(1) To a point enabling its available capital to comply with the standards set forth in subparagraphs (b)(1)(A), (B), or (C) of this rule if any of the following conditions continue to exist, or have existed, for more than fifteen (15) consecutive business days:

(A) A firm's liquid capital is less than 125 percent of total haircuts or such greater percentage thereof as may from time to time be prescribed by the Association.

(B) A firm's liquid capital minus total haircuts is less than 125 percent of its minimum dollar capital requirement.

(C) The deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1).

(2) As required by the Association when it restricts a member for any other financial or operational reason.

Explanation of the Board of Governors

Restrictions on a Member's Activity

This explanation outlines and discusses some of the financial and operational deficiencies which could initiate actions under the rule. Subparagraphs (b)(2) and (c)(2) of the rule recognize that there are various unstated financial and operational reasons for which the Association may impose restrictions on a member so as to prohibit its expansion or to require a reduction in overall level of business. These provisions are deemed necessary in order to provide for the variety of situations and practices which do arise and, which if allowed to persist, could result in increased exposure to customers and to broker-dealers.

In the opinion of the Board of Governors, it would be impractical and unwise to attempt to identify and list all of the situations and practices that might lead to the imposition of restrictions or the types of remedial actions the Corporation may direct be taken because they are numerous and cannot be totally identified or specified with any degree of precision. The Board believes, however, that it would be helpful to members' understanding to list some of the other bases upon

which the Corporation may conclude that a member is in or approaching financial difficulty.

(a) For purposes of subparagraphs (b)(2) and (c)(2) of the rule, a member may be considered to be in or approaching financial or operational difficulty in conducting its operations and therefore subject to restrictions if it is determined by the Corporation that any of the parameters specified therein are exceeded or one or more of the following conditions exist:

(1) The member has experienced significant reduction in excess liquid capital in the preceding month or in the three-month period immediately preceding such computation.

(2) The member has experienced a substantial change in the manner in which it processes its business which, in the view of the Corporation, increases the potential risk of loss to customers and members.

(3) The member's books and records are not maintained in accordance with the provisions of Section 404.2 of the Treasury Department rules.

(4) The member is not in compliance, or is unable to demonstrate compliance, with applicable capital requirements of Section 402 of the Treasury Department rules.

(5) The member is not in compliance, or is unable to demonstrate compliance, with Section 403.4 of the Treasury Department rules (Customer Protection — Reserve and Custody of Securities).

(6) The member is unable to clear and settle transactions promptly.

(7) The member's overall business operations are in such a condition, given the nature and kind of its business that, notwithstanding the absence of any of the conditions enumerated in subparagraphs (1) through (6), a determination of financial or operational difficulty should be made.

(8) The member is registered as a Futures Commission Merchant and its net capital is less than required by Section 402.1(d) of the Treasury Department rules.

(b) If the Corporation determines that any of the conditions specified in subparagraph (a) of this Explanation exists, it may require that the

member take appropriate action by effecting one or more of the following actions until such time as the Corporation determines they are no longer required:

- (1) Promptly pay all free credit balances to customers.
- (2) Promptly effect delivery to customers of all fully paid securities in the member's possession or control.
- (3) Introduce all or a portion of its business to another member on a fully disclosed basis.
- (4) Reduce the size or modify the composition of its inventory.
- (5) Postpone the opening of new branch offices or require the closing of one or more existing branch offices.
- (6) Promptly cease making unsecured loans, advances, or other similar receivables, and, as necessary, collect all such loans, advances, or receivables where practicable.
- (7) Accept no new customer accounts.
- (8) Undertake an immediate audit by an independent public accountant at the member's expense.
- (9) Restrict the payment of salaries or other sums to partners, officers, directors, shareholders, or associated persons of the member.
- (10) Effect liquidating transactions only.
- (11) Accept unsolicited customer orders only.
- (12) File special financial and operating reports.
- (13) Be subject to such other restrictions or take such other actions as the Corporation deems appropriate under the circumstances in the public interest and for the protection of members.

Approval of Change in Exempt Status Under SEC Rule 15c3-3

Sec. 7. (a) Application — For the purposes of this rule, the term "member" shall be limited to any member of the Association that is not designated to another self-regulatory organization by the Securities and Exchange Commission for financial responsibility pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule

17d-1 thereunder. Further, the term shall not be applicable to any member that is subject to Section 402.2(c) of the rules of the Treasury Department.

(b) A member operating pursuant to any exemptive provision as contained in subparagraph (k) of SEC Rule 15c3-3 under the Securities Exchange Act of 1934 (Rule 15c3-3) shall not change its method of doing business in a manner that will change its exemptive status from that governed by subparagraph (k)(1) or (k)(2)(ii) to that governed by subparagraph (k)(2)(i); or from subparagraph (k)(1), (k)(2)(i), or (k)(2)(ii) to a fully computing firm that is subject to all provisions of Rule 15c3-3; or commence operations that will disqualify it for continued exemption under Rule 15c3-3 without first having obtained the prior written approval of the Association.

(c) In making the determination as to whether to approve or to deny in whole or in part an application made pursuant to subsection (b), the Association staff shall consider, among other things, the type of business in which the member is engaged, the training, and experience, of persons associated with the member, the member's procedures for safeguarding customer funds and securities, the member's overall financial and operational condition and any other information deemed relevant in the particular circumstances and the time these measures would remain in effect.

Communications With the Public

Sec. 8

(a) Definitions

(1) Advertisement — For purposes of this section and any interpretation thereof, "advertisement" means material published, or designed for use in, a newspaper, magazine, or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, telephone directories (other than routine listings), or other public media.

(2) Sales Literature — For purposes of this section and any interpretation thereof, "sales literature" means any written communication distributed or made generally available to customers or the public that does not meet

the foregoing definition of "advertisement." Sales literature includes, but is not limited to, circulars, research reports, market letters, performance reports or summaries, form letters, standard forms of option worksheets, seminar texts, and reprints or excerpts of any other advertisement, sales literature, or published article.

(b) Approval and Recordkeeping

(1) Each item of advertising and sales literature shall be approved by signature or initial, prior to use, by a registered principal (or designee) of the member.

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

(c) Filing Requirements and Review Procedures

(1) Advertisements concerning government securities (as defined in Section 3(a)(42) of the Securities Exchange Act of 1934) shall be filed by members with the Association's Advertising Department for review within 10 days of first use or publication.

(2)(A) Each member of the Association that has not previously filed advertisements with the Association shall file its initial advertisement concerning government securities with the Association's Advertising Department at least 10 days prior to use and shall continue to file its advertisements concerning government securities at least 10 days prior to use for a period of one year.

(B) Each member that, on the effective date of this section, had been filing advertisements with the Association for a period of less than one year shall continue to file its advertisements concerning government securities at least 10 days prior to use, until the completion of one year from the date the first advertisement was filed with the Association.

(3) Notwithstanding the foregoing provisions, any District Business Conduct Committee of the Association, upon review of a member's government securities advertising and/or sales literature, and after

determining that the member will again depart from the standards of this section, may require that such member file all government securities advertising and/or sales literature, or the portion of such member's material that is related to any specific types or classes of securities or services, with the Association's Advertising Department and/or the District Committee, least 10 days prior to use.

The Committee shall notify the member in writing of the types of material to be filed and the length of time such requirement is to be in effect. The requirement shall not exceed one year, however, and shall not take effect until 30 days after the member receives the written notice, during which time the member may request a hearing before the District Business Conduct Committee, and any such hearing shall be held in reasonable conformity with the hearing and appeal procedures of the Code of Procedure

(4) In addition to the foregoing requirements every member's government securities advertising and sales literature shall be subject to routine spot-check procedure. Upon written request from the Association's Advertising Department, each member shall promptly submit the material requested. Members will not be required to submit material under this procedure that has been previously submitted pursuant to one of the foregoing requirements.

(5) The following types of material are excluded from the foregoing filing requirements and spot-check procedure:

(A) Advertisements of sales literature solely related to changes in a member's name, personnel, location, ownership, offices, business structure, officers or partners, telephone or teletype numbers, or concerning a merger with, or acquisition by, another member;

(B) Advertisements or sales literature that do no more than identify the member and/or offer a specific security at a stated price;

(C) Material sent to branch offices or other internal material that is not

distributed to the public;

(6) Material that refers to government securities solely as part of a listing of products and/or services offered by the member, is excluded from the requirements of paragraph (c)(1) of this section.

(d) Standards Applicable to Communications With the Public

(1) General Standards

(A) All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in light of the context of the material presented, would cause the advertising or sales literature to be misleading.

(B) Exaggerated, unwarranted, or misleading statements or claims are prohibited in all public communications of members. In preparing such literature, members must bear in mind that inherent in investment are the risks of fluctuating prices and the uncertainty of dividends, rates of return, and yield, and no member shall, directly or indirectly, publish, circulate, or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

(C) When sponsoring or participating in a seminar, forum, radio, or television interview, or when otherwise engaged in public appearances or speaking activities that may not constitute advertisements, members and persons associated with members shall nevertheless follow the standards of paragraph (d) of this section.

(2) Specific Standards

In addition to the foregoing general standards, the following specific standards apply:

(A) Necessary Data: Advertisements and sales literature shall contain the name of the member, the person or firm preparing the material, if other than the member,

and the date on which it is first published, circulated, or distributed (except that, in advertisements, only the name of the member need be stated; and except also that, in any so-called "blind" advertisement used for recruiting personnel, the name of the member may be omitted). If the information in the material is not current, this fact should be stated.

(B) Recommendations: In making a recommendation, whether or not labeled as such, a member must have a reasonable basis for the recommendation made and must disclose the price at the time the recommendation is made, as well as any of the following situations which are applicable:

- (i) that the member usually makes a market in the securities being recommended, or in the underlying security if the recommended security is an option, and/or that the member or associated persons will sell to or buy from customers on a principal basis;
- (ii) that the member and/or its officers or partners own options, rights, or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;
- (iii) that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation.

A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade, or classification of securities made by a member within the last year. More years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the

general market conditions during the period covered.

Also permitted is material that does not make any specific recommendation but offers to furnish a list of all recommendations made by a member within the past year or over more consecutive years, including the most recent year, if this list contains all the information specified in the previous paragraph. Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

(C) Claims and Opinions: Communications with the public must not contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis or forecasts of future events that are unwarranted or that are not clearly labeled as forecasts.

(D) Testimonials: In testimonials concerning the quality of a firm's investment advice, the following points must be clearly stated in the communication:

(i) the testimonial may not be representative of the experience of other clients;

(ii) the testimonial is not indicative of future performance or success;

(iii) if more than a nominal sum is paid, the fact that it is a paid testimonial must be indicated;

(iv) if the testimonial concerns a technical aspect of investing, the person making the testimonial must have knowledge and experience to form a valid opinion.

(E) Offers of Free Service: Any statement to the effect that any report, analysis, or other service will be furnished free or without any charge must not be made unless such report, analysis, or other service actually is or will be furnished entirely free and without condition or obligation.

(F) Claims for Research Facilities: No claim or implication may be made for search or other facilities beyond those that the member actually possesses or reasonable capacity to provide.

(G) Hedge Clauses: No cautionary statements or caveats, often called "hedge clauses," may be used if they are misleading or inconsistent with the content of material.

(H) Recruiting Advertising: Advertisements in connection with the recruitment of sales personnel must not contain exaggerated or unwarranted claims or statements about opportunities in the investment banking or securities business and should not refer to specific earnings figures or ranges that are not reasonable under the circumstances.

(I) Periodic Investment Plans: Communications with the public should not discuss or portray any type of continuous or periodic investment plan without disclosing that such a plan does not assure profit and does not protect against loss declining markets. In addition, if the material deals specifically with the principles of dollar cost averaging, it should point out that since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels.

(J) References to Regulatory Organizations: Communications with the public shall not make any reference to membership in the Association or to registration or regulation of the securities being offered, or of the underwriter, sponsor, or any member or associated person, that could imply endorsement or approval by the Association or any federal or state regulatory body.

References to membership in the Association or the Securities Investor Protection Corporation shall comply with all applicable by-laws and rules pertaining thereto.

(K) Identification of Sources: Statistical

tables, charts, graphs, or other illustrations used by members in advertising or sales literature should disclose the source of the information if not prepared by the member.

Availability to Customers of Certificate, By-Laws, Rules, and Code of Procedure

Sec. 9. Every member of the Corporation shall keep in each office maintained by him, in the form to be supplied by the Board of Governors, a copy of the Certificate of Incorporation, By-Laws, Government Securities Rules, and Code of Procedure of the Corporation, and of all additions and amendments from time to time made thereto, and of all interpretative rulings made by the Board of Governors, all of which shall be available for the examination of any customer who makes requests therefore.

Complaints

Sec. 10.

Complaints by public against members

(a) Any person feeling aggrieved by any act, practice, or omission of any member or any person associated with a member of the Corporation, which such person believes to be in violation of the Securities Exchange Act of 1934, the rules and regulations thereunder including the rules of the Treasury Department or these Government Securities rules, may, on the form to be supplied by the Board of Governors, file a complaint against such member or such persons associated with a member in regard thereto with any District Business Conduct Committee of the Corporation, and any such complaint shall be handled in accordance with the Code of Procedure of the Corporation.

Complaints by District Business Conduct Committees

(b) Any District Business Conduct Committee which, on information and belief, is of the opinion that any act, practice, or omission of any member of the Corporation or any person associated with a member is in violation of the Securities Exchange Act of 1934, the rules and regulations thereunder including the rules of the Treasury Department or these Government Securities rules may, on the form to be supplied by the Board of Governors, file a complaint against such member or such person associated

with a member in regard thereto with itself or with any other District Business Conduct Committee of the Corporation, as the necessities of the complaint may require, and any such complaint shall be handled in accordance with the Code of Procedure and in the same manner as if it had been filed by an individual or member.

Complaints by the Board of Governors

(c) The Board of Governors shall have authority, when on the basis of information and belief, it is of the opinion that any act, practice, or omission of any member of the Corporation or of any person associated with a member is in violation of the Securities Exchange Act of 1934, the rules and regulations thereunder including the rules of the Treasury Department or these Government Securities rules, to file a complaint against such member or such person associated with a member in respect thereto or to instruct any District Business Conduct Committee to do so, and any such complaint shall be handled in accordance with the Code of Procedure.

Reports and Inspection of Books for Purpose of Investigating Complaints

Sec. 11. For the purpose of any investigation, or determination as to filing of a complaint, or any hearing of any complaint against any member of the Corporation or any person associated with a member made or held in accordance with the Code of Procedure, any District Business Conduct Committee, or the Board of Governors, or any duly authorized member or members of any such Committees or Board, or any duly authorized agent or agents of any such Committee or Board shall have the right to:

(1) require any member of the Corporation or person associated with a member to report orally or in writing with regard to any matter involved in any such investigation or hearing; and

(2) to investigate the books, records and accounts of any such member with relation to any matter involved in any such investigation or hearing.

No member or person associated with a member shall refuse to make any report as required in this Section, or refuse to permit any inspection of

books, records, and accounts as may be validly called for under this Section.

Resolution of the Board of Governors
Suspension of Members for Failure to Furnish Information Duly Requested

1. The President is hereby directed and authorized to notify members of the Corporation that fail to provide information with respect to their business practices, and/or that fail to keep membership applications and supporting documents current, and/or that fail to furnish such other information or reports or other material or data duly requested by the Corporation pursuant to the powers duly vested in it by its Certificate of Incorporation, By-Laws, and such other duly authorized resolutions and directives as are necessary in the conduct of the business of the Corporation, and that the continued failure to furnish duly requested information, reports, data, or other material, constitutes grounds for suspension from membership.

2. After fifteen (15) days' notice in writing thereof and continued failure to furnish the information, reports, data, or other material as described above in paragraph 1, the President is hereby directed and authorized to suspend the membership of any such member on behalf of the Board of Governors and to cause notification thereof in the next following membership supplement, to the effect that the membership has been suspended for failure to furnish such duly requested information.

3. Prior to such notice in writing to the member, the Executive Committee of the Board of Governors shall be notified in writing of such contemplated action by the President.

4. The President shall advise the member concerned, in writing, of the suspension.

Sanctions for Violation of the Rules

Sec. 12. Any District Business Conduct Committee, Market Surveillance Committee or the Board of Governors, in the administration and enforcement of the Securities Exchange Act of 1934, the rules and regulations thereunder including the rules of the Treasury Department or these Government Securities rules, and after compliance with the Code of Procedure, may:

(1) censure any member or person associated with a member; and/or

(2) impose a fine [not in excess of Fifteen Thousand Dollars (\$15,000.00)] upon any member or person associated with a member and/or

(3) suspend the membership of any member or suspend the registration of a person associated with a member, if any, for a defined period; and/or

(4) expel any member or revoke the registration of any person associated with a member if any; and/or

(5) suspend or bar a member or person associated with a member from association with all members; or

(6) impose any other fitting sanction deemed appropriate under the circumstances, for any violation of such provisions by a member or person associated with a member for any neglect or refusal to comply with orders, directions, or decisions issued by District Business Conduct Committee, Market Surveillance Committee or by the Board of Governors in the enforcement of these rules, including any interpretation made by the Board of Governors, as any such Committee or Board, in its discretion may deem to be just;

provided, however, that no such sanction imposed by any District Business Conduct Committee or Market Surveillance Committee shall take effect until the period for appeal therefrom or review has expired, as provided in Article III, Section 1 of the Code of Procedure; and provided, further, that all parties to any proceeding resulting in a sanction shall be deemed to have assented to or to have acquiesced in the imposition of such sanction unless any party aggrieved thereby shall have made application to the Board of Governors for review pursuant to the Code of Procedure, within fifteen (15) days after the date of such notice.

Payment of Fines or Costs

Sec. 13. All fines imposed pursuant to Section 12 of these rules shall be paid to the Treasurer

of the Corporation and shall be used for the general corporate purposes. Any member that fails promptly to pay any fine imposed pursuant to Section 12 of these rules, or any costs imposed pursuant to Section 12 of these rules, or any costs imposed pursuant to Section 14 of these rules after such fine or costs have become finally due and payable, may after seven (7) days' notice in writing be summarily suspended or expelled from membership in the Corporation. A member may also be summarily suspended or expelled from membership in the Corporation if the member fails to immediately terminate the association of any person who fails to pay promptly any fine imposed pursuant to Section 12 of these rules or any costs imposed pursuant to Section 14 of these rules after such fine or costs have become finally due and

payable after seven (7) days' notice in writing. The registration of a person associated with a member, if any, may be summarily revoked if such person fails to pay promptly any fine imposed pursuant to Section 12 of these rules, or any costs pursuant to Section 14 of these rules after such fine or costs have become finally due and payable after seven (7) days notice in writing.

Cost of Proceedings

Sec. 14. Any member or person associated with such member disciplined pursuant to Section 12 of these rules shall bear such part of the costs of the proceedings as the District Business Conduct Committee or Market Surveillance Committee in the Board of Governors deems fair and appropriate in the circumstances.