NOTICE TO MEMBERS: 79-19
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 4, 1979

TO: All NASD Members

RE: Link-Up + 1 Securities, Inc.
3 Park Central, Suite 685
Denver, Colorado 80202

ATTN: Operations Officer, Cashier, Fail-Control Department

On Friday, May 18, 1979, the National Association of Securities Dealers, Inc. was appointed Receiver for Link-Up + 1 Securities, Inc. Members may use the "immediate close-out" procedures as provided in Section 59(i) of the NASD's Uniform Practice Code to close-out open OTC contracts. Also, MSRB Rule G-12 (h)(iv) provides that members may use the above procedures to close-out transactions in municipal securities.

Questions regarding the firm should be directed to:

National Association of Securities Dealers, Inc.
c/o Mr. Edward C. Larkin
909 - 17th Street, Room 608
Denver, Colorado 80202
Telephone (303) 825-7234

Thomas R. Cassella
Director, Financial Responsibility

NOTICE TO MEMBERS: 79-20
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 4, 1979

TO: All NASD Members

RE: Francis Eugene Mooney, Jr.
d/b/a Bach Planning Company
Knoxville, Tennessee

ATTN: Operations Officer, Cashier, Fail-Control Department

On Wednesday, May 23, 1979, the Securities Investor Protection Corporation was appointed Trustee for Francis Eugene Mooney, Jr., d/b/a Bach Planning Company, a former NASD member. Previously, a temporary receiver had been appointed for the firm on May 27, 1977. NASD Press Release dated September 26, 1977 described that the firm was expelled from membership in the Association as a result of disciplinary action taken by the NASD.

Should you have any questions regarding this firm, please 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

AMERICAN STOCK EXCHANGE, INC.
CHICAGO BOARD OPTIONS EXCHANGE, INC.
MIDWEST STOCK EXCHANGE, INCORPORATED
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
NEW YORK STOCK EXCHANGE, INC.
PACIFIC STOCK EXCHANGE, INCORPORATED
PHILADELPHIA STOCK EXCHANGE, INC.

IMPORTANT NOTICE

May 16, 1979

TO: All Members, Member Organizations and Interested Persons

ATTENTION: Chief Executive Officers or Managing Partners

PROPOSED RULE CHANGES AND
INTERPRETATIONS CONCERNING OPTIONS TRADING

Enclosed with this notice are proposed responses to a substantial number of the recommendations of the Special Study of the Options Markets. These draft responses were developed during the past two months by representatives of the seven self-regulatory organizations issuing this notice, with valuable input coming from many industry sources. These drafts are being circulated for comment as a part of the process looking toward formal filing of the proposed rule changes with the Securities and Exchange Commission.

It should be noted that these proposed rule drafts have not yet been approved by the governing bodies of any of the self-regulatory organizations.

This notice includes responses to recommendations I.A.1.a. through I.A.1.p., I.A.2.b. through I.A.2.d. and I.A.3.a. through I.A.3.c., as those recommendations are designated in Securities Exchange Act Release No. 15575, dated February 22, 1979 (the "Release"). The format of the material presented here is (i) the text of the recommendation from the Release, (ii) the proposed response and (iii) a rationale or explanation for each response, headed "Comment", including a proposed effective date.

BACKGROUND

On February 15, 1979, the Securities and Exchange Commission (the "Commission") issued the Report of the Special Study of the Options Markets (the "Report" or the "Options Study"). The Report contained an introduction and seven additional chapters that outlined the results of the Commission's lengthy investigation of standardized options trading. Interspersed throughout the Report were recommendations from the staff of the Options Study that, if adopted, would result in a number of changes in the present scheme of options regulation. Certain of the recommendations called for the self-regulatory organizations ("SROs") to adopt uniform new options rules and to make uniform amendments to existing rules, while others sought modifications in present SRO examination and surveillance procedures.

Following issuance of the Options Study, the Commission issued Release No. 15575, in which the Commission stated its requirements with respect to implementation of the Options Study's recommendations. The Release also provided a timetable for the termination of the moratorium

on options expansion that has been in effect since October, 1977. Essentially, the Commission agreed to lift the moratorium if the SROs, 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 Commission calls for the filing of numerous rule change proposals and the submission of 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 this timetable should make it possible to lift the options moratorium within six months. The Release states, and the Commission has repeated, that the Commission is prepared to act on its own initiative to implement the recommendations of the Options Study if the self-regulatory organizations fail to do so.

THE SRO TASK FORCE

On March 13, 1979, the chief executive officers of the SROs met with Commission Chairman Harold Williams for the purpose of discussing the Release in detail. Following that meeting, the SROs determined that it would be appropriate to form a joint task force in order to provide, where possible, uniform responses to the Options Study's recommendations. As presently constituted, the Task Force consists of staff members of the American, Midwest, New York, Pacific, and Philadelphia Stock Exchanges, the Chicago Board Options Exchange and the National Association of Securities Dealers, and one broker-dealer officer appointed as an industry representative by the New York Stock Exchange. The group has held a series of meetings devoting attention primarily to those recommendations that require uniform responses by the SROs.

In drafting these proposals, the Task Force has attempted to design rules that would satisfy the thrust of the Commission's concerns but that would also keep to a minimum the cost, burdens and disruption flowing from the cumulative effect of implementing the recommendations of the Options Study in their original form. Therefore, the draft rules do not necessarily mirror, word for word, the recommendations in the Release, but do present a reasonable and substantial response to the problems identified by the Options Study, and a response on which the representatives of the seven SROs can all agree.

REQUEST FOR COMMENT

On April 19, 1979, the Task Force presented a package of draft rules to the staff of the Commission for preliminary comment. The staff was receptive to these proposals, in a majority of instances making only minor suggestions for changes. While there remain differences of opinion on certain points, the Task Force was sufficiently encouraged following the meeting to submit the proposed rules for general membership comment. In this connection, it was determined that the best manner in which to provide complete dissemination of this material would be to issue a joint notice to members and member organizations containing the text of each proposal, together with a narrative explanation of what each is designed to achieve.

Each organization represented on the Task Force believes that member input is critical to this rule making process, and to that end, the SROs directly solicited comment from the industry at the time the Release was issued. The SRO representatives have received comments from a number of sources: interviews with principals of firms most active in the options business, comment letters to the Commission from those firms that have commented on the Release and furnished the SROs with a copy, the participation by at least one member firm representative in each of the meetings where the drafts were worked on, input from the NASD's Options Committee, the appropriate Securities Industry Association committees and the formal comments of the SIA to the Commission. While the Task Force has not had all the input that would be desirable, particularly from the medium and small brokerage firms, the SRO representatives do believe that this package of proposals is a reasonable approach to problems identified by the Options Study and one that is also responsive to the industry comments received thus far. If there are aspects of these proposed responses that do not adequately meet the concerns expressed by the industry or that present difficulties that have not yet been expressed, it is extremely important that such comments be made at this time.

One example of the type of comments which would be particularly helpful is member reaction to the proposal that firms receiving more than $100,000 in options commission income yearly and employing more than 50 registered options representatives should be required to employ a Compliance Registered Options Principal ("CROP") who would have no sales function and who would be responsible to review,

and to propose appropriate action to secure, member compliance with securities laws and SRO rules with respect to options (see pages 9-11). The Task Force is interested in member reaction both to the CROP concept and to whether the numbers selected for options commission income and registered employees are appropriate.

The Task Force would also appreciate comment on Interpretation .03 to the new "Opening of Accounts" rule (see page 4). Recommendation I.A.1.c. would have required that the currency of customer suitability information be confirmed semi-annually. The initial response that the SRO representatives presented to the Commission would have required (1) that the currency of such information be confirmed annually, (2) that the confirmation could be by exception (i.e., customers would be asked to provide updated information annually and, in the absence of a response, the information on file would be deemed current) and (3) that the annual confirmation could be accomplished by sending each customer a written request (which could have appeared on a monthly or quarterly statement) for verification of the currency of information that the customer had previously furnished the firm, without sending the customer a copy of the information previously furnished. Point (3) was unacceptable to the Commission staff, who wanted the customer to receive an actual copy of all suitability information on file with the member. The present draft version of the rule conforms with the staff's position. In responding to this notice, firms should provide whatever cost or other information is available in support of the use of a customer statement request for purposes of verifying customer suitability information.

As you know, these proposals do not cover all of the recommendations of the Options Study, and several difficult problems remain on which member firm input is extremely important. We specifically direct your attention to the recommendations concerning revisions to customer account statements, requirements for headquarters office review of options accounts, training of registered representatives and the retesting of registered representatives and Registered Options Principals. If there are alternatives to the recommendations set forth in the Release on these matters, they should be included in your comments.

Members and member organizations again are urged to read the Release and this notice carefully and to measure the impact which compliance with each of the proposed options

rules would have on their business. Comments should be directed to any of the undersigned no later than June 15, 1979.

Sincerely,

AMERICAN STOCK EXCHANGE

By _____
Robert J. Birnbaum
President

CHICAGO BOARD OPTIONS EXCHANGE

By _____
William M. Smith
President

MIDWEST STOCK EXCHANGE

By _____
Richard B. Walbert
President

NATIONAL ASSOCIATION OF SECURITIES DEALERS

By _____
Gordon S. Macklin
President

NEW YORK STOCK EXCHANGE

By _____
Robert M. Bishop
Senior Vice President

PACIFIC STOCK EXCHANGE

By _____
Charles J. Henry
President

PHILADELPHIA STOCK EXCHANGE

By _____
Elkins Wetherill
President

PROPOSALS* IN RESPONSE TO OPTIONS STUDY RECOMMENDATIONS

(April 20, 1979 DRAFT)

TABLE OF CONTENTS

*NOTE: These proposals have not been approved by the governing bodies of any self-regulatory organization.

Options Study Recommendations I.A.1.a., b. and c.

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.

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.

c. The SROs should amend their rules to require that member firms semi-annually confirm the currency of customer suitability information.

RESPONSE: OPENING OF ACCOUNTS

(a) Approval Required. No member organization shall accept an order from a customer to purchase or write an option contract unless the customer's account has been approved for options transactions in accordance with the provisions of this rule.

(b) Diligence in Opening Account. In approving a customer's account for options transactions, a member organization shall exercise due diligence to learn the essential facts as to the customer, his investment objectives, financial situation and needs, and shall make a record of such information which shall be retained in accordance with Rule ____ [Maintenance of Records]. Based upon such information, the branch office manager or other Registered Options Principal shall approve in writing the customer's account for options transactions, provided, however, that if the branch office manager is not a Registered Options Principal, his approval shall be confirmed within a reasonable time by a Registered Options Principal.

(c) Verification of Customer Background and Financial Information. The background and financial informa-

tion upon which a customer's account has been approved for options trading shall be sent to every new options customer for verification within fifteen (15) days after the customer's account has been approved for options transactions, and the currency of such information shall be confirmed annually as to all approved options customers.

(d) Agreements to Be Obtained. Within fifteen (15) days after a customer's account has been approved for options transactions, a member organization shall obtain from the customer a written agreement that the account shall be handled in accordance with the Rules of the SRO and the Rules of the Clearing Corporation and that such customer, acting alone or in concert with others, will not violate the position or exercise limits set forth in Rules ____ and ____.

(e) Prospectus to Be Furnished. At or prior to the time a customer's account is approved for options transactions, a member organization shall furnish the customer with a current Prospectus as defined in Rule ____.

...Interpretations and Policies

.01 In fulfilling its obligations pursuant to paragraph (b) of Rule ____, a member organization shall seek to obtain the following information at a minimum:

1. Name of customer -- residence address -- telephone number

2. Investment objectives (e.g., safety of principal, income, growth, trading profits, speculation; amount of funds available for speculative activity)

3. Place of employment -- address -- business phone -- position -- nature of duties -- length of service

4. If self-employed -- address -- business phone -- type of business -- how long engaged

5. Date of birth

6. Marital status -- number of dependents (ages)

7. Highest level of education achieved

8. Is spouse employed -- place of employment -- address and business phone -- position -- nature of duties -- length of service

9. Estimated annual income from employment (Husband and Wife)

10. Estimated annual income from other sources: real estate -- dividends -- interest -- partnerships -- others

11. Does customer rent or own his own home -- equity

12. Estimated net worth (exclusive of family residence)

13. Estimated liquid net worth (cash, securities, other)

14. Insurance

15. Bank references -- average balance -- loan experience

16. Previous brokerage accounts -- firm -- type of account -- activity

17. Does customer currently have an account with firm (how long; type of account; activity)

18. Does customer currently maintain account(s) with other firm(s) (name of firm; type of account; activity)

19. Investment experience and knowledge (number of years, size and frequency of transactions) for options, stocks and bonds, commodities, other

20. If joint account, identity of other participants

In addition, the customer's account records must contain the following information:

a. Source or sources of background and financial information concerning the customer

b. Nature of transactions for which account is approved (unsolicited; recommended; discretionary)

c. Discretionary trading authorization
agreement on file
name, relationship to customer and experience of person holding trading authority

d. Date prospectus furnished to customer

e. Type of transaction for which account is approved (e.g., call buying, covered call writing, put writing)

f. Name of registered representative

g. Name of ROP approving account

h. Dates of verification of currency of account information

The member organization should consider utilizing a standard account approval form so as to ensure the receipt of all the required information.

.02 Refusal of a customer to provide any of the information called for in Items 1 through 20 of Interpretation .01 shall be so noted on the customer's records by the member organization personnel opening the account. Information provided shall be considered together with the other information available in determining whether and to what extent to approve the account for options transactions.

.03 The requirement of paragraph (c) of Rule ____ for the initial verification of customer background and financial information may be satisfied by sending to the customer such appropriate information as is contained in the member's records and providing the customer with an opportunity to correct or complete the information. The annual verification of the currency of customer background and financial information may be accomplished in the same manner as provided for initial verification. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified. Background and financial information with respect to existing options customers must be brought into substantial compliance with the requirements of this rule within two years of its effective date.

COMMENT:

The first element of recommendation I.A.1.a. calls for a standard options customer information form. In response, we have added a new Interpretation .01 to the "opening of accounts" rules of the SROs that lists the minimum information a member organization must seek to obtain before opening an options account. We have not required that all member organizations adopt a uniform options customer information form, since we believe it appropriate that firms should be permitted to develop their

own versions of information forms so long as the minimum information required by Interpretation .01 is included. However, we have been in discussion with representatives of the Securities Industry Association and the SIA expects to develop and make available contemporaneously with the effective date of this rule a standard options customer information form that would satisfy the content requirements of Interpretation .01.

The second element of the recommendation concerns record keeping requirements applicable to options customer information. This would be implemented by including in paragraph (b) of the "opening of accounts" rule a cross-reference to the record-keeping rule that states how options customer information should be maintained. (See I.A.1.d. below.)

Recommendations I.A.1.b. and c. are dealt with in new paragraph (c) to the "opening of accounts" rule. As recommended, this paragraph requires that every new options customer be sent for his verification the background and financial information reflected in his customer account information form within 15 days of the approval of his account for options transactions. In addition, this information must be verified at least annually by sending to the customer the appropriate background and financial information reflected in his customer account information form. We have required that the currency of this information be verified on an annual basis, rather than semi-annually, because we believe that annual verification is more appropriate for this type of information (e.g., annual income; net worth) and because the added costs of more frequent verification do not appear to be justified.

The rule does not require that a copy of the customer information itself be sent to the customer (although many firms may choose to do this), because a number of major firms maintain this information in a computerized data bank, and these firms would prefer to send the customer a computer-generated letter containing the information, rather than to have to duplicate many thousands of forms. (See Interpretation .03.) We have also included in Interpretation .03 a provision requiring firms to bring background and financial information with respect to existing options customers into substantial compliance with the requirements of the rule within two years of its effective date. The two-year period will enable firms to spread out the task of updating information as to large numbers of customers. The term "substantial compliance" is used so that firms whose existing customer information records contain most of the information required by this rule will not be required

to revise their records as to large numbers of existing customers in order to add one or two relatively minor items.

Proposed effective date: 60 days following Commission approval.

Options Study Recommendation I.A.1.d.

> The SROs should adopt recordkeeping 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 a readily accessible headquarters office location.

RESPONSE: INFORMATION OR SUPPLEMENTAL MATERIAL TO RULE CONCERNING MAINTENANCE OF RECORDS

Background and financial information of customers who have been approved for options transactions shall be maintained at both the branch office servicing the customer's account and the principal supervisory office having jurisdiction over that branch office. Monthly account statements of options customers or other records necessary to the proper supervision of accounts shall be maintained at a place easily accessible both to the branch office servicing the customer's account and to the principal supervisory office having jurisdiction over that branch office.

COMMENT:

These records presently must be maintained pursuant to SEC Rule 17a-4 as well as comparable SRO rules. In response to the recommendation that these records be maintained at an easily accessible place at both the branch sales office and at the firm's headquarters, we propose to add an interpretation to the general record keeping rule that would require background and financial information of customers approved for options transactions to be maintained both at the branch office and at the principal supervisory office having jurisdiction over the branch office. In addition, the interpretation would require that monthly account information or other records necessary to the proper supervision of accounts be maintained at a place "easily accessible to" both offices. We believe that this requirement is fully responsive to the concern of the Options Study that in some cases customer background and financial information has not been available to registered representa-

tives who give advice to their customers. We have not gone so far as to require that all information with respect to a customer be physically located both at the branch and at the headquarters office, since we do not believe that the costs of maintaining duplicate sets of records can be justified if the information can in some other way be "easily accessible" to both places. Of course, there is always the possibility the registered representatives will not utilize this information notwithstanding its accessibility, but this problem could just as likely arise if the information were physically located at the sales office. A better answer to the problem of non-utilization of the information is proper supervision, which is being strengthened in response to other recommendations of the Options Study. In place of the reference to "headquarters office," we have substituted the "principal supervisory office having jurisdiction over [the] branch office," reflecting the fact that certain large securities firms have decentralized supervision from the headquarters office to regional supervisory offices.

Proposed effective date: 60 days following Commission approval.

Options Study Recommendation I.A.1.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 broker-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.

RESPONSE: TO REPLACE SECOND PARAGRAPH OF CURRENT RULES CONCERNING SUITABILITY OF RECOMMENDATIONS

No member, Registered Options Principal or Registered Representative shall recommend to a customer an opening transaction in any option contract unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the option contract.

COMMENT:

At present, the suitability rules of all SROs contain a general suitability requirement applicable to all recommended options transactions, and also contain more stringent requirements (that the customer be able to evaluate the risks of the transaction and be financially able to bear them) that apply to certain kinds of options writing transactions or recommendations (see, e.g., AMEX Rule 923; CBOE Rule 9.9). As the Commission has recommended, our proposal would revise that portion of the SRO suitability rules that contains the more stringent requirements so that a broker-dealer would be prohibited from recommending any opening options transaction to a customer unless these requirements are met.

Proposed effective date: Upon Commission approval.

Options Study Recommendation I.A.1.f.

The SROs should adopt recordkeeping rules which require member firms which have branch offices to 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.

RESPONSE: MAINTENANCE OF BOOKS AND RECORDS

Every member organization conducting a non-member customer business shall maintain and keep current a separate central log, index or other file for all options-related complaints, through which these complaints can easily be identified and retrieved. The central file shall be located at the principal place of business of the member organization or such other principal office as shall be designated by the member organization. At a minimum, the central file shall include: (i) identification of complainant, (ii) date complaint was received, (iii) identification of Registered Representative servicing the account, (iv) a general description of the matter complained of, and (v) a record of what action, if any, has been taken by the member organization with respect to the complaint. The term "options-related complaint" shall mean any written statement by a customer or person acting on behalf of a customer alleging a grievance arising out of or in connection with listed options. Each options-related complaint received by a branch office of a member organization shall be forwarded to the office

in which the separate, central file is located not later than 30 days after receipt by the branch office. A copy of every options-related complaint shall be maintained at the branch office that is the subject of the complaint.

COMMENT:

This recommendation repeats the recommendation contained in Item I.A.1.d. above, and it makes a new recommendation concerning the need for brokerage firms to maintain copies of customer complaints at branch and headquarters offices. In response to the latter recommendation, we are proposing a new record-keeping rule drafted along the lines of the recently adopted Interpretation .01 to CBOE Rule 15.1 (which would be revised to conform to the uniform responses) that would require member firms to maintain a file of all options-related complaints containing specified information concerning each complaint. The file would be maintained at a single central location. Copies of the complaints themselves would also be forwarded to and maintained at that central location. In addition, a copy of every options-related complaint would be maintained at the branch office that is the subject of the complaint. We have not specified that the central file must be maintained at "headquarters" because this is not a meaningful concept for a number of securities firms. It should be sufficient that the complaints are all recorded in a central place, which will presumably relate to where supervision over the firm's options compliance activities is located.

Proposed effective date: 60 days following Commission approval.

Options Study Recommendation I.A.1.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 functions, direct or indirect, relating to options or otherwise.

RESPONSE: SUPERVISION OF ACCOUNTS

(a) Senior Registered Options Principal. Every member organization shall designate and specifically identify

to the SRO a Senior Registered Options Principal who is an officer (in the case of a corporation) or general partner (in the case of a partnership) of the member organization who shall supervise all of the organization's non-member customer accounts and all orders in such accounts, insofar as such accounts and orders relate to option contracts.

(b) Compliance Registered Options Principal. Member organizations shall designate and specifically identify to the SRO a Compliance Registered Options Principal (who may be the SROP) who shall have no sales functions and who shall be responsible to review and to propose appropriate action to secure the member organization's compliance with securities laws and regulations and SRO rules in respect of its options business. The requirement that the Compliance Registered Options Principal have no sales functions shall apply only to a member organization that has received more than $100,000 in gross commissions on options business as reflected in its FOCUS Report for the preceding fiscal year and has more than 50 Registered Options Representatives, and as to any such member organization, shall not apply if it demonstrates to the SRO compelling reasons why it should not have to comply with this requirement.

COMMENT:

In response to the recommendation that brokerage firms assign a senior ROP with no sales functions to supervise options compliance procedures, we propose to amend the existing "supervision of accounts" rules of the SROs (e.g., AMEX Rule 922, CBOE Rule 9.8), which assign such responsibility to the Senior Registered Options Principal. We propose to add a new paragraph (b) to the rule to require that brokerage firms specifically identify a Compliance Registered Options Principal having no sales functions who will be responsible to review the firm's compliance and to propose any appropriate remedial action. Final responsibility for supervision over all of the firm's options activities would remain with the SROP. This separation provides for audit of compliance by someone having no sales functions and yet recognizes that the leadership of most securities firms appropriately has and will continue to have sales functions in combination with supervisory responsibilities. In proposing this amendment, we have attempted to clarify the "compelling circumstances" exception suggested in the Commission's recommendation by providing objective standards relating to the amount of options business done by the firm, so that a firm that did a small amount of options business, and for which the designation of a non-

sales compliance ROP would represent a severe economic burden, would not be required to appoint a non-sales ROP to this position.

We propose to include in an educational circular a fuller description of the CROP's duties and we would also make clear in the circular that it is expected that the CROP will be reporting to senior management of the firm.

Proposed effective date: December 31, 1979.

Options Study Recommendation I.A.1.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.

RESPONSE: DISCIPLINARY ACTION BY OTHER ORGANIZATIONS

Every member shall promptly notify the SRO in writing of any disciplinary action, including the basis therefor, taken by any national securities exchange or association, clearing corporation, commodity futures market or government regulatory body against the member or its associated persons, and shall similarly notify the SRO of any disciplinary action taken by the member itself against any of its associated persons involving suspension, termination, the withholding of commissions or imposition of fines in excess of $2,500, or any other significant limitation on activities.

COMMENT:

Most SROs presently have rules on their books that satisfy both aspects of this recommendation, although member compliance with notification requirements has not always been strictly enforced. (See, e.g., recently adopted NYSE Rule 351 and CBOE Rule 4.9.) We propose the adoption by all SROs of a uniform rule that would be strictly enforced, and would require notification to the SRO of any disciplinary action taken by another SRO or by a government regulator, and would also require notification of internal disciplinary

action involving suspension, termination, monetary penalty in excess of $2,500 or imposition of any significant limitation on activities. The exclusion of minor internal disciplinary actions is deemed an essential element of a strict enforcement program, since otherwise SROs and member firms would be burdened with having to process an unmanageable volume of reports of minor infractions. We have determined that no amendment of existing SRO rules is necessary in response to the recommendation for retained jurisdiction over terminated employees, since all SROs except PHLX already have such a provision in their rules, and no difficulties of enforcement have arisen. PHLX intends to adopt such a rule promptly.

Proposed effective date: Upon Commission approval.

Options Study Recommendations I.A.1.i-j-k-l and I.A.3.a-b-c

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.

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.

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.

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.

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.

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.

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.

RESPONSE: COMMUNICATIONS TO CUSTOMERS

Rule (a) General Rule. No member organization or person associated with a member shall utilize any advertisement, sales literature or other communications to a customer or potential customer concerning options which:

(i) contains any untrue statement or omission of a material fact or is otherwise false or misleading;

(ii) contains promises of specific results, exaggerated or unwarranted claims, opinions for which there is no reasonable basis or forecasts of future events which are unwarranted or which are not clearly labeled as forecasts;

(iii) contains hedge clauses or disclaimers which are not easily identifiable, which attempt to disclaim responsibility for the content of such literature or for opinions expressed therein, or which are otherwise inconsistent with such advertisement or sales literature;

(iv) fails to meet general standards of good taste, judgment and truthfulness common to the securities industry; or

(v) would constitute a prospectus as that term is defined in the Securities Act of 1933, unless it meets the requirements of Section 10 of said Act.

(b) Approval by Compliance Registered Options Principal. All advertisements and sales literature (except completed worksheets) issued by a member or member organization pertaining to options shall be approved in advance by the Compliance Registered Options Principal or, in member organizations not having a Compliance Registered Options Principal, by the Senior Registered Options Principal. Copies thereof, together with the names of the persons who prepared the material and, in the case of sales literature, the source of any recommendations contained therein, shall be retained by the member or member organization and be kept at an easily accessible place for examination by the SRO for a period of three years.

(c) SRO Approval Required for Options Advertisements. In addition to the approval required by paragraph (b) of this Rule, every advertisement of a member or member organization pertaining to options shall be submitted to the Department of Sales Practice Compliance of the SRO at least ten days prior to use (or such shorter period as the Department may allow in particular instances) for approval and, if changed or expressly disapproved by the SRO, shall be withheld from circulation until any changes specified by the SRO have been made and further, in the event of disapproval, until the advertisement has been resubmitted for, and has received, SRO approval. The requirements of this paragraph shall not be applicable to:

(i) advertisements submitted to another self-regulatory organization having comparable standards pertaining to advertisements pursuant to an arrangement approved by the SRO; and

(ii) advertisements in which the only reference to options is contained in a listing of the services of a member organization.

(d) Except as otherwise provided in the Interpretations and Policies hereunder, no written materials respecting options may be disseminated to any person without prior or contemporaneous dissemination to such person of a current prospectus of the Options Clearing Corporation.

(e) Definitions. For purposes of this Rule, the following definitions shall apply:

(i) The term "advertisement" shall include any material that reaches a mass audience through public media such as newspapers, periodicals, magazines, radio, television, telephone recording, motion picture, audio or video device, billboards, signs, or through letters designed for customer mailing not required to be accompanied or preceded by a current prospectus of The Options Clearing Corporation.

(ii) The term "sales literature" shall include any written communication for distribution to customers, potential customers or the public (or which may be shown or made accessible to one or more customers or potential customers or to the public) that contains

any analysis, performance report, projection or recommendation with respect to options, underlying securities or market conditions, standard forms of worksheets, or any seminar text which pertains to options and which is communicated to customers, potential customers or the public at seminars, lectures or similar such events, or any SRO-produced materials pertaining to options.

...Interpretations and Policies

.01 The special risks attendant to options transactions and the complexities of certain options investment strategies shall be reflected in any advertisement or sales literature which purports to discuss the uses or advantages of options. In the preparation of communications respecting options, the following guidelines should be observed.

A. Any statement referring to the opportunities or advantages presented by options should be balanced by a statement of the corresponding risks. The risk statement should reflect the same degree of specificity as the statement of opportunities, and broad generalities should be avoided. Thus, a statement such as "with options, an investor has an opportunity to earn profits while limiting his risk of loss", should be balanced by a statement such as "of course, an options investor may lose the entire amount committed to options in a relatively short period of time."

B. It should not be suggested that options are suitable for most investors, or for small investors. Indeed, it is strongly suggested that there be included in all literature discussing the use of options a warning to the effect that options are not for everyone.

C. Statements suggesting the certain availability of a secondary market for options should not be made.

.02 Advertisements pertaining to options shall conform to the following standards:

A. Advertisements may only be used (and copies of the advertisements may be sent to persons who have not received a prospectus of The Options Clearing Corporation) if the material meets the requirements of Rule 134 under the Securities Act of 1933, as that Rule has been interpreted as applying to options. Under Rule 134, advertisements must be limited to general descriptions of the security being offered and of its issuer. Advertisements under

this Rule shall state the name and address of the person from whom a current prospectus of The Options Clearing Corporation may be obtained. Such advertisements may have the following characteristics:

(i) The text of the advertisement may contain a brief description of such options, including a statement that the issuer of every such option is The Options Clearing Corporation. The text may also contain a brief description of the general attributes and method of operation of the exchange or exchanges on which such options are traded and of The Options Clearing Corporation, including a discussion of how the price of an option is determined on the trading floor(s) of such exchange(s);

(ii) The advertisement may include any statement required by any state law or administrative authority;

(iii) Advertising designs and devices, including borders, scrolls, arrows, pointers, multiple and combined logos and unusual type spaces and lettering as well as attention getting headlines and photographs and other graphics may be used, provided such material is not misleading.

B. The use of performance figures, including annualized rates of return, is not permitted in any advertisement pertaining to options.

.03 Sales literature pertaining to options must be preceded or accompanied by a current prospectus of The Options Clearing Corporation and shall conform to the following standards:

A. Sales literature and other communications to customers may contain projected performance figures (including projected annualized rates of return) provided that:

(i) no suggestion of certainty of future performance is made;

(ii) parameters relating to such performance figures are clearly established (e.g., to indicate exercise price of option, purchase

price of the underlying stock and its market price, option premium, anticipated dividends, etc.);

(iii) commissions, material transaction costs and interest charges (if applicable with regard to margin transactions) are included and separately identified in all calculations; and such returns are plausible and are intended as a source of reference or a comparative device to be used in the development of a recommendation;

(iv) All material assumptions made in such calculations are clearly identified (e.g., "assume option expires", "assume option unexercised", "assume options exercised," etc.);

(v) The risks involved in the proposed transactions are also discussed;

(vi) In the case of an options program (i.e., an investment plan employing the systematic use of an options strategy), the cumulative history or unproven nature of the program is described; and

(vii) In the case of literature relating to annualized rates of return, that such returns are not calculated on any more than four (4) consecutive three-month option periods; any formulas used in making calculations are clearly displayed; and a statement is included to the effect that the annualized returns cited might be achieved only if the parameters described can be duplicated.

B. Sales literature may feature records and statistics which portray past performance of actual transactions, provided that:

(i) Such material includes the date of each initial transaction, the price(s) of such security at that date and at the end of the period when liquidation of the security position(s) was effected and the trend of the market during that period;

(ii) Any records or statistics must be confined to a specific "universe" that can be fully

isolated and described and that is applicable to the customer or customers receiving the material;

(iii) A Registered Options Principal determines that the records or statistics fairly present the status of the accounts or transactions reported upon and so initials the report; and

(iv) Such sales literature shall state that the results presented should not and cannot be viewed as an indicator of future performance.

C. All sales literature shall state that supporting documentation for any claims (including any claims made on behalf of options programs or the options expertise of sales persons), comparisons, recommendations, statistics or other technical data, will be supplied upon request.

D. Sales literature and other communications to customers that portray past performance of actual transactions or that project the potential risks and rewards of proposed transactions shall be kept at a place easily accessible to the sales office for the accounts or customers involved.

E. Standard forms of options worksheets utilized by member organizations, in addition to complying with the requirements applicable to sales literature, must be uniform within a member organization.

COMMENT:

For our response to these recommendations, we intend to build upon the proposed "Sales Communications" rule and the proposed publication Guidelines for Options Communications that each of the five exchanges currently trading options now has pending with the Commission.* We propose to add to the pending rules the particular details recommended by the Option Study. The new "Communications to Customers" rule would contain a general statement of principles of truthfulness and good taste applicable to all customer communications (paragraph (a)).

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* File Nos. SR-AMEX-78-21; SR-CBOE-78-26; SR-MSE-79-1; SR-PSE-79-2; SR-PHLX-78-21.

The proposed rule would require approval by the Compliance Registered Options Principal of all advertisements and sales literature issued by a member or member organization (paragraph (b)) (except for completed worksheets) and would require prior SRO approval of every advertisement (paragraph (c)). The proposed rule would require dissemination of an OCC prospectus (paragraph (d)); "advertisement" and "sales literature" would be defined terms (paragraph (e)).

Interpretation .01 under the proposed rule would give more specific disclosure requirements for advertisements and sales literature. Interpretation .02 would set minimum standards and certain other requirements for advertisements. Interpretation .03 would set minimum standards and certain other requirements for sales literature.

Specific Recommendations

I.A.1.i. (Disclosure re: calculation of annual rates of return)

The recommendation requires, whenever rates of return are calculated for disclosure to investors, that all relevant costs be included in the computation and, whenever annualized rates of return are used, that all material assumptions in the process of annualizing must be disclosed and that a written record of any rate of return quoted must be kept.

The proposed rule would prohibit the use of performance figures, including annualized rates of return, in advertisements. (See Interpretation .02.B.) The standards for the use of projected annualized rates of return in sales literature are set forth in Interpretation .03.A., especially subparagraphs (ii), (iii) and (iv). The record-keeping requirement of the recommendation is satisfied by the general requirement in paragraph (b) that sales literature be kept at an easily accessible place for examination by the SRO for a period of three years and by the more specific requirements of Interpretation .03.D. Material presenting an annualized rate of return is encompassed by the terms "sales literature" or "other communications to customers ... that project the potential risks and rewards of proposed transactions" and therefore must be kept at a place easily accessible to the sales office for the customers or accounts involved. This response satisfies the terms of the recommendation.

I.A.1.j. (Uniform options worksheets)

The recommendation requires the development of uniform standardized options worksheets which disclose

all relevant costs and which discuss the risks involved. The recommendation would also prohibit the use of anything other than the uniform format.

We decided to establish uniform minimum standards for option worksheets and in addition, to require that standard worksheets be uniform within a particular firm (e.g., a particular firm would have a single form of covered call writing worksheet for use throughout the firm). The standards for all worksheets are set forth in Interpretation .03.A. and fully satisfy the content requirements of the recommendation. The uniformity requirement is set forth in Interpretation .03.E. Where a firm prepares a standard form of worksheet, that form must be approved by the Compliance Registered Options Principal, by virtue of the form being included within the definition of "sales literature" (paragraph (e)(ii) of the rule). We are not requiring "uniform standardized worksheets" for use throughout the industry. We understand that different firms view the same strategy in different ways. Because of the difficulty and complexity of developing such worksheets and because it was felt that firms should be free to develop their own marketing efforts, subject only to adequate minimum standards, the proposed rule requires only that standard forms of worksheets be uniform within each firm.

I.A.1.k. (Retention of worksheets)

The recommendation specifies that all options worksheets used as the basis for any sales presentation be retained in a separate file in the sales office in which the customer has an account.

This requirement is satisfied by Interpretation .03.D. Completed worksheets are "other communications to customers" which "project the potential risks and rewards of proposed transactions." The concept of "an easily accessible place" has been used in place of the "in a separate file in the sales office" language of the recommendation. This change supplies the substance of the recommendation, but would also give firms flexibility in how they set up their record-keeping programs. In addition, the costs of maintaining a separate file in each local sales office could be avoided. (See Comment under I.A.1.d.)

I.A.1.l. (Review and retention of customer performance reports)

The recommendation requires that performance reports shown, given or sent to customers be initialed

by the local office supervisor to confirm the accuracy of such reports, and also requires that copies of such reports be maintained in a separate file at the local sales office.

The proposed rule is responsive to the substance of this recommendation. Performance reports are included within the definition of "sales literature" (see Interpretation .03.B.) and therefore must be approved by the CROP. The record-keeping requirement is supplied by paragraph (b) of the rule and Interpretation .03.D.

I.A.3.a. (Customer performance reports)

The recommendation would prohibit a registered representative from showing a performance report of one customer's options account to any other customer or potential customer unless composite figures showing all that registered representative's accounts are shown.

The proposed rule contains standards for performance reports, i.e., reports which portray past performance of the actual transactions. (See Interpretation .03.B.) The concept of confining reports to a specifically identifiable "universe" (see subparagraph (ii) of Interpretation .03.B) is responsive to the concern behind the recommendation that use of selected results be avoided. In addition, the performance reports must be "applicable" to the customer, i.e., the report must be descriptive of a work product, service, individual or account to which the customer will have access.

I.A.3.b. (Evidence of claims of performance or expertise)

The recommendation would require member firms to make available for public inspection unequivocal and comprehensive evidence to support claims made on behalf of options programs or the options expertise of salespersons.

The proposed rule contains language on this point from the earlier version of the rule (See Interpretation .03.C.) and more specific language from the recommendation.

I.A.3.c. (Seminar disclosure)

The recommendation would require that (1) any financial interest of a seminar lecturer in attracting new customers be disclosed, (2) that the cumulative experience of an option program be disclosed, together with a warning that past results are no measure of future performance, and (3) that, if an options program is too new to have a history, the untried nature of the program be described.

The proposed rule (including the publication Guidelines for Options Communications) would be fully responsive to this recommendation. Points (2) and (3) are included in the minimum standards for performance reports set forth in Interpretation .03.A. and B. Point (1) would be covered by a revised paragraph on "Seminars" in the Guidelines.

Proposed effective date: Upon Commission approval.

Options Study Recommendation I.A.1.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 their customer accounts.

RESPONSE: ALLOCATION OF EXERCISE NOTICES

Each member organization shall establish fixed procedures for the allocation of exercise notices assigned in respect of a short position in such member organization's customers' account. The allocation shall be made on a "first-in, first-out" basis or on a random selection basis that has been approved by the SRO. Each member organization shall inform its customers in writing of the method it uses to allocate exercise notices to its customers' accounts, explaining its manner of operation and the consequences of that system.

COMMENT:

We have departed somewhat from the Option Study's recommendation that all allocations of exercise notices be made pursuant to a uniform method of random allocation. We agree that all firms that choose in the future to allocate exercise notices randomly should do so in accordance with a uniform method of allocation (essentially in order to simplify the job of auditing the method used to assure that it is, in fact, random), and we anticipate that the SROs will adopt a single automated and a single manual random method of allocation--basically the ones recommended by AMEX and the NASD, respectively--for use by all firms that choose to use a random method. Those existing random methods that differ from the methods adopted by the SROs will be subject to SRO review and approval. We also do not believe that there is anything inherently unfair or inequitable about FIFO per se, or that there are valid regulatory reasons for precluding the allocation of exercise notices on a FIFO basis, so long as the potential abuses

identified by the Options Study are not permitted. Under the proposed rule, any FIFO method used would have to be approved by an SRO, and no such method would be approved unless it was determined to be fair and equitable to customers. In addition, we believe that a firm should inform its customers of the method of allocation it uses, and we have included a requirement to this effect in the rule. We expect to describe in our educational circular the features of an appropriate FIFO plan.

Proposed effective date: 60 days following Commission approval.

Options Study Recommendation I.A.1.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.

RESPONSE: ALLOCATION OF EXERCISE ASSIGNMENT NOTICES

Each member organization shall preserve for a three-year period sufficient work papers and other documentary materials relating to the allocation of exercise assignment notices to establish the manner in which allocation of such exercise notices is in fact being accomplished.

COMMENT:

We propose adopting a uniform requirement that documentation relating to exercise allocation be preserved for at least three years. This is the retention period prescribed for various documents under SEC Rule 17a-4(b), and should be more than adequate to serve the purpose of auditing compliance with required methods of exercise allocation. Such records would include the record of OCC assignment, a stock record and, in the case of random, a computer-generated or other random number and in the case of FIFO, copies of customer statements showing when positions were established.

Proposed effective date: Upon Commission approval.

Options Study Recommendation I.A.1.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.

RESPONSE: REPORTS OF ACCOUNTS

In a manner prescribed by the SRO, each Market-Maker shall file with the SRO and keep current a list identifying all accounts for stock, option, and related securities trading in which the Market-Maker has an interest or may engage in trading activities or over which he exercises investment discretion. No Market-Maker shall engage in stock, option, or related securities trading in an account which has not been reported pursuant to this Rule _____.

COMMENT:

This proposed rule virtually mirrors the recommendation of the Options Study, except that in addition to requiring that stock and option accounts be reported by market makers, we have included a requirement that accounts in which related securities (e.g., convertibles, warrants, etc.) are carried also be reported. We have also included accounts over which a market maker exercises investment discretion among those required to be reported.

Proposed effective date: Upon Commission approval.

Options Study Recommendation I.A.1.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.

RESPONSE: REPORTS OF UNDERLYING SECURITY ORDERS AND POSITIONS

In a manner prescribed by the SRO, each Market-Maker shall, on the business day following order

entry date, report to the SRO every order entered by the Market-Maker for the purchase or sale of a security underlying options traded on the SRO or a security convertible into or exchangeable for such underlying security as well as opening and closing positions in all such securities held in each account reported pursuant to Rule [Response to I.A.1.o.] . The report pertaining to orders must include the terms of each order, identification of the brokerage firms through which the orders were entered, the times of entry or cancellation, the times reports of executions were received and, if all or part of the order was executed, the quantity and execution price.

COMMENT:

We have proposed a uniform rule that includes all of the elements of the Commission's recommendation, not only with respect to stocks underlying options traded in a particular SRO's market, but also with respect to securities convertible into or exchangeable for such underlying stocks.

Proposed effective date: 60 days following Commission approval.

Options Study Recommendation I.A.2.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.

RESPONSE: REGISTRATION OF OPTIONS PRINCIPALS

No branch office of a member organization shall transact options business with the public unless the principal supervisor of such branch office accepting options transactions has been qualified as a Registered Options Principal, except that this requirement shall not apply to branch offices in which not more than three Registered Representatives are located, provided that the member organization can demonstrate that the options activities of these branch offices are appropriately supervised by a Registered Options Principal.

COMMENT:

We propose adopting a uniform rule requiring that the principal supervisor of every branch office that transacts options business must be qualified as a Registered

Options Principal except that, in order to avoid unwarranted burdens on firms having small sub-branch or satellite offices, this requirement will not apply to offices in which not more than three registered representatives are located. However, even as to those small offices, the firm will have to demonstrate appropriate supervision by a ROP of the options activities of such offices.

Proposed effective date: December 31, 1979

Options Study Recommendations I.A.2.c. and d.

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.

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 SROP make and maintain a record of the basis for each determination.

RESPONSE: DISCRETIONARY ACCOUNTS

(a) Authorization and Approval Required. No member organziation shall exercise any discretionary power with respect to trading in options contracts in a customer's account unless such customer has given prior written authorization and the account has been accepted in writing by a Registered Options Principal. The Senior Registered Options Principal shall review the acceptance of each discretionary account to determine that the Registered Options Principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed, and he shall maintain a record of the basis for his determination. Each discretionary order shall be approved and initialled on the day entered by the branch office manager or other Registered Options Principal, provided that if the branch office manager is not a Registered Options Principal, his approval shall be confirmed within a reasonable

time by a Registered Options Principal. Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review.

(b) Options Programs. Where the discretionary account involves the systematic use of one or more options strategies, the customer shall be furnished with a written explanation meeting the requirements of Rule [pertaining to sales literature] of the nature and risks of such strategies.

COMMENT:

Recommendation I.A.2.c. calls for the furnishing of a written description pertaining to "the program and strategies" employed in discretionary accounts. The Report of the Options Study observed that special problems were found where customers "entrusted funds to registered representatives to be managed on a discretionary basis according to the terms of options 'programs' which entailed speculative or risky options strategies." [Ch. V, p. 183] Presumably, the fact that the perceived problems centered on options "programs" was also relevant to the nature of the solution, since the preparation of written explanations is practical insofar as standardized programs are concerned, but would not work for discretionary accounts that are not handled on any systematic basis. For this reason, we have drafted our rule to require a written explanation where the discretionary account involves the "systematic use of one or more options strategies." Although this may be somewhat broader than the "programs" referred to by the Options Study (which may not have been intended to go beyond "managed" options accounts), we think that firms should be required to describe to their customers any strategies that are systematically employed in discretionary accounts. All such descriptive material would be required to meet the "sales literature" minimum standards of the proposed "Communications to Customers" rule.

We do not believe that it is possible to comply literally with recommendation I.A.2.d., namely, that the SROP of each brokerage firm must make a personal determination that every discretionary customer understands and can bear the risks of the options program or strategies, for a number of reasons: First, if by "personal determination" it is intended that the SROP be in direct contact with every discretionary customer, this is obviously impossible in a firm of any size. Second, the most that can be required is for the SROP to review the account to determine that

the ROP who approved the account had a reasonable basis for believing that the customer had the necessary understanding of and ability to bear the risks. There is no way, short of giving every customer some kind of test, to "determine" that he, in fact, understands the risks of options trading, and even then it would be impossible to make a similar determination as to the customer's ability to bear the risk. Therefore, we are proposing that the SROP review the acceptance of each discretionary account to determine whether the ROP accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the proposed strategies or transactions. Under existing rules, a ROP must personally accept every discretionary account, and the added step of a SROP's review of the ROP's acceptance would seem to provide the kind of supervisory audit that the Options Study found to be missing. As recommended, we propose to require the SROP to make a record of his review.

Proposed effective date: December 31, 1979.

NOTICE TO MEMBERS: 79-21
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 20, 1979

IMPORTANT

TO: All NASD Members
Attention: All Operations Personnel

RE: Securities and Exchange Commission Approves Amendments to Rule 17f-1 and the Lost and Stolen Securities Program

The Securities and Exchange Commission has adopted a number of amendments to Rule 17f-1 and its Lost and Stolen Securities Program (the "Program") which will become effective on July 1, 1979. In Securities Exchange Act Release No. 15867, dated May 23, 1979, the SEC announced the details of those changes. One such change requires that certain participants reregister in the Program by July 15, 1979. A discussion of the significant aspects of these amendments follows.

- All reporting institutions including brokers, dealers and municipal securities dealers will be required by rule to be registered with Securities Information Center, Inc. (SIC), the Commission's designee to operate the Program. Exempt from this requirement are (a) brokers and dealers engaged solely in the sale of variable contracts or limited partnerships, and (b) floor brokers and specialists of a national securities exchange who do not conduct a public business but effect transactions only for their own account or those of other members.

- Reporting institutions presently registered with SIC as direct inquirers will be required to submit a new completed registration form to SIC by no later than July 15, 1979. Indirect inquirers are not required to reregister unless they desire to amend their prior registration form and/or reregister as a direct inquirer.

- Corporate and municipal securities not assigned CUSIP numbers, and bond coupons will be permanently exempt from required reporting and inquiry.

- The data base of information maintained by the Federal Reserve System has been assimilated into SIC's data base. All inquiries concerning U.S. Government or Agency securities should henceforth be directed only to SIC.

- Reports and inquiries involving the identification of securities where the alphabetical prefixes and/or suffixes of certificate numbers are missing will be processed in the normal manner. However, in cases where prefixes or suffixes are missing, reporting institutions are advised that occasionally a report and inquiry will result in an erroneous match because some certificates with the same numbers will have different alpha designations.

- Transfer agents have been permanently exempted from the inquiry provisions of the Lost and Stolen Securities Program.

- Permanently exempted from required inquiry are securities transactions of $10,000 or less market value in the case of stocks, and par or face value in the case of bonds.

- Permanently exempted from required inquiry are bearer securities which a reporting institution takes into possession from a customer to whom the securities were originally sold or delivered.

- Permanently exempted from required inquiry are securities received from an institution which is affiliated with a reporting institution and acts as a "certificate drop" or from a Federal Reserve Bank or Branch in any capacity.

- All reporting institutions are required to maintain and preserve copies of agreements which designate one institution as the direct inquirer for another, and all confirmations and other information received as a result of the reporting and inquiry requirements of Rule 17f-1.

* * *

The various items discussed above represent some of the more important changes brought about by the Commission's action with respect to its Lost and Stolen Securities Program. These changes including those regarding the recordkeeping provisions of Rule 17a-3 will become effective on July 1, 1979.

Reregistration Required by July 15, 1979

Please note that all reporting institutions which are presently registered as a direct inquirer must reregister with SIC by no later than July 15, 1979. A copy of the SIC Registration Form is attached and should promptly be completed and sent to SIC. Reporting institutions which elect to change their status from direct to indirect inquirer after July 15, 1979, will have the opportunity to do so on a semi-annual basis.

* * * *

Should you have any questions concerning this matter, please contact Jack Rosenfield, Assistant Director, Department of Regulatory Policy and Procedures, NASD, 1735 K Street, N. W., Washington, D. C., 20006, telephone (202) 833-4828.

Sincerely,

Gordon S. Macklin
President

Attachment

SIC REGISTRATION FORM

LOST AND STOLEN SECURITIES PROGRAM

Return This Form To:

Securities Information Center, Inc.
Post Office Box 421
Wellesley Hills, Massachusetts 02181

Deadline for Filing this Form is July 15, 1979
(A photocopy of the completed form
should be retained for your records)

SIC Registration Form
Lost and Stolen Securities Program

Instructions

COMPLETION AND FILING OF THE FORM - All institutions completing and filing this form should fill in Part I and Part IV and either Part II or Part III of the form. Completed forms should be returned to:

Securities Information Center, Inc.
Post Office Box 421
Wellesley Hills, Massachusetts 02181

The deadline for filing this form is July 15, 1979.

WHO SHOULD USE THIS FORM - This form should be completed and filed by all institutions subject to Rule 17f-1 (17 CFR §240.17f-1) 1/ which are not exempt from the registration provisions of the rule 2/ and

(1) Who have NOT submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc., OR
(2) Who have submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc. and registered as a DIRECT INQUIRER, OR
(3) Who have submitted a registration form for the Lost and Stolen Securities Program to Securities Information Center, Inc., and registered as an INDIRECT INQUIRER AND desire to amend their prior registration form to either update the information submitted OR change their inquiry participation status.

1/ The institutions subject to Rule 17f-1 are as follows: 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/ Brokers and dealers whose only business is conducted on a national securities exchange and who do not conduct a public business, and brokers and dealers who limit their business to sales of variable contracts or limited partnership, are exempt from the registration provisions of Rule 17f-1.

WHO SHOULD NOT USE THIS FORM - Institutions should NOT complete or file this form if they have previously registered as an INDIRECT INQUIRER in the Lost and Stolen Securities Program by submission of a registration form to Securities Information Center, Inc. AND the data submitted thereon is current AND they do not desire to change their inquiry participation status. If an institution does not submit this form, the prior election of inquiry participation status will continue and be binding until cancelled by the institution.

PART I

A. Name of Institution _____

Mailing Address _____

_____

Zip Code _____

FINS Identification No. 3/ __ __ __ __ __ __

Name, Title, and Telephone Of Person to Whom Bills Should Be Directed: _____

( ) _____

Name, Title and Telephone of Person Responsible for Institution's Compliance with Rule 17f-1 (if different from above): _____

( ) _____

3/ FINS ("Financial Industry Number Standard") numbers are compiled in the 1976 FINS Directory (First Edition), published by the Depository Trust Company. If an institution is uncertain as to whether it has a FINS number, it should consult this Directory, its self-regulatory organization, its trade association, or SEC personnel at 202-376-8129. If an institution has not been assigned a FINS number, a number may be obtained at no cost by writing the Depository Trust Company, Attention: FINS Publication, 55 Water Street, New York, New York 10041.

B. Type of Institution - Check all classifications listed below that describe the institution. 4/

( ) 1. Federal Reserve System member.
( ) 2. Bank whose deposits are insured by the Federal Deposit Insurance Corporation.
( ) 3. National Securities Exchange.
( ) 4. National Securities Exchange member.
( ) 5. National Securities Exchange member firm.
( ) 6. Registered Securities Association.
( ) 7. Registered Securities Association member.
( ) 8. Securities broker.
( ) 9. Securities dealer.
( ) 10. Municipal securities dealer.
( ) 11. Registered transfer agent.
( ) 12. Registered clearing agency.
( ) 13. Participant in a registered clearing agency.

C. Size of Institution - Check the line below that describes the size of the institution.

1. Banks (those who checked lines 1 or 2 of B, above)

( ) More than $1 billion in deposits
( ) $500 million to $1 billion in deposits
( ) Less than $500 million in deposits

2. Securities Organizations (those who checked lines 3 through 10 of B, above)

( ) More than $25 million in annual revenues
( ) $5 million to $25 million in annual revenues
( ) $500,000 to $5 million in annual revenues
( ) Less than $500,000 in annual revenues

3. Non-Bank Transfer Agents (those who checked only classification 11 of B, above)

( ) That issued 100,000 shares or more last year
( ) That issued less than 100,000 shares last year

4/ If no classification describes the institution, the institution is not subject to Rule 17f-1. If the institution desires to participate in the Lost and Stolen Securities Program as a "permissive inquirer," a special application must be made to the Commission pursuant to paragraph (e) of Rule 17f-1 in accordance with the instructions given in Securities Exchange Act Release No. 13832 at 42 FR 41024 (August 12, 1977).

PARTS II & III

Election of Inquiry Participation Status

To register as a DIRECT INQUIRER, complete Part II below. To register as an INDIRECT INQUIRER, complete Part III below. This election of inquiry participation status is binding until cancelled.

Direct inquirers will be able to make inquiries of the data base directly and will be charged usage fees and registration fees as described in the Appendix of Securities Exchange Act Release No. 15289. Indirect inquirers will NOT be able to make inquiries directly and so must make arrangements with a registered direct inquirer to inquire on its behalf. Indirect inquirers will NOT be charged any fees by Securities Information Center, Inc. but should be aware that the institution making inquiries on their behalf may assess costs and service charges. (Indirect inquirers, however, should make reports of loss directly).

PART II

DIRECT INQUIRER

To register as a direct inquirer, please complete (A), (B), and (C) below.

A. Registration of Access Stations - Indicate the number of primary and secondary access stations the institution will use to make inquiries of the system. 5/ All institutions must have at least one primary access station. There is an annual registration fee of $20.00 for each primary access station and $10.00 for each secondary access station. 6/

NUMBER OF PRIMARY ACCESS STATIONS-----_____
NUMBER OF SECONDARY ACCESS STATIONS---_____

5/ Access stations are described in the "Description of the System" included in Securities Exchange Act Release No. 15289.

6/ Institutions establishing secondary access stations should append to this form a list of the titles, addresses, and names of the responsible individual for each secondary access station.

B. Optional Prompt Written Confirmation Service - Indicate whether the institution desires prompt written confirmation service. If an institution desires this service, the Securities Information Center, Inc. will send the institution written confirmations of all inquiries and reports received by telephone, telex, and mail on a daily basis. If an institution does not desire this service, confirmations of inquiries will be sent on a monthly basis. There is a $20.00 per quarter charge for each primary access station using this service.

( ) We do NOT desire prompt written confirmation service.
( ) We do desire prompt written confirmation service and agree to pay the fee for this service.

C. Agreement to Pay Fees - After reading the statement below, please sign in the space provided.

Beginning July 1, 1979 we will participate in the Lost and Stolen Securities Program as a direct inquirer. We agree to pay Securities Information Center, Inc. the annual registration fee of $20.00 for each primary access station and $10.00 for each Secondary Access Station. We also agree to pay in advance quarterly usage fees, charges for optional services we request, and all sales, use and excise taxes, or other taxes, which may be levied on or in connection with, the furnishing of the facilities or services of the Securities Information Center, Inc. We understand that all fees are due and payable within ten days of date of invoicing.

_____
(Signature of Authorized Institutional Representative)

_____
(Type or Print) (TITLE)

PART III
INDIRECT INQUIRER

To register as an indirect inquirer, please complete the statement below and sign in the space provided.

Beginning July 1, 1979 we will participate in the Lost and Stolen Securities Program as an indirect inquirer. We have entered into an agreement with _____
who will (Name of Registered Direct Inquirer)

make inquiries on our behalf and we have a copy of this agreement on file available for inspection. We are aware that we will receive no direct confirmations from Securities Information Center, Inc., and that the institution that makes inquiries for us may pass through to us the costs of using the system on our behalf as well as additional service charges.

_____

(Signature of Authorized Institutional Representative)

_____

(Type or Print) (TITLE)

PART IV

ALL institutions filing this form must complete (A) and (B) below.

A. Agreement - After reading the statement below, please sign in the space provided.

We understand that our participation in the Lost and Stolen Securities Program is required by Rule 17f-1 (17 CFR §240.17f-1) under the Securities Exchange Act of 1934, as amended. We agree that we will make reports of missing, lost, counterfeit and stolen securities and make inquiries relative thereto, in accordance with Rule 17f-1 and instructions of the Commission or its designee.

We understand that the Securities Exchange Commission has designated Securities Information Center, Inc. to operate the Lost, Missing, Stolen, and Counterfeit Securities Information System. Securities Information Center, Inc. will perform its work in a businesslike manner and in accordance with reasonable standards of care. It does not, however, guarantee the accuracy of any information contained in the records of the System or of the responses to inquiries concerning missing, lost, counterfeit, and stolen securities furnished by it. Securities Information Center, Inc. shall not be liable for any unintentional delays, inaccuracies, errors or omissions in said responses, or for any damages arising therefrom or occasioned thereby, nor

will it be liable for non-performance or interruption of services due to fire, storms, strikes, labor disputes or any causes beyond its control or due to the act or omission of any other person, firm or corporation.

_____
(Signature of Authorized Institutional Representative)

_____
(Type or Print) (TITLE)

B. Names and Signatures of Persons Making Reports on Behalf of the Institution - All reports of missing, lost, counterfeit or stolen securities and all reports of recoveries must be submitted on Form X-17F-1A and signed by an individual whose signature is on file with Securities Information Center, Inc. All individuals having this authority should fill in the spaces below (attach additional pages on institution letterhead if necessary).

_____	_____
(Signature and Date)	(Signature and Date)
_____	_____
(Print or Type) (TITLE)	(Print or Type) (TITLE)

MAIL THIS FORM TO:

Securities Information Center, Inc.
Post Office Box 421
Wellesley Hills, Massachusetts 02181

DEADLINE FOR FILING IS JULY 15, 1979

NOTICE TO MEMBERS: 79-22
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 26, 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 Wednesday, July 4, 1979, in observance of Independence Day. "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	
June	27	July	5	July	9
	28		6		10
	29		9		11
July	2		10		12
	3		11		13
	4	Independence Day			----
	5		12		16

The above settlement dates should be used by brokers, dealers and municipal securities dealers for purposes of clearing and

*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."

settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

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) 422-8844.

Sincerely,

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

NOTICE TO MEMBERS: 79-23
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 17, 1979

IMPORTANT NOTICE
MISSING SECURITIES

TO: All NASD Members and Municipal Securities Bank Dealers

Recently, the U.S. Trust Company of New York, 45 Wall Street, New York, New York, 10005, reported to the Association that the following securities were missing:

The Municipal Assistance Corporation for the City of New York, Series FF, 7-1/2%, due February 1, 1986:

Certificate No.	Denomination	Issue Date
FFR1/FFR2	$10,000,000	8/1/77
FFR3/FFR4	$ 1,000,000	8/1/77
FFR5	$ 100,000	8/1/77
FFR6	$ 15,000	8/1/77

The Municipal Assistance Corporation for the City of New York, Series 9, 7-1/2%, due July 1, 1992:

Certificate No.	Denomination	Issue Date
9R1	$100,000,000	9/1/77
9R2/9R4	$ 10,000,000	9/1/77
9R5/9R16	$ 1,000,000	9/1/77
9R17	$ 750,000	9/1/77
9R18/9R27	$ 100,000	9/1/77

The Municipal Assistance Corporation for the City of New York, Series HH, 7-1/2%, due February 1, 1995:

Certificate No.	Denomination	Issue Date
HHR1/HHR2	$100,000,000	8/1/77
HHR3/HHR5	$ 10,000,000	8/1/77
HHR6/HHR7	$ 1,000,000	8/1/77
HHR8	$ 15,000	8/1/77

Each of the foregoing certificates is registered in the name of PENY & Co., c/o U.S. Trust Company of New York, 45 Wall Street, New York, New York. If anyone comes into possession of any of the above cited certificates or receives information in regard to this matter, kindly call collect Mr. Frederick Drexler, Vice President and Auditor, U.S. Trust Company of New York, at (212) 425-4500 (extension 1404).

Please distribute this Notice to appropriate staff personnel in your organization. This Notice may be duplicated in quantities to satisfy your needs.

Sincerely,

Gordon S. Macklin
President

Notice to Members 79-24

(Notices to Members should be retained for future reference)

lim

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 20, 1979

MAIL VOTE

Officers * Partners * Proprietors

TO: Members of the National Association of Securities Dealers, Inc.

RE: Mail Vote on Proposed Amendments to Article III, Section 37 of the Rules of Fair Practice

Last voting date is August 20, 1979

Enclosed herewith are proposed amendments to Section 37 of Article III of the Association's Rules of Fair Practice. Section 37, which was approved by the membership in late 1978 and subsequently filed with the Securities and Exchange Commission for approval, makes several changes to the Association's filing requirements and review procedures concerning member advertising and sales literature, and codifies and consolidates various interpretations and policies of the Board of Governors. The proposals which are the subject of this notice would result in further changes to the advertising and sales literature review program of the Association. All of these new proposed changes are related to filing requirements and spot-check procedures. The primary purposes of the proposals are to liberalize the filing requirement applicable to investment company-related advertising and sales literature and to clarify the application of certain filing requirements and spot-check procedures to advertising and sales literature concerning municipal securities.

The primary authority for the proposed amendments is Section 15A(b)(6) of the Securities Exchange Act of 1934, as amended (15 U.S.C. §78o-3(b)(6)) and Article VII of the Association's Bylaws.

Explanation of Proposed Amendments

Subsection C.(1) of Section 37, as filed with the Commission, would continue the existing filing requirement applicable to members' advertising and sales literature concerning

investment companies (¶5002 NASD Manual). It is now proposed that the requirement to file advertising and sales literature with the Association within three business days be amended to extend the filing period to ten calendar days. It is also proposed that independent dealers be exempted from this requirement and that a routine spot-check procedure be applied to such dealers in place of the filing requirement. The filing requirement would then apply only to principal underwriters and it would be consistent with current Securities and Exchange Commission requirements under Section 24(b) of the Investment Company Act.

With respect to municipal securities, the Securities Acts Amendments of 1975 designated the Association as the appropriate organization to conduct periodic examinations of the municipal securities activities of its members.(1) Among other things, Section 37 contains two surveillance mechanisms to be used by the Association with respect to members' advertising and sales literature, including material concerning municipal securities. The relevant provisions are subsection C.(3), which would establish a requirement that members file advertising material with the Association in advance for one year,(2) and subsection C.(5), which outlines the procedure to be used by the Association to periodically spot-check members' advertising and sales literature.(3) Both of these subsections contain exemptive provisions relating to the optional submission of material to registered securities exchanges having comparable standards. As currently written, these provisions do not mention municipal securities and amendments are therefore being proposed to clarify that the exemptive provisions do not relate to municipal securities.

Also, a new provision is proposed which would exclude certain advertising concerning investment companies or options from the filing requirements of subsections C.(1) and C.(2) of Section 37. Often members' advertising constitutes a simple listing of products or services offered. Currently, the inclusion of mutual funds, variable annuities, or options in such listings results in the application of a filing requirement. When such advertisements do not contain descriptions or explanations of these products and are

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(1) See Section 15B(b)(7)(A) of the Securities Exchange Act of 1934, as amended.

(2) Members who had previously filed for one year prior to the effective date of the rule wouldn't be subject to this requirement.

(3) Municipal securities material received pursuant to these requirements is not reviewed for compliance with Section 37, but for compliance with applicable federal securities laws and rules of the Municipal Securities Rulemaking Board.

limited to simple listings, it does not seem necessary to impose filing requirements with respect to such advertising. It is therefore proposed to add a new subsection C.(7) to exclude such advertisements from the filing requirements applicable to investment company and options advertising. The routine spot-check procedure would then be applied to such advertising.

The Board of Governors believes the proposed amendments to be appropriate and recommends that members vote their approval. Please mark the ballot according to your convictions and return it in the enclosed stamped envelope to "The Corporation Trust Company." Ballots must be postmarked no later than August 20, 1979.

Very truly yours,

David P. Parina

David P. Parina
Secretary

Text of Proposed Amendments to Article III
Section 37 of Rules of Fair Practice

(Deleted material in brackets, new material underlined)

C. Filing Requirements and Review Procedures

(1) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts), shall be filed with the Association's Advertising Department [by any member preparing it, or who has such material prepared,] within [three business days] 10 days of first use or publication, by any member who has prepared or distributed such material in connection with the offer or sale of securities issued by companies for which such member is a principal underwriter. [Dealers need not file material prepared and filed by sponsors or underwriters unless a change in content or format is contemplated.] Filing [of such material] in advance of use [is permitted and encouraged but is not required] is optional.

(3)(c) Except for advertisements related to municipal securities, direct participation programs or [to] investment company securities, members subject to the requirements of subsection (a) or (b) above may, in lieu of filing with the Association, file advertisements on the same basis, and for the same time periods specified in those subsections, with any registered securities exchange having standards comparable to those contained in this Section 37.

(5) In addition to the foregoing requirements, every member's advertising and sales literature shall be subject to a routine spot-check procedure. Upon written request from the Association's Advertising Department, each member shall promptly submit the material requested. Members will not be required to submit material under this procedure which has been previously submitted pursuant to one of the foregoing requirements and, except for material related to municipal securities or investment company securities, the procedure will not be applied to members who have been, within the preceding calendar year, subjected to a spot-check by a registered securities exchange or other self-regulatory organization utilizing comparable procedures.

(7) Material which refers to investment company securities or options solely as part of a listing of products and/or services offered by the member, is excluded from the requirements of subsections C.(1) and C.(2).

NOTICE TO MEMBERS: 79-25
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 24, 1979

IMPORTANT

TO: All NASD Members and Interested Persons

Re: Adoption of Amendments to the Annual Review of Coverage Section of the Fidelity Bonding Rule (Paragraph (c) of Appendix C to Article III, Section 32 of the Rules of Fair Practice)

The Securities and Exchange Commission has approved the enclosed amendments to paragraph (c) of Appendix C to Article III of the Rules of Fair Practice. The amendments were recommended by the Fidelity Bonding Committee and approved by the Board of Governors in 1978 after being submitted for comment to the membership, in accordance with paragraph (b) of the rule.

Purpose of the Amendments

The amendments provide relief to certain members in their second year in business. Such members were required to maintain fidelity bonding coverage approximately double that required of members, similarly situated, in their third and subsequent years in business. This anomalous situation arose following changes in the net capital rule after the bonding rule was promulgated in 1973.

In addition, the amendments extend, from 30 to 60 days following the anniversary date of a bond, the time available during which members must make any required adjustment in the amount of their bonding coverage.

Explanation of the Amendments

(1) Paragraph (c) of Appendix C requires a member to review its bonding coverage on the anniversary date of its bond, and, if necessary, adjust its coverage to equal at least 120% of the highest required net capital it experienced during the preceding twelve months.

When the maximum aggregate indebtedness/net capital ratio was 20/1, all members were treated equally. But when the maximum ratios were changed to 8/1 in a member's first year and 15/1

in subsequent years, the terms of the bonding rule caused some members in their second year to maintain almost twice as much bonding coverage as members, similarly situated, were required to maintain in their third and subsequent years.

To illustrate: assume a member commences business with required minimum net capital of $25,000. The minimum fidelity bond it would be required to maintain in its first year would be $30,000. Assume that its highest aggregate indebtedness during its first year was $1,200,000. At that point in time it would have been required to have minimum net capital of $150,000 ($1,200,000 ÷ 8). At the end of its first year it would be required to increase its bonding coverage to $180,000 (120% x $150,000). A member in similar circumstances in its third and subsequent years would use the 15/1 ratio and its minimum required bond coverage would be only $96,000 ($1,200,000 ÷ 15 x 120%).

The amendment corrects this situation.

(2) Increasing the time available for adjusting bond coverage from 30 to 60 days after the bond anniversary date recognizes the current difficulties some members are experiencing in renewing bond coverage and provides more time to obtain competitive quotations.

Detailed Explanation of Rule Changes

1. The first sentence in present paragraph (c) is deleted because it was appropriate only during the initial implementation of Section 32 in 1974.

2. New paragraph (c)(1) describes the basic procedure to be used by members in business for two years or more to calculate required minimum bonding coverage for an ensuing year.

3. New paragraph (c)(2) allows a member, which has been in business for one year, to use a 15/1 rather than an 8/1 ratio of the highest aggregate indebtedness it experienced during its first year when calculating the minimum bonding coverage it must carry in its second year.

4. The last sentence of present paragraph (c) is renumbered subparagraph 3 and is amended to allow 60 days rather than 30 days as the maximum time period allowed for making required adjustments in bonding coverage.

The amendments are effective immediately.

Averaging Provisions Not Approved

In 1978 the Association also submitted to the Securities and Exchange Commission a further amendment to the fidelity bonding

rule. This amendment would have based fidelity bonding coverage on an average of net capital during the 12 months preceding a bond's anniversary date rather than the highest required net capital. The Securities and Exchange Commission staff has advised the Association that it will defer action indefinitely on the averaging proposal pending completion of a comprehensive review of fidelity bonding which it intends to conduct. Hence, although the proposal has not been rejected, no action thereon is likely at this time.

Sincerely,

Gordon Macklin
President

AMENDMENTS TO APPENDIX C OF ARTICLE III, SECTION 32 OF THE RULES OF FAIR PRACTICE

(Deleted material is stricken; new material is indicated by underlining.)

APPENDIX C

Coverage Required

(a) No change

Deductible Provision

(b) No change

Annual Review of Coverage

(c) ~~Each member shall initially determine minimum required coverage of the bond pursuant to subsections (a)(2), (3), (4) and (5) herein, by reference to the highest required net capital during the twelve-month period immediately preceding issuance of the bond thereafter. Thereafter,~~

(1) Each member, other than members covered by subsection (c)(2) herein, shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subsections (a)(2), (3), (4) and (5) herein.

(2) Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest aggregate indebtedness it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under Rule 15c3-1 in determining the minimum required coverage to be carried in the members' second year pursuant to subsections (a)(2), (3), (4) and (5) herein. Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than ~~thirty days~~ sixty days after the anniversary date of the issuance of such bond.

Notification of Change

(d) No change