NOTICE TO MEMBERS: 79-9
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

March 21, 1979

TO: All NASD Members and Interested Persons

RE: Amendments to Schedule C Affecting Foreign Broker/Dealers and Others Who do not Maintain Offices in the Continental United States

The Board of Governors of the Association has proposed a new Part V to Schedule C of Article I, Section 2 of the By-Laws which is being published at this time to give interested persons an opportunity to comment. All comments must be in writing and received by April 23, 1979. After the comment period has closed the proposal will be reviewed by the Board. Thereafter, if approved by the Board, the proposal must be submitted to and approved by the Securities and Exchange Commission prior to becoming effective.

Background and Explanation of Proposal

As a result of receipt of several applications for membership from foreign broker/dealers who did not intend to establish an office in the United States, the Board established an Ad Hoc Committee to consider the ability of the Association to maintain an effective regulatory program over such broker/dealers and to make recommendations in respect thereto to the Board. Thereafter, that Committee proposed to the Board that certain specific requirements should be imposed in light of monetary and language differences but that otherwise such foreign broker/dealers should be regulated to the extent possible in the same manner as existing members with offices in the United States. 1/ The Committee deemed it appropriate that financial statements and all reports including trial balances, capital computations, FOCUS, and other computations for regulatory purposes be required to be prepared in English and in U.S. dollars. It also believed any general ledger charts of accounts, and descriptions thereof, should be maintained in English.

1/ Section 15A(b)(9) of the Securities Exchange Act of 1934 requires the Association's rules not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Section 19(g) provides that self-regulatory organizations must enforce compliance by their members with the provisions of the Act, their own rules and the rules of the Municipal Securities Rulemaking Board. Section 15A(b)(6) requires the Association's rules not permit unfair discrimination.

Further, the Committee recognized that the obligation of NASDAQ market makers to execute a transaction in a normal unit of trading could create problems if the foreign broker/dealer did not maintain an agent for clearance within the continental United States. It recommended, therefore, that an agent for clearance within the United States should be required of all foreign broker/dealers including existing members.

The Committee also was of the view that foreign broker/dealers should be required to reimburse the Association for the extraordinary costs of Association examinations to the extent that such costs exceed the examination of a member furthest removed from the Association's District Office having jurisdiction.

Lastly, because a foreign broker/dealer may maintain certain of its records in a foreign language, the Committee believed a foreign broker/dealer should provide a responsible individual who is fluent in English to assist Association examiners in any examination.

The Association's Board of Governors has approved these Committee proposals to be published for comment. The text of the proposal follows:

Proposed Amendment to Schedule C

V. Foreign Members and Members Not Located in the United States

All members that do not maintain an office responsible for preparing and maintaining all broker/dealer financial and regulatory reports in any of the United States shall be required and must agree with the Association in writing:

(1) to maintain all financial reports, regulatory reports, and a general ledger chart of accounts and any descriptions thereof in English and U.S. dollars;

(2) to reimburse the corporation for any extraordinary expenses of examination;

(3) to provide a responsible individual who is fluent in English to assist representatives of the corporation in any examination; and

(4) to appoint and maintain an agent for clearance within the United States.

Sections V and VI will be renumbered as VI and VII.

All comments should be addressed to David Parina, Secretary, National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006 and received by the Association no later than April 23, 1979. Questions concerning this release should be addressed to Andrew McR. Barnes, Assistant General Counsel at (202) 833-7369.

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

NOTICE TO MEMBERS: 79-10
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

March 21, 1979

IMPORTANT

TO: All NASD Members

RE: Report of the Special Study of the Options Markets

On February 15, 1979, the Securities and Exchange Commission released the Report of the Special Study of the Options Markets. The Report contained an introduction and seven additional chapters which outlined the results of the SEC's lengthy investigation of standardized options trading. Interspersed throughout the Report were recommendations from the staff of the Options Study which, if adopted, would result in a number of changes in the present scheme of options regulation. Certain of the recommendations call for the self-regulatory organizations to adopt new options rules and to amend existing ones, while others request modifications in present examination and surveillance procedures.

Following the Report, the Commission issued Release No. 34-15575, dated February 22, 1979, which contained the SEC's response to the Options Study's recommendations. The release also provided a timetable for the termination of the moratorium on options expansion which has been in effect since October, 1977. Essentially, the Commission agreed to lift the moratorium if the SRO's, individually or collectively, agreed to adopt certain rules and to implement certain procedures within specified periods of time from the date of the release. The program envisioned by the SEC calls for the Association to file numerous rule change proposals and to provide certain written undertakings with respect to changes in surveillance and compliance procedures within 90 to 120 days of the release date. According to the Commission, adherence to the timetable will insure that the options moratorium can be lifted within six months.

Many of the rule changes recommended by the Options Study and supported by the Commission will affect the manner in which NASD members presently conduct an options business and are likely to require additional expenditures of manpower and funds. Therefore, in order to

facilitate members' understanding of the specific requirements which the Commission has established as prerequisites to further expansion of options programs, a copy of Release No. 34-15575, from the March 2, 1979, edition of the Federal Register (Vol. 44-No. 43), is reprinted at the conclusion of this notice.

The Association strongly urges members to examine the release closely and to furnish both the Association and the Commission with their written views and comments on the recommendations contained therein. This should be done as promptly as possible.

Member comment on the release will be helpful to the Association in making certain determinations and in formulating policy judgments on the SEC's recommended changes. Such comments will also be beneficial to the Association in connection with its participation in a recently formed task force of self-regulatory organizations which will be considering the Commission's proposals.

Members' written comments should be directed to the designated individuals at the NASD and the SEC at the following addresses:

NASD

Mr. S. William Broka, Assistant Director
Department of Regulatory Policy and Procedures
National Association of Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D. C. 20006

SEC

Mr. George A. Fitzsimmons, Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549
File No. S7-772

Questions with respect to the attached material or other aspects of the SEC's Options Study may be directed to S. William Broka at (202) 833-7247.

Sincerely,

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

Attachment

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-15575]

SPECIAL STUDY OF THE OPTIONS MARKET

The Securities and Exchange Commission today announced a program for implementing certain of the recommendations made by the Special Study of the Options Markets (the "Options Study") [1] and for terminating the voluntary moratorium on further expansion of the standardized options markets.[2] Consistent with the scheme of self-regulation embodied in the Securities Exchange Act of 1934 (the "Act"), the Commission is asking each self-regulatory organization on which standardized options presently are traded or which has proposed to initiate a program for the trading of such options,[3] and the Options Clearing Corporation ("OCC"), to join with the Commission in a cooperative effort to implement many of the Options Study's recommendations, pursuant to the plan and projected timetable set forth in the latter part of this release.

The plan is based on a determination by the Commission that, before further expansion of the standardized options markets can be permitted, the deficiencies identified by the Options Study in the regulatory framework governing the standardized options markets must be corrected to insure that those markets operate in a manner consistent with the Act. The plan also reflects the Commission's conclusion that immediate implementation of a number of the Options Study's recommendations is necessary to achieve that goal. The Commission, therefore, is requesting the self-regulatory organizations to continue to honor the voluntary moratorium, by refraining from filling previously authorized but unfilled options classes and by deferring the filing of proposals that would expand or materially alter existing options trading programs, or that would initiate new options trading programs, until the steps outlined in this release for effectuating most of the Options Study's recommendations have been completed.

The plan set forth in this release specifies those actions the Commission asks each self-regulatory organization to take, and certain actions the Commission itself will take, in response to the Options Study's recommendations. These actions are grouped under three main headings: First, actions which must be addressed by the self-regulatory bodies and the Commission prior to expansion; second, actions which the Commission asks the self-regulatory organizations to consider and report on by the end of the year; and third, certain actions to be taken by the Commission. These actions, particularly those grouped under the first heading, are addressed primarily to the protection of investors, to be achieved, in large part, by self-regulatory rules concerning such matters as improper sales practices, determinations of suitability, misleading sales presentations, inadequate training and supervision of personnel, and internal controls through recordkeeping, together with improved self-regulatory surveillance and compliance procedures. The plan contemplates completion, within six months, of those actions which the Commission believes must be taken before the moratorium can be lifted. If the self-regulatory organizations agree to take the steps specified in the plan, the Commission intends to defer final action on proposed Securities Exchange Act Rule 9b-1(T).[4]

The Commission's request that the self-regulatory organizations act promptly, on a voluntary basis, to resolve the regulatory problems identified by the Options Study reflects the essential role each of these organizations must fulfill to maintain the integrity of the standardized options markets. Indeed, many of the Options Study's recommendations could not have been formulated without the assistance which the self-regulatory organizations provided to the Options Study staff in the course of its work. The Commission is confident that, through continued cooperation of this kind and a coordinated effort by the self-regulatory organizations and the Commission, the regulatory concerns which prompted the Commission's initial request for a voluntary moratori-

[1] The Report of the Options Study was made publicly available on February 15, 1979. *See* Securities Exchange Act Release No. 15569 (February 15, 1979).

[2] *See* Securities Exchange Act Release No. 13760 (July 18, 1977), 42 FR 38035 (July 26, 1977); Securities Exchange Act Release No. 14878 (June 22, 1978); Securities Exchange Act Release No. 15026 (August 3, 1978); and Securities Exchange Act Release No. 15485 (January 10, 1979).

[3] These are: the American Stock Exchange, Inc. ("Amex"); the Chicago Board Options Exchange, Incorporated ("CBOE"); the Midwest Stock Exchange, Incorporated ("MSE"); the National Association of Securities Dealers, Inc. ("NASD"); the New York Stock Exchange, Inc. ("NYSE"); the Pacific Stock Exchange Incorporated ("PSE"); and the Philadelphia Stock Exchange, Inc. ("Phlx").

[4] Securities Exchange Act Release No. 14056 (October 17, 1977), 42 FR 56706 (October 27, 1977).

um—concerns documented by the findings of the Options Study—can be substantially resolved, and the moratorium terminated, within the next six months.

As noted above, the Commission believes that the options moratorium should be terminated once the actions specified in its plan have been completed. To achieve that goal within six months, however, close cooperation among the self-regulatory organizations is essential. The Commission's resources are not sufficient to permit it to respond to separate and varying self-regulatory organization proposals to implement the Options Study recommendations within that relatively brief period of time. For this reason, the Commission has determined to urge the self-regulatory organizations to work together to develop, wherever possible, uniform responses to each of the Options Study's recommendations within the Commission's projected timetable for action on each recommendation. Only through such uniform and coordinated action will the Commission be able to complete action on these initiatives and terminate the moratorium within six months. If necessary, the Commission is prepared to act on its own initiative to implement the recommendations of the Options Study. The Commission does not believe, however, that it could conclude such action within the time frame contemplated by the plan.

Successful completion of the steps outlined in the plan will permit the Commission to begin considering proposals to expand existing options trading programs and to initiate new options trading programs. It will also enable the Commission to withdraw its request that self-regulatory organizations with existing standardized options trading programs refrain from filling previously authorized but unfilled options classes. The Commission will not, however, be in a position to give favorable consideration to expansionary options proposals filed by any self-regulatory organization which has failed to complete the actions specified in the plan. Indeed, such a failure could compel the Commission to take action to preclude any such organization from filling previously authorized but unfilled options classes, and to take such other remedial steps as it deems appropriate.[5]

Because the Options Study was released publicly only last week, the Commission wishes to solicit public comment on its contents and on the plan articulated herein to implement the Options Study's recommendations and to terminate the moratorium. The Commission believes, however, that the findings of the Options Study demonstrate that immediate and forceful action must be taken to correct deficiencies in the existing scheme of Commission and self-regulatory organization regulation of the standardized options markets. The Commission, therefore, is limiting to 30 days the comment period on its plan to implement the Options Study's recommendations. In addition, in order to proceed as expeditiously as possible, the Commission urges the self-regulatory organizations to begin immediately, and before the expiration of the comment period, to take the steps requested of them under the implementation plan.

The Commission will work closely with the self-regulatory organizations to ensure that all steps outlined in the plan are completed as efficiently and expeditiously as possible and within the time specified. In addition, although the plan is addressed primarily to the protection of retail customers, the Commission intends, during the next six months, to consider certain of the key options market structure issues discussed in the Options Study Report. The Commission plans to focus first on the addition of new standardized put options classes and on the question of whether restrictions should be placed on multiple or "dual" trading of standardized options. The Commission invites further public comment on these issues to assist it in its deliberations and to facilitate their resolution by the end of the six-month period. The Commission also intends to consider, in the near future, the proposed merger between the Chicago Board Options Exchange, Incorporated, and the Midwest Stock Exchange, Inc., and to announce its decision on that proposal as promptly as possible.[6]

To the extent it is able to do so, given other demands on its time and resources, the Commission also will begin considering, during the next six months, the remaining significant options market structure questions discussed in the Options Study Report, to prepare for final resolution of these questions in the context of specific expansionary proposals which may be filed by the self-regulatory organizations after termination of the moratorium. The Commission, however, cannot now commit itself to a firm timetable within which the difficult issues posed by certain of the proposals that may be filed can be resolved.

Comments in response to this release should be submitted in writing, and in triplicate, to George A. Fitzsimmons, Secretary, Secruities and Exchange Commission, Washington, D.C. 20549, and should refer to File No. S7-772. All submissions will be made available for public inspection at the Commission's Public Reference Section, Room 60101, 1100 L Street, NW., Washington, D.C. Comments on the Commission's plan and projected timetable for implementing the Options Study's recommendations should be submitted by March 26, 1979.

* * * * *

PLAN AND PROJECTED TIMETABLE FOR IMPLEMENTING CERTAIN RECOMMENDATIONS OF THE OPTIONS STUDY

On the basis of its review of the findings and recommendations of the Options Study Report, the Commission has determined that prompt action should be taken by the self-regulatory organizations and the Commission to ensure that the regulatory programs applicable to trading in standardized options satisfy the objectives and requirements of the Act. The Commission, threrefore, asks the NASD, the OCC, and each national secruities exchange which presently trades, or has proposed to trade, standardized options to take the following steps to implement certain of the Options Study recommendations.

I. OPTIONS STUDY RECOMMENDATIONS WHICH MUST BE ADDRESSED PRIOR TO EXPANSION

Set forth below are those Options Study recommendations which the Commission believes must be addressed by the self-regulatory organizations and the Commission before further expansion of the standardized options markets is permitted to occur. In order to effect certain of the changes contemplated by these recommendations, the Commission asks the self-regulatory organizations to file with the Commission proposals to amend their existing rules or to adopt new rules. The Commission also re-

[5] The timetable contemplated by the Commission's plan is designed to afford all self-regulatory organizations an opportunity to complete, within six months, the steps requested of them as a prerequisite to expansion. The timetable also reflects the Commission's estimate of the time within which it will be able to respond to these initiatives, provided that the proposed rule changes necessary to carry out the Options Study's recommendations are uniform and are presented simultaneously to the Commission as specified in the plan. If the plan is successful, the Commission expects to remove the moratorium as to all self-regulatory organizations at the same time. Thus, the existing options exchanges could begin to fill previously authorized but unfilled options classes simultaneously and the Commission would be in a position to consider expansionary proposals filed thereafter by any self-regulatory organization. The Commission wishes to emphasize, however, that if its implementation plan does not proceed as scheduled, it may be necessary to extend the moratorium, either on a voluntary basis or by formal Commission action, as to some or all self-regulatory organizations.

[6] *See* File Nos. SR-MSE-78-30 and SR-CBOE-78-34, Securities Exchange Act Release Nos. 15494 and 15495 (January 12, 1979), 44 FR 4073 (January 19, 1979).

quests the self-regulatory organizations to make certain improvements in their surveillance and compliance procedures. In the case of particular recommendations which the Commission believes may take longer than six months to implement fully, notwithstanding an earnest effort by the self-regulatory organizations, the Commission asks the self-regulatory organizations to undertake to complete their implementation efforts by a specified date. The Commission will work closely with the self-regulatory organizations to assure that the problems and regulatory deficiencies identified by the Options Study are corrected as promptly as possible.

A. OPTIONS STUDY RECOMMENDATIONS WHICH CALL FOR SELF-REGULATORY ORGANZIATION RULE CHANGE PROPOSALS

The Commission asks the self-regulatory organizations to submit proposals to amend their existing rules, or adopt new rules, which will implement the Options Study recommendations listed below. In order to realize the Commission's objective of terminating the voluntary moratorium on expansion of the options markets in six months, it will be necessary for the self-regulatory organizations to work together to develop uniform rule proposals which will realize the objectives of each of these recommendations; to file all uniform proposals relating to a particular recommendation at the same time; and to complete the submission of these proposals no later than 90 days from the date of this release. The Commission also asks the self-regulatory organizations to begin filing their uniform proposals as promptly as possible and to stagger their filings throughout the ninteyday period according to a schedule agreed upon by all of them and submitted to the Commission. The Commission intends to complete its review and action on each group of uniform rule proposals within 90 days after they are filed.

The Commission believes that uniform self-regulatory organization rules are necessary and appropriate in this context since most of the problems identified by the Options Study which can be corrected by self-regulatory organization rule changes are industry-wide and bear little or no relationship to operational differences among the self-regulatory organizations.[7] Uniformity also will help to reduce the compliance burdens on those brokers and dealers which are members of two or more self-regulatory organizations. In addition, uniform and simultaneously-filed rule change proposals will reduce substantially the amount of Commission and staff time required to review the proposals, and will permit the Commission to issue a consolidated notice of the filing of, and a consolidated order reflecting its action on, all uniform self-regulatory organization proposals to implement each Options Study recommendation. Uniformity and simultaneous filing of these proposals, therefore, will be essential if the Commission is to meet its goal of completing action on these proposals within 90 days after they are filed.

The Commission recognizes that the self-regulatory organizations and their member firms may require additional time to comply with certain of the rule changes recommended by the Options Study (identified in § 2 below) and, in those instances, the Commission requests that the self-regulatory organizations file the necessary rule changes within the next 90 days, but provide that the rules shall be effective as of a specified future date agreed upon by all of them.

For the reasons discussed above, the Commission requests that the self-regulatory orgnaizations specify uniform effective dates for all proposals relating to a particular recommendation.

In some instances, the Commission has determined that the self-regulatory organizations should be given the opportunity to develop alternative solutions to the concerns underlying the Options Study's recommendations. With respect to those recommendations (identified in § 3 below), the Commission asks that the self-regulatory organizations submit undertakings to develop appropriate methods, through rules or otherwise, of preventing the abuses identified by the Options Study which these recommendations address.

1. *Options Study recommendations which the self-regulatory organizations are asked to implement by filing, within the next 90 days, uniform rule change proposals to become effective immediately upon approval by the Commission.* a. The self-regulatory organizations ("SROs") should amend their options rules (i) to provide a standard options information form which requires that broker-dealers obtain and record sufficient data, as specified by the rules, to support a suitability determination; and (ii) to require firms to adopt procedures to insure that all the information on which account approval is based is properly recorded and reflected in the firm's records. (Ch. V, p. 66).[8]

b. The SROs should amend their options account opening rules to require that (i) the management of each firm send to every new options customer for his verification a copy of the form containing the customer's suitability information; and (ii) the source(s) of customer suitability information, including the basis for any estimated figures, be recorded on the customer information forms. (Ch. V, p. 62).

c. The SROs should amend their rules to require that member firms semi-annually confirm the currency of customer suitability information. (Ch. V, p. 69).

d. The SROs should adopt record-keeping rules which require that member firms keep copies of account statements, and background and financial information for current customers, and maintain these records both in a readily accessible place at the sales office at which the customer's account is serviced and in readily accessible headquarters office location. (Ch. V, p. 75).

e. The SROs should revise their options customer suitability rules to prohibit a broker-dealer from recommending any opening options transaction to a customer unless the broken-dealer has a reasonable basis for believing the customer is able to evaluate the risks of the particular recommended transaction and is financially able to bear the risks of the recommended positions. (Ch. VI, p. 55).[9]

f. The SROs should adopt record-keeping rules which require member firms which have branch offices to

[7] The Commission realizes that nothing in the Act or the Commission's rules thereunder requires self-regulatory organizations to act in this kind of coordinated manner in responding to common regulatory needs. Without such action, however, in this instance, it would be impossible to adhere to the six-month timetable for termination of the options moratorium.

[8] References are to chapters and page numbers of the Options Study Report which contain each recommendation. The text of the Options Study Report preceding each of the recommendations explains the recommendation and the concerns underlying it.

[9] The Options Study also made the following related recommendation:

The rules of the SROs should be amended to prohibit firms from recommending opening options transactions to any customer who refuses to provide information, and for whom the firms do not otherwise have independently verified information sufficient for the suitability determination. (Ch. V, p. 56-57).

The Commission believes that, if the self-regulatory organizations amend their suitability rules as recommended in paragraph e, above, those rules, together with self-regulatory organization guidelines and interpretations, should be sufficient to prevent the type of sales practice abuses which the above-quoted recommendation was designed to address. The Commission requests the self-regulatory organizations to consider, however, whether a separate amendment to their suitability rules is necessary to correct the abuses which may result from customer refusals to furnish suitability information to member firms. The Commission also intends to consider the need for such a rule and to closely oversee the enforcement and effectiveness of self-regulatory organization suitability rules in its continuing review of the investor protections applicable to the options markets.

keep copies of customer complaints, customer suitability information and customer account statements at both the branch office where the account is serviced and the headquarters office. (Ch. V, p. 38).

g. The rules of the SROs should be amended to require that brokerage firms assign at least one high ranking person who is qualified as a Registered Options Principal ("ROP") to perform, or to directly supervise, home office compliance procedures relating to options. The rules should provide that, absent a clear showing of compelling circumstances, this person have no sales function, direct or indirect, relating to options or otherwise. (Ch. V, p. 47).

h. The SROs should amend their rules: (i) To require member firms to notify SROs promptly in writing of all internal disciplinary actions against employees, and (ii) to provide that when a registered individual's employment is terminated or he resigns from a member firm, the SRO shall retain jurisdiction over the individual for a reasonable time. The SROs should also vigorously enforce member firm compliance with the notification requirements. (Ch. VI, p. 44).

i. The SROs should amend their rules to require (i) that whenever rates of return in options accounts are calculated for disclosure to investors, all relevant costs must be included in the computation; and (ii) that whenever annualized returns are used to express the profitability of an options transaction, all material assumptions in the process of annualizing must be disclosed to the investor and a written record of any rate of return quoted to a customer must be kept. (Ch. V, p. 110).

j. The SROs should (i) develop uniform standardized options worksheet forms which require disclosure of all relevant costs and other information, including an appropriate discussion of the risks involved in proposed transactions; and (ii) prohibit the use of any options worksheets other than the new uniform formats and require that all items in the new worksheets be completed whenever used. (Ch. V, p. 130.

k. The SROs should require that copies of all options worksheets which are shown or sent to existing or prospective customers, or which are used as the basis for any sales presentation to a customer, be retained by member firms for an appropriate time in a separate file in the sales office with which the customer has an account. (Ch. V, p. 132).

l. The SROs should amend their rules to require that:

(i) All performance reports shown, given or sent to customers by member firms be initialed by the firm's local office supervisor to indicate a determination by that supervisor that the performance report fairly presents the status of the account or the transactions reported upon;

(ii) Copies of all such performance reports shown, given or sent to customers be retained by member firms in a separate file at the local sales office. (Ch. V, p. 133).

m. The SROs should amend their rules to require member firms to adopt promptly a uniform method for the random allocation of exercise notices among customer accounts. (Ch. V, p. 192).

n. The SROs should require member firms to keep sufficient specific workpapers and other documentation relating to allocations of exercise notices in proper order of time so that a firm's compliance with the uniform exercise allocation system can be verified promptly for an appropriate period. (Ch. V, p. 194).

o. The SROs should adopt rules (i) to require all registered market makers to report to the SROs, promptly and in writing, all accounts, for stock and options trading, in which they have an interest or through which they may engage in trading activities, and (ii) to prohibit trading by market makers through accounts other than those reported. (Ch. IV, p. 34).

p. The SROs should adopt rules requiring all registered options market makers to report to the SROs by appropriate means and on a daily basis: (i) The time that each stock order for the market maker's account, or an account in which he has an interest was transmitted for execution; (ii) the type and terms of each order; (iii) the time reports of any executions were received, and the volume and prices of those executions; and (iv) the opening and closing stock positions for each account in which the market maker has an interest. (Ch. IV, p. 33).

q. All SROs should (i) issue interpretations of their rules to make clear that frontrunning by their members is inconsistent with just and equitable principles of trade and (ii) take prompt disciplinary action against those members who have been found to have engaged in frontrunning. (Ch. III, p. 64).

2. *Options Study recommendations which the Commission asks the self-regulatory organizations to implement by filing, within the next 90 days, uniform rule change proposals to become effective upon approval by the Commission, or, if additional time is needed for the self-regulatory organizations or their member firms to comply with these rule changes, on a future effective date, no later than the end of this year, mutually agreed upon by the self-regulatory organizations.*

a. The SROs should adopt rules requiring the account statement of each options customer to show (i) the equity in the customer's account with all options and other securities positions marked to market; (ii) the profit or loss in the account for the year to the date of the statement; and (iii) the amount of margin loans outstanding as well as commission charges applicable to each transaction and other expenses paid or payable for the period covered by the account statement and the year to the date of the statement. (Ch. V, p. 85).

b. The SROs should adopt rules to require that the principal supervisor of any and all offices accepting options transactions be qualified as an ROP. (Ch. V, p. 35).

c. The SROs should amend their rules to require that each options customer over whose account discretion is to be exercised shall be provided with a detailed written explanation of the nature and risks of the program and strategies to be employed in his account. (Ch. V, p. 184).

d. The SROs should amend their rules to require that the Senior Registered Options Principal ("SROP") of each brokerage firm personally make a determination that each discretionary customer understands and can bear the financial risks of each options trading program or strategy for which it is proposed that the customer grant investment discretion to the firm or any of its employees; and that the SROs make and maintain a record of the basis for each such determination. (Ch. V, p. 185).

e. The SROs should adopt rules requiring that the headquarters office of each broker-dealer accepting options transactions by customers be in a position to review each customer's options account on a timely basis to determine (i) commissions as a percentage of the account equity; (ii) realized and unrealized losses in the account as a percentage of the customer's equity; (iii) unusual credit extensions; and (iv) unusual risks or unusual trading patterns in a customer's account. (Ch. V, p. 182).

f. The SROs should adopt rules to require that the training of registered representatives who recommend options transactions to customers be formalized to include a minimum number of hours of approved classroom and on-the-job instruction. (Ch. V, p. 13).

g. The SROs should establish and maintain a central data file to be available to and used in common by all SROs, containing all customer complaints received directly by the SROs and the disposition of such complaints; the SROs should amend their rules to require their member firms to submit all complaints received from

customers, and the disposition thereof, to the central data file. (Ch. VI, p. 41).

3. *The Options Study recommendations listed in this category call for specific changes in self-regulatory organization rules and are designed to curb the use, by broker-dealers and their registered representatives who sell listed options to public investors, of the types of misleading options sales presentations and promotional materials which are discussed in the text of the Options Study Report preceding each recommendation. The Commission believes that the self-regulatory organizations must act promptly to correct the sales practice abuses identified by the Study which underlie these recommendations, either through the adoption of the rule changes recommended by the Study or by other means which the self-regulatory organizations believe will best achieve these goals. The Commission, therefore, asks the self-regulatory organizations to submit, within the next 90 days, written undertakings detailing their plans for addressing these abuses, together with target dates by which they intend to complete their efforts.*

a. The SROs should take steps, by amending their rules or otherwise, to require that registered representatives be prohibited from showing the performance report of the options account of one customer to other existing or potential customers, unless composite figures which fairly present the performance of all that registered representative's customer options accounts during the same period are shown. (Ch. V, p. 133).

b. The SROs should take steps, by amending their rules or otherwise, to require that member firms make available for public inspection unequivocal and comprehensive evidence to support any claims made on behalf of options "programs" or the options "expertise" of salespersons. (Ch. V, p. 114).

c. The SROs should take steps, by amending their rules or otherwise, to require that when member firms use seminars to promote options, they make the following disclosures to those attending:

If the "lecturer" in the seminar is a brokerage firm employee compensated in whole or part by commissions, and is using the seminar technique to attract customers, his financial interest in the acquisition of customers from the audience should be disclosed;

If a "program" or "system" described in the seminar is already in use, the cumulative experience of the program's participants should be fully disclosed and documented, and the audience should be warned that past results are no measure of future performance;

If the program is too new to have a performance history, the audience should be fully apprised of the untried nature of the program. (Ch. V, pp. 119-120).

B. *Options Study Recommendations Which Call for Improvements in the Self-Regulatory Organizations' Surveillance and Compliance Procedures*

The Options Study recommendations in this category are designed to ensure improvements in the compliance and surveillance procedures of the self-regulatory organizations and to address deficiencies found by the Options Study. The Commission asks that, within the next 90 to 120 days, the self-regulatory organizations make certain of the recommended changes (identified in § 1 below). To the extent practicable and consistent with the variations in the surveillance systems employed by each self-regulatory organization, the Commission asks the self-regulatory organizations to work together to develop uniform methods of responding to these recommendations of the Options Study. The Commission asks the SROs to submit to the Commission written documentation of the steps taken to implement these recommendations. The Commission will review the documentation supplied and, whenever necessary, will conduct on-site inspections of the self-regulatory organizations to determine whether the modifications fulfill the objectives of the Options Study's recommendations. The Commission also will work with the self-regulatory organizations to remedy promptly any perceived deficiencies in the changes made.

In the case of those recommendations for improved surveillance and compliance procedures which may require more than 120 days to implement (identified in § 2 below), the Commission has asked the self-regulatory organizations to submit, within 120 days from the date of this release, written undertakings detailing their plans for implementing these recommendations and to supply target dates by which they will complete these efforts. Wherever possible, the Commission has asked that action on these recommendations be completed within the next six months, but in any event no later than the end of this year.

1. *Options Study recommendations which the Commission asks the self-regulatory organizations to implement within the next 90 to 120 days by modifying their compliance and surveillance procedures.*

a. The Amex should establish a complete audit trail for each option transaction that takes place on the Amex floor and should submit a complete report on the results of its "pilot test" of such an audit trail within 90 to 120 days of the date of this release. (Ch. IV, p. 25)

b. The SROs should revise their account selection procedures when conducting routine examinations to ensure the use of a statistically valid random selection of accounts together with an account selection process designed to identify those accounts which have a higher probability of being the subjects of particular sales practice abuses than other accounts. (Ch. VI, p. 52).

c. In investigating complaints, inquiries or questionable activities, SROs should develop procedures which assure timely independent verification of evidence, in a manner suggested in Chapter VI of the Report, whenever such verification is obtainable. (Ch. VI, p. 61).

d. SROs should interview public customers regularly, as part of routine or cause sales practice examinations, whenever such interviews would be germane to the resolution of factual disputes or to ascertain facts necessary to determine whether there is a reasonable likelihood that an SROs rule or provision of law has been violated. (Ch. VI, p. 20).

e. The SROs should use due diligence to ascertain all relevant facts before closing a cause examination or investigation without action and should determine, and keep a record of the bases for determining, whether there is a reasonable likelihood that an SRO rule or provision of law has been violated.

The SROs should establish procedures to assure that interviews with, or testimony of, members, supervisors, salespersons and others is obtained regularly in sales practice cause and routine examinations when necessary to determine whether there may have been a violation of the applicable laws or rules, to verify information obtained from other sources, or to resolve disputed issues of fact. (Ch. VI, p. 62).

f. The SROs should routinely request access to any relevant compliance information retained by government agencies, including the Commission, in connection with routine or cause sales practice examinations. (Ch. VI, p. 33).

g. The SROs should make and retain a written record of each oral customer complaint, made in person or by telephone, evaluate each such complaint carefully, and take such complaints into consideration in planning routine and cause examinations. (Ch. VI, p. 20).

h. The SROs should retain a record of the results of each routine or cause examination, setting forth reasons why no action was taken when apparent violations were detected or why only informal disciplinary action was

initiated, and should ensure that such records are reviewed periodically by each SRO's governing board or committee. (Ch. VI, p. 80).

i. The Amex should form a special committee of its Board of Governors that will review the investigation and enforcement activities of the exchange. The committee should be composed of floor and non-floor members, exchange officials and a representative of the public. In addition to its general review, the committee should specifically examine, at least every six months, every investigative file in which the investigative and enforcement activities of the staff have been completed.

Each investigative file should identify the reasons that the investigation was initiated, the steps that were taken to investigate the matter, the conclusions that were reached concerning each aspect of the potentially violative conduct, the rationale for each conclusion, and full documentation to support the result. (Ch. IV, pp. 63-64).

j. The SROs should adopt a policy whereby a copy of each letter of caution or other document noting an informal disciplinary action against a registered representative is sent to the current employer of that registered representative and to the firm which employed him at the time of the violation which resulted in such action. (Ch. VI, p. 75).

k. The SROs should restrict informal disciplinary actions to those cases involving minor, isolated rule violations that do not involve injury to public customers. (Ch. VI, p. 75).

1. The SROs should develop a program in which surprise attendance by SRO representatives at seminars presented by their member firms forms part of their overall inspection program relating to options sales practices. (Ch. V, p. 120).

m. CCC should implement the revisions in its adjustment procedures described in the Options Study Report. (Ch. IV, p. 43).

2. *Options Study recommendations with respect to which the Commission asks the self-regulatory organizations to submit, within 120 days from the date of this release, undertakings to modify their compliance and surveillance procedures and target dates for completion of those efforts.*

a. The SROs should revise and broaden their sales practice examinations, including their checklists and guidelines, to (i) assure that examiners will review all aspects of a firm's procedures and dealings with the public, including the solicitation of customers and marketing of securities, (ii) provide that each sales practice examination will include a thorough evaluation of the firm's internal compliance system, and (iii) provide for on-site inspections of branch offices as appropriate. (Ch. VI, p. 50).

b. The SROs should conduct more comprehensive analyses of customer account, including an evaluation of the number and type of transactions in the account, relative risks, actual and unrealized profits and losses, commissions, and suitability of trading strategies for individual customers. SROs should also develop and use computerized systems to aid in the analysis of customer accounts. (Ch. VI, p. 58).

c. The SROs should develop standards for the establishment of minimum compliance programs for implementation by each SRO; the programs should provide industry-wide objectives for the monitoring, examination and disciplinary programs of the SROs and provide standards by which the success of the programs would be measured. (Ch. VI, p. 84).

d. The SROs should revise the registered representative "options qualifying" examinations to require a thorough knowledge of options and of the options exchange rules designed to protect customers. These examinations should be readministered to all options salespersons, and all examinations should be given under controlled surroundings by independent examiners. (Ch. V, p. 12).

e. The ROP qulaifications examination should be revised substantially to test candidates' understanding of supervisory requirements relating to options as well as their knowledge of options.

All ROPs should be required to successfully complete this revised version of the examination administered under controlled conditions. (Ch. V, p. 31).

f. The SROs should devise a uniform detailed program for supervision of options trading within member firms which would establish minimum supervisory standards and procedures and which would address the issues raised in and incorporate the recommendations of Chapter V of the Options Study Report among those standards and procedures. (Ch. V, p. 45).

g. The SROs should create a central repository of regulatory information about their common members and employees of such members (in addition to the central complaint file described at p. 13, *supra.*) for shared used on a day-to-day basis. (Ch. VI, p. 30).

h. The SROs should develop standards for minimum position and transaction reporting rules and standardized inquiry forms. (Ch. IV, p. 55).

i. The SROs should consider, and report to the Commission their conclusions, regarding the feasibility of identifying the actual time that a trade is executed to supplement surveillance information that is currently captured. (Ch. IV, p. 25).

j. The SROs and their member firms should work to establish an economical method for identifying and distinguishing member firm proprietary and customer stock orders and transactions. (Ch. IV, p. 36). The SROs should report to the Commission what steps they intend to take to implement this recommendation within 45 days from receipt of the SIAC report on the feasibility and cost of distinguishing between proprietary and customer trades in the stock clearing process, and provide a target date for implementation of this recommendation.

k. The SROs should use the integrated surveillance data base that they are establishing for stock and options trading to detect unlawful trading activities and conduct appropriate enforcement actions and to identify patterns of stock and options trading that should be regulated or prohibited. The SROs' suggestions as to priorities for these studies should be submitted to the Commission within 90-120 days. The SROs should regularly report the results of such studies as they actually conduct to the Commission. (Ch. III, p. 58).

C. *Options Study Recommendations Which Require Joint Action by the Commission and the Self-Regulatory Organizations*

Several of the Options Study's recommendations which the Commission believes should be implemented before further expansion of the standardized options markets is permitted call for joint action by the Commission and the self-regulatory organizations to assure that adequate surveillance programs are in place at the OCC and each self-regulatory organization which trades standardized options. The Commission's Division of Market Regulation will work closely with the self-regulatory organizations to assure that these recommendations, listed below, are fully implemented within the next six months.

1. When conducting oversight inspections of the options exchanges, the Commission should review the surveillance techniques that each options exchange is using to assure that the most effective techniques available are being employed. (Ch. IV, p. 54).

2. The Commission should conduct a complete investigation of the MSE options surveillance program. The inspection should seek to determine whether the MSE has the ability to enforce compliance with the Act, the rules and regulations thereunder, and MSE rules with respect to options trading on the MSE floor. Ch. IV. p. 65).[10]

[10]The Commission recognizes that, in the event the proposed merger between the

Footnotes continued on next page

3. The Commission should follow the progress of the Amex closely to assure that the exchange enhances the capabilities of its surveillance system and establishes a proper audit trail as quickly as possible. The Commission should receive a status report from its staff on the progress of the Amex initiatives within 180 days. (Ch. IV, p. 29).

4. The Phlx should provide the Commission, within 90 days of the date of this release, with complete documentation regarding routine surveillance functions and investigations that the exchange performs showing that the Phlx is carrying out its statutory responsibilities properly. (Ch. IV, p. 59).

5. OCC should consider the feasibility of imposing a surcharge for position adjustments that firms effect above a certain number of contracts. The number of adjustments that a firm should be permitted without the imposition of the charge should be determined, giving full consideration to the number of contracts that the firm regularly clears. In addition, OCC should consider the feasibility of requiring its member firms to balance their records to OCC records on a daily basis. The OCC should study these issues and report its conclusions and recommendations to the Commission within 90 days. (Ch. IV, pp. 43-44).

II. *Options Study recommendations which the Commission asks the self-regulatory organizations to undertake to consider. The Commission asks the self-regulatory organizations to submit to the Commission, no later than the end of this year, reports on the progress of their consideration of these recommendations.*

The Commission asks the self-regulatory organizations to agree to consider the Options Study recommendations listed below, and to submit to the Commission, no later than the end of this year, reports on the progress they have made. Although the Commission encourages the self-regulatory organizations to begin considering these recommendations as promptly as possible, the Commission does not believe that these recommendations must be implemented, or that the self-regulatory organizations must complete their consideration of them, before expansion to the standardized options markets is permitted to occur.

1. The SROs should amend their rules in order specifically to permit the award of restitution as a disciplinary sanction, whenever such a sanction would be appropriate. (Ch. VI, p. 81).

2. OCC should review its margin and clearing fund deposit rules regarding OCC members that clear market maker accounts with a view to determining whether it would be appropriate to increase their market maker margin deposit requirements in order that the clearing fund deposits of OCC members that do not clear market maker accounts are not unreasonably subject to the risks of those that do clear these accounts. (Ch. VII, p. 31).

III. *Options Study Recommendations Which Require Action by the Commission.*

Many of the Options Study's recommendations call for action by the Commission. The Commission intends to implement immediately the recommended improvements in its self-regulatory organization inspection and oversight procedures and to continue to work with the self-regulatory organizations in their efforts to share surveillance and compliance information and better coordinate their self-regulatory activities. The Commission also intends to schedule the recommended inspection of the NYSE's market surveillance system as promptly as possible. The Commission intends to give priority in the allocation of its staff and other resources during the next six months, however, to responding to those actions it has requested the self-regulatory organizations to take and to addressing certain of the options market structure issues discussed in the Options Study Report. For this reason, action on certain of the Options Study recommendations listed below (recommendations 5 to 23), most of which call for Commission rulemaking initiatives, may be delayed.

1. Commission inspections of the Amex should emphasize a review of case files that are closed after investigation to assure that Amex enforcement responsibilities are properly carried out. (Ch. IV, p. 54).

2. The Commission should closely monitor the efforts of the SROs to share surveillance information and coordinate self-regulatory activities. The Commission should acknowledge by letter the formation of the self-regulatory conference and suggest that the use of Section 17(d)(2) of the Act and Rule 17d-2 thereunder to allocate surveillance responsibilities among the SROs is appropriate and desirable. In addition, the Commission should send a representative to future meetings of the conference. The Commission should also seek to coordinate its own surveillance operations with those of the SROs. (Ch. IV, p. 53).

3. The Commission should conduct a complete inspection of the NYSE market surveillance system to determine whether the exchange has the ability to carry out the purposes of the Act and to comply and enforce compliance by its members with the Act, the rules and regulations thereunder, and NYSE rules. Specifically, the inspection should consider whether the NYSE can detect, on a daily basis and for each stock traded on the NYSE, trading practices that may be inconsistent with the Act, the rules and regulations thereunder, or exchange rules. The inspection should be conducted and completed as expeditiously as possible and a complete report should be presented to the Commission within 60 days after the completion of the review.

In the event that the inspection reveals that the NYSE cannot fulfill its statutory responsibilities on a daily basis, the Commission should take appropriate remedial steps and should specifically consider requiring, by Commission rule, that the exchange collect and maintain essential surveillance information. (Ch. IV, pp. 30-31).

4. The Commission should transmit for inclusion in the central customer complaint file a record of relevant information about all broker-dealer complaints it receives unless release of such information would be contrary to law, would have an adverse effect upon a pending or proposed investigation, or otherwise would be inappropriate. (Ch. VI, p. 42).

5. The Commission should adopt a rule which requires SROs to notify the Commission of all informal remedial actions. (Ch. VI, p. 75).

6. The Commission should obtain and review all instances of option and stock trading which are or have been the subject of informal or formal investigations by the SROs. The Commission should review this data with a view toward proposing antimanipulative options and stock trading rules, where appropriate. (Ch. III, p. 58).

7. The Commission should adopt a special registration form under the Securities Act of 1933 for OCC which would not require OCC to describe information about options trading and should exercise its authority under the Exchange Act to require that a disclosure document filed under the Exchange Act describing options, their risks and the mechanics of options trading be prepared by OCC and be delivered by broker-dealers to each options customer at or prior to the time the customer opens an options account. (Ch. V, p. 92)

Footnotes continued from last page

CBOE and the MSE is consummated, this recommendation may become moot and that it may not be practicable for either the Commission or the MSE to expend the resources necessary to implement all of the Options Study recommendations. The Commission also recognizes that resolution of the questions presented by the merger proposal may affect the steps to be taken by the CBOE, as well as by the MSE and the Commission's staff, toward implementing certain of the Options Study's recommendations. For this reason, the Commission intends to address the merger proposal in the near future.

8. The Commission should consider recommending to the Federal Reserve Board that the clearing firms for market makers be permitted to finance positions in a stock underlying a market maker's options position on a good faith basis provided the market maker's specialist account contains only those shares necessary to hedge an options position, as determined in accordance with an appropriate options pricing formula. (Ch. VII, p. 75).

9. The SROs should revise their rules to restrict the ability of options market makers to obtain specialist stock credit to stock underlying no more than 20 options classes, without specific exchange approval. (Ch. VII, p. 77).[11]

10. The Commission should consider revising its net capital rule to establish requirements for upstairs dealers that take into consideration the effects on risk of spreading strategies in listed options and the existence of a secondary market in options. (Ch. VII, p. 58).

11. The Commission should consider revising its net capital rule to require market makers that do not carry customer accounts or clear transactions to maintain a minimum equity of $5,000. (Ch. VII, p. 46).

12. The Commission should consider revising its net capital rule to increase the deduction in computing net capital for near or at-the-money options by providing the deductions for short options positions in market maker accounts be equal to the greater of (i) 75 percent of the premium value, (ii) $75, or (iii) 5 percent of the market value of the underlying stock reduced by the amount by which the exercise price of the options varies from the current market price for the stock. (Ch. VII, p. 40).

13. The Commission should consider revising its net capital rule to require an additional charge in an OCC member's computation of its net capital for any net long or net short options positions in all market maker accounts guaranteed by the OCC member which are in excess of 10 percent of the open interest in the options class. This deduction should be equal to an additional 50 percent of the charge otherwise required for each series in that options class. (Ch. VII, p. 37).

14. The Commission should consider revising its net capital rule to limit the net capital deduction for market maker options conversion, reverse conversion or equivalent conversion positions to the maximum possible loss on these positions provided that in both cases the off-setting put and call options have the same exercise price and expiration date and are traded on an exchange. (Ch. VII, p. 52).

15. The Commission should consider revising its net capital rule to permit a market maker clearing firm one business day to obtain additional capital or market maker equity before meeting the net capital deductions arising out of its market maker clearing business. (Ch. VII, p. 49).

16. The Commission should consider revising its net capital rule so that the capital required for all of the positions in an account in which a clearing firm, its officers, partners, directors or employees maintain a financial interest are increased. This may be accomplished by requiring that such accounts meet the same financial requirements that are applicable to upstairs dealer firms. (Ch. VII, p. 48).

17. The Commission should consider revising its net capital rule to reduce the permissible amounts of gross deductions to net capital resulting from the options and stock positions carried by a clearing firm for market makers. (Ch. VII, pp. 41-42).

18. The Commission should issue an interpretive release or initiate rulemaking proceedings specifically to clarify that inter-market manipulative trading activity involving options and their underlying securities may violate Section 9. (Ch. III, p. 54).

19. The Commission should undertake a complete review of the position limit rules of the options exchanges. This review should include: (1) the possibility of eliminating position limit rules; (2) the feasibility of relaxing position limit rules (a) for all market participants, (b) for accounts which hold fully paid, freely transferable securities or (c) for "hedged" positions; and (3) whether exceptions from the rules should be granted to options specialists and, if so, under what circumstances. (Ch. III, p. 68).

20. The Commission should begin to study the most appropriate means of establishing a uniform method of identifying stock and option customers on a routine, automated basis. The Commission should review the NYSE and SIAC Report on this subject and should determine the steps that should be taken to establish a uniform account identification system in light of the Report. (Ch. IV, p. 39).

21. The Commission should consider the elimination of the restricted options rules as soon as the overall effectiveness of the Options Study's suitability recommendations can be evaluated. (Ch. III, p. 71).

22. The Commission should adopt, where feasible, rules to govern SECO broker-dealers [regarding minimum position and transaction reporting rules and standardized inquiry forms] which are parallel to self-regulatory organization rules. (Ch. IV, p. 55).

23. In the event that the SROs do not devise a method for easily identifying member firm proprietary and customer trading, the Commission should consider whether it is appropriate to require that they do so by Commission rule. (Ch. IV, p. 36).

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[FR Doc. 79-6237 Filed 3-1-79; 8:45 am]

[11] The Commission will consider the need for adoption of this Options Study recommendation or some other form of restrictions on the use of exempt credit by options market makers in connection with its continuing review of specialist stock credit. Specifically, the Commission intends to consider whether, and to what extent, specialist stock credit should continue to be made available to various types of stock and options market makers in light of their market making obligations and their contributions to the maintenance of fair and orderly markets.

NOTICE TO MEMBERS: 79-11
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

March 28, 1979

MEMORANDUM

TO: All NASD Members

RE: Withdrawal of SEC Statement of Policy on Investment Company Sales Literature

On March 8, 1979, the Securities and Exchange Commission announced that it was withdrawing its Statement of Policy concerning investment company sales literature (see Release No. 33-6034, a copy of which is attached hereto). In this same release, the Commission also announced that it was soliciting public comment on a proposed interpretive rule, Rule 156, concerning the use of false and misleading investment company sales literature. Comments on the proposed rule should be furnished the Commission on or before May 15, 1979.

Adopted in 1950, the Statement of Policy was developed jointly by the Commission and the Association. It was published as a guide so that issuers, underwriters and dealers would understand the types of advertising and sales literature which the Commission considered violative of statutory standards. Since its adoption, the Association has been the primary administrator of the Statement. The Association has carried out this function through the review of all sales literature and advertising prepared by members to promote the sale of investment company securities. NASD rules have required that this material be filed with the Association's Advertising Department within three days after first use or publication. Now that the Statement of Policy has been withdrawn, questions have arisen as to the impact of that action on the Association's requirements regarding the filing of sales literature on investment company securities, and the nature of the standards which now apply to advertising and sales literature of such securities.

Advertising and Sales Literature Review

The Advertising Interpretation of the Board of Governors (Para. 2151.01, NASD Manual) generally applies to members' advertising and sales

literature. Although the Interpretation contains an advertising filing requirement, an exclusion is provided for material subject to the SEC's Statement of Policy. The withdrawal of the Statement by the Commission renders this exclusion inoperable, thereby creating a situation where the filing requirements of the Interpretation would seem to apply concurrently with the separate filing requirement for investment company material (Para. 5002, NASD Manual). These two filing requirements differ in several respects and the Board of Governors has determined that, at least on an interim basis, the filing requirement currently applicable to investment company-related advertising and sales literature will continue to apply.

As to the standards which will be applied to the content of such material, communications subject to Rules 134 or 135A under the Securities Act of 1933 will continue to be reviewed for compliance with those rules. Sales material will not, of course, be reviewed for conformance with the detailed provisions of the Statement of Policy. However, this material will be subject to the Association's Advertising Interpretation and, to the extent practicable, will be reviewed for conformance with the applicable provisions of that interpretation. In general, the Interpretation prohibits members' use of any advertisement or sales literature which contains any untrue statement of a material fact or is otherwise false and misleading. The principles of the Interpretation are consistent with those of the Commission's proposed new rule.

Members should understand that the Association staff, in reviewing members' filings, may not always be able to provide detailed comments on material filed and, as always, whatever comments are offered are advisory in nature and do not displace the primary responsibility of District Business Conduct Committees for determining compliance with the Association's rules.

The Association's Investment Companies Committee is expected to meet shortly to evaluate the impact of the Commission's action on the Association's advertising review programs. In that connection, it is expected that the Committee will recommend to the Board changes in those programs as it deems appropriate and necessary. Although no final decisions have as yet been made, the Board is of the view that, consistent with the Commission's initiatives in this area, some liberalization of NASD requirements concerning the preparation of sales literature about investment company securities can be expected.

Qualification Examinations

The Association administers several qualification examinations which contain test questions dealing with the Statement of Policy. These examinations include the following:

funds that exist today. Sample charts nd tables were criticized as being too echnical and containing too much information for the average investor to understand. The Statement and its administration were attacked as inhibiting use by the industry of more helpful and understandable presentations.

More specifically, the comments can be divided into those involving charts and tables and those involving all other provisions of the Statement. Considering the latter comments first, the computation of yields approved by the Statement was severely criticized as not being suitable for many of the funds that invest primarily in debt securities and particularly those in which investor turnover is high. The provisions of the Statement concerning comparisons were held to be too restrictive. A number of sections were criticized for requiring certain boilerplate language which informs investors that an investment in an investment company entails some degree of risk. It was argued that such language, which may not always convey the intended warning, should be vastly simplified and made to suit both fund circumstances and the audience to which a sales piece is directed. Allegations also were made that certain other provisions of the Statement were either no longer meaningful or, in some instances, incorrect.

The most important subject for the majority of the commentators was performance illustrations.[1] Apart from the general comment that sample charts and tables, especially the total return charts, are too complicated and contain too much data, commentators suggested that redundant data contained in charts and tables be eliminated and that the content of certain core charts be made sufficiently flexible to appeal to a variety of investor groups. In addition, it was suggested that after-tax rate of return information be included on certain charts and that "appropriate" illustrations for variable annuities be developed to replace those currently contained in the Statement.

The Commission's Position

The Commission has concluded that substantial changes in the regulation of investment company sales literature are in order based on its reexamination of the Statement, including consideration of comments received and the staff's experience in recent attempts to update performance illustrations. To implement those changes the Commission is: (1) Withdrawing the Statement; (2) considering revised procedures for sales literature review; and (3) proposing an interpretive rule concerning mutual fund sales literature.

Withdrawal of the Statement

The Statement was intended merely to provide some guidance to the public about what the Commission and the staff thought might be misleading in investment company sales literature. It explicitly neither prescribes the content of sales literature nor proscribes presentations which are not covered by the Statement provided that they are not misleading. Nevertheless, in practice the Statement has taken on the character of a comprehensive and mandatory rule. Investment companies have tended to restrict sales literature to formats explicitly approved in the Statement or, if they wished to deviate from those formats, to seek prior staff approval. Investment companies and their representatives have criticized the Statement and sought to have it amended. For its part, the staff has experienced significant burdens in administering the Statement. These developments have had unintended and adverse consequences. On the one hand, the Statement has operated to limit the flexibility of investment companies in advertising. Yet, at the same time, some may have been led to believe that use of a format which is included in the Statement or the failure of the staff to object to a particular representation created a "safe harbor."

The Commission does not believe that the problems with the Statement can be resolved by further attempts to amend it. What is or is not misleading in sales literature may depend greatly on the totality of the circumstances, including the context in which it is used and the sophistication of the investor. The Commission doubts the feasibility of developing mechanical or technical guidelines to define what is or is not misleading in sales literature in all circumstances. Rather the Commission believes that the fundamental responsibility for protecting investors from misleading sales literature resides with those who prepare and use it.[2] This approach is consistent with the objectives of the Investment Company Act Study. Accordingly, the Commission is withdrawing the Statement as an official expression of its views.

However, the Commission does not want withdrawal of the Statement construed as a repudiation of its contents because many of the Statement's principles appear valid in light of the Commission's regulatory experience. Withdrawing the Statement is intended to (1) emphasize that the Statement does not have the status of a restrictive rule; (2) establish the Statement as a historical expression of views but relieve the Commission of any obligation to update or correct technical flaws in its provisions; (3) stress that investment companies and users of sales literature cannot rely on mechanical application of the Statement's provisions but must decide on their own whether sales literature is in fact misleading.

Staff Procedures

The staff will, however, continue to monitor sales literature on a regular basis by systematically spot checking the required filings made with the Commission but normally will not give interpretive opinions on the appropriateness of sales literature prior to its use.[3] Moreover, greater emphasis will be placed on reviewing sales literature during investment company inspections than has been the case in the past. The review of promotional material during a comprehensive examination of fund operations should enable the staff to consider all the circumstances which existed when the sales literature was developed and thereby assist in assessing the propriety of selling representations made to the public. In addition, the staff will continue to follow up on specific problems in sales literature use which are discovered during the review of filings and the inspection program or which are brought to the staff's attention by NASD referrals, investor complaints and the industry. When a matter does arise which is of particular regulatory significance the staff intends to issue an interpretive release to advise the industry of staff views and concerns.

Proposed Interpretive Rule

In an effort to provide some guidance to persons who wish to determine whether sales literature is misleading, the Commission is proposing for public comment an interpretive rule concerning investment company sales literature.[4] In light of the history of

[1] Comments submitted in connection with the Commission's most recent amendment of the Statement involving only certain aspects of performance illustrations (Securities Act Release No. 5899 (January 18, 1978) (43 FR 3350) (January 25, 1978)) contained numerous comments on the most recently adopted charts.

[2] Of course, the Commission and its staff have affirmative obligations in connection with the content of prospectuses and tombstones ads, which are included in the definition of sales literature.

[3] This policy reaffirms the Commission's position as announced in Securities Act Release No. 5661 (December 30, 1975) and reverses the policy announced in Securities Act Release No. 5862 (September 1, 1977) (42 FR 47563 (September 9, 1977)) inviting requests for staff interpretive views relating to certain presentations of investment company performance.

[4] An interpretive rule is an "expression of the agency's view of what another rule, regulation or statute means." *Pacific Gas & Elec. Co.* v. *Federal Power Commission*, 506 F.2d 33, 37 n.14 (C.A.D.C., 1974). Such rules "constitute a body of experience and informed judgment to which the courts and

Footnotes continued on next page

proposed rules

[8010-01-M]

SECURITIES AND EXCHANGE COMMISSION

[17 CFR Part 230]

[Release Nos. 33-6034, 34-15621, IC-10621]

GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

Investment Company Sales Literature Interpretive Rule

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is withdrawing its Statement of Policy on investment company sales literature ("Statement") and requesting public comment on a proposed interpretive rule concerning the use of false and misleading investment company sales literature. The Commission is also adopting a policy whereby: (1) Neither the Commission nor its staff will give detailed interpretive advice on sales literature prior to its use; (2) the staff will undertake a systematic "spot check" of sales literature filed with the Commission and will review sales literature in connection with its inspections of investment companies; and (3) staff advisory views on the content of sales literature will be published in staff interpretive releases from time to time as the need arises. These actions are being taken following a general review of the Statement and of public comments received on the revision and controlled use of the Statement. The Commission believes that these actions will encourage the investment company industry to assume principal responsibility for the development and use of sales literature that is not misleading and limit the extent to which government regulators intrude on investment company marketing decisions.

DATES: Comments should be submitted on or before May 15, 1979.

ADDRESSES: Send comments in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. All communications with respect to this matter should refer to File No. S7-716. Such communications will be available for public inspection at the Commission's Public Reference Room, Room 6101, 1100 L Street, NW., Washington, D.C.

FOR FURTHER INFORMATION CONTACT:

Anthony A. Vertuno (202) 755-1192, or Sarah B. Ackerson (202) 755-1792, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, NW. Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On September 14, 1977, the Securities and Exchange Commission announced that it was undertaking a general review of its Statement of Policy on investment company sales literature ("Statement") in Securities Act Release No. 5864 (September 14, 1977) [42 FR 47563 (September 21, 1977)]. That release invited comment on the specific provisions of the Statement, continued use of the Statement and adoption of rules on the use of investment company sales literature. A number of considerations led the Commission to undertake a general review of the Statement: problems in administering the Statement's provisions; growing sentiment in the investment company industry for an updating and modernization of the Statement; the length of time since the adoption of the Statement; developments in the industry during the interim; the reluctance of the industry to use presentations unless they are included in the Statement; and the prospect of an increasing role for the Commission and its staff in determining the content of sales literature for the industry.

The Statement, which was adopted in 1950, offers guidelines for users of investment company sales literature so that use of material which the Commission considers false and misleading can be avoided. The Statement describes certain types of representations which are considered misleading and includes a number of approved presentations, including certain charts and tables. Since its adoption the only amendments to the Statement have related to charts and tables which illustrate fund performance.

Comments Received

Pursuant to the Commission's request for comments on the Statement, eleven submissions were received, including an oral presentation before the Commission made by the Investment Company Institute ("ICI"). The submissions as a whole dealt with two general subjects: The approach the Commission should take in its future regulation of sales literature and how specific provisions of the Statement should be updated.

(a) The Commission's approach to sales literature regulation. The commentators offered several approaches which they thought the Commission should consider in designing the future structure of investment company sales literature regulation. The most significant departure from the existing regulatory scheme suggested was the elimination of the Statement and, perhaps, the several advertising rules as well and the adoption of a simple anti-fraud provision or rule instead. The ICI asked that a Commissioner be appointed to supervise personally the development of an advertising code which would replace all existing advertising rules with a single anti-fraud rule incorporating a revised Statement, charts and tables, and procedures for periodic updating and modifications. A somewhat less sweeping proposal involved replacing the Statement with a rule which would contain broad, overall principles governing sales literature with specific guidelines (but no sample illustrations) for charts and tables. Other commentators, either expressly or implicitly, supported the concept of a Statement as opposed to a rule or a simple anti-fraud provision but recommended the establishment of a schedule for regular updatings. One commentator suggested that the Statement should be updated before or concurrently with the adoption of any revised advertising rules.

Only three of the respondents considered the possibility of discarding the Statement or substantially changing the way in which the Commission regulates sales literature. Even their comments can be read as endorsing the Commission's continuing close regulation albeit in a more flexible and less detailed manner.

(b) Revision of the Statement. All commentators submitted suggestions concerning revision of the Statement. In general terms, the most prevalent comment was that the provisions of the Statement are out of date because they are oriented toward equity funds and do not consider the different characteristics of the many non-equity

- General Securities Representative Examination (Test Series 7)
- General Securities Principal Examination (Test Series 24)
- Limited Representative Examination (Test Series 1)
- Limited Principal Examination (Test Series 40)
- Securities Industry Regulations Examination (Test Series 18)

All of these examinations have been reviewed in light of the withdrawal of the Statement of Policy by the Commission. Effective immediately, new forms of the above-mentioned examinations will not contain questions specifically related to the Statement of Policy. Statement of Policy questions in existing supplies of examination forms currently in use will be deleted in the grading process and will not contribute to candidate scores. Where necessary, the passing grade on examinations will be rescaled to adjust for questions no longer applicable.

* * *

The membership will be kept apprised of future developments in this area. In that connection, the Board welcomes member comment on the direction of the Association's future regulatory policy with respect to investment company sales literature. Such should be submitted promptly since the Association expects to act as expeditiously as possible in considering this matter. Correspondence or questions should be directed to Robert L. Butler, Vice President, Investment Companies-Advertising, National Association of Securities Dealers, Inc., 1735 K Street, N. W., Washington, D. C. 20006.

Sincerely,

Gordon S. Macklin
President

Attachment

regulation of this subject matter, it seems appropriate to try to give some indication of what the problem areas are based on the Commission's experience. It must be emphasized, however, that the proposed rule is not a legislative rule, that is, one which is "designed to implement * * * or prescribe law or policy." [5] Although subsection (a) of the rule does include a general prohibition against the use of misleading sales literature, that prohibition merely reiterates pertinent statutory provisions and does not supplement or alter any existing applicable legal standards. Subsection (b) of the proposed interpretive rule addresses particular problem areas but is deliberately couched in general language so that it cannot be construed as prohibiting or permitting any particular representations or presentations. The rule merely highlights general areas which our experience suggests may be the most vulnerable to misleading statements. If the proposed rule is adopted, these general warnings may be supplemented from time to time with staff interpretive releases. Subsection (c) of the proposed rule defines sales literature for purposes of the rule. The definition is similar to that contained in the Statement in most respects, but there are two changes which warrant comment. The exception for material transmitted to dealers but not delivered to investors has been narrowed so that if the *substance* of the material transmitted is likely to be communicated to investors, the exception would not apply. In addition, the exclusion for reports of issuers not containing an express offer of sales appears unnecessary and has been deleted.

TEXT OF PROPOSED RULE

It is proposed to amend Part 230 of Chapter II of Title 17 of the Code of Federal Regulations by adding (Rule 156 § 230.156) as follows:

§ 230.156 Investment company sales literature.

(a) It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, to use sales literature which is materially misleading in connection with the offer or sale of securities issued by an investment company. Sales literature is materially misleading if it (1) contains an untrue statement of a material fact or (2) omits to state a material fact necessary in order to make a statement made, in the light of the circumstances of its use, not misleading.

(b) Whether or not a particular description, representation, illustration, or other statement involving a material fact is misleading depends on evaluation of the context in which it is made. In considering whether a particular statement involving a material fact is or might be misleading, weight should be given to all pertinent factors, including, but not limited to, those listed below:

(1) A statement could be misleading because of:

(i) Other statements being made in connection with the offer of sale or sale of the securities in question;

(ii) The absence of explantions, qualifications, limitations or other statements necessary or appropriate to make such statement not misleading; and

(iii) General economic or financial conditions or circumstances.

(2) Representations about past or future investment performance could be misleading because of statements or omissions made involving a material fact, including situations where:

(i) Portrayals of past income, gain, or growth of assets which tend to convey an impression of the net investment results achieved by an actual or hypothetical investment would not be justified under the circumstances; and

(ii) Representations, whether express or implied, about future investment performance, including: (A) Representations as to security of capital, possible future gains or income, or expenses associated with an investment; (B) representations implying that future gain or income may be inferred from or predicted based on past investment performance; or (C) portrayals of past performance, are made in a manner which would imply that gains or income realized in the past would be repeated in the future.

(3) A statement involving a material fact about the characteristics or attributes of an investment company could be misleading because of:

(i) Statements about possible benefits connected with or resulting from services to be provided or methods of operation which do not give equal prominence to discussion of any risks or limitations associated therewith;

(ii) Exaggerated or unsubstantiated claims about management skill or techniques, characteristics of the investment company or an investment in securities issued by such company, services, security of investment or funds, effects of government supervision, or other attributes; and

(iii) Unwarranted or incompletely explained comparisons to other investment vehicles or to indexes.

(c) For purposes of this section, the term "sales literature" shall be deemed to include any communication (whether in writing, by radio, or by television) used by any person to offer to sell or induce the sale of shares of any investment company. Communications between issuers, underwriters and dealers are included in this definition of sales literature if such communications, or the information contained therein, can be reasonably expected to be communicated to prospective investors or are designed to be employed in either written or oral form in the sale of securities.

AUTHORITY: The Commission proposes Rule 156 for comment pursuant to the provisions of Section 38(a) of the Investment Company Act of 1940 (15 U.S.C. 80a(a)), and Section 19(a) of the Securities Act of 1933 (15 U.S.C. 77s(a), and Sections 10(b) and 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78j(b) and 78w(a))].

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

MARCH 8, 1979.

[FR Doc. 79-8374 Filed 3-19-79; 8:45 am]

Footnotes continued from last page

litigants may properly resort for guidance." *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944). The Administrative Procedure Act (5 U.S.C. 500-576) does not require public comment on an interpretive rule, but the Commission deems it advisable to have the views of interested persons on this matter.

[5] Administrative Procedure Act, § 551(4) (5 U.S.C. 551(4)). A legislative rule has been defined as the "product of an exercise of legislative power by an administrative agency, pursuant to a grant of legislative power by the legislative body." (Davis, *Administrative Law Treatise*, § 5.03, p. 299 (1958)). As to the difference between legislative and interpretive rules, see *Joseph* v. *U.S. Civil Service Commission*, 554 F.2d 1140, 1143 (C.A.D.C., 1977): The relevant distinction between legislative and interpretive or any other non-legislative rules is not the nature of the questions they address but the authority and intent with which they are issued and the resulting effect on the power of a court to depart from the decision embodied in the rule.

NOTICE TO MEMBERS: 79-12
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

March 28, 1979

TO: All NASD Members and Municipal Securities Bank Dealers
Attention: All Operations Personnel

RE: Holiday Trade Date - Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Good Friday, April 13, 1979. "Regular-Way" transactions made on the business days immediately preceding that day will be subject to the following schedule.

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

Trade Date	Settlement Date	*Regulation T Date
April 5	April 12	April 17
6	16	18
9	17	19
10	18	20
11	19	23
12	20	24
13	Good Friday	----
16	23	25

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

*Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within (7) seven days of the date of purchase. The date upon which members must take such action for the trades indicated is shown in the column entitled "Regulation T Date."

Questions concerning the application of these settlement dates to a particular situation should be directed to the Uniform Practice Department of the NASD at (212) 422-8841.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 79-13
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

April 20, 1979

IMPORTANT

TO: All NASD Members
Attention: All Operations Personnel

RE: SEC Rule 17f-1; Lost and Stolen Securities Program

SUMMARY

On March 29, 1979, the Securities and Exchange Commission issued Release No. 34-15683 in which it announced certain proposed amendments to its Lost and Stolen Securities Program (the "Program"). The purpose of the release is to solicit comments on the proposed amendments and modifications to Rule 17f-1 and the Program from members of the public and other interested parties. For additional background information on Rule 17f-1, please refer to NASD Notice to Members Nos. 78-33 and 78-48, dated August 17, 1978, and November 22, 1978, respectively.

Among other things, the various proposals would accomplish the following:

- Establish formal registration requirements for all reporting institutions subject to Section 17(f)(1) of the Act except that exemptions would be provided for (a) brokers and dealers whose only business is conducted on the floor of an exchange and who do not deal with the public and, (b) brokers and dealers engaged exclusively in the sale of variable contracts or limited partnerships and who do not hold or receive securities subject to the rule;

- Combine the Federal Reserve System's checklist of reported securities thefts and losses into the data base maintained by Securities Information Center (SIC);

- Make permanent certain pilot period exemptions pertaining to inquiry requirements for transfer agents, securities transactions of $10,000 or less and, securities received (a) directly from the issuer at issuance, (b) from another reporting institution or, (c) from a customer where the certificate is registered in the name of the customer or its nominee; and,

- Establish a new permanent exemption from required inquiry for bearer securities received by a reporting institution directly from a customer to whom they were previously sold.

A more detailed discussion of these proposals on which the SEC is soliciting comments follows.

DISCUSSION OF THE PROPOSALS

Institutions Subject to the Rule

The Commission is proposing a technical amendment to Rule 17f-1 which would incorporate into the rule the requirement that all reporting institutions register as such with the Commission. Although the proposed requirement was originally discussed in SEC Release No. 34-13832, dated August 5, 1977, it was never made part of the rule itself. The proposed registration requirement would pertain to both new and existing brokers and dealers.

The Commission has also determined that it would be appropriate to grant certain classes of brokers and dealers an exemption from the registration provisions of the Program due to the limited nature of their securities activities. In this regard, the SEC is proposing that (a) brokers and dealers whose only business is conducted on the floor of a national securities exchange and who do not conduct a public business and, (b) brokers and dealers whose business is limited to sales of variable contracts or limited partnerships and who do not hold or receive securities subject to the reporting and inquiry provisions of the rule be exempt from registering with the Commission or its designee, SIC.

Dual Appropriate Instrumentalities

Presently, there are two "appropriate instrumentalities" to which reports and inquiries must be made. For U.S. Government or Agency securities, the appropriate instrumentality is any Federal Reserve bank or branch. For reports and inquiries regarding all other securities, the appropriate instrumentality is the SEC.

The Commission is proposing to create a single data base for missing, lost, stolen and counterfeit securities by eliminating the dual responsibility and designating SIC as the sole agency to receive all inquiries and reports. If approved, this proposal would permit the Federal Reserve System's checklist of securities to be melded into SIC's data base and all future inquiries could be made to SIC only.

Pilot Period Exemptions

Transfer Agents

During the pilot period, registered transfer agents have been exempt from the inquiry provisions of the Program. The Commission is proposing to make the transfer agent exemption permanent since to require otherwise would, it has concluded, be duplicative and of minimal value from a cost/benefit viewpoint. In addition, reporting institutions would be required to submit a copy of Form X-17F-1A to both SIC and the transfer agent for the issue one business day after discovery of any counterfeit security.

De Minimis Transactions

The Commission is also proposing to make the pilot period "$10,000 de minimis exemption" permanent. As modified by subsequent staff interpretations, securities valued at $10,000 or less are exempt from required inquiry provided that the "reporting institution must view a securities transaction in its entirety and not on a piecemeal basis when determining whether the exemption is applicable." In other words, if a single transaction involving different stocks and/or bonds in the aggregate is in excess of $10,000, inquiry would be required even though the individual securities are valued at less than $10,000.

CUSIP Numbers

The Program is currently applicable only to those securities which have been assigned CUSIP numbers. The Commission is proposing that the exemption of non-CUSIP securities be continued without change.

New Inquiry Exemptions

The rule presently provides an exemption from inquiry only when securities are received: (1) directly from the issuer or issuing agent at issuance; (2) from another reporting institution or a Federal Reserve bank in its capacity as fiscal agent; or, (3) from a customer and the certificate is registered in the name of the customer or his nominee.

In response to comments received from the NASD and others, the SEC has proposed a "Know Your Customer" exemption as a means of providing a measure of relief to brokers and dealers which handle large numbers of bearer form securities. In sum, the Commission has proposed a new permanent exemption from the rule's inquiry requirements in instances in which the reporting institution knows its customer and can verify from its own internal records that the securities presented are those previously sold to the customer.

Form X-17F-1A

In response to suggestions received from several commentators, the Commission is proposing to modify Form X-17F-1A to include the following additional information:

(1) A designation of the specific type of loss being reported;

(2) The telephone number of the reporting institution;

(3) The specific designation of the parties to whom copies of filed reports are required to be sent;

(4) The names and addresses of transfer or paying agents and insurance companies who will be receiving copies of filed reports; and,

(5) Under the heading "Type of Security," Item No. 5, the designation of "Government/Agency" has been added while certain existing designations have been removed.

In regard to the above, the Commission noted in its release that there is some confusion regarding the requirement to include the alphabetical prefix or suffix of the certificate number when making reports and inquiries. The SEC advises that if a reporting institution is unable to determine the prefix or suffix of a certificate number, it should nonetheless proceed with filing a report. However, certificates of different issuers may have the same number but a different prefix or suffix. A security entered into SIC's data base without the appropriate prefix or suffix may erroneously match up with (and indicate as a "hit") another security with the same certificate number. In such a situation, the proper prefix or suffix would be required for absolute identification.

Direct/Indirect Inquirer Status

Comments previously received by the Commission suggest that communications problems may exist between indirect inquirers and

their direct inquirers. As a result, the Commission has proposed an amendment to the recordkeeping provisions of the rule to require all indirect inquirers to maintain copies of agreements designating other institutions as their direct inquirers.

Further, the Commission states that an indirect inquirer should not designate another reporting institution as its direct inquirer prior to reaching an agreement with that institution. In this regard, paragraph (g) of Rule 17f-1 is being amended to formalize the proposed new recordkeeping requirements.

* * *

The above discussion briefly addresses the issues and proposed amendments to the Program on which the Commission is soliciting comment. A reprint of the text of the proposed amendments from the April 5, 1979, edition of the Federal Register is attached. For a more complete explanation, members are advised to review Release No. 34-15683. Copies of this release can be obtained from the NASD's Washington office.

In connection with the above, the Association strongly recommends that members provide the Commission with their written comments on the proposals. The deadline for comments on the proposed amendments is May 4, 1979. The Association would appreciate receiving copies of any such comment letters submitted to the SEC. Please direct any comments or questions you may have regarding this matter to Jack Rosenfield, Assistant Director, Department of Regulatory Policy and Procedures, National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C., 20006, telephone (202) 833-4828.

Sincerely,

Gordon S. Macklin
President

Attachment

ATTENTION

The text of the following proposed amendments uses arrows ►◄ to indicate additions and brackets [] to indicate deletions.

§ 240.17f-1 Requirements for reporting and inquiry with respect to missing, lost, counterfeit or stolen securities.

(a) *Definition[s]*— [1] *Reporting institution.* For purposes of this section, the term "reporting institution" shall include every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, registered transfer agent, registered clearing agency, participant therein, member of the Federal Reserve System and bank whose deposits are insured by the Federal Deposit Insurance Corporation.

[(2) *Appropriate instrumentality.* For purposes of this section the term "appropriate instrumentality" shall mean:

(i) Any Federal Reserve Bank or branch thereof with respect to securities issued by:

(A) The United States Government,

(B) Any agency or instrumentality of the United Sates Government,

(C) The International Bank for Reconstruction and Development,

(D) The Inter-American Bank, or

(E) The Asian Development Bank; and

(ii) The Securities and Exchange Commission with respect to all other securities.]

(b) ► Every reporting institution shall register with the Commission or its designee in accordance with instructions issued by the Commission *except*

(1) A member of a national securities exchange who effects securities transactions exclusively on the floor of such national securities exchange solely for other members and does not receive or hold customer securities; and

(2) A registered broker or dealer who is engaged exclusively in the sale of variable contracts and/or limited partnership interests and does not receive or hold securities that are subject to the provisions of paragraphs (c) and (d) herein.◄

([b]) ►(c)◄ *Reporting requirements*— (1) *Stolen Securities.* (i) Every reporting institution shall report to the [appropriate instrumentality] ►Commission or its designee◄ and to a registered transfer agent for the issue the discovery of the theft or loss of any security where there is substantial basis for believing that criminal activity was involved. Such report shall be made within one business day of the discovery and, if the certificate numbers of the securities cannot be ascertained at that time, they shall be reported as soon thereafter as possible.

* * * * *

(2) *Missing or lost securities.* Every reporting institution shall report to the [appropriate instrumentality] ► Commission or its designee◄ and to a registered transfer agent for the issue the discovery of the loss of any security where criminal actions are not suspected when the security has been missing or loss for a period of two business days. Such report shall be made within one business day of the end of such period except that:

* * * * *

(3) *Counterfeit securities.* Every reporting institution shall report the discovery of any counterfeit security to the [appropriate instrumentality] ►Commission or its designee, to a registered transfer agent for the issue,◄ and to the appropriate law enforcement agency within one business day.

(4) *Recovery.* Every reporting institution shall report the recovery or finding of any security previously reported missing, lost, or stolen pursuant to this section to the [appropriate instrumentality] ►Commission or its designee◄ and to a registered transfer agent for the issue within one business day of such recovery or finding. If a report of stolen securities was made to the appropriate law enforcement agency, a report of such recovery shall also be made to such agency. Recovery may only be reported by the institution which reported the security as missing, lost or stolen.

* * * * *

[(c)] ►(d)◄ *Required inquiries.* (1) Every reporting institution ►except a registered transfer agent◄ shall inquire of the [appropriate instrumentality] ►Commission or its designee◄ with respect to every security which comes into its possession or keeping, whether by pledge, transfer, or otherwise, to ascertain whether such security has been reported as missing, lost, counterfeit, or stolen, unless

(i) * * *

(ii) The security is received from another reporting institution or from a Federal Reserve Bank or Branch [in its capacity as fiscal agent];

(iii) The security is received from a customer of the reporting institution and

►(A)◄ is registered in the name of such customer or its nominee[.] ►or

(B) was previously sold to such customer, as verified by the internal records of the reporting institution;

(iv) The security is part of a transaction which has an aggregate face value of $10,000 or less in the case of bonds or market value of $10,000 or less in the case of stocks; or

(v) The security is received directly from a drop which is affiliated with a reporting institution for the purposes of receiving and delivering certificates on behalf of the reporting institution.◄

* * * * *

[(d)] ►(e)◄ Every reporting institution may report to or inquire of the [appropriate instrumentality] ►Commission or its designee◄ with respect to any security not otherwise required by this section to be the subject of a report or inquiry. The Commission on written request or upon its own motion may permit reports to and inquiries of the system by any other person or entity upon such terms and conditions as it deems appropriate and necessary in the public interest and for the protection of investors.

[(e)] ►(f)◄ *Exemptions.* ►The following types of securities are not subject to paragraphs (c) and (d), above:

(1)◄ Registered securities of the United States Government, any agency or instrumentality of the United States Government, the International Bank for Reconstruction and Development, the Inter-American Development Bank, or the Asian Development Bank, and counterfeit securities of such entities; [are not subject to the provisions of this section relating to reporting and inquiry with the appropriate instrumentality.]

►(2) Security issues not assigned CUSIP numbers;

(3) Bond coupons.◄

[(f)] ►(g)◄ *Recordkeeping.* Every reporting institution shall maintain and preserve in an easily accessible place for three years copies of all Forms X-17F-1A filed pursuant to this section►, all agreements between reporting institutions regarding registration or other aspects of this section,◄ and all confirmations or other information received from the [appropriate instrumentality] ►Commission or its designee◄ as a result of inquiry.

* * * * *

§ 249.1200 [Amended]

2. The Securities and Exchange Commission, pursuant to Section 17(f) of the Securities Exchange Act of 1934, proposes the following modifications to Form X-17F-1A, § 249.1200 in Chapter II of Title 17 of the Code of Federal Regulations as appended hereto.

(not attached)

NOTICE TO MEMBERS: 79-14

Notices to Members should be retained for future reference

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

April 26, 1979

TO: COMPANIES QUOTED IN THE NASDAQ SYSTEM

MEMBERS OF THE NASD

The Board of Governors at its meeting March 16, 1979 adopted, with certain modifications, the proposal relating to the notification to NASD of news releases by NASDAQ quoted companies that was circulated for comment by companies in February, 1979. A copy of the text approved by the Board is attached.

The Board is recommending that NASDAQ companies notify the NASD of the release of material news no later than simultaneously with its release to the public through the press. The purpose of the recommendation is to provide the NASD with the opportunity to consider, in consultation with the company, whether or not it is desirable to halt the display of quotations through the NASDAQ System while the news is being disseminated to the public.

This action was taken after all comment letters submitted by companies had been reviewed independently by the NASDAQ Committee and by the Board. A number of suggested changes offered in the comment letters are reflected in the text as adopted.

The Board would like to express its appreciation to those who commented on the proposals relating to the release of news that were circulated for comment.

Sincerely,

Gordon S. Macklin
President

NOTIFICATION TO NASD OF NEWS RELEASES

Schedule D requires NASDAQ companies to disclose promptly to the public through the press any material information which may affect the value of their securities or influence investors' decisions. The Board of Governors recommends that NASDAQ companies notify the NASD of the release of any such information no later than simultaneously with its release to the public through the press. Notification may be provided directly to the NASD Market Surveillance Department by telephone (call 202 833-7842). Information communicated orally should be confirmed promptly in writing. Where public release of information occurs after 5:30 p.m. Eastern Time, notification should be made by 9:30 a.m. of the following trading day.

The purpose of this recommendation is to assist in maintaining a stable and orderly market for NASDAQ securities. One of the methods used by the NASD to accomplish such is the institution of NASDAQ quotation halts. A quotations halt benefits current and potential shareholders by halting the display of quotations through the NASDAQ System until there has been an opportunity for the information to be disseminated to the public. This decreases the possibility of some investors acting on information known to them but which is not known to others. A quotations halt normally lasts about one to two hours after the appearance of the news on wire services, but it may last longer if a determination is made that the news has not been adequately disseminated. A quotations halt provides the public with an opportunity to evaluate the information and consider it in making investment decisions. It also alerts the marketplace to the fact that news has been released.

Upon receipt of the information from the company, the NASD, after consultation with the company, will immediately evaluate the information, estimate its potential impact on the market and determine whether a quotations halt in the security is appropriate.

Material information which might reasonably be expected to affect the value of the securities of a company or influence investors' decisions would include information regarding corporate events of an unusual and/or non-recurrent nature. The following list of events, while not an exhaustive summary of all situations in which disclosure to the NASD should be considered, may be helpful in determining whether information is material. It should also be noted that every development that might be

reported to the NASD in these areas would not necessarily be deemed to warrant a quotations halt.

- a merger, acquisition or joint venture;
- a stock split or stock dividend;
- earnings and dividends of an unusual nature;
- the acquisition or loss of a significant contract;
- a significant new product or discovery;
- a change in control or a significant change in management;
- a call of securities for redemption;
- the public or private sale of a significant amount of additional securities;
- the purchase or sale of a significant asset;
- a significant change in capital investment plans;
- a significant labor dispute;
- establishment of a program to make purchases of the company's own shares;
- a tender offer for another company's securities; and
- an event requiring the filing of a current report under the Securities Exchange Act.

NOTICE TO MEMBERS: 79- 15
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

April 27, 1979

TO: ALL NASD MEMBERS
ATTENTION: REGISTRATION PERSONNEL

RE: Implementation of the Uniform Securities Agent State Law Examination (USASLE)

CONTENTS

Background

The NASD is pleased to announce the implementation of the North American Securities Administrators Association's (NASAA) Uniform Securities Agent State Law Examination (USASLE - Series 63). Through adoption of this testing vehicle, an important step towards uniformity within the securities industry has been achieved. At the present time, there are approximately 23 states which require agents to qualify by examination on their respective blue sky laws and related rules. The USASLE has been developed to satisfy the securities agent qualification testing requirements for all state jurisdictions.

Before introduction of the USASLE, it was possible that a representative of a brokerage firm would be required to take and pass numerous state law examinations during the course of an active career in the securities industry. The new examination will substantially reduce the inconvenience and cost to brokerage firms in complying with the qualification requirements of numerous state jurisdictions.

Content of the Uniform State Law Examination and Study Guide

The USASLE was designed by a committee of NASAA representatives, industry volunteers, ICI, SIA, and NASD staffs. The committee also prepared the study outline material for this new test. The examination is one hour in length and consists of fifty multiple choice questions based upon the Uniform Securities Act. The USASLE Study Guide has been prepared to assist an applicant in preparing for the examination. The guide has five basic sections as follows:

1. Definitions of Terms

2. Licensing and registration requirements

3. Registration of securities, exempt securities and exempt transactions

4. Fraudulent and other prohibited practices

5. Regulatory oversight, criminal penalties, civil liabilities, scope of the Act and general provisions

Appendix A of the guide is the Uniform Securities Act itself and Appendix B contains the titles and addresses of all state securities regulatory agencies.

Study Guide Requests and Changes Relating Thereto

The 102 page USASLE Study Guide will be sold by the North American Securities Administrators Association through the NASD at a charge of $3.00 per copy. Copies can be obtained by forwarding requests to either the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C., 20006 or your local NASD District Office. Proper payment must accompany all requests for the Study Guide.

Procedures for Requesting Admission to the USASLE Examination

The NASD will be the sole administrator of the USASLE Examination. A Uniform Securities Agent State Law Examination Request Form (Form U-63) has been enclosed with this notice. This form must be completed and submitted on behalf of each candidate required to take the uniform test. The completed form and a $30.00 examination fee for each candidate is to be forwarded to the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C., 20006. In completing the form, please make note of the following:

1. Each state jurisdiction which is to be advised of the grade results must be identified by marking the appropriate boxes in item 6.

2. The location of the NASD examination center where the candidate wishes to sit for the USASLE (Series 63) should be identified. A listing of the NASD centers is located on the reverse of the request form.

After processing Form U-63, the NASD will forward a Series 63 admission certificate to the submitting firm in order that the candidate may attend an examination session. A schedule of examination dates and times will accompany this certificate. Each certificate of admission will expire 90 days from the date of issuance. Should the candidate not sit for the Series 63 examination prior to the expiration date, the Association will withdraw the candidate's request form. It is not anticipated that extensions of time will be permitted nor will the NASD transfer or refund the qualification examination fee. If another admission certificate needs to be obtained, another request form and attendant $30.00 examination fee must be submitted. Re-examination requests for candidates who fail to pass the examination will be honored upon resubmission of a new form and $30.00 fee.

Supply of the Uniform State Law Examination Request Form

To request an inventory of USASLE Request Form U-63, please complete a self-addressed mailing label to the attention of the NASD Mail Room in our Washington, D.C. office. The label should detail the words USASLE Form U-63 and the number of copies desired. These requests will be serviced as promptly as possible.

Phase In and Phase Out Period for State Law Examination

It is the NASD's intention to honor the admission certificates for current individual state law examinations presently outstanding in accordance with the schedule detailed below. After the expiration date has passed, the individual state law examination will be withdrawn and the USASLE test will be the only qualification vehicle. The schedule also details the implementation date for the USASLE examination by state jurisdiction. As an example, the state of Arizona has determined that the USASLE examination may be taken in lieu of its Series 51A test commencing May 15, 1979. Both the present Series 51A and the USASLE examination will be honored until July 30, 1979. After such date, Series 51A will be permanently withdrawn and the sole qualification vehicle will be the Series 63 USASLE test.

Implementation Schedule

State Jurisdiction	Implementation Date - USASLE Examination	Phase Out Date Present Examination
Arizona	May 15, 1979	Series 51A - 7/30/79
Arkansas	July 1, 1979	Series 61A - 7/1/79
Colorado	April 1, 1979	N/A
Georgia	May 1, 1979	Series 19A - 7/1/79
Indiana	May 1, 1979	Series 29B - 7/1/79
Kansas	May 1, 1979	Series 30A - 7/1/79
Kentucky	May 1, 1979	Series 62A - 7/1/79
Minnesota	July 1, 1979	Series 48A - 8/30/79
Missouri	May 1, 1979	Series 33A - 7/1/79
New Mexico	April 1, 1979	Series 34B - 7/1/79
North Dakota	May 1, 1979	Series 57A - 7/1/79
Pennsylvania	*June 1, 1979	Series 35A - 8/1/79

* Subject to Change

State Jurisdiction	Implementation Date - USASLE Examination	Phase Out Date Present Examination
Rhode Island	April 1, 1979	Series 36B - 7/1/79
South Dakota	May 1, 1979	N/A
Tennessee	August 1, 1979	Series 37A - 8/1/79
Wisconsin	April 1, 1979	Series 23A - 7/1/79

While it is anticipated that those state jurisdictions which presently have state law examinations whose names do not appear on the implementation schedule will accept USASLE, written authorization has not as yet been received. When these states report, an updated schedule will be forwarded to all members. State procedures and/or requirements related to the USASLE examination such as a higher passing grade for supervisors and written certifications, should be obtained from the individual jurisdiction with which the applicant desires to license.

State Jurisdiction Notification Procedure

During the initial phase in period of the USASLE test, it will be the responsibility of the firm receiving the grade results from the NASD to notify the appropriate state jurisdictions of the candidate's completion of the examination requirement. After a period of approximately two months, the NASD intends to send this notification on behalf of the firm and candidate.

Questions respecting this notice or the procedures relating to implementation of this new examination should be directed to Ms. Janet Hale, Assistant Director, Qualifications Examinations, at (202) 833-7174.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 79-16
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

May 8, 1979

TO: All NASD Members and Municipal Securities Bank Dealers
Attention: All Operations Personnel

RE: Memorial Day Trade Date - Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Monday, May 28, 1979, for the observance of Memorial Day. On Wednesday, May 30, 1979, securities markets and the NASDAQ System will be open for trading. However, May 30 will not be a settlement date since banking institutions in several states will be closed. The following adjustments to the settlement date schedule have been made to insure uniformity since the observance of public holidays and banking holidays differs from state to state.

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

Trade Date	Settlement Date	*Regulation T Date
May 18	May 25	May 30
21	29	31
22	31	June 1
23	June 1	4
24	4	5
25	5	6
28	Memorial Day Observance	---
29	6	7
30	6	8

*Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) days of the date of purchase. The date upon which members must take such action for the trades indicated is shown in the column entitled "Regulation T Date."

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

On Wednesday, May 30, securities will not be quoted ex-dividend and buy-ins, sell-outs, reclamations and marks-to-the-market, as provided in the Uniform Practice Code and MSRB Rule G-12, will not be made and/or exercised.

Questions regarding this notice may be directed to the Uniform Practice Department at (212) 422-8841.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 79-17
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

May 8, 1979

TO: All NASD Members

RE: Paul Kendrick & Co., Inc.
One Post Street, Room 350
San Francisco, CA 94104

ATTN: Operations Officer, Cashier, Fail-Control Department

On Tuesday, April 17, 1979, the Securities Investor Protection Corporation (SIPC) was appointed Trustee for Paul Kendrick & Co., Inc., a former NASD member. NASD Press Release dated July 31, 1978 described that Paul Kendrick & Co., Inc. was expelled from membership in the Association on June 22, 1978 as a result of a disciplinary action taken by the NASD, which action is currently on appeal to the SEC.

Should you have any questions regarding this firm, address your inquiries to:

Securities Investor Protection Corporation
Attention: Mr. J. H. Moelter
Suite 800, Farragut Building
900 Seventeenth Street, N.W.
Washington, D.C. 20006
Telephone (202) 223-8400

Thomas R. Cassella
Director, Financial Responsibility

NOTICE TO MEMBERS: 79-18
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

May 15, 1979

TO: All NASD Members and Interested Persons

RE: New Qualification Requirements and Test Administration System for Limited Principals

ATTENTION: TRAINING DIRECTORS AND REGISTRATION PERSONNEL

The purpose of this notice is to inform the membership of the following developments in the Association's qualification examination program for principals.

- Implementation of New Qualification Examination for Investment Company Products/Variable Contracts (IC/VC) Principals (Test Series 26) on June 1, 1979.
- Implementation of New Qualification Examination for Direct Participation Programs (DPP) Principals (Test Series 39) on June 1, 1979.
- Pre-requisite Representative Registration Requirements for Limited Principals
- Automation of Test Administration for the New Limited Principal Examinations

Implementation of New Qualification Examinations for Limited Principals

The Association will implement new qualification examinations for Investment Company Products/Variable Contracts Principals and for Direct Participation Programs Principals on June 1, 1979. Effective that date all persons who apply for registration as either IC/VC Principals or DPP Principals will be required to take and pass the appropriate examination for the designated category of registration. Under NASD rules, a principal is defined as any sole propreitor, officer, partner, manager of an office of supervisory jurisdiction or director associated with the member who is actively engaged in the management of the member's general investment banking or securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions.

Persons who meet the definition of a principal, but whose supervisory activities are limited to investment company products and variable contracts, may satisfy the Association's minimum qualification requirements by passing the IC/VC Principal Examination. Such products include redeemable securities of companies registered pursuant to the Investment Company Act of 1940; securities of closed-end companies registered pursuant to the Investment Company Act of 1940 during the period of original distribution only; and variable contracts and insurance premium funding programs registered pursuant to the Securities Act of 1933.

Persons who meet the definition of a principal, but whose supervisory activities are limited to direct participation programs, may satisfy the Association's minimum qualification requirements by passing the DPP Principal Examination. The term "direct participation programs" shall mean programs which provide for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not necessarily limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 402(a) of the Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code and any company, including separate accounts, registered pursuant to the Investment Company Act of 1940.

The new examinations represent minimum qualification standards for limited principals. Persons whose supervisory activities will extend to both investment company products/variable contracts and direct participation programs may satisfy the Association's minimum qualification requirements by passing both the IC/VC Principal Examination and the DPP Principal Examination. All limited principals may elect to satisfy the Association's qualification requirements by taking the General Securities Principal Examination. Successful completion of this examination will entitle a registrant to function as an IC/VC Principal and as a DPP Principal, as well as to engage in supervisory activities with respect to other investment instruments.

* * *

Pre-Requisite Representative Registration Requirements for Limited Principals

Effective June 1, 1979, all new applicants for registration as IC/VC Principals and/or DPP Principals must be registered with the Association as

either General Securities Representatives or Limited Representatives before taking their limited principal examinations. Persons who apply for registration as limited principals prior to June 1, 1979, will not be subject to this pre-requisite representative registration requirement.

At this time, Limited Representatives may qualify by taking the NASD Series 1 examination. This examination will be in effect until the fall of 1979, at which time the Association intends to withdraw the Series 1 examination and replace it with two new limited representatives examinations--one for Investment Company Products/Variable Contracts Representatives and the other for Direct Participation Programs Representatives. More definitive information regarding the introduction of these programs will be the subject of a future notice to members.

* * *

Study Outlines

The Association, in December, 1978, published preliminary study outlines for both the IC/VC Principal Examination and the DPP Principal Examination. The Association is in the process of printing final versions of these outlines which will be available by May 20, 1979, from the NASD Executive Office in Washington, D. C. and any of its fourteen district offices.

The IC/VC Principal Examination will be two hours in length and will be comprised of 75 multiple-choice questions. The DPP Principal Examination will be an hour and a half in length and will be comprised of 50 multiple-choice questions. The study outlines for these examinations contain additional detail regarding their structure and content.

* * *

Automation of Test Administration

Administration of the limited principal examinations will be accomplished in an automated manner using the Plato system of the Control Data Education Company. Plato is a large, fully dedicated time-sharing system capable of delivering a wide variety of programs to remote visual display terminals located in learning centers owned and operated by Control Data Education Company. The system has been modified to serve as a medium for delivering the types of qualification examinations utilized by the Association. Control Data learning centers are currently operating in cities where existing NASD test centers account for approximately 90% of the examinations administered each year.

The automated capabilities of the Plato system will eliminate the need to administer the limited principal examinations on a fixed schedule. When enrolled on the system by the NASD, a candidate need only make an appointment at the nearest learning center to sit for an examination. All learning centers are open between the hours of 8:30 A.M. to 5:30 P.M. local time. Some learning centers are also open in the evenings and on weekends. Using Plato, the Association will also be able to enter the bank of test questions for the limited principal examinations into the system and to program the computer to generate a unique examination for each candidate. Within one day of a candidate's testing date, a hard-copy grade report will be generated at the Association's Executive Office and forwarded to the sponsoring member firm as well as to the state securities commissions designated on the candidate's registration application. A more detailed description of test administration on the Plato system is contained in the sections which follow.

Plato Enrollment - After receiving a candidate's registration application and appropriate fees, the Association will enroll the candidate on the Plato system. Enrollment must occur in order for a candidate to sit for an examination on the system. After a candidate has been enrolled on the system, a confirmation notice will be sent to the sponsoring member firm. This notice will identify the candidate, the qualification examination for which the candidate has been enrolled and the expiration date of the enrollment. The expiration date will be 90 calendar days from the date the enrollment is entered into the system. If a candidate does not sit for the examination during this period, he may be re-enrolled on the system upon receipt by the Association of another $30 testing fee accompanied by NASD Form ER-1.

Appointment Scheduling - Along with the enrollment confirmation notice sent to the firm, the Association will include a schedule of Control Data learning centers at which the examination can be taken. The candidate need only call the nearest learning center in order to make an appointment to sit for the examination. Unless otherwise requested by the candidate, appointments will be scheduled within five business days from the date the appointment request is received by Control Data. Appointments will not be made for candidates who are not enrolled on the system or for candidates requesting an appointment date which falls after the expiration date of the candidate's enrollment. The sponsoring member firm will be charged a penalty fee of $10.00 in the event that a candidate does not appear for a scheduled appointment or cancels a scheduled appointment less than 72 hours prior to the appointed time and date. At the learning center administrator's discretion, a candidate who arrives more than 15 minutes late for a scheduled appointment may not be allowed to sit for the examination if the terminal has been otherwise reserved, in which case a penalty fee of $10.00 will also be levied. All penalty fees will be billed to member firms by the Association.

Group Reservations - Member firms or training organizations planning training classes may block-reserve terminals at a learning center by calling the learning center at least one month in advance of the desired testing date. The same procedures outlined above with respect to late cancellations, no shows and late arrivals for appointment sessions will be in effect for individuals in groups.

Admission to Learning Centers - Since a candidate's enrollment on the Plato system is entered into the computer by the NASD and is available on-line to learning center administrators, it will not be necessary for candidates to present their enrollment confirmation notices at the time they appear at a learning center. However, a candidate will be required to provide two forms of identification, both of which must contain the signature of the candidate and at least one of which must contain either a physical description of the candidate or a picture. This requirement is in effect today in the Association's existing test centers. All candidates will be required to check briefcases, books, papers, study material, etc., with the learning center administrator before being seated at the terminal. Neither the NASD nor Control Data assume responsibility for any articles which are required to be left at the admission's desk in the learning center. Candidates may use pocket electronic calculators while taking an examination provided that such devices have independent power sources and no operable print mechanisms.

Examination Presentation on the System - After a candidate is seated at a terminal the actual examination will be preceded by an introductory lesson designed to familiarize the candidate with the procedures to be followed in answering and reviewing test questions. These procedures are simple and do not require any previous experience with a computer terminal or typing ability. All questions are answered by touching the appropriate location on the terminal screen itself. In addition, there is a simple procedure available to the candidate during the test and at the end of the examination for reviewing any question in the examination. At the end of the allotted time period or when a candidate voluntarily terminates a testing session, the computer will automatically score the examination and component sub-sections, and display the scores on the terminal. A hard-copy grade notification will be forwarded by the Association to the sponsoring firm and to the state securities commissions designated on the candidate's application on the first business day following the testing session.

Plato Learning Center Locations - The following cities are presently serviced by at least one Control Data learning center. A current list of learning center locations and telephone numbers will be included with each confirmation notice sent to candidates. Candidates located in areas serviced by Control Data learning centers must take the limited principal examinations on the Plato system.

Anaheim, California
Los Angeles, California
San Diego, California
San Francisco, California
Sunnyvale, California
Denver, Colorado
Stamford, Connecticut
District of Columbia
Miami, Florida
Atlanta, Georgia
Chicago, Illinois
Louisville, Kentucky
New Orleans, Louisiana
Baltimore, Maryland
Rockville, Maryland
Boston, Massachusetts
Quincy, Massachusetts
Detroit, Michigan
Arden Hills, Minnesota
Bloomington, Minnesota
Edina, Minnesota
Minneapolis, Minnesota
Roseville, Minnesota
St. Louis, Missouri
Omaha, Nebraska
New York, New York
Charlotte, North Carolina
Cincinnati, Ohio
Cleveland, Ohio
Columbus, Ohio
Lima, Ohio
Oklahoma City, Oklahoma
Philadelphia, Pennsylvania
Pittsburgh, Pennsylvania
Rapid City, South Dakota
Dallas, Texas
Houston, Texas
San Antonio, Texas
Salt Lake City, Utah
Seattle, Washington
Milwaukee, Wisconsin

Non-Plato Testing Locations - On a special request basis the Association will make printed limited principal examinations available at its traditional test centers which are located in cities not serviced by a Control Data learning center. A request for an examination to be administered at one of these locations should be made at the time the candidate's application papers are submitted.

* * *

Implementation Procedures for the New Limited Principal Examinations

Effective May 21, 1979, all new applicants for registration as IC/VC Principals and/or DPP Principals will be enrolled for testing on the Plato system. Testing on the system will commence on June 1, 1979. Candidates who apply for registration as limited principals prior to June 1, 1979, and who are holding unexpired Test Series 40 admission tickets (the current examination for limited principals) on June 1 will be enrolled on the Plato system for one or both of the new examinations in keeping with the registration categories designated on their applications. Such candidates are advised not to take the Series 40 examination on or after June 1, 1979, since this test will not be accepted as of that date as meeting the Association's qualification requirements for either category of limited principal registration.

The testing fee for each limited principal examination will be $30. Therefore, with the introduction of these tests, applicants for registration as both IC/VC Principals and DPP Principals will be required to pay two separate testing fees, one for each test.

* * *

Questions regarding this notice should be directed to Frank J. McAuliffe at (202) 833-7394, Carole Hartzog at (202) 833-7392 or David Uthe at (202) 833-7273.

Sincerely,

John T. Wall
Senior Vice President
Compliance