

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

October 5, 1973

TO: All NASD Members

RE: Uniform Transfer Form for Transactions in Mutual Fund Shares

Attached hereto is a sample transfer form (Attachment A) for use by dealers in connection with transactions in open-end investment company shares. This form was originally developed by the Investment Company Institute, in cooperation with representatives of the broker-dealer community. It has been reviewed by various NASD Committees and by the Board of Governors and the Board is now recommending that members utilize this format for the transmission of registration or transfer instructions to mutual fund transfer agents.

Although the Board is not now proposing that members be required to use this format, the standardization of mutual fund transfer forms could have a great impact on the unnecessary paperwork, expense, and error-correction that exists with the current system.


Currently, there may be significant differences in the transfer forms used by mutual funds. And while many broker-dealers utilize the turn-around transfer form which is sent with the confirmation by many fund groups, other broker-dealers find that they cannot utilize this form and therefore prepare their own. The forms used by these dealers may also vary greatly, which further complicates the transfer process. Increased uniformity in this area could be beneficial for all concerned with the registration and transfer process.

The attached form is designed to be compatible with the BASIC transfer form for general securities transactions, and the additional information necessary to complete the mutual fund form is contained within the spaces left open or optional in the BASIC form. This will hopefully result in a minimum of changes in computer programming formats.

Each space on the attached form has a letter within it which corresponds to the explanation sheet (Attachment B).

Members are urged to implement the uniform transfer form as soon as possible.

Sincerely,

  
Frank J. Wilson  
Senior Vice President  
Regulation

**ANY BROKER**  
INCORPORATED

**Broadway, New York, N.Y. 10017**  
NO. (212) 123-4567  
ATTN: MUTUAL FUND DEPARTMENT

M  
A  
I  
L  
T  
O

(A)

FUND NAME

OFFICE OF ORIGIN

(J)

(K)

(L)

DEALER INFORMATION

ACCOUNT NUMBER

(G)

IDENTIFICATION NO.

(H)

SETTLEMENT DATE

(I)

REGISTERED REPRESENTATIVES INFORMATION

BRANCH OFF.# REP.#

REPRESENTATIVE LAST NAME

FUND CONFIRMATION NUMBER (M)

TRADE DATE (O)

PRICE (N)

NET AMOUNT DUE (P)

CHECK REFERENCE NO. (Q)

SOCIAL SEC. NO. (R)

CUSIP NO. (S)

PRESENTOR # (T)

DATE IN (U)

QUANTITY (D)

(E)

TYPE OF ACCOUNT

- New  Existing Plan # \_\_\_\_\_
- Dividend & Capital Gain Reinvested
- Dividend in Cash/Cap. Gain Reinvested
- All in Cash
- Sys. Wdwl. Plan (App. to Follow) (App. Attached)
- Letter of Intent Amount:
- Rights of Accumulation (See Attached)

(W)

SPECIAL INSTRUCTIONS

DISPOSITION OF SHARES

(F)

- DEPOSIT  MAIL CTF TO DEALER  SPEC. INST.
- MAIL CTF TO SHAREHOLDER  (X)

OUTLINE OF STANDARDIZED MUTUAL FUND TRANSFER UNIT

- A - Mail To  
The name and address of the transfer agent or clearing agent to whom the transfer unit is being sent.
- B - Fund Name  
The name of the fund being purchased or transferred.
- C - Quantity  
The number of shares being purchased or transferred.
- D - Blank Space  
This blank space is for some possible future use. However, some dealers might use it to designate the certificate denominations on a transfer.
- E - To Be Registered In the Name Of  
The shareholder registration on a purchase or transfer.
- F - Special Instructions  
This could be used for such things as:  
1. Third party mailing (name and address)  
2. To indicate certificate denominations on a transfer  
3. To show the existing registration on the account being transferred  
4. Any special instructions which might apply to a purchase or transfer

Dealer Information

- G - Account Number  
The dealer's internal account number for his customer.
- H - Identification No.  
The dealer's internal order or trade number (optional).
- I - Settlement Date  
The settlement date of the wire purchase (optional).

Registered Representative Information

- J - Branch Office #  
The alpha and/or numeric branch office number from which the purchase or transfer originated.
- K - Rep. #  
The number of the registered representative on the account.
- L - Representative Last Name  
The last name of the registered representative on the account.
- M - Office of Origin  
The location of the branch office from which the purchase or transfer originated.
- N - Fund Confirmation Number  
The fund's trade number on a wire purchase confirmation.

- O - Trade Date  
The date the wire purchase was executed by the dealer.
- P - Price  
The price at which the wire purchase was executed.
- Q - Net Amount Due Fund  
The amount due from the dealer on a wire purchase (gross amount minus the dealer commission).
- R - Check Reference No.  
The number on the dealer's check which is sent in payment for a wire purchase.
- S - Social Security Number  
The social security or taxpayer identification number of the customer.
- T - Cusip No.  
The industry security identification number of the fund being purchased or transferred.
- U - Presenter #  
The FINS number (financial institution numbering system) which, when developed, will be the standard industry dealer or financial institution identification number. No entry is necessary in this space at this time.
- V - Date In  
The date the transfer is sent by the dealer to a transfer agent.
- W - Type of Account  
To indicate the following information:  
1. Whether the account is a new account or an existing account (if existing, the account number should be supplied).  
2. What income dividend and capital gains distribution options are to be applied to the account (should be indicated for both wire purchases and transfers).  
3. Whether the account is a systematic withdrawal plan (with an application attached or to follow) or a letter of intention.
- X - Disposition of Shares  
To indicate whether the shares are to be deposited in unissued form and held by the transfer agent or whether a certificate is to be issued and mailed to either the dealer or the shareholder. In addition, if there are special instructions, it is indicated here and thus, refers the transfer agent to the special instructions block (F).

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

October 5, 1973

To: All NASD Members

Re: Quarterly Check-List of Notices to Members (Third Quarter)

Listed below are the Notices to Members which have been issued during the third quarter of 1973.

Members should note that only one copy of each Notice to Members is mailed to every main office of every member. Copies are not mailed to branch offices or to additional personnel in the main office other than the Executive Representative. Therefore, we suggest that all members retain the original copy of each Notice to Members in a separate file in their main office, and that copies needed for internal or branch office distribution be duplicated from the original Notice.

If your main office file is missing any one of the following notices, please contact the Office Services Administrator at the NASD Executive Office (202) 833-7332.

<u>Serial No.</u>	<u>Subject</u>	<u>Date</u>
73-49	Quarterly Check-List of Notices to Members (Second Quarter)	6/29/73
73-50	NASD Proposed Tax Shelter Rules	7/13/73
73-51	Functional Directory - Membership Department	7/13/73
73-52	Proposal to Revise National List Criteria	7/13/73
73-53	SIA Proposal Regarding a New Approach to Broker-Dealer Financial Responsibility Requirements	7/20/73
73-54	Mail Vote Concerning Proposed Restrictions on Securities "Failed to Deliver" and "Failed to Receive"	7/26/73
73-55	Stabilizing Bids in the NASDAQ System	7/27/73

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<u>Serial No.</u>	<u>Subject</u>	<u>Date</u>
73-56	SEC Rule 15c3-2 (Use of Customer Free Credit Balances)	7/27/73
73-57	Use of "immediate close-out" procedures with Memme & Company Incorporated	8/3/73
73-58	Use of "immediate close-out" procedures with First Harvard Co.	8/17/73
73-59	Appointment of Receiver for Memme & Company Inc.	8/17/73
73-60	Revised Procedures for Filing Reports of Backing Away; and Clarification Regarding Registering as a Stabilizing Market Maker (NASDAQ)	8/17/73
73-61	Appointment of SIPC Trustee for Klee & Company, Inc.	8/28/73
73-62	Appointment of Temporary Receivers for Shoaf (Cash) & Co., Inc., and First Harvard Co.	9/7/73
73-63	Proposed New Rules Concerning Standards for Entry Into The Securities Business	9/14/73
73-64*	Exempted Security Questionnaire	9/19/73
73-65	Resolution Requiring Cooperation of Members with Trustees Appointed Under the SIPC Act	9/19/73
73-66	Revised Criteria for OTC-NASDAQ Newspaper Quotation Lists	9/19/73
73-67	Adoption of New Rule of Fair Practice Concerning Restrictions on Securities "Failed to Receive" and "Failed to Deliver"	9/21/73
73-68	Settlement Dates Affected by the Columbus Day (October 8, 1973) and Veteran's Day (October 22, 1973) Holidays	

Sincerely,

*John S. R. Schoenfeld*

John S. R. Schoenfeld  
Executive Vice President

\*Only members who are not members of the New York or American Stock Exchange and who do more than \$2500 business in exempted securities received this notice.



## NATIONAL CLEARING CORPORATION

UNIFORM PRACTICE DIVISION \*

October 12, 1973

TO: All NASD Members

RE: Fidelity Registrar & Transfer Co.  
1 Exchange Place  
Jersey City, NJ

Attention: Operations Officer, Cashier, Fail-Control Dept.

Registrar and Transfer Co., as Receiver for Fidelity Registrar & Transfer Co., has requested that the Uniform Practice Division assist in the dissemination to all NASD members of the attached General Release.

We have been advised that additional lists and information will be forthcoming.

Questions regarding this notice should be directed to Fidelity Registrar & Transfer Co., 1 Exchange Place, Jersey City, New Jersey.

\* The Board of Directors of National Clearing Corporation has been delegated the authority to interpret and enforce the provisions of the Uniform Practice Code pending full implementation of NCC's national clearing system.

-over-

F I D E L I T Y   R E G I S T R A R   &   T R A N S F E R   C O .

1 EXCHANGE PLACE • JERSEY CITY, N.J.

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201-433-2000

212-227-4092-93

GENERAL RELEASE

RE:      Fidelity Registrar & Transfer Company

Registrar and Transfer Company has been appointed Receiver of Fidelity Registrar & Transfer Company, effective October 2, 1973 by the United States District Court of New Jersey.

Under an interim plan, certain issues will be transferrable. Notices will be published periodically on issues so qualified.

The following issues are transferrable at:

FIDELITY REGISTRAR & TRANSFER CO.  
1 EXCHANGE PLACE  
JERSEY CITY, NJ

ALPHAGENICS INSTITUTE LTD.  
AMERICAN WORLD TRAVEL CORP.  
AUTOMATIC COMPACTOR CORP.  
BROOKLYN POLY INDUSTRIES, INC.  
BUSINESS LIQUIDATORS, INC.  
CENTURY DENTAL LABS  
CINE-PRIME CORPORATION  
DENTO-ENZYME PHARMACEUTICAL CORP.  
ECOLOGICAL MANUFACTURING CORP.  
ENVIRONMENTAL SPECTRUM, INC.  
EQUITABLE DEVELOPMENT CORP.  
EQUITY PLANNING CORP.  
FIRST ASSET MANAGEMENT CORP.

GIL DEVELOPMENT CORPORATION  
HIGH ENERGY PROCESSING CORP.  
HYDRO ELECTRONICS CORPORATION  
LOCKE-SCHULER CORPORATION  
MAJESTIC ELECTRO INDUSTRIES, LTD.  
NATIONAL RECYCLED CONTAINERS CORP.  
OH-BOY! INDUSTRIES, INC.  
ORAL VISUAL MEDICAL, INC.  
RENARD MANUFACTURING CO., INC.  
TOWN & COUNTRY FASHIONS, INC.  
VACATION INCENTIVES & PROPERTIES, INC.  
VISUAL SOUNDS, INC.  
PARK AVENUE FASHIONS, LTD.  
HOUSE OF CHROME, INC.

REGISTRAR AND TRANSFER COMPANY  
(As Receiver)





NATIONAL CLEARING CORPORATION

UNIFORM PRACTICE DIVISION \*

October 17, 1973

TO: All NASD Members

RE: Fidelity Registrar & Transfer Co.  
1 Exchange Place  
Jersey City, N.J.

Attention: Operations Officer, Cashier, Fail-Control Dept.

Supplementary Notice #1

As previously announced in NASD Notice to Members 73-71, Registrar & Transfer Co. was recently appointed as Receiver for Fidelity Registrar & Transfer Co., Jersey City, New Jersey and has requested the Uniform Practice Division to assist in disseminating General Releases containing information with regard to transfers.

On the reverse side of this notice is an updated list received from the Receiver naming issues which may now be submitted for transfer.

Questions regarding the General Release should be directed to Fidelity Registrar & Transfer Co.

(over)

- \* The Board of Directors of National Clearing Corporation has been delegated the authority to interpret and enforce the provisions of the Uniform Practice Code pending full implementation of NCC's national clearing system.

F I D E L I T Y   R E G I S T R A R   &   T R A N S F E R   C O .

1 Exchange Place   Jersey City, N.J.

201-433-2000

212-227-4092-93

GENERAL RELEASE

RE: Fidelity Registrar & Transfer Company

Registrar and Transfer Company has been appointed Receiver of Fidelity Registrar & Transfer Company, effective October 2, 1973 by the United States District Court of New Jersey.

Under an interim plan, certain issues will be transferable. Notices will be published periodically on issues so qualified.

The following issues are transferable at:

FIDELITY REGISTRAR & TRANSFER CO.  
1 EXCHANGE PLACE  
JERSEY CITY, N.J.

ALPHAGENICS INSTITUTE LTD.  
AMERICAN WORLD TRAVEL CORP.  
AUTOMATIC COMPACTOR CORP.  
BROOKLYN POLY INDUSTRIES, INC.  
BUSINESS LIQUIDATORS, INC.  
CENTURY DENTAL LABS  
CINE-PRIME CORPORATION  
DENTO-ENZYME PHARMACEUTICAL CORP.  
ECOLOGICAL MANUFACTURING CORP.  
ENVIRONMENTAL SPECTRUM, INC.  
EQUITABLE DEVELOPMENT CORP.  
EQUITY PLANNING CORP.  
FIRST ASSET MANAGEMENT CORP.  
GIL DEVELOPMENT CORPORATION  
HIGH ENERGY PROCESSING CORP.  
HYDRO ELECTRONICS CORPORATION  
HYDRO ELECTRONICS CORPORATION  
LOCKE-SCHULER CORPORATION  
MAJESTIC ELECTRO INDUSTRIES, LTD.  
NATIONAL RECYCLED CONTAINERS CORP.  
OH-BOY! INDUSTRIES, INC.  
ORAL VISUAL MEDICAL, INC.  
RENARD MANUFACTURING CO., INC.  
TOWN & COUNTRY FASIONS, INC.  
VACATION INCENTIVES & PROPERTIES, INC.  
VISUAL SOUNDS, INC.  
PARK AVENUE FASIONS, LTD.  
HOUSE OF CHROME, INC.

ADDITIONAL ISSUES  
BORNE CHEMICAL COMPANY, INC.  
CENTURION OIL & MINERAL COMPANY  
ECOLOGICAL RECYCLING COMPANY  
GROWTH CANADIAN, INC.  
METCALF FARMS HAWAII, INC.  
P.E.C. INDUSTRIES, INC.  
TRANSCO INDUSTRIES, INC.  
VERNON VALLEY RECREATION ASSOC., INC.  
WALL STREET COMPUTER CORPORATION  
WENDY JEWELRY ENTERPRISES, INC.  
ATLANTIC MEDICAL CORPORATION  
BELL MOUNTAIN SILVER MINES, INC.  
COMSTOCK LODE SILVER & COPPER MINES, INC.  
ECOM SYSTEMS, INC.  
ELECTRONIC ENTERPRISES, INC.  
FIRST AMERICAN EQUITY CORPORATION  
GREAT NORTHERN MANAGEMENT CO., INC.  
INCOTEL LTD.  
PAN MINERALS, INC.

REGISTRAR AND TRANSFER COMPANY  
(RECEIVER)



# NATIONAL CLEARING CORPORATION

UNIFORM PRACTICE DIVISION \*

October 26, 1973

TO: All NASD Members

Transactions made on Tuesday, November 6, 1973, Election Day, and on the business days immediately preceding that day will be subject to the schedule of settlement dates below (for "regular-way" transactions). No trade settlements will be made on November 6, but securities markets and the NASDAQ System will be in operation for trading.

Deliveries of securities and payments of funds ordinarily due on November 6 shall be due on the next business day following that day.

Transactions made on November 6 and transactions made on November 5 will be combined for settlement on November 13, a double-settlement day.

November 6 shall not be considered a business day in determining the day for settlement of a transaction, the day on which stock shall be quoted ex-dividend, or in computing accrued interest on bonds.

Further, marks to the market, reclamations, buy-ins and sell-outs, as provided for in the Uniform Practice Code, shall not be exercised on November 6.

### Settlement dates for "regular-way" transactions

<u>Trade Date</u>	<u>Settlement Date</u>
October 30	November 7
31	8
November 1	9
2	12
November 5 and 6	13

Questions regarding this notice may be directed to the Uniform Practice Division of National Clearing Corporation, Two Broadway, 8th Floor, New York, N.Y., 10004, (212) 952-4018.

\* The Board of Directors of National Clearing Corporation has been delegated the authority to interpret and enforce the provisions of the Uniform Practice Code pending full implementation of NCC's national clearing system.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 5, 1973

IMPORTANT

## CHANGES IN FREE-RIDING POLICY

To: All NASD Members and Branch Offices

Re: (1) Amendments to "Free-Riding and Withholding" Interpretation  
(2) Clarification of Certain Areas of the Interpretation

The Board of Governors of the Association has recently adopted several amendments to the "Free-Riding and Withholding" Interpretation. This Interpretation in its entirety appears on pages 2039 to 2045 of the Association's Manual. The changes will amend paragraph 4, the proviso paragraph following paragraph 5, paragraph 8, and the paragraph entitled "Violations by Recipient". A new section entitled "Investment Partnerships and Corporations" will be added and the word "shares" will be replaced with the word "securities" wherever it appears in the Interpretation. A copy of the amendments which will become effective on December 1, 1973 is attached.<sup>1/</sup> They were previously submitted to the membership for comment on June 6, 1973 by Release No. 73-45. A total of 17 comments were received after which the proposals were again considered by the National Business Conduct Committee and the Board of Governors.

Explanation of Amendments

The amendments to paragraph 4 of the Interpretation adds "savings and loan institutions" and "registered investment companies" to the list of institutions whose senior officers and certain other employees are restricted to receiving securities of a "hot issue" in a manner consistent with the prohibitions established by the Interpretation. Such individuals have always been considered restricted by the Association as officers and employees of institutional type accounts. The Board believes that for purposes of clarity they should be specifically included in the Interpretation.

<sup>1/</sup> The Association's Manual Supplement No. 90 inadvertently indicated an effective date of November 1, 1973. This date is incorrect.

The amendment to the proviso paragraph following paragraph 5 would totally prohibit members, persons associated with members and members of their immediate families, as defined, from receiving shares of a "hot issue" under any circumstances. This differs from present provisions which allow purchases by such persons if such were in accordance with the person's normal investment practice and if the securities sold to restricted accounts were insubstantial and not disproportionate in amount as compared to sales to members of the public. The amendment discontinues this practice and places a total prohibition on the receipt of shares of such issues by members of the Association, persons associated therewith and their family members receiving support from them. The new provisions would also prohibit any account in which such persons have a beneficial interest from purchasing shares of a "hot issue".

The amendment to paragraph 8 simply changes the words "underwriting agreement" to "agreement among underwriters". The present language was inadvertently inserted when that paragraph was adopted. As written, it refers to the agreement between the managing underwriter and the issuer and such was not the intent. The intent was to refer to the agreement between the several underwriters and the managing underwriter and the amendment clarifies that intent.

The paragraph entitled "Violations by Recipient" (page 2044 of the Manual) applies, in one respect, to a situation where a member of the immediate family of a person associated with a member has been the recipient of securities of a "hot issue". The amendment thereto is clarifying in nature and is intended to make clear that a person associated with a member whose relative received securities of a "hot issue" must have directly or indirectly caused such distribution in order for him to be deemed to have violated the Interpretation. This was the intent of the paragraph when adopted.

The new section entitled "Investment Partnerships and Corporations" concerns the sale of "hot issues" to investment partnerships, investment corporations and other like accounts. The new section prohibits a member from selling a "hot issue" to any investment partnership or corporation, domestic or foreign, unless the member receives from the account, prior to the execution of the transaction, the names and business connections of all persons having a beneficial interest in the account. This information is necessary to the determination by a member of whether the sale of a "hot issue" to such an account is consistent with paragraph (5) of the Interpretation. That paragraph prohibits sales of "hot issues", contrary to the terms of the Interpretation, to any account in which a restricted person has a beneficial interest. Such beneficial interest covers not only ownership interests, but every type of financial interest, including but not limited to, management fees and other fees based on the performance of the account. This requirement applies to hedge funds, investment clubs or any other account whose primary function consists of investing in securities. The information will be

required to be updated as the participants in the account change. If this information is not received by the member, the sale of a "hot issue" to the account would be in violation of the Interpretation. Further, if any person enumerated in paragraphs (1) through (4) of the Interpretation has a beneficial interest in the account, the entire account would, pursuant to the provisions of paragraph (5), be restricted and any sale of securities of a "hot issue" to the account would be required to comply with the provisions of the Interpretation.

The Association recognizes that in some cases, particularly with respect to foreign accounts, the partnership or corporation may be prohibited by law from disclosing the names of persons having a beneficial interest in the account. In such cases, the new section on "Investment Partnerships and Corporations" provides that the member must receive written assurance from the account that no person restricted under the Interpretation has a beneficial interest in the account. All cases where foreign law is cited as prohibiting disclosure of the names of persons having a beneficial interest in the account will receive close scrutiny by the Association and the legal basis for such claim must be demonstrated by the person urging such as a basis for his failure to submit the required names. Such must include a citation to the specific law relied upon.

#### Clarification of Certain Areas of the Existing Interpretation

The Free-Riding Interpretation provides that a member may sell securities of a "hot-issue" to certain restricted accounts if it can demonstrate that the securities so sold were in accordance with their normal investment practices, that the aggregate of the securities sold is insubstantial and not disproportionate in amount as compared to sales to members of the public, and that the amount sold to any one restricted account is insubstantial. Thus, "disproportionateness", "insubstantiality" and "normal investment practice" must be conscious considerations in sales of shares of a "hot issue" to any restricted account. Questions have been raised by the membership concerning the guidelines followed by the Association in determining compliance or non-compliance with those standards. The Board is, therefore, issuing this clarifying memorandum.

In respect to the determination of what constitutes a disproportionate allocation, the Association uses as a guideline 10% of the member's participation in the issue, however acquired. Thus, if 10% or more of the members' participation is distributed to accounts restricted by the Interpretation a disproportionate allocation could be considered to have been made. It should be noted, however, that the 10% factor is merely a guideline similar to the Association's 5% Mark-Up guideline, and is one of a number of factors which are considered in reaching determinations of violations of the Free-Riding policy on the basis of a disproportionate allocation. These other factors include, among other things, the size of the participation, the offering price of the issue, the amount of securities sold to restricted accounts,

and the price of the securities in the after-market. It should be noted that disciplinary action has been taken against members for violations of the Free-Riding Interpretation where the allocations made to restricted accounts were less than 10% of the member's participation.

The Board has also determined that a normal unit of trading (100 shares or 10 bonds) will, hereafter, in most cases, not be considered a disproportionate allocation notwithstanding the amount of the member's participation. This means that if the aggregate number of shares of a member's participation which is allocated to restricted accounts does not exceed a normal unit of trading, such allocation will, in most cases, not be considered disproportionate. For example, if a member receives 500 shares of a hot issue, he may allocate 100 shares to a restricted account or accounts, even though such allocation represents 20% of the member's participation. Of course, all of the remaining shares would have to be allocated to unrestricted accounts, and all other provisions of the Interpretation would have to be satisfied. Specifically, the allocation would have to be consistent with the normal investment practice of the account to which it was allocated and the member would not be permitted to sell to restricted persons who are totally prohibited from receiving hot issues.

Notwithstanding the above, it should be noted that the requirement relating to "insubstantiality" is separate and distinct from the requirements relating to "disproportionateness" and "normal investment practice". In addition, that term applies both to the aggregate of the securities sold to restricted accounts and to each individual allocation. In other words, there could be a substantial allocation to an individual account in violation of the Interpretation and yet be no violation on that ground as to the total number of shares allocated to all accounts. The determination of whether an allocation to a restricted account or accounts is substantial is based on, among other things, the number of shares allocated and/or the dollar amount of the purchase.

The third factor which must be demonstrated by a member who sells securities to a restricted account is that the sale is in accordance with that account's normal investment practice with the member. The Interpretation defines "normal investment practice" as:

"Normal investment practice" shall mean the history of investment in an account with the member. Such history must include purchases with some regularity. If such history discloses a practice of purchasing mainly "hot issues" such record would not constitute a "normal investment practice" as used in this Interpretation. If the account involved is that of the member, such account clearly must be an investment account as distinct from a regular inventory or trading account."

Requests have been made for further clarification of what constitutes "normal investment practice." The Association considers various relevant factors in the determination of such. These factors include, but are not limited to:

(1) An examination of the period of time in which the account has engaged in securities activity with the member. Present practice is for the Association to look to at least the previous three year period of securities activity. Where warranted, a longer or shorter period will be reviewed.

(2) The frequency of transactions during that period of time. Relevant in this respect is the nature and size of the investments.

(3) A comparison of the dollar amount of the previous transactions with the dollar amount of the hot issue purchase. Obviously if a restricted person purchases \$1,000 of a hot issue and his account revealed a series of purchases and sales in \$100 amounts, the \$1,000 purchase would not be consistent with the normal investment practice of the account.

(4) The Interpretation states that a practice of purchasing mainly "hot issues" would not constitute a "normal investment practice." The Association does, however, consider as contributing to the establishment of a "normal investment practice" the purchase of new issues which are not "hot issues".

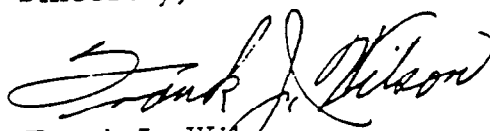
The above factors are not necessarily exhaustive but they are the most common and most frequently used since they are all relevant in many cases. They are being published at this time to assist the membership in its compliance with the Interpretation. Other factors may be considered depending on the facts and circumstances of each individual situation.

Paragraph 4 of the Interpretation prohibits the sale of a hot issue to any senior officer of a bank, savings and loan institution, insurance company, registered investment company, registered investment advisory firm, or any other institutional type account. Questions have been raised as to the meaning of the term "senior officer" as it relates to the Free-Riding Interpretation. The Association is aware that many of these institutions, particularly large ones, have a number of officers who do not actually function as senior officers but may be given a title without the commensurate responsibility which normally accompanies the position of a senior officer. In such cases, the Association looks to the duties and responsibilities of the specific officer in question. This determination does not, necessarily, involve the specific officer's duties with respect to securities activity but whether his general duties and responsibilities with the institution would classify him as a senior officer of that institution. A senior officer is a restricted account per se and his duties do not have to involve the buying or selling of securities to cause



him to be restricted. The Association believes that the president and chairman of the board of all institutions are clearly senior officers. Below this level, the member should look to the duties of the particular officer to determine whether the individual is actually a senior officer. The affirmative obligation is on the member to make this determination prior to the sale of the "hot issue" to such an account.

Sincerely,



Frank J. Wilson  
Senior Vice President  
Regulation

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TEXT OF AMENDMENTS

Deleted Material indicated by striking out  
New Material indicated by underlining

[Note: The following five paragraphs of the Free-Riding and Withholding Interpretation are amended as indicated. In addition, the word "securities" is substituted for the word "shares" wherever it appears throughout the Interpretation which, in its entirety, appears in the Association's Manual commencing on page 2039]

(1) Paragraph 4 of the "Free-Riding and Withholding" Interpretation (page 2041 of the Association's Manual).

4. Sell any securities to any senior officer of a bank, savings and loan institution, insurance company, registered investment company, registered investment advisory firm or any other institutional type account, domestic or foreign, or to any person in the securities department of, or to any employee or any other person who may influence or whose activities directly or indirectly involve or are related to the function of buying or selling securities for any bank, savings and loan institution, insurance company, registered investment company, registered investment advisory firm, or other institutional type account, domestic or foreign, or to a member of the immediate family of any such person.

(2) The proviso paragraph following paragraph 5 (page 2041 of the Manual.)

Provided, however, a member may ~~withhold for its own account,~~  
or sell part of its securities acquired as described above to:

(a) persons enumerated in paragraph (2), (3) or (4) or (5) hereof; and

(b) members of the immediate family of persons enumerated in paragraph (2) hereof provided that such person enumerated in paragraph (2) does not contribute directly or indirectly to the support of such member of the immediate family; and

(c) any account in which any person specified under paragraph (3) or (4) or subparagraph (b) of this paragraph has a beneficial interest;

~~part of the shares acquired as described above if the member is prepared to demonstrate that the securities withheld for its own account were withheld for bonafide investment in accordance with the members' normal investment practice or were sold to such other persons in accordance with their normal investment practice with the member, that the aggregate of the securities so withheld and/or sold is insubstantial and not disproportionate in amount as compared to sales to members of the public and that the amount withheld and/or sold to any one of such persons is insubstantial in amount.~~

(3) Paragraph 8(a) of the "Free-Riding and Withholding" Interpretation (page 2042 of the Association's Manual).

8(a) In the case of a foreign broker-dealer or bank which is participating in the distribution as an underwriter, the underwriting agreement among underwriters contains a provision which obligates the said foreign broker-dealer or bank not to sell any of the shares securities, which it receives as a participant in the distribution to persons enumerated in paragraphs (1) through (5) above, or in a manner inconsistent with the provisions of paragraph (6) hereof; or

(4) Violations by Recipient (page 2044 of the Manual).

In those cases where a member or person associated with a member, ~~or a member of the immediate family thereof~~, has been the recipient of shares securities of a public offering to the extent that such violated the Interpretation, the member or person associated with a member shall be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation as well as the member who sold the shares securities since their responsibility in relation to the public distribution is equally as great as that of the member selling them. In those cases where a member or a person associated with a member has caused, directly or indirectly, the distribution of securities to a person falling within the

restrictive provisions of this Interpretation he shall also be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation. Receipt by a member or a person associated with a member of shares securities of a "hot issue" which is being distributed by an issuer itself without the assistance of an underwriter and/or selling group is also intended to be the subject of this Interpretation.

(5) Investment Partnerships and Corporations (page 2043 of the Manual)

A member may not sell securities of a public offering which immediately after the distribution process is commenced, trade at a premium in the secondary market ("hot issue"), to the account of any investment partnership or corporation, domestic or foreign, (except companies registered under the Investment Company Act of 1940) including but not limited to, hedge funds, investment clubs, and other like accounts unless the member receives from such account, prior to the execution of the transaction, the names and business connections of all persons having any beneficial interest in the account, and if such information discloses that any person enumerated in paragraphs (1) through (4) hereof has a beneficial interest in such account, any sale of securities to such account must be consistent with the provisions of this Interpretation; provided, however, that if the disclosure of such information by the account is prohibited by law, then in such case, the member must receive written assurance from the account that no person enumerated in paragraphs (1) through (4) hereof has a beneficial interest in such account.

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

November 19, 1973

## I M P O R T A N T

### MANDATORY FIDELITY BONDING RULE TO BECOME EFFECTIVE MARCH 15, 1974

TO: All NASD Members and Interested Persons

RE: Adoption of Article III, Section 32 of Rules of  
Fair Practice and Appendix C to Article III,  
Section 32 (Mandatory Bonding Rule)

Enclosed herewith is new Section 32 of Article III of the Association's Rules of Fair Practice and Appendix C thereto concerning mandatory fidelity bonding for NASD members. This new rule was approved by the membership and submitted to and not disapproved by the Securities and Exchange Commission subject to the development and adoption by the Association by March 1, 1974 of a plan acceptable to the Commission to make certain that no member subject to the rule will be excluded from the securities business merely because it cannot obtain a fidelity bond at reasonable cost. Affirmative steps have already been taken by the Association to develop such a plan; hence, the rule will be declared effective as of March 15, 1974.

Subsection (a) of proposed Section 32 will require every member to carry a blanket fidelity bond in such form and amount as prescribed by the Board of Governors of the Association. Appendix C to the rule limits this requirement to those members who are required to join the Securities Investor Protection Corporation, who are subject to SEC Rule 15c3-1 (the net capital rule), and who have employees. Subsection (b) authorizes the Board to adopt rules, regulations and provisions concerning mandatory fidelity bonding covering the form, amount and

type of coverage thereof and to incorporate them in Appendix C to the rule. The Board is further authorized to change Appendix C without a vote of the membership subject only to the requirement that such changes be sent to the membership for a period of comment prior to adoption. Appendix C thus contains the operative provisions governing the mandatory fidelity bonding authorized by Section 32. Those provisions will be explained hereinafter in detail.

### Background and Explanation

As most members are aware, the 1969-1970 operational stresses upon the financial community resulted in the formation by Congress of the Securities Investor Protection Corporation (SIPC). SIPC was designed to protect the customers of broker/dealers against certain losses in the event liquidation became necessary. It was within this framework that the Board of Governors of the Association formed a Committee on Bonding Coverage in December, 1971 to conduct a study of the present bonding practices of the industry and to make recommendations to the Board responsive to a request by SIPC that misappropriation of assets be excluded from the risks assumed by that corporation. The new Section 32 and Appendix C thereto were the result of that Committee's recommendations.

Subsequently, the proposed rule and accompanying appendix were distributed to the membership for comment on July 27, 1972. After consideration of the comments received, the Board of Governors submitted the rule and accompanying appendix to the membership for vote on January 2, 1973. It was thereafter approved by the membership by a vote of 1,394 to 676 and filed with and not disapproved by the Securities and Exchange Commission subject to the condition noted above.

All members subject to the rule will be required to conform to its provisions no later than its effective date, March 15, 1974. Accordingly, it will be necessary that all such members take immediate steps to obtain the required coverage so as to allow sufficient time to investigate any problems in local availability of such and to assess the comparability of various firms' rates and services. Upon obtaining the required coverage, each affected member must immediately communicate this information in writing, together with the amounts of coverage and name of the insurance carrier, to the Association on Form B appearing on the cover page hereof. If by February 1, 1974, certain members find they are unable to procure the required coverage, it is imperative that such fact immediately be communicated to the Association via Form B so it may assist the member in obtaining specialized coverage to prevent a violation of the rule and its attendant penalties.

In anticipation of the possibility that some members will not be able to obtain the required coverage, the Association has taken steps to develop with the insurance industry a plan whereby such members will be able to obtain coverage on a specialized basis. Understandably, such an arrangement will undoubtedly involve higher costs to the participating members. It should be considered only as a final alternative. Accordingly, each member affected by the rule should immediately arrange to obtain the required coverage through its own insurance company, broker or agent and thus obtain optimum benefits in terms of price and service received. If further information or assistance is necessary in obtaining a Brokers Blanket Fidelity Bond, the Association staff is prepared to promptly reply to telephone or written inquiries from the membership in connection with this matter. Form B and all other inquiries concerning this matter should be submitted to Mr. A. John Taylor, Vice President, Variable Contracts, at the Association's Executive Office, 1735 K Street, N. W., Washington, D. C. 20006 (202-833-7318).

#### Section-by-Section Analysis

Subsection (a) of Section 32 provides that each affected member is required to carry a Blanket Fidelity Bond in such form and amount as prescribed by the Board of Governors in Appendix C. Subsection (b) authorizes the Board to adopt and change the requirements governing Blanket Fidelity Bonds embodied in Appendix C without a vote of the membership, although changes would be required by subsection (b) to be submitted to the membership for comment prior to their effectiveness.

Appendix C contains the operative provisions implementing the mandatory bonding authorized by Section 32. Subsection (a) of Appendix C establishes the class of members covered by the new requirements as being those members who are required to join SIPC, who are subject to Rule 15c3-1 under the Securities Exchange Act of 1934 and who have employees.

Subsection (a) (1) provides that all affected members shall maintain a Blanket Fidelity Bond covering its officers and employees containing the insuring agreements listed therein. The insuring agreements listed in this subsection, except for paragraph (h), represent the coverage normally contained in standard Brokers Blanket Fidelity Bonds currently in use in the insurance industry. Paragraph (h) of subsection (a) (1) requires a provision in the bond whereby the insurance carrier will agree to use its best efforts to promptly notify the Association in the event of cancellation, termination, or substantial modification of the bond. Such provisions for best efforts notification have been found generally acceptable by the insurance industry.

Subsection (a) (2) provides that in no event shall the minimum coverage for any insuring agreement contained in the bond be less than \$25,000 in amount. This minimum coverage would be required to increase, however, in proportion to the member's net capital requirement as detailed in subsections (a) (3), (4) and (5). Subsection (a) (3) sets forth a method of computing minimum coverage for the first five insuring agreements contained in the bond; namely, Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration. Subsection (a) (4) sets forth the method of computing Fraudulent trading coverage; subsection (a) (5) sets forth the method of computing Securities loss coverage.

Under subsection (a) (3), coverage for the first five insuring agreements would be determined by multiplying required net capital under Rule 15c3-1 (up to a maximum of \$600,000) by 120%. The product of such computation will yield the minimum coverage required. The determination of minimum required coverage for net capital in excess of \$600,000 will be required to be made by reference to the table contained in subsection (a) (3) of Appendix C. Maximum required coverage would be \$5,000,000 for firms with required net capital of \$12,000,000 and above.

Computation of the amount of Fraudulent trading coverage required is determined by reference to subsection (a) (4) which provides that such coverage shall be one-half the amount of the minimum required coverage computed under subsection (a) (3) subject, however, to the provision that at no time shall such be less than \$25,000. Maximum required Fraudulent trading coverage has been set at \$500,000. Similarly, under subsection (a) (5), minimum Securities loss coverage will be required to be 25% of the minimum coverage required under subsection (a) (3) subject to the provision that in no event shall such coverage be less than \$25,000. Maximum Securities loss coverage has been set at \$250,000.

Subsection (b) of Appendix C provides that a deductible provision may be included in the bond of \$5,000, or 10% of required minimum coverage, whichever is greater. A significant factor to an insurance company in determining the premium to be charged for a bond is the high risk of payout attendant to smaller claims if such are covered under the insuring agreement. The provisions for inclusion of a deductible provision under our rule has the effect of lowering the cost of required bonding coverage for members since the numerous and costly smaller losses would be required to be absorbed by the member itself.

Subsection (c) of Appendix C provides that the required minimum coverage of the bond under subsections (a) (2), (3), (4) and (5) shall be

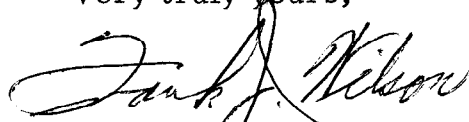
determined by reference to the highest required net capital during the immediately preceding twelve-month period. This provision recognizes that there are fluctuations in a member's required net capital over the course of the year. In this connection, it is important to note that notwithstanding the fact that this type of bond is normally written for a three year period, revisions in minimum coverage will be required to be made every year, if necessary, as of the anniversary date of the issuance of the bond with the adjustments being required to be made no later than thirty days after the anniversary date of the bond. It presently appears impractical to require revisions on other than an annual basis for existing members of the Association.

It should be noted that the provisions of Appendix C establish only minimum requirements rather than an optimum level of coverage in all situations. Accordingly, the Association encourages the membership to anticipate upward revisions of required net capital in determining bonding coverage to assure needed, rather than merely required, coverage.

Subsection (d) of Appendix C provides that each member shall report a cancellation, termination or substantial modification of the bond to the Association within ten (10) business days of such occurrence. The term "substantial modification" shall be construed to mean any modification which will result in a violation of Appendix C. In determining the time frame within which a member is required to report such occurrence to the Association, the ten (10) business days' requirement is intended to operate from the time the cancellation, termination or substantial modification is made known to the member rather than the effective date thereof. Accordingly, upon notice of future cancellation, termination or substantial modification by the insurer, the member will be required to report such to the Association within ten (10) business days thereof.

As stated above, members will be required to conform to these provisions no later than the effective date of this rule, March 15, 1974. Deferral of the effective date until March 15 should allow members an adequate time and opportunity to comply with the new requirements.

Very truly yours,



Frank J. Wilson  
Senior Vice President  
Regulation



New Article III, Section 32 of Rules of Fair Practice

- (a) Every member shall be required to carry a blanket fidelity bond meeting requirements as to form, amount and type of coverage as the Board of Governors may prescribe pursuant to the authorization granted by paragraph (b) hereof.
- (b) The Board of Governors is hereby authorized to adopt rules, regulations and procedures for blanket fidelity bonds concerning the form, amount and type of coverage thereof. The rules, regulations and procedures authorized hereby shall be incorporated into Appendix C to be attached to and made part of this rule. The Board of Governors shall have the power to alter, amend, supplement or modify the provisions of Appendix C from time to time without recourse to the membership for approval, as would otherwise be required by Article VII of the By-Laws. All contemplated changes shall, however, be submitted to the membership for comment prior to effectiveness. Appendix C shall become effective as the Board of Governors may prescribe unless disapproved by the Securities and Exchange Commission.

New Appendix C to Article III, Section 32

- (a) Each member required to join the Securities Investor Protection Corporation who is subject to Rule 15c3-1 under the Securities Exchange Act of 1934, and has employees, shall:
  - (1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America, covering officers and employees which provides against loss and has agreements covering at least the following:
    - a. Fidelity
    - b. On Premises
    - c. In Transit
    - d. Misplacement

- e. Forgery and Alteration (including check forgery)
- f. Securities Loss (including securities forgery)
- g. Fraudulent Trading
- h. Cancellation Rider providing that the insurance carrier will use its best efforts to promptly notify the National Association of Securities Dealers, Inc. in the event the bond is cancelled, terminated or substantially modified.

- (2) Maintain minimum coverage for all insuring agreements required in this subsection (a) of not less than \$25,000;
- (3) Maintain required minimum coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less than 120% of its required net capital under Rule 15c3-1 up to \$600,000. Minimum coverage for required net capital in excess of \$600,000 shall be determined by reference to the following table:

<u>Net Capital Requirement</u> <u>under Rule 15c3-1</u>	<u>Minimum Coverage</u>
\$ 600,001 - 1,000,000	\$ 750,000
1,000,001 - 2,000,000	1,000,000
2,000,001 - 3,000,000	1,500,000
3,000,001 - 4,000,000	2,000,000
4,000,001 - 6,000,000	3,000,000
6,000,001 - 12,000,000	4,000,000
12,000,001 - and above	5,000,000

- (4) Maintain Fraudulent Trading coverage of not less than \$25,000 or 50% of the coverage required in subsection (a) (3), whichever is greater, up to \$500,000;
- (5) Maintain Securities Forgery coverage of not less than \$25,000 or 25% of the coverage required in subsection (a) (3), whichever is greater, up to \$250,000.

- (b) A deductible provision may be included in the bond of up to \$5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.
- (c) Each member shall initially determine minimum required coverage of the bond pursuant to subsections (2), (3), (4) and (5) herein, by reference to the highest required net capital during the twelve-month period immediately preceding issuance of the bond. Thereafter, each member shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period. Each member shall make required adjustments not more than thirty days after the anniversary date of the issuance of such bond.
- (d) Each member shall report the cancellation, termination or substantial modification of the bond to the Association within ten business days of such occurrence.

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

November 23, 1973

## NOTICE

TO: All NASD Members

SUBJECT: NASD Survey Regarding SEC Rule 15c3-3

As you know, SEC Rule 15c3-3, the "Customer Protection Rule," became effective on January 15, 1973. Prior to the adoption of the rule, the Association conducted a number of studies to determine the financial impact of the proposed rule upon members. Based on information obtained through such studies and letters of comment filed by interested parties, the Association was able to provide the Commission with sufficient data to substantiate the validity of a number of recommended changes. These recommendations were offered to minimize certain computational and record-keeping requirements of the rule without sacrificing the goal of maximum protection of customers' funds and/or securities. As a result of these efforts, the rule as adopted, provides that a broker-dealer whose ratio of aggregate indebtedness to net capital does not exceed 8:1 and whose customer credits do not exceed \$1,000,000 may perform the required computation of the reserve formula on a monthly rather than a weekly basis. Among other areas, the proposed rule was modified to enable a broker-dealer whose mode of operation satisfies specified criteria concerning the complete separation of customer funds and securities to claim an exemption pursuant to the provisions of paragraph (k).

The "Customer Protection Rule" has now been in effect for approximately ten months. In announcing the adoption of the rule, the Commission stated that, "The operation of Rule 15c3-3 will be carefully monitored by the Commission to determine whether there will be need in the public interest for the protection of investors to tighten or relax any of the restraints and time frames embodied in the rule." In an endeavor to assist the Commission in fulfilling its stated objective, the Association is conducting a survey of all members to obtain comments and suggestions pertaining to the requirements of SEC Rule 15c3-3. In this regard, it would be extremely helpful if members would take this opportunity to submit comments and, at a minimum, respond to the following:

- a. Provisions of the rule which are considered either inadequate or unnecessary for the protection of

customers' funds or securities; an explanation of such and alternative suggestions, if any;

- b. Requirements of the rule which are believed to be unduly burdensome in relation to the level of customer protection achieved; and,
- c. Provisions of the rule or interpretations thereof which have been found to be either ambiguous or questionable as to application and/or intent.

The above is not intended to be all-inclusive or restrictive as to the type of comments being solicited. Relevant comments and alternative suggestions regarding all aspects of the rule are welcomed.

A summation of the views and comments as expressed by the membership will be forwarded to the Commission at the conclusion of this survey. To determine the true impact of the rule and to insure that the rule functions in the manner consistent with its intended purpose, total participation and cooperation is necessary, for without such, it will be impossible to develop a representative viewpoint of the Association's membership.

It is requested that comments be mailed to the Association by December 20, 1973. Said comments should be sent to:

National Association of Securities Dealers, Inc.  
c/o Department of Regulatory  
Policy and Procedures  
1735 "K" Street, N. W.  
Washington, D. C. 20006

Should you have any questions concerning this matter, please contact Robert L. Smith at (202) 833-7356 or Stephen A. Boyko at (202) 833-4827.

Very truly yours,



Frank J. Wilson  
Senior Vice President  
Regulation

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

December 10, 1973

## NOTICE

TO: All NASD Members

RE: SEC Release 10304/July 30, 1973 - Application of  
Minimum Net Capital Requirements of Rule 15c3-1(a)(3)  
And (4) Under the Securities Exchange Act of 1934.

In Securities Exchange Act Release No. 10304, dated July 30, 1973, the Commission sought to clarify the applicability of the provisions of Rule 15c3-1 (the "net capital rule") pertaining to the minimum net capital requirements of \$5,000 and \$2,500 as set forth in subparagraphs (a)(3) and (a)(4) of said rule.

Since the publication of that release however, the Association has received a substantial number of inquiries from members and others seeking additional clarification of the application and availability of these minimum requirements. In this connection, the Association recently met with members of the Commission's Division of Market Regulation staff and requested the staff's position on these matters.

The following is a summary of the questions raised by the Association at this meeting and the views of the SEC with regard to such.

Question: Has SEC Release No. 10304, in any manner altered or restricted the permissible activities of the \$2,500 minimum net capital category of broker-dealer as specified in subparagraph (a)(4) of SEC Rule 15c3-1?

Answer: No. There are no changes in the limiting conditions previously set forth for this category of broker-dealer.

Question: Can a broker-dealer in the \$2,500 category participate in the distribution of tax shelter, real estate or similar type of program?

Answer: No. If a broker-dealer in the \$2,500 category increases the scope of its business to include the sale of limited partnership interests, its minimum capital requirement would be \$15,000 or \$25,000 depending upon its date of registration. However, if a broker-dealer limits its activity to the sale of investment company shares and tax shelter programs and handles such on a subscription or application basis only, its minimum capital requirement would then be \$5,000.

Question: May the \$2,500 category of broker-dealer safekeep customers' fully-paid securities or maintain customers' free credit balances?

Answer: No, he must promptly transmit all funds and deliver all securities received in connection with his activities as a broker-dealer and cannot hold funds or securities for, or owe money or securities to, customers.

Question: What is the definition of "promptly"?

Answer: The term "promptly" has generally been determined on a case-by-case basis depending on the specific fact situation. However, SEC Release Nos. 9891 and 10525 (Proposed Uniform Net Capital Rule Releases) dated December 5, 1972 and November 29, 1973 respectively, provide a definition of the term "promptly transmits" in subparagraph (c)(14) which reads as follows:

"A broker or dealer is deemed to 'promptly transmit' all funds and 'promptly deliver' all securities . . . where such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities."

The definition cited above should be considered the staff's present thinking in this area.

In presenting its views with regard to the \$5,000 minimum net capital requirement, the Commission stated in SEC Release No. 10304 that:

"In administering the net capital rule, the \$5,000 requirement has been held to be applicable if the broker or dealer engages only in one, or any combination, of the following activities:

- (1) The broker or dealer introduces all of its transactions to another broker or dealer or bank as provided in Rule 17a3(b). Such transactions are confirmed to customers by the clearing broker or dealer who is deemed to carry such customer's account. All checks in payment for such purchases are to be made payable to the clearing broker or dealer by the customer and if received by the introducing broker or dealer they are to be promptly transmitted to the clearing broker or dealer by noon of the next business day. Also, deliveries of securities by customers are to be made directly to the clearing broker or dealer who confirms such transactions. Any payments received by the introducing broker or dealer from customers for the payment of securities purchased and any securities received from customers by the introducing broker or dealer in settlement of sales shall be transmitted promptly to the clearing broker or dealer;
- (2) The broker or dealer promptly transmits subscriptions for securities (including but not limited to limited partnership interests or redeemable shares of registered investment companies) to the issuer, sponsor or distributor of such securities and delivers checks, drafts, notes or other evidences of indebtedness which shall be payable solely to the issuer, sponsor or distributor who in turn delivers the related security directly to the subscriber or who holds such security as custodian for such customer; or
- (3) The broker or dealer promptly transmits customers' checks, drafts, notes or other evidences of indebtedness payable to an independent escrow agent in payment for customer purchases of securities (including best efforts underwritings or deposits for the purchase of condominium units) and where the escrow agent has agreed in writing to hold all such funds in escrow for the persons who have beneficial interest therein and to return such funds or delivers securities purchased directly to the customers who have the beneficial interest therein.

"The Commission wishes to make clear that simply because a broker or dealer is entitled to an exemption from Rule 15c3-3 under subparagraph (k)(2)(A) thereof, the broker or dealer is not automatically entitled to maintain minimum net capital of not less than \$5,000 unless the activities of such broker or dealer are limited as described above.



Finally, the \$5,000 minimum net capital requirement of Rule 15c3-1 is not intended to preclude the broker or dealer from effecting an occasional transaction for his own account". 1/

Question: May a broker-dealer in the \$5,000 minimum net capital category engage in any market making activities?

Answer: Yes, if such trades are cleared and carried by another broker-dealer or bank on a fully-disclosed basis.

Question: Can a broker-dealer in the \$5,000 category maintain security positions for the purpose of retail transactions?

Answer: Yes. Again, this type of activity is permitted only if such positions and transactions are carried and cleared by another broker-dealer or bank on a fully-disclosed basis.

Question: May a broker-dealer in the \$5,000 category manage or participate in a firm commitment underwriting?

Answer: Yes, but again, all such positions and transactions must be carried and cleared by another broker-dealer or bank on a fully-disclosed basis.

Important: It should be understood that the aforementioned activities currently permitted a \$5,000 category broker-dealer may change with the pending adoption of the Commission's Uniform Net Capital Rule which was recently re-released for comment. 2/

Question: Must simultaneous or riskless principal transactions with customers be cleared through another broker-dealer or bank on a fully-disclosed basis by a broker-dealer in the \$5,000 category?

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1/ SEC Release No. 10304/July 30, 1973 - Application of Minimum Net Capital Requirements of Rule 15c3-3(a)(3) and (4) Under the Securities Exchange Act of 1934.

2/ SEC Release No. 10525/November 29, 1973, "Notice of Revision of Proposed Amendments to Rule 15c3-1 Under the Securities Exchange Act of 1934".

Answer: Yes. Other than an occasional transaction for its own investment account and/or the sales of investment company shares or limited partnership interests executed on an application basis, a broker-dealer in the \$5,000 category must clear all retail and wholesale transactions through another broker-dealer or bank on a fully-disclosed basis.

Question: If a broker-dealer effects an occasional trade for its own investment account, should such trade be cleared and carried by another broker-dealer or bank?

Answer: No, a broker-dealer in the \$5,000 minimum net capital category, be it a sole proprietor, partnership or corporation, may execute and clear an occasional transaction for its own investment account.

Question: May a broker-dealer in the \$5,000 category buy or sell redeemable shares of registered investment companies on a direct wire order basis for the account of its customers?

Answer: Yes, as long as such transactions are cleared and carried by another broker-dealer or bank on a fully-disclosed basis.

Question: What would be the broker-dealer's minimum net capital requirement if he elects to do any of the activities which have been described as unavailable to those members in the \$5,000 minimum net capital category?


Answer: The broker-dealer's minimum net capital requirement would be \$15,000 if it was registered prior to August 13, 1971 and \$25,000 if registered thereafter.

\* \* \*

Members of the Commission's Division of Market Regulation staff have reviewed this notice prior to its mailing and have concurred with its contents.

Should you have any questions concerning this matter, please contact Robert L. Smith at (202) 833-7356.

Very truly yours,

  
Frank J. Wilson  
Senior Vice President  
Regulation

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

December 10, 1973

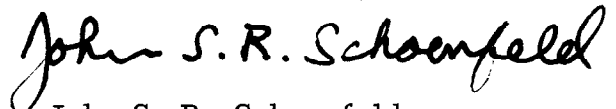
To: All NASD Members  
Subject: Missing Stock Certificates

The Association has recently been informed that the following blank common stock certificates are missing. Several of the missing certificates have shown up in the Atlanta, Georgia area.

<u>Certificate Numbers</u>	<u>Company</u>
G13959 through G14000	NLT Corporation

If any NASD member comes into the possession of any of the above listed certificates, or receives any information concerning these certificates, he should contact: Chase A. Horton, Assistant Vice President, Third National Bank, Arcade Station Box 2844, Nashville, Tennessee 37219, (615) 748-4742.

Sincerely,



John S. R. Schoenfeld  
Executive Vice President

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

December 13, 1973

## I M P O R T A N T

TO: All NASD Members

SUBJECT: Proposed Changes - National Clearing Corporation  
Operating and Interim Rules - Additional Protections  
Relative to Financially Impaired Members.

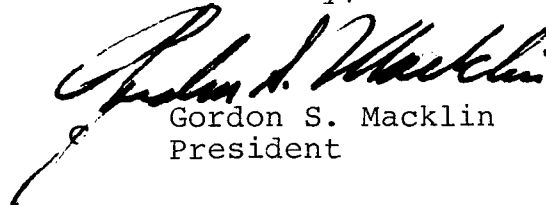
National Clearing Corporation (NCC), the clearing subsidiary of the Association, is in the process of completing the implementation of its nationwide CNS clearance and settlement system for over-the-counter transactions. At the present time, NCC has its main base of operations in New York City with eight regional facilities located throughout the country. In the course of operating its present Continuous Net Settlement and its Envelope Settlement Systems, experience has shown that additional safeguards and procedures are required to better protect Clearing Members and ultimately the public.

At the present time, the Board of Directors of NCC is studying a proposal for additional safeguards which would provide for amendments to the existing By-Laws, Operating and Interim Rules of the Clearing Corporation. Because of the impact on existing members of NCC and the possible future impact on present non-NCC/Association members, and other possible users, the Board of Directors of NCC has requested that the accompanying Rule changes with explanation be forwarded to all NASD broker-dealers for comment.

Please address your comments or questions to Robert J. Woldow, Corporate Secretary, National Clearing Corporation, 1801 K Street, N.W., Washington, D. C. 20006.

Comments should be received no later than January 15, 1974.

Sincerely,



Gordon S. Macklin  
President

Proposed Changes - National Clearing Corporation  
Operating and Interim Rules - Additional Protections  
Relative to Financially Impaired Members.

INTRODUCTION

Under current methods and procedures of conducting a clearance and settlement operation for transactions entered into by its Clearing Members, National Clearing Corporation (NCC) is exposed to a risk of financial loss should any one Clearing Member become financially or operationally impaired and be unable to meet its commitments. The general nature of securities markets, cyclical trends and the planned expansion of National Clearing Corporation tend to apply additional pressure to the "risk factor" already inherent in the Continuous Net Settlement (CNS) and Envelope Settlement System (ESS) as a result of settlements being made through one centralized facility. Actual failures by several Clearing Members demonstrate that experience with the exposure is by no means abstract and has depicted, in dollars and cents, the necessity for improvements in protection for NCC and its Clearing Members.

In recognition of this need, the Board of Directors of NCC approved certain recommendations of its Subcommittee on Clearing Funds, Regulation and Capital. However, until full implementation of the Subcommittee recommendations is accomplished, institution of certain interim procedures are recommended by the Board within the framework of NCC's current By-Laws and Operating Rules.

Present, NCC's By-Laws and Operating Rules fail to provide direct intermediate courses of action with respect to Clearing Members which are financially distressed. The Rules are silent or lack clarity in outlining what NCC may do to restrict financial liability upon disclosure that a problem exists. It is the Board's belief that resolution of these problems should not, nor need not, result in a decision to "cease-to-act" for such Member. The accompanying Rule changes, it is believed, provide the necessary tools to enable the Clearing Corporation to take intermediate courses of action short of "ceasing-to-act."

I. General

A. Currently, the Envelope Settlement System (ESS) is governed by the Interim Rules of the National OTC Clearing Corporation duly adopted by NCC. Section 103.07 is generally broad in language and gives NCC the ability to demand assurances from Clearing Members of their ability to meet commitments and conform to conditions NCC may impose for its and the Membership's protection.

The July 20, 1970 Policy Statement of the Board of Directors, provides that NCC may deliver securities to a Clearing

Member "only against receipt from the Member of cash or a certified check in payment of the securities." Section 108.03 provides that NCC may require a Clearing Member to pay to NCC the entire amount or a fractional amount of the interim balance to NCC owed by a Clearing Member (early money provisions). Section 112.01 provides that NCC has a lien "on any and all securities and cash which it holds at any time for the account of a Member delivered to it. . .for all amounts which may from time to time become due to it from such Member. . ." Section 107.06 provides that envelopes are deemed to be accepted and delivered when the Clearing Corporation has stamped the attached credit list but Section 107.07 provides that such envelopes are subject to the lien provided in Section 112.01 above. Section 102.02 gives NCC the ability, under certain circumstances, to decline to act with respect to any transaction or class of transactions at any time. Section 113.05 provides that, where NCC has ceased to act for a Clearing Member, it must decline to accept from Clearing Members and others envelopes to be delivered to such Member.

#### B. Recommendations

The current Rules regulating the procedure for ESS activities provide NCC with flexibility to deal with Clearing Members under surveillance to minimize the risk of loss. Therefore, no recommendation to alter any of those Rules has been made.

A recommendation is being considered by the Board of Directors to revise Rule 3(g) of the NCC Operating Rules to reflect the thinking behind Rule 103.07 of the Interim Rules and subsequent July 20, 1970 Policy Statement of the Board of Directors. Rule 103.07 and the Policy Statement of the Board of Directors gives NCC the ability to take certain action before the decision to cease-to-act is made. This ability should be reflected in the Operating Rules governing CNS operations. Rule 3(g) should be expanded to include other actions which NCC may take in addition to declining to act for any particular transaction or class of transactions.

Rule 3(g): The Clearing Corporation may, ~~without otherwise ceasing to act for a Clearing Member, may decline to act in respect of any particular transaction or class of transactions when, in the judgment of the Clearing Corporation, so declining to act is necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of these Rules~~ demand assurances from each Clearing Member of his ability to meet commitments and the Clearing Corporation may take such action or impose conditions including, but not limited to, the following:

(i) require, at any time, a Clearing Member to increase his required Clearing Fund balance to an

amount deemed appropriate by the Clearing Corporation, notwithstanding the parameters hereafter contained in Rule 5 of these Rules;  
(ii) require the reduction of CNS Long Valued or Short Valued Positions being maintained by the Clearing Member;  
(iii) initiate internal procedures to decrease the CNS Long Valued Positions by appropriate alteration of the allocation system;  
(iv) initiate buy-ins against any open Short Valued Position at any time subsequent to settlement date;  
(v) deliver securities to a Clearing Member only against receipt from the Clearing Member of cash or a certified check in payment for the securities;  
(vi) decline to act in respect of any particular transaction or class of transactions without otherwise ceasing to act for such Clearing Member when so declining to act is necessary or appropriate in the public interest or the protection of investors or to carry out the purposes of these Rules;  
(vii) or impose such other conditions or take such other action as the Clearing Corporation may determine to be appropriate to protect the public, Clearing Members or the Clearing Corporation from financial loss.

In addition to the above general Rule change, the Board of Directors is considering several specific revisions to the Operating and Interim Rules to accomplish these goals.

## II. Envelope Settlement System

### A. Discussion

The present provisions regulating the ESS portion of the Clearing Fund fail to provide NCC with the ability to pursue a course of action designed to further limit financial loss in that (1) no allowance is specifically made for increasing ESS Clearing Fund requirements of Clearing Members at any time (2) no operational remedy for collection is prescribed where a request for additional funds is made and not met on a timely basis and (3) there is no general provision to deny a refund, even though the normal system determines that one may be given.

### B. Recommendations

In view of the foregoing, the Board of Directors believes that Article 8, Section 8.01 of the By-Laws, should be amended to provide NCC with the ability to increase the ESS portion of the Clearing Fund, at any time and to such amounts, as NCC shall deem necessary under the circumstances. In this manner, the effect of

Rule 103.07 and the July 20, 1970 Policy Statement of the Board of Directors can be maximized. Specifically, the modification is as follows:

Section 8.01: The contribution of each Clearing Member to the Clearing Fund shall be fixed by the Corporation in its discretion at the time of the Clearing Member's application for membership and may thereafter from time to time be increased or diminished by the Corporation at such time and in such amount as the Corporation, its Board of Directors or the Financial Responsibility Committee of the Board may deem necessary for the protection of the Clearing Members and/or the Corporation, but the minimum contribution to be made by a Clearing Member shall be ten thousand dollars (\$10,000.).

The Board further believes that NCC should have the ability to directly charge a Clearing Member the amount of a requested increase to the Clearing Fund if that Clearing Member fails to pay or deposit by the date and hour specified in the written notice. Accordingly, consideration is being given to revise Section 8.06 as follows:

Section 8.06: The Corporation shall give to each Clearing Member at least 24 hours' notice in writing of any proposed increase in his contribution to the Clearing Fund, specifying the amount and the day and hour when the increase is to be effective. Unless, prior to the time on which the increase is to be effective, the Clearing Member gives written notice to the Corporation of his election that it shall definitively cease to act for him, the Clearing Member shall pay the amount of the increase to the Corporation not later than the time specified, and the liability of his contribution for losses shall at and after such time be fixed and determined by the amount of his contribution as increased. If the Clearing Member should fail to make such payment by the date and hour specified, the Corporation may, in its discretion, charge the entire amount in the daily settlement. If a pro rata charge against any Clearing Member's contribution is made pursuant to the provisions of Section 8.04, he shall forthwith pay or deliver to the Corporation such cash as may be necessary to make good the amount of his contribution, and his liability on account of other transactions occurring before he ceases to be a Clearing Member shall be measured by the amount of his contribution as so made good.



In the Board's determination, the provision regulating excess balances in the Clearing Fund should also be amended to allow NCC the ability to deny a request for a refund, to wit:

~~Section 8.08: If the amount of a Clearing Member's contribution to the Clearing Fund is decreased by the Corporation, the~~ The Corporation may, upon request, refund to a Clearing Member any excess balance or portion thereof in the Clearing Fund contributions which the Corporation deems appropriate unless in the determination of the Clearing Corporation such refund would not be in the best interests of Clearing Members or the Clearing Corporation. Any excess of his contribution ~~shall~~ may be paid to the Clearing Member as soon as all transactions open at the time of such decrease from which losses and payments chargeable to the Clearing Fund might result have been closed, and after charging to his contribution any amount so chargeable on account of transactions previously had.

### III. Continuous Net Settlement System

#### A. Clearing Fund

(i) Rule 5 is inflexible to the extent that (1) it does not provide a method by which the Clearing Fund of a Clearing Member known to be experiencing difficulties may be increased to further insulate NCC and its Clearing Members from financial loss, (2) there is no alternative given to NCC where a Clearing Member fails to pay within the designated time a demand for an additional Clearing Fund contribution and (3) the refund provision may be enforced by a Clearing Member whose financial viability may be in question.

Further, experience has proven that the percentages stipulated in Rule 5(b)(iii) are not enough to adequately protect NCC from loss, i.e., the Clearing Fund requirements calculated according to the formula have been consistently lower than losses realized. NCC should have the ability to demand an increased contribution from those Clearing Members who pose the greatest threat of financial loss. The current Rules outline no such ability.

The current Rule (5(b)(iii)) states that a demand for increased deposit be met in two business days following receipt of NCC's notice. The current Rule does not provide a course of action which NCC may take short of ceasing-to-act if a Clearing Member fails to pay or fails to give evidence of intent to pay.

The refund provision of Rule 5(b)(v) is inflexible in that it is too broad. A Clearing Member, under surveillance because of deteriorating financial or capital position, may

request and receive a refund due to the fact that the percentage criterion has been met. In giving such a Clearing Member the refund, NCC is further widening its exposure to loss.

Rule 5(b)(iii) provides that NCC may make demands for additional deposits to the Clearing Fund at the end of each calendar month. Also, such demands may be made when the requirement exceeds the previous month's balance by 25%. These sections of Rule 5 are limiting in two respects: (1) the calendar month is too long a period of time to base calculations and requests for additional deposits and (2) the 25% provision is too inflexible to allow proper attempts to guard against losses that may be generated by financially troubled Clearing Members.

(ii) Recommendation

The Board of Directors has determined that the provisions of Rule 5(iii) should be amended so that (1) the basis of the calculation of the CNS Clearing Fund Requirement is changed from the average daily balances of the long and short positions to the current daily long and current daily short positions, (2) NCC has the ability to collect amounts due automatically in the CNS Money Settlement procedures and (3) to allow NCC to require deposits over and above the minimum calculated requirement.

Rule 5(b)(iii): Thereafter, ~~at-the-end-of-each month~~, the Clearing Fund balance of each Clearing Member shall be ~~approximately~~ equal to 2% of the average current daily closing long valued position plus 2% of the average current daily closing short valued positions, as shown on its Net Position and Accounting Report, valued at the Current Market Price. The difference between each Clearing Member's balance in the Clearing Fund and such percentage minimum required amount shall be calculated daily and the Clearing Corporation shall notify charge each Clearing Member each month daily of the amount of such difference. Within-two-business-day-of-receiving such-notice, The Clearing Member shall pay such difference amount to the Clearing Corporation upon demand. Notwithstanding the above, the Clearing Corporation may require a Clearing Member to increase its Clearing Fund required balance to an amount deemed appropriate by the Clearing Corporation, its Board of Directors or any-committee-thereof the Financial Responsibility Committee of the Board of Directors for the protection of Clearing Members and/or the Clearing Corporation.

Because of the proposed amendment to Rule 5(b)(iii) the provisions of Rule 5(c), allowing a Clearing Member to dispute the amount of the increase, must also be amended as follows:

Rule 5(c): If a Clearing Member disputes the amount of any increase in its Clearing Fund balance, it shall first pay such additional amount ~~within two business days as required in (b) above~~, and then shall promptly seek to resolve such dispute by the procedure provided in Rule 18 of these Rules.

Rule 5(b)(v) should be amended to allow NCC to deny a request for refund of excess deposits over and above the minimum required amount when NCC determines such action to be proper under the circumstances:

Rule 5(b)(v): If the Clearing Member's balance ~~at the end of the previous month~~ exceeds by ~~15%~~ the amount calculated for its required balance and if his Clearing Fund deposit contains a sufficient cash balance at the end of the current month such excess shall ~~upon request~~ be automatically be refunded to the Clearing Member through the Continuous Net Settlement System. Where, however, the Clearing Corporation has demanded an amount greater than the minimum required balance pursuant to Rule 5(b)(iii), any refund shall be in the discretion of the Clearing Corporation.

## B. CNS Long Valued Positions

### (i) Discussion

The current provisions of the Operating Rules relating to the CNS Long Valued Positions are silent in that NCC is not given the ability via the Rules to decrease the Long Valued Positions until the Clearing Member fails to pay for securities delivered. Any action taken at that time is after the fact since the risk of loss becomes a reality, especially in a period of declining market prices. If NCC could reduce a Clearing Member's Long Valued Positions, the risk of loss is narrowed in that a smaller position would be sold out if necessary. The greater the number of sales required to be made, the size of the positions, the depth of the market in these securities, and the trend of market prices, may all increase NCC's eventual financial exposure.

### (ii) Recommendations

The Board of Directors believes that the provisions of Rule 7(g) should be amended to include the ability to alter the allocation program so that selected Clearing Members may receive preferential treatment. Available securities would be

delivered in order to reduce those Members' CNS Long Valued Positions.

Rule 7(g): In providing the Continuous Net Settlement Service, the Clearing Corporation shall employ a formula for allocating the securities available to fill open positions by establishing priorities on a basis reasonably calculated to satisfy the needs of all Clearing Members. A statement of the order of priorities for allocating securities shall be published in accordance with Rule 20. However, notwithstanding the above, the Clearing Corporation, acting through the Financial Responsibility Committee of the Board of Directors may modify the formula with respect to one or more Clearing Members for the protection of Clearing Members and/or the Clearing Corporation.

C. CNS Short Valued Positions

(i) Discussion

The current Rules, again, are inflexible in that attempts to reduce risk are only allowed to be taken after the fact, i.e., after a Clearing Member has been suspended or deemed financially impaired and NCC ceases to act for the Clearing Member or, after 30 days have elapsed. The provisions for buying in short positions over 30 days old is somewhat impractical since NCC does not presently have either the manpower or manhours to scan files to separate aged shorts and initiate buy-ins against them. NCC is somewhat protected by the Mark to Market provisions of Rule 8 but not to the extent desired.

(ii) Recommendations

The Board of Directors has determined that greater flexibility can be provided to NCC with respect to CNS Short Valued Positions via an amendment to Rule 9(g) reflecting the ability of NCC to initiate buy-ins against short positions after settlement date.

Rule 9(g): In addition to the procedures specified in Section (e) of This Rule 9, above, the Clearing Corporation may of its own accord institute "buy-in" and/or sell out procedures against Clearing Members under the provision of Rule 12(b) (Tender Offers), Rule 13 (Suspension of a Clearing Member) of these Rules, Rule 14 (Financial Impairment of a Clearing Member) and, in the discretion of the Clearing

Corporation, for any open short valued position ~~which has been open for more than 30 calendar days~~ subsequent to settlement date for the protection of Clearing Members and/or the Clearing Corporation.

The application of such a provision must be the result of a careful evaluation of the situation surrounding the Clearing Member whose Short Valued Position has been deemed excessive. NCC does not wish to be the catalyst for a Clearing Member's insolvency and must evaluate any possible adverse impact of a buy-in prior to initiation. Consideration will be given to the reasons behind a Clearing Member's maintenance of a large short position, e.g., stock in transfer, customer is failing to deliver, or whether the market is declining or increasing. The reason should be determined prior to the initiation of the buy-in. Should NCC decide that the buy-in method would have a more adverse impact than desired, it can resort to other methods of protection, e.g., the Clearing Fund. Even though this method will only be employed on a very selective basis, NCC should have this ability in the event that the proper situation presents itself.



# NATIONAL CLEARING CORPORATION

UNIFORM PRACTICE DIVISION \*

December 14, 1973

TO: All NASD Members

RE: Christmas Day and New Years Day Closings - Non-NCC Transactions<sup>+</sup>

Securities markets and the NASDAQ System will be closed on Christmas Day, Tuesday, December 25, 1973 and New Years Day, Tuesday, January 1, 1974. Transactions made on the business days immediately preceding such days will be subject to the schedule of settlement dates below (for "regular-way" transactions).

Settlement dates for "regular-way" transactions

<u>Trade Date</u>	<u>Settlement Date</u>
December 14	December 21
December 17	December 24
18	26
19	27
20	28
21	31
December 24	January 2
25 Christmas Day	
26	3
27	4
28	7
December 31	January 8
January 1 New Years Day	
2	9

<sup>+</sup> Members with NCC transactions should refer to NCC Important Notices N#204 and R#4.

Questions regarding this notice may be directed to the Uniform Practice Division of National Clearing Corporation, Two Broadway, 8th Floor, New York, N.Y., 10004, (212) 952-4018.

\* The Board of Directors of National Clearing Corporation has been delegated the authority to interpret and enforce the provisions of the Uniform Practice Code pending full implementation of NCC's national clearing system.