NOTICE TO MEMBERS: 81-16
Notices to Members should be retained for future reference.

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

April 15, 1981

IMPORTANT

OFFICERS, PARTNERS, AND PROPRIETORS

TO: Members of the National Association of Securities Dealers, Inc. and Other Interested Persons

RE: Request for Comments on Proposed Corporate Financing Rule

COMMENT PERIOD CLOSES ON: May 15, 1981

The National Association of Securities Dealers, Inc. (the "Association") is publishing for comment a proposed new section of the Rules of Fair Practice which, if adopted, would replace the current interpretation of the Board of Governors on corporate financing adopted under Article III, Section 1 of the Rules of Fair Practice.

Comments on the proposed rule are invited from members and other interested persons. The text of the proposed rule, an analysis of the rule, and the text of the present corporate financing interpretation are attached to this notice. A discussion of the background and purpose of the new rule appears below.

## Background and Purpose

Article III, Section 1 of the Association's Rules of Fair Practice obligates members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their businesses. In the early 1960's, the Association began reviewing underwriting terms and arrangements of securities offerings in which members were participating. The

Association's review was intended to determine whether those terms and arrangements were in compliance with the broad standard of fairness in Artcile III, Section 1. By 1970, the criteria for determining fairness and reasonableness had become more defined and were incorporated into the Interpretation of the Board of Governors--Review of Corporate Financing (the "Interpretation").

The Interpretation requires that most public offerings of securities in which members participate be filed with the Association's Corporate Financing Department for review. The Interpretation makes it a rule violation for a member or associated person to participate in a public offering if any of the underwriting terms or arrangements are unfair or unreasonable. Guidelines utilized in determining fairness and reasonableness are provided, but the guidelines generally lack specificity.

The language of the Interpretation has not been amended since the early 1970's and no longer accurately reflects all current industry practices. The language is also presented in a manner which sometimes makes it difficult for members and their counsel to clearly understand the requirements to which they are subject. Over the past several years, various clarifications of the policy embodied in the Interpretation have been rendered but these have never been incorporated into the language of the Interpretation.

For these reasons, the Association now proposes to replace the Interpretation with a new rule of fair practice. The new rule is intended to codify and clarify existing Association policy and procedures and in some cases to implement new standards of fairness. The new rule is being published at this time to provide an opportunity for members and other interested persons to comment on its provisions. The text of the new rule is attached.

All interested parties are urged to carefully study the text of the rule and the analysis of its subsections. While the new rule generally recodifies the Interpretation, some provisions of the Interpretation (e.g., restrictions on issuer-directed shares) are eliminated and some new requirements (e.g., a prohibition on non-accountable expense allowances) are added.

After reviewing all comments received, the Association will decide whether to proceed with the proposed new rule. If the Association decides to proceed, the proposal will be submitted to the membership for a vote. If approved by the membership, the proposed change will be filed with the Securities and Exchange Commission and will not become effective until approved by the Commission.

The Association encourages members, their counsel and other interested parties to comment on the proposed rule. All comments should be directed to:

S. William Broka,
Secretary,
National Association of Securities Dealers, Inc.,
1735 K Street, N. W.,
Washington, D.C. 20006.

All communications will be considered available for public inspection. All comments should be received by May 15, 1981.

The following documents are attached for the benefit of persons wishing to comment:

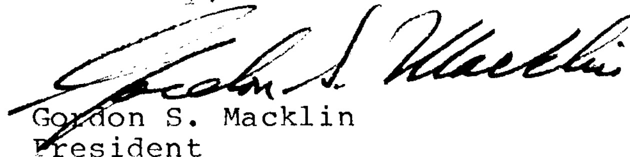
a subsection-by-subsection analysis of the proposed rule,

2. the text of the proposed rule, and

3. the text of the present Corporate Financing Interpretation.

Any questions regarding this Notice should be directed to Dennis C. Hensley, Vice President, Corporate Financing at (202) 833-7240.

Sincerely,



Gordon S. Macklin
President

## Subsection-by-Subsection Analysis of Proposed Corporate Financing Rule

Subsection (a): Definitions - This section would incorporate definitions of "affiliate," "public offering," and "underwriter" in the rule. These terms are not defined in the Interpretation of the Board of Governors--Review of Corporate Financing ("Interpretation"), but the proposed definitions are based on generally accepted concepts. The definition of "person related to an underwriter" which is found in the Interpretation would be clarified to reflect present Association reading of the definition as including persons performing a service for the issuer which is normally performed by an underwriter.

Subsection (b): Underwriting Compensation and Arrangements - Paragraph (b)(1) of the proposed rule would first state a prohibition against any member or associated person participating in a public offering if the terms or arrangements are unfair or unreasonable. This prohibition is analogous to that currently found in the Interpretation. Subparagraph (b)(2)(i) of the rule would prohibit such persons from receiving an unreasonable amount of underwriting compensation.

Subparagraph (b)(2)(ii) would explain how the amount of underwriting compensation is determined by the Association. The explanation contained in Subparagraph (b)(2)(ii) codifies existing practices and is intended to be more specific than the Interpretation in explaining their application to any particular fact situation. The rule would explain that all items of compensation received pursuant to an agreement or other arrangement entered into within twelve months prior to filing are presumed to be underwriting compensation received in connection with the offering.

Subparagraph (b)(2)(iv) is important in that it lists factors considered in determining whether a proposed amount of underwriting compensation is fair and reasonable. The factors listed generally would simply restate those now in the Interpretation. Subparagraph (b)(2)(v) would expressly state the

Association's policy that more compensation is permitted for offerings with greater risk but lower percentages of compensation are permitted for larger offerings.

Subparagraph (b)(2)(vi) expands upon the concept of risk used in Subparagraphs (b)(2)(iv) and (v) and lists factors to be considered in determining the amount of risk being assumed by an underwriter.

Subparagraph (b)(2)(vii) sets forth means to determine the value of securities received as underwriting compensation. The provisions of this subparagraph closely resemble those of the Interpretation except that the language of the subparagraph seeks to clarify that all types of securities (e.g., stock, warrants, convertible debt) are valued in a similar manner.

Proposed Paragraph (b)(3) of the Corporate Financing Rule would deal generally with items of compensation. Subparagraph (i) sets forth a list of items which are typically included as underwriting compensation, although it is clearly stated that "all other items of value received or to be received by an underwriter or related person...in connection with or related to an offering shall be included" as compensation. The list of items contained in this subparagraph include all of the items currently stated in the Interpretation as well as other items generally included as compensation but heretofore not specifically enumerated. Special sales incentive items, rights of first refusal, and demand registration rights are among such items. In particular, it should be noted that compensation to be received by an underwriter or related person as a result of the exercise of warrants or similar securities distributed as part of the offering would be considered as underwriting compensation if the exercise occurs within twelve months following the effective date.

Items of underwriting compensation having been set forth in Subparagraph (b)(3)(i), Subparagraphs (ii) and (iii) contain provisions for excluding certain items from compensation. Subparagraph (ii) provides the basis for excluding financial consulting and advisory fees where an on-going relationship is demonstrated. Subparagraph (iii) clarifies that expenses customarily borne by an issuer, even when paid through an underwriter, will not be included as underwriting compensation.

Subparagraph (b)(3)(iv) would clarify and recodify the factors used to determine whether securities are received in connection with an offering and are therefore underwriting compensation. This subparagraph would provide basis for rebutting the presumption in Subparagraph (b)(2)(ii) that particular securities are to be included or excluded in computing

underwriting compensation. Factors to be used in determining whether securities are includable as underwriting compensation would be specifically set forth and explained. Those factors are generally analogous to the factors presently contained in the Interpretation.

Subparagraph (b)(3)(v) would clarify that securities acquired by an underwriter pursuant to an arrangement entered into more than twelve months prior to the filing of an offering and securities received by persons other than an underwriter or related person are generally presumed not to be underwriting compensation.

Paragraph (b)(4) would list terms and arrangements presumed to be unfair and unreasonable. The arrangements listed generally reflect present Association policy, although in several instances the specified arrangements have never been publicized as presumptively unfair and unreasonable.

Subparagraph (b)(4)(i)(A), however, varies from present policy. The provision would treat the receipt by an underwriter of a nonaccountable expense allowance as unfair and unreasonable. The Association has been concerned for some time with the proliferation of nonaccountable expense allowances. In the Association's opinion, such arrangements are often a means of obtaining additional underwriting compensation above that disclosed on the cover of the prospectus and a means for a manager to obtain a larger percentage of underwriting compensation than would normally be permitted by syndicate members. Although nonaccountable expense allowances are currently included as underwriting compensation, the Association believes that members should be required to account to issuers for expenses charged in connection with an offering. The Association believes it is not inappropriate, however, for a managing underwriter to receive compensation for performing particular services in managing or structuring an offering. The language of Subparagraph (b)(4)(i)(B) relating to accountable expense allowances would permit the receipt of such fees on a fully disclosed basis.

Particular attention is directed to items (C) through (J) under subparagraph (b)(4)(i) which contain specific arrangements that are presumed to be unfair and unreasonable. These provisions restrict the payment of fees prior to commencement of an offering, the duration of certain rights of first refusal and warrants or options, the exercise or conversion terms of certain securities, the receipt of any indeterminate compensation, the receipt of any over-allotment option greater than ten percent, the receipt of certain compensation for offerings which are not completed, and the receipt of certain securities which are convertible or exercisable on terms more favorable than those received by the public.

Subparagraph (b)(4)(i)(K) would contain the present "ten percent rule" in modified form. The Interpretation provides that underwriters may not receive an amount of securities as underwriting compensation which is greater than ten percent of the number of shares being offered. The present language, however, is unclear as to offerings of warrants, options, or convertible securities. The Association believes that members should be permitted to receive securities as underwriting compensation irrespective of the nature of the security offered to the public. The proposed language would therefore make no distinction among various types of securities but would limit the securities received as compensation to ten percent of the number or dollar amount of securities offered.

The proposed provisions of Subparagraph (b)(4)(i)(L) represent a new clarification of Association standards of fairness in connection with the exercise or conversion of warrants, options, or convertible securities. The receipt by a member and certain other persons of any compensation or expenses as a result of the exercise or conversion of such securities would be presumed to be unfair and unreasonable in enumerated circumstances. The circumstances described in items (1) through (4) of subparagraph (L) are intended to assure that compensation is not received unless exercise or conversion will profit the investor, the investor retains the discretion to accept or reject the transaction, the investor is informed of the arrangements for compensation, the investor has not initiated the exercise or conversion, and the investor has designated in writing the broker/dealer which is to receive the compensation.

These conditions are viewed by the Association as necessary to avoid abuses in this area. The Association has witnessed a rash of proposed arrangements recently which provide compensation of varying amounts and under varying cicumstances to broker/dealers upon public investors' exercise or conversion of securities. In most instances, these arrangements appear to be attempts to secure greater amounts of underwriting compensation than normally considered fair. The payment of such compensation also presents potential conflicts between the investor's best economic interests and the broker/dealer's possible gain. Taken together with Subparagraph (b)(3)(i)(K), Subparagraph (b)(4)(i)(L) should assure the fairness and reasonableness of compensation arrangements for the exercise or conversion of securities.

Subparagraph (b)(4)(ii) of the proposed rule recodifies existing procedures for excluding certain securities when calculating the amount of securities which may be received as underwriting compensation. Subparagraph (b)(4)(iii) also recodifies existing requirements and states that securities

constituting unreasonable underwriting compensaton received by an underwriter or related person shall be returned at cost.

Under proposed Subparagraph (b)(4)(iv), underwriting terms or arrangements not in compliance with the standards of the proposed rule may nonetheless be found fair and reasonable in exceptional or unusual cases upon written application to the Association. This is a codifiction of existing practice.

Paragraph (b)(5) sets forth a recodification of the Assoication's longstanding "lock-up" policy. This policy requires securities received as underwriting compensation to be restricted from sale, transfer, assignment, or hypothecation for one year, except under certain limited circumstances. Certificates of such securities are required to bear a legend describing the restriction.

<u>Subsection (c): Filing Requirements</u> - Subsection (c) would codify existing requirements for the filing of offerings with the Association without substantial change. Paragraph (c)(1) prohibits members and associated persons from participating in offerings unless required documents have been filed with the Association. The paragraph also would clarify that "participation in a public offering" is intended to be broadly construed to include assistance in the preparation of documents, and performing advisory functions as well as distributing securities on any basis.

Paragraph (c)(2) states technical procedures for filing and (c)(3) lists offerings which need not be filed. The latter paragraph codifies existing practice and clarifies the language of the Interpretation in some respects. The new language would clarify, for example, that Form S-16 "shelf" registrations need not be filed unless an agreement exists pertaining to the underwriting arrangements.

Paragraph (c)(4) reaffirms Association policy to treat filings confidentially. Paragraph (c)(5) sets forth the parties responsible for filing in various circumstances. Both of these paragraphs only restate present policy.

Subparagraph (c)(6)(i) would list those documents which must be filed. The subparagraph generally tracks present requirements except for the fact that fewer copies of documents would be required.

A new requirement would be added by Subparagraph (c)(6)(ii). That provision would require amendments to filed documents to be marked to show changes, <u>i.e.</u> "red-lined". The Association believes this change will benefit all members filing offerings by expediting the review of each.

Subparagraph (c)(6)(iii) also would add a new requirement. That subparagraph would codify the present requirement to notify the Association when an offering becomes effective and would add a requirement for such notice whenever an offering is withdrawn or abandoned. The latter requirement would enable the Association to keep abreast of the status of all offerings, thereby assuring that full resources are directed to those which are being actively pursued.

Paragraph (c)(7) would codify within the substantive rule the means of computing filing fees.

Subsection (d): Code of Procedure - Proposed Subsection (d) would incorporate into the proposed new rule those procedures presently used on an informal basis to provide a review by hearing subcommittees and standing committees of the Association's Board of Governors of determinations made by the Department with respect to underwriting arrangements. These procedures would provide for a hearing on the record, a written determination, and a right of appeal to a standing Board committee. In a departure from present practices for hearings of this nature, costs could be assessed. Costs are now assessed in other types of Association hearings.

The Code of Procedure would not provide for any review beyond standing Board committees. This is consistent with the Association's policy that determinations by the staff and Committees regarding underwriting arrangements constitute opinions as to fairness and reasonableness and probable compliance with Association rules. Such determinations do not, however, constitute a finding of a rule violation; such a finding is made only by a District Business Conduct Committee following formal complaint procedures. To permit Board review of opinions as to fairness would arguably taint the disciplinary process and place members in double jeopardy. This policy is explained in the Code of Procedure.

## Text of Proposed Corporate Financing Rule*

### Article III, Section : Underwriting Terms and Arrangements

#### Subsection (a): Definitions

When used in this section, the following terms shall have the meanings stated below:

(1) "affiliate" means a person controlling, controlled by, or under common control with the entity in question;

(2) "person related to an underwriter" means an affiliate of the underwriter or a person who has performed a professional service for the underwriter in connection with the offering in question, or has performed a service for the issuer in connection with the offering which service is normally performed by an underwriter;

(3) "public offering" means any primary or secondary distribution of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings pursuant to a merger or acquisition, straight debt offerings, and all other securities distributions of any kind whatsoever except any offering made pursuant to an exemption under Section 4(1) or 4(2) of the Securities Act of 1933, as amended;

(4) "underwriter" means an underwriter as defined in Section 2(11) of the Securities Act of 1933, as amended.

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*Entire text is new; if adopted, this rule would replace in its entirety the present Corporate Financing Interpretation under Article III, Section 1 of the Rules of Fair Practice.

## Subsection (b): Underwriting Compensation and Arrangements

### (1) General

No member or person associated with a member shall participate in any manner in any public offering of securities in which the terms or arrangements relating to the distribution of the securities are unfair or unreasonable as determined by application of this section.

### (2) Amount of Compensation

(i) No member or person associated with a member shall receive an amount of underwriting compensation in connection with a public offering which is unfair or unreasonable.

(ii) For purposes of determining the amount of underwriting compensation, all items of compensation received or to be received from the issuer or an affiliate of the issuer by an underwriter or related person pursuant to an agreement or other arrangement entered into within 12 months prior to the filing with the Association of the registration statement or similar document will be presumed to be underwriting compensation paid or to be paid in connection with the offering.

(iii) All items of underwriting compensation shall be disclosed in the prospectus or offering circular.

(iv) For purposes of determining whether the amount of underwriting compensation is fair and reasonable, the following factors, as well as any other relevant factors and circumstances, shall be taken into consideration:

(A) the gross dollar amount of the offering;

(B) the type of offering, whether the offering is being underwritten and, if so, the type of commitment, *e.g.*, "firm commitment," "best efforts," or "best efforts all or none", to which an underwriter is subject;

(C) the type of securities being offered;

(D) the amount of risk being assumed by an underwriter;

(E) the nature and amount of underwriting compensation received or to be received by an underwriter or related

person;

(F) the existence of any affiliate relationship between the issuer and an underwriter or related person; and

(G) the absence of arm's-length bargaining or the existence of a conflict of interest between the issuer and underwriter or related person.

(v) The amount of compensation (stated as a percentage of the dollar amount of the offering) which is considered fair and reasonable generally will vary directly with the amount of risk to be assumed by an underwriter and related persons and inversely with the gross dollar amount of the offering.

(vi) The amount of risk being assumed by an underwriter, shall be determined by considering the following factors:

(A) the type of security being offered and the amount of effort required to distribute such a security,

(B) the anticipated duration of the offering period,

(C) whether the offering is an initial public offering, and

(D) any other factors deemed relevant by the Association.

(vii) For purposes of determining the value to be assigned to securities received as underwriting compensation, the following criteria and procedures shall be applied:

(A) securities shall be valued on the basis of the difference between the cost of such securities to the recipient and the proposed public offering price or, if a bona fide independent market exists for the security, the market price on the date of acquisition;

(B) in the case of options, warrants, or convertible securities, consideration shall also be given to the terms of the options, warrants, or convertible securities; the difference between the initial exercise or conversion price and either (1) the proposed public offering price of the options, warrants, or convertible securities or the underlying security, or (2) where a bona fide independent market exists for the options, warrants, convertible securities, or the underlying security, the market price on the date of acquisition; the date on which the options or warrants first become assignable or transferable; and any other relevant factors; and

(C) a lower value shall generally be assigned if securities, and, where relevant, underlying securities, are, or will be, restricted from sale, transfer, assignment or other disposition for a period of up to two years beyond the one-year period of restriction required by paragraph (b)(5)(i)(A).

(3) Items of Compensation

(i) For purposes of determining the amount of underwriting compensation received or to be received by an underwriter or a related person pursuant to paragraph (2) hereof, the following items and all other items of value received or to be received by an underwriter or related person from the issuer or an affiliate of the issuer in connection with or related to an offering shall be included:

(A) underwriter's discount, commission, or concession;

(B) expenses incurred by an underwriter or related person payable by the issuer or from the proceeds of the offering, to or on behalf of an underwriter or related person;

(C) fees and expenses of underwriter's counsel;

(D) finder's fees;

(E) wholesaler's fees;

(F) financial consulting and advisory fees, whether in the form of cash, securities, or any other item of value;

(G) stock, options, warrants, and other securities;

(H) special sales incentive items;

(I) any right of first refusal provided to an underwriter or related person to underwrite or participate in future offerings by the issuer;

(J) a right provided to an underwriter or related person to require the issuer upon demand to register securities on behalf of the underwriter or person in the future without any expense to them; and

(K) commissions, expense reimbursements, or other compensation to be received by an underwriter or related person as a result of the exercise or conversion

within 12 months following the effective date of the offering of warrants, options, convertible securities, or similar securities distributed as part of the offering.

(ii) Notwithstanding the provisions of subparagraph (i)(F) hereof, financial consulting and advisory fees may be excluded from underwriting compensation upon a finding by the Association, on the basis of conclusive evidence presented, that an ongoing relationship between the proposed issuer or affiliate and the proposed underwriter or related person has been established at least 12 months prior to the filing of the registration statement or similar document with the Association or that the relationship, if established subsequent to that time, was not entered into in connection with the offering, and that actual services have been or will be rendered which were not or will not be connected with or related to the offering.

(iii) Expenses customarily borne by an issuer, such as printing costs, registration fees, "blue sky" fees, and accountant's fees, shall be excluded from underwriter's compensation whether or not paid through an underwriter.

(iv) Notwithstanding the provisions of paragraph (b)(2) hereof, the Association may find that securities acquired by an underwriter or related person pursuant to an agreement or other arrangement entered into during the 12-month period immediately preceding the filing with the Association of the registration statement or similar document should be excluded from underwriting compensation or that securities acquired by an underwriter or related person pursuant to an agreement or other arrangement entered into prior to such 12-month period should be included as underwriting compensation. In determining whether such securities are includable in underwriting compensation, the Association shall give consideration to the following factors:

(A) any disparity between the price paid and the offering or market price at the time of acquisition, with a greater disparity tending to indicate that the securities constitute compensation;

(B) the length of time between the date of acquisition of the securities and the date of filing of the registration statement or similar document, with a shorter period of time tending to indicate that the securities constitute compensation;

(C) the amount and type of securities acquired, with a larger amount of readily marketable securities tending to indicate that the securities constitute compensa-

tion;

(D) the amount of risk assumed, with a lesser amount of risk tending to indicate that the securities constitute compensation;

(E) the presence or absence of arm's-length bargaining between the proposed issuer and the proposed underwriter or related person, with an absence of arm's-length bargaining tending to indicate that the securities constitute compensation;

(F) the existence of a potential or actual conflict of interest, with the existence of such a conflict tending to indicate that the securities constitute compensation; and

(G) the relationship of the receipt of the securities by the underwriter or related person to purchases by unrelated purchasers on similar terms at approximately the same time with an absence of similar purchases tending to indicate that the securities constitute compensation.

(v) Securities acquired by an underwriter or a related person pursuant to an agreement or other arrangement entered into more than 12 months immediately preceding the date of filing with the Association of the registration statement or similar document or securities of the issuer acquired at any time by persons other than an underwriter or related person will be presumed not to be underwriting compensation.

(4) Unreasonable Terms and Arrangements

(i) Without limiting the generality of the foregoing paragraphs hereof, the following terms and arrangements, when proposed in connection with the distribution of a public offering of securities, shall be presumed to be unfair and unreasonable:

(A) any expense allowance granted by an issuer or an affiliate to an underwriter or a related person on a non-accountable basis;

(B) any accountable expense allowance granted by an issuer or an affiliate to an underwriter or a related person which includes payment for general overhead, salaries, supplies, or similar expenses of the underwriter incurred in the normal conduct of business, except a disclosed fee to be received by an

underwriter for performing specific services in connection with structuring or managing the offering;

(C) any payment of commissions or fees by an issuer or an affiliate directly or indirectly to an underwriter or a related person prior to commencement of the public sale of the securities being offered;

(D) any right of first refusal granted by an issuer or an affiliate to an underwriter or a related person regarding future public offerings, private placements or other financings which has a duration of more than five years from the effective date of the offering;

(E) the receipt by an underwriter or related person of underwriting compensation consisting of any option or warrant which has a duration of more than five years from the effective date of the offering;

(F) the receipt by an underwriter or related person of underwriting compensation consisting of any option, warrant or convertible security which is exercisable or convertible at a price below either the public offering price of the underlying security or, if a bona fide independent market exists for the security or the underlying security, the market price at the time of receipt;

(G) the receipt by an underwriter or a related person of any item of compensation for which a value cannot be determined at the time of the offering;

(H) any overallotment option granted to an underwriter or related person providing for the overallotment of more than ten percent of the amount of securities being offered, computed excluding any securities offered pursuant to the overallotment option;

(I) the payment of any compensation by an issuer or an affiliate to an underwriter or related person in connection with an offering of securities which is not completed according to the terms of agreement between the issuer and underwriter; provided, however, that the reimbursement of out-of-pocket accountable expenses other than sales commissions actually incurred by the underwriter or related person shall not be presumed to be unfair or unreasonable under normal circumstances;

(J) the receipt by an underwriter or related person of

convertible securities, warrants, or options as underwriting compensation which are convertible or exercisable on terms more favorable than the terms of the securities being offered to the public;

(K) the receipt by an underwriter or related person of securities which constitute underwriting compensation in an aggregate amount greater than ten percent of the number or dollar amount of securities being offered to the public;

(L) the receipt, pursuant to an agreement entered into at any time before or after the effective date of a public offering of warrants, options, convertible securities or units containing such securities, by a member, a person associated with a member, or a person related to an underwriter of any compensation or expense reimbursement in connection with the exercise or conversion of any such warrant, option, or convertible security in any of the following circumstances:

(1) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

(2) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion;

(3) the arrangements whereby compensation is to be paid are not disclosed both in the prospectus or offering circular by which the warrants, options, or convertible securities are offered to the public, if any agreement exists as to such arrangements at that time, and in a prospectus or offering circular provided to securityholders at the time of exercise or conversion; or

(4) the exercise or conversion of the warrants, options or convertible securities is not solicited by the underwriter or related person, provided however that any request for exercise or conversion will be presumed to be unsolicited unless the customer states in writing that the transaction was solicited and designates in writing the broker/dealer to receive compensation for the exercise or conversion.

(ii) In calculating the amount of securities being offered for purposes of determining compliance with the provisions of subparagraph (i)(K) hereof, the following shall be excluded:

(A) any securities deemed to constitute underwriting compensation;

(B) any securities issued or to be issued pursuant to an overallotment option; and

(C) in the case of a "best efforts" offering, any securities not actually sold.

(iii) In the event that an underwriter or related person receives securities deemed to be underwriting compensation in an amount constituting unfair and unreasonable compensation pursuant to subparagraph (i) (K) hereof, the underwriter or person shall return any excess securities at cost and without recourse.

(iv) Notwithstanding the foregoing provisions of this subsection, terms and arrangements not in compliance with the requirements specified herein may be permissible in exceptional or unusual cases in which a member, upon written application to the Association, demonstrates that such terms and arrangements are fair and reasonable giving consideration to the particular facts and circumstances surrounding the offering.

<u>(5) Restrictions on Securities Deemed to be Underwriting Compensation</u>

(i) No member or person associated with a member shall participate in any public offering which does not comply with the following requirements:

(A) securities deemed to be underwriting compensation under this rule shall not be sold, transferred, assigned, pledged or hypothecated by any person, except as provided in subparagraph (ii) for a period of one year following the effective date of the offering for which the securities were received; <u>provided, however,</u> that securities which are convertible into other types of securities or which may be exercised for the purchase of securities or which may be exercised for the purchase of other securities may be so converted or exercised if the securities received remain subject to the restriction specified herein for the remainder of the initially applicable time period; and

(B) certificates or similar instruments representing

securities restricted pursuant to subparagraph (A) hereof shall bear an appropriate legend describing the restriction and stating the time period for which the restriction is operative.

(ii) The provisions of subparagraph (i) notwithstanding, the transfer of any security by operation of law or by reason of reorganization of the issuer shall not be prohibited by this paragraph.

## Subsection (c): Filing Requirements

### (1) General

No member or person associated with a member shall participate in any manner in any public offering of securities unless documents and information as specified herein relating to such offering have been filed with and reviewed by the Association for compliance with this section. For purposes of this section, participation in a public offering shall include participation in the preparation of offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, or participation in any advisory capacity related to the offering.

### (2) Means of Filing

Persons filing documents or information required by this rule to be filed with the Association shall direct such documents or information to the Corporate Financing Department at the Executive Office of the Association, and such documents or information will be considered to be filed only upon receipt by that Department.

### (3) Excepted Offerings

The provisions of paragraph (1) notwithstanding, documents and information shall not be required to be filed with respect to offerings of the following types of securities:

(i) securities which are defined as "exempt securities" in Section 3(a)(12) of the Securities Exchange Act of 1934, as amended;

(ii) securities of investment companies registered under the Investment Company Act of 1940, as amended, except securities of a management company defined as a "closed-end company" in Section 5(a)(2) of that Act;

(iii) variable contracts as defined in Article III, Section 29(b)(1) of the Rules of Fair Practice;

(iv) nonconvertible debt securities which are rated "B" or better by a national rating agency recognized by the Association;

(v) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act of 1935, as amended;

(vi) "shelf" registrations filed with the Securities and Exchange Commission on Form S-16 which do not involve an underwriting agreement;

(vii) private offerings which are exempt from registration under Section 4(1) or 4(2) of the Securities Act of 1933, as amended; and

(viii) tender offers made pursuant to Rule 14d-1 of the General Rules and Regulations of the Securities Exchange Act of 1934.

(4) Confidential Treatment

The Association shall accord confidential treatment to all documents and information required by this section to be filed and shall utilize such documents and information solely for the purpose of review by the Corporate Financing Department to determine compliance with the provisions of this section or for other regulatory purposes deemed appropriate by the Association.

(5) Requirement for Filing

(i) Any member acting as a managing underwriter or in a similar capacity with respect to an offering of securities subject to this section shall file the documents specified in paragraph (6) with the Association at the same time those documents are filed with the Securities and Exchange Commission or other federal or state agency for review or approval.

(ii) Any member or person associated with a member which anticipates participating in an offering of securities other than

in a capacity subject to subparagraph (5)(i), shall ascertain prior to such participation whether the documents specified in paragraph (6) have been filed with and reviewed by the Association; if such documents have not been so filed, the member or associated person shall not participate in the offering until such documents have been filed with and reviewed by the Association.

(iii) Any member acting as a managing underwriter or in a similar capacity which has been informed of a determination by the Association that the terms or arrangements of a proposed offering are unfair or unreasonable shall notify all other members proposing to participate in the offering of that determination at a time sufficiently prior to the effective date of the offering as to permit each member to determine whether to proceed with its participation in the offering.

(6) Documents to be Filed

(i) The following documents shall be filed with the Association with respect to each offering of securities subject to this section:

(A) two copies of the registration statement or similar document and any amendments thereto;

(B) three copies of the preliminary prospectus or similar document and any amendments thereto, including the final prospectus;

(C) two copies of any underwriting agreement, agreement among underwriters, and selling group agreement, or similar documents, and any amendments thereto;

(D) two copies of any agreements between the issuer and any member or person associated with a member participating in the distribution which agreements relate to the receipt by such member or person of any item of value which may be deemed to be underwriting compensation under this section;

(E) in the case of offerings of partnership interests, two copies of the partnership agreement and any amendments thereto; and

(F) other documents requested by the Association.

(ii) Any person filing amended documents pursuant to subparagraph (6)(i) shall clearly indicate additions and deletions

made to the prior document.

(iii) Any person filing documents pursuant to subparagraph (6)(i) shall file with the Association written notice that the offering has been declared effective or approved by the Securities and Exchange Commission or other agency within 12 hours following such declaration or approval or that the offering has been withdrawn or abandoned within three business days following the withdrawal or decision to abandon the offering.

(7) Filing Fees

(i) The initial documents relating to any offering filed with the Association pursuant to this section shall be accompanied by a filing fee equal to $100 plus .01% of the gross dollar amount of the offering, not to exceed a fee of $5100. The amount of filing fee may be rounded to the nearest dollar.

(ii) Filing fees shall be paid in the form of cash or certified check, bank cashier's check, bank money order or United States postal money order payable to the National Association of Securities Dealers, Inc.

(iii) Amendments to the initially filed documents which increase the number of securities being offered shall be accompanied by any additional amount of filing fee required by applying subparagraph (7)(i) to the amended gross dollar amount of the offering.

(iv) The provisions of Rule 457 of the General Rules and Regulations under the Securities Act of 1933 shall govern the computation of filing fees for all offerings filed pursuant to this rule, including intrastate offerings, to the extent the terms of Rule 457 are not inconsistent with subparagraphs (7)(i), (ii) or (iii).

Subsection (d): Code of Procedure for Handling Corporate Financing and Direct Participation Program Matters

(1) Purpose

This Code of Procedure is adopted pursuant to the authority of the Board of Governors set forth in Article IV, Section 2(b), and Article VII, Sections 1 and 3(b), of the By-Laws and is prescribed to provide a procedure for review of determinations by

the Association's staff regarding compliance with Association rules relating to corporate financing and direct participation program matters by which any person is aggrieved.

(2) Application by Aggrieved Person

Any person aggrieved by a determination of the Corporate Financing Department rendered pursuant to any rule or regulation of the Association relating to underwriting terms or arrangements may make application for review of such determination. In exceptional or unusual circumstances, a member may request conditionally or unconditionally an exemption from such rules or regulations. The Director of the Corporate Financing Department may, of his own initiative, request review of the fairness or reasonableness of any terms and arrangements proposed in documents filed pursuant to this section. Normally, applications for review will be accepted only with respect to offerings for which a registration statement or similar document has been filed with the appropriate federal or state regulatory agency; provided, however, that a hearing committee may waive the requirement for filing prior to review upon a finding that such review is appropriate under the circumstances.

(3) Application for Review

Any person making application for review pursuant to paragraph (d)(2) (hereinafter referred to in this subsection as "applicant") shall request such review in writing and shall specify in reasonable detail the source and nature of the aggrievement and the relief requested. The applicant shall state whether a hearing is requested and shall sign the written application. All applications shall be directed to the Corporate Financing Department at the Association's Executive Office.

(4) Notice of Hearing

Any applicant shall have a right to a hearing before a hearing committee constituted as provided in paragraph (5). The hearing committee may request a hearing on its own motion. The Director of the Corporate Financing Department shall schedule any hearing within ten days following receipt by the Association of the written application for review, or as soon thereafter as practicable, at a location determined by the hearing committee. The Director of the Corporate Financing Department shall send written notice of the hearing to the applicant at the earliest practicable date, stating the date, time, and location of the hearing.

(5) Hearing Committee and Procedure

(i) Any hearing pursuant to this section shall be before an individual or individuals designated by the President of the Association, who shall be persons engaged in the investment banking or securities business. Any applicant shall be entitled to appear at, and participate in, the hearing, to be represented by counsel, and to submit any relevant testimony or evidence. A representative of the Association shall be entitled to appear at, and participate in, the hearing, to be represented by counsel, and to submit any relevant testimony or evidence. Upon agreement of the applicant, representatives of the Association, and the hearing committee, a hearing may be conducted by means of a telephonic or other linkage which permits all parties to participate simultaneously in the proceeding.

(ii) In the event that no applicant requests a hearing, the hearing committee shall review the matter on the record before it. Any applicant and the Association shall be entitled to submit any relevant written testimony or evidence to the hearing committee.

(6) Requirement for Written Determination

The hearing committee shall render a determination as to all issues which the committee finds to be relevant as soon as practicable following conclusion of the hearing or, in cases in which a hearing is not requested, completion of the committee's review of the record. The hearing committee may determine whether proposed arrangements are fair and reasonable and in compliance with applicable rules and regulations. The determination of the hearing committee shall be issued in writing. The Director of the Corporate Financing Department shall send a copy of the determination to each applicant.

(7) Review by Committee of Board

(i) Any person aggrieved by a determination of a hearing committee shall have a right to have that determination reviewed by the appropriate standing committee of the Board of Governors. With respect to matters relating to offerings other than offerings of direct participation programs, the Corporate Financing Committee shall be the appropriate committee. With respect to matters relating to offerings of direct participation programs, the Direct Participation Programs Committee shall be the appropriate committee.

(ii) Any person seeking a review of a determination of a hearing committee shall submit a written request for such review to the Director of the Corporate Financing Department within fifteen days following issuance of the hearing committee's written determination. Any such person shall submit with the written request for review a written statement specifying the portion of the hearing committee's determination for which review is requested and the relief sought. Any such person may submit written testimony or evidence for consideration by the committee. Representatives of the Association may also submit written testimony or evidence to the committee.

(iii) Pursuant to a request duly made, the appropriate standing committee of the Board of Governors will review the determination of a hearing committee, giving consideration to all parts of the record which the Board committee finds relevant. The Board committee shall render a determination as to all issues which the committee finds to be relevant. The determination of the Board committee shall be issued in writing. The Director of the Corporate Financing Department shall send a copy of the determination to each person requesting review.

(8) Assessment of Costs

A hearing committee may, in its discretion, assess costs of a hearing against any person requesting the hearing.

(9) Nature of Determination

Any determination by a hearing committee or standing committee rendered pursuant to this section shall constitute the opinion of that committee as to compliance with applicable Association rules, interpretations or policies. No such determination shall constitute a finding of a violation of any rule, interpretation or policy. A finding of a violation shall be made only by a District Business Conduct Committee pursuant to the Code of Procedure for Handling Trade Practice Complaints.

## Interpretation of the Board of Governors-- Review of Corporate Financing*

### Introduction

The following Interpretation of Article III, Section 1 of the Association's Rules of Fair Practice and the accompanying Filing Requirements and Guidelines which are considered to be a part thereof, is adopted by the Board of Governors of the Association pursuant to the provisions of Article VII, Section 3(a) of the Association's By-Laws and Article I, Section 3 of the Rules of Fair Practice. It shall, unless otherwise indicated herein, be applicable to the public distribution of all issues of securities in which members of the Association participate in addition to all other offerings, whether such issues are underwritten or not. It shall, therefore, be specifically applicable to public offerings of securities in companies in which a member, or a person associated with a member, may have made piror purchases of securities in connection with or related to the offering regardless of whether that member or any member otherwise participates in the current distribution or its preparation and regardless of whether it or they have or will receive compensation in connection with the preparation or the distribution of the issue for any function related thereto. Unless the context otherwise requires or unless otherwise defined in this Interpretation the terms used herein shall, if defined in the By-Laws or the Rules of Fair Practice, have the meaning as defined therein.

Members who participate or intend to participate in the preparation or in the distribution of the referred to issues of securities, whether as an underwriter, a selling group member, or otherwise have an obligation in respect to that distribution to act at all times in accordance with high standards of commercial honor and just and equitable principles of trade. Thus, members may not so participate when the underwriting or other arrangements in connection with or related to the distribution, or the terms or conditions relating thereto, are unfair or unreasonable.

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*This Interpretation is proposed to be deleted in its entirety.

In the case of an issue which is underwritten, the managing underwriter is charged with the responsibility of insuring that such arrangements, terms and conditions are fair and reasonable. In the case of an issue being distributed by the issuer itself, or its bona fide officers and employees, without an underwriter but with the assistance of a member or members of the Association in an advisory, distributing or other capacity, each such member-participant is charged with the responsibility of determining whether the arrangements, terms and conditions are fair and reasonable.

In the case of such direct offerings by the issuer, if the issuer hires persons primarily for the purpose of distributing or assisting in the distribution of the issue, or assisting in any other way in connection with the underwriting, members of the Association cannot assist in the underwriting or its distribution in any capacity whatsoever.

In the case of an underwritten issue, the managing underwriter has the responsibility of filing the appropriate documents with the Association for review pursuant to the provisions of the Filing Requirements set forth hereafter. In the case of direct offerings by the issuer, each member intending to assist in the distribution has the responsibility first to determine that the appropriate documents have been filed with the Association. Thus, the participation by a member who is a managing underwriter in the case of an underwritten issue, or by a member in any capacity in the case of a direct offering by the issuer, in the distribution of an issue of securities in respect to which the appropriate documents have not been filed with the Association shall constitute conduct inconsistent with high standards of commercial honor and just and equitable principles of trade.

To assist in reaching determinations as to the fairness or reasonableness of the underwriting or other arrangements in connection with or related to the distribution, and the terms and conditions relating thereto, the Board of Governors has appointed a committee known as the Committee on Corporate Financing. This Committee, composed of individuals who are experienced in the field of corporate financing and in the distribution of issues or securities, with the assistance of the staff of the Association's Corporate Financing Department, reviews all filings made with the Association pursuant to the filing requirements hereof. As a result of that review, it makes determinations as to the fairness and reasonableness of the referred to arrangements, terms and conditions.

The Committee, in a letter from the Corporate Financing Department, will give an opinion as to the fairness and reasonableness of issues filed with it. In those cases in which it believes the arrangements, terms or conditions to be unfair or unreasonable, notification to that effect will be given and an opportunity will be afforded to change them in a manner which will enable compliance with standards of fairness and reasonableness. If they are not subsequently changed to so comply and a member participates in the distribution of the securities, or if he has or will participate in an advisory or any other capacity, the Committee will forward all necessary data and the results of its review and conclusions to the appropriate District Business Conduct Committee for whatever action it deems necessary. The same procedure will be followed if the Committee determines that the appropriate documents in a given issue have not been filed at all or if they have not been timely filed. Determinations of violations of this Interpretation upon which penalties can be based are, therefore, pursuant to the provisions of the By-Laws, the Rules of Fair Practice and the Code of Procedure for Handling Trade Practice Complaints, made by District Busines Conduct Committees subject to review by or appeal to the Board of Governors.

In a situation where a managing underwriter has been notified that the arrangements, terms and conditions of an issue are unfair or unreasonable and it does not take advantage of the opportunity to modify them in accordance with standards of fairness and reasonableness, it has the duty and obligation to notify the members of the underwriting syndicate and selling group of the Committee's determination so they will have an opportunity as a result of specific notice to comply with their obligation not to participate in any way in the preparation or distribution of an issue containing arrangements, terms and conditions which are unfair or unreasonable.

The Committee on Corporate Financing will, as noted, review the arrangements, terms and conditions of all public offerings of securities filed with the Association pursuant to the filing requirements stated hereafter. The Committee does not, however, attempt to pass upon or evaluate the merits of any issue of securities or the fairness of the public offering price, and, therefore, any determination made by the Committee should not be construed as having a reflection, either favorable or unfavorable, upon the securities being offered. The primary function of the Committee is to make a determination as to the fairness and reasonableness of the underwriting and other arrangements in connection with or related to the distribution, and the terms and conditions relating thereto and to notify the

appropriate member of its determination. The sole test to be applied by the Committee in determining fairness and reasonableness is whether the referred to arrangements, terms and conditions, when taking into consideration all elements of compensation and all of the surrounding circumstances and relevant factors, appear fair and reasonable in each case.

Definition

Underwriter and related persons.--For purposes of this Interpretation, the term "underwriter and related persons" shall be deemed to include underwriters, underwriter's counsel, financial consultants and advisors, finders, members of the selling or distribution group, and any and all other persons associated with or related to any of the aforementioned persons.

Interpretation

It shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade and a violation of Article III, Section 1 of the Rules of Fair Practice:

(1) for a member to participate in any way in the public distribution of an issue of securities in which the underwriting or other arrangements in connection with or related to the distribution, or the terms or conditions relating thereto, when taking into consideration all elements of compensation and all of the surrounding circumstances and relevant factors, are unfair or unreasonable;

(2) for a member who is a managing underwriter, or the equivalent thereof, of a public offering of an issue of securities to fail to timely file with the Association the documents and other information required by the Filing Requirements hereof;

(3) for a member to participate in an advisory, distributing or other capacity with an issuer, or its bona fide officers or employees, in the public distribution of a non-underwritten issue of securities if:

(a) the issuer hires persons primarily for the purpose of distributing or assisting in the

distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting; or

(b) the documents and other information required by the Filing Requirements hereof have not been filed with the Association and reviewed by it prior to the effective date thereof.

(4) for a member who is a managing underwriter, or the equivalent thereof, of a public offering of an issue of securities to fail to notify the members of the underwriting syndicate and selling group of a determination by the Committee on Corporate Financing that the underwriting or other arrangements in connection with or related thereto, or the terms and conditions related thereto, are in its opinion unfair or unreasonable if such arrangements, terms and conditions are not modified to conform to standards of fairness and reasonableness prior to the effective date thereof, and

(5) for a member who has made a purchase(s) of securities of a company prior to the filing of a registration statement or offering circular for the public distribution of an issue of securities of that company or parent or subsidiary thereof, which purchase(s) is deemed to be in connection with or related to that distribution, or who has or will receive compensation in any form for assistance in connection with the preparation or distribution of the issue, or otherwise, not to timely file with the Association, or to be certain that a timely filing has been made with the Association, of the documents required to be filed by the Filing Requirements hereof notwithstanding that the securities being distributed are being offered directly by the company or its bona fide officers, directors and employees. Assistance in connection with the preparation or distribution of an issue shall be deemed to include assisting in any way in the preparation of the registration or other documents in connection with or relating to the issue, furnishing of customer and/or broker lists for solicitation and assistance in a consulting capacity, among other activities.

Filing Requirements

All documents and other information required hereby to

be filed with the Association, or any communications or inquiries pertaining thereto, shall be submitted to the Director, Corporate Financing Department at the Executive Office of the Association, 1735 K Street, N.W., Washington, D. C. 20006.

Interstate Offerings

The following documents relating to all proposed interstate public offerings of securities shall be filed for review at the time they are filed with the Securities and Exchange Commission:

(1) Full registration pursuant to 1933 Act: One (1) copy of the registration statement (without exhibits); seven (7) copies of the preliminary prospectus; seven (7) copies of the underwriting agreement filed with the Commission, and any other information or documents, which may be material to or part of the underwriting or other arrangements in connection with or related to the distribution and the terms and conditions relating thereto and which may have a bearing upon the Committee's review, i.e., purchase agreement, letter of intent and consulting agreement, among others;

(2) Regulation "A" Offerings: Seven (7) copies of the initial offering circular as filed with the Commission; one (1) copy of the notification of filing, and seven (7) copies of the underwriting agreement;

(3) Pre- and Post Effective Amendments: One (1) copy of each amendment and seven (7) copies of any prospectus or offering circular which changes the underwriting or other arrangements or the terms or conditions thereof; and

(4) Final Prospectus or Definitive Offering Circular: One (1) copy of the final prospectus or definitive offering circular and a list of the members of the underwriting syndicate if such is not indicated therein.

Documents relating to the following issues need not be filed with the Association:

(1) securities which pursuant to the provisions of Section 3(a)(12) of the Securities Exchange Act of 1934 are exempt securities;

(2) securities of investment companies as defined in

Section 3 of the Investment Company Act of 1940 (except issues of closed-end management companies);

(3) variable contracts; and

(4) straight debt issues rated "B" or better by a recognized rating service.

Documents relating to all other offerings including, but not limited to, the following must be filed for review:

(1) partnership interests;

(2) oil and gas participation plans;

(3) mortgage and real estate investment trusts;

(4) rights offerings; and

(5) any other offerings of a similar nature.

Intrastate Offerings

The following documents relating to all proposed intrastate public offerings of securities shall be filed for review. Documents referred to in paragraphs (1) and (2) must be filed at the time of filing with the state securities commission (by whatever name known) but at least fifteen (15) business days prior to the anticipated offering date. Documents referred to in paragraph (3) shall be filed on the day the issue becomes effective.

(1) Seven (7) copies of the preliminary prospectus, offering circular, notice of intention, and/or any other document which describes the underwriting or other arrangements in connection with or related to the distribution, and the terms and conditions relating thereto; seven (7) copies of the underwriting agreement, and any other information or documents, which may be material to or part of the said arrangements, terms and conditions and which may have a bearing upon the Committee's review, i.e., purchase agreement, letter of intent and consulting agreement, among others;

(2) One (1) copy of each amendment as and when filed with the state commission and seven (7) copies of any amendment which may change the said underwriting or other arrangements or the terms or conditions thereof; and

(3) One (1) copy of the final prospectus, offering circular or other comparable definitive document and a list of the members of the underwriting syndicate if such is not indicated therein.

Supplementary Requirements

The following information is also required, when such is not stated in the above documents, to be filed for review at the time of the filing of the initial and amended documents with respect to both interstate and intrastate offerings:

(1) Exact or estimated maximum and minimum public offering price per share or unit;

(2) Exact or estimated maximum underwriting discount or commission;

(3) Exact or estimated maximum reimbursement for underwriter's expenses; underwriter's counsel's fees and expenses; financial consulting and advisory fees; finder's fees; and any other type of compensation which may accrue to the underwriter and related persons;

(4) Purchase price and dates of purchase of and payment for warrants, options, and any other securities acquired by the underwriter and related persons within a period of twelve (12) months prior to the filing of the registration statement or offering circular;

(5) A list of all purchasers, and information with respect to their identity and the nature of their employment, who may have participated in any private placement which occurred within eighteen (18) months prior to the filing of the issue and their relationship to, affiliation or association with the underwriter or others in the stream of distribution, if any. Details of all such purchases should also be supplied. In those cases where the purchasers are a private investment group, such as a hedge fund or other group of investors, the names of all persons who comprise the group and their association with or relationship to any broker/dealer should also be supplied;

(6) Any other pertinent information not stated in the original registration statement or initial offering circular which pertains to underwriting compensation and arrangements and any other dealings between the

underwriter and related persons, or other members of the Association, and persons associated therewith, and the issuer within the previous twelve (12) month period; and

(7) Exact date of filing with the Securities and Exchange Commission or state securities commission when not so stated on the documents.

In all cases, regardless of whether the issue is interstate or intrastate, where a timely filing has not been made or, when subsequent to an initial filing, changes in the arrangements, terms or conditions have been made, thereby necessitating a filing thereof, at least fifteen (15) business days are required for the Committie to make a complete review unless notified to the contrary by the Corporate Financing Department.

Members who are required to file the above documents and information with the Association shall also be required to notify the Corporate Financing Department of the Association promptly by telephone or telegram when they have been notified by the Securities and Exchange Commission or state securities commission of the anticipated offering date of the securities. All documents and information required hereby to be filed will be considered confidential by the Association and will be used only for the purpose of review by the Committee on Corporate Financing or for other appropriate and properly authorized proceedings of the Association.

In addition to constituting a violation of this Interpretation and of Article III, Section 1 of the Association's Rules of Fair Practice, failure to file documents with respect to both interstate and intrastate offerings may constitute grounds for suspension of membership pursuant to Article IV, Section 5 of the Asssociation's Rules of Fair Practice and a resolution of the Board of Governors appearing in the Association's Manual on page 2112.

Guidelines

The following guidelines shall be utilized by the Committee on Corporate Financing in making its determinations, and by District Committees and the Board of Governors in making findings of violation of the Interpretation and of Article III, Section 1 of the Rules of Fair Practice. They should also be followed by members in their preparation of the arrangements, terms and conditions of a public issue of securities which they intend to underwrite or in reviewing an issue in the distribution of which they intend to participate or give any assistance

whatsoever in the distribution or preparatory process. These guidelines should not, however, be considered exhaustive or all-inclusive since all surrounding circumstances and relevant factors whatever they may be are important to a proper and accurate determination by the appropriate Association committees and the Board of Governors regardless of whether they are delineated herein in detail.

As noted in the "Introduction" of this Interpretation, the primary function of the Committee on Corporate Financing is to make a determination as to the fairness and reasonableness of the underwriting and other arrangements in connection with or related to the distribution and the terms and conditions relating thereto. The evaluation of various factors is essential in reaching such a determination. These factors are outlined hereafter and, in addition to certain general considerations, are divided into "arrangement" and "compensation" factors. The amount of compensation received or to be received by an underwriter and related persons is, of course, important in determining the fairness and reasonableness of the overall underwriting arrangements, terms and conditions.

General

In reaching a determination of fairness or reasonableness the following factors, as well as any other relevant factors and circumstances, shall be taken into consideration: the size of the offering; whether it is being underwritten; if so, the type of commitment, i.e., whether it is being sold on a firm commitment, best efforts, or best efforts all or none basis; the type of securities being offered; the existence of restrictions, or the lack thereof, on stock, warrants, options or convertible securities received or to be received in connection with or related to the offering by the underwriter and related persons and the amount of such stock, warrants, options, or convertible securities; received by the underwriter and related persons; the underwriter's relationship to the issuer, or its parent, subsidiary or affiliate, including whether a member of the Association is underwriting an issue of its own securities or of its parent, subsidiary or affiliate; and whether a lack of arm's-length bargaining or a conflict of interest exists in connection with the offering.

Arrangement Factors

Restrictions on Securities Received or to be Received:

It shall be the policy of the Committee on Corporate Financing to examine closely the circumstances surrounding the

purchase of securities by an underwriter and related persons and other broker/dealers and persons associated with and related to them during the twelve (12) month period prior to the filing of the registration statement or offering circular. Normally, but not necessarily in all instances, purchases made by such persons within six months prior to such filings will be considered part of the offering package and will be considered to have been acquired in connection with or in relation to the offering. A more flexible policy will be followed, however, in connection with purchases in the six to twelve-month period prior to such filing. Factors to be considered in determining whether any of such prior acquired securities were acquired in connection with or in relation to the offering shall be pricing, i.e., disparity between the price paid by the recipient and the public offering price; timing, i.e., date of acquisition of the shares by the recipient in relation to the date of filing of the registration statement; number of securities purchased; their relationship to other purchases by other purchasers and to the contemplated offering; relationship of earlier purchases to the proposed financing; the risk factors involved; the presence or absence of arm's-length bargaining and the existence of a potential or actual conflict of interest. Purchases of securities prior to an offering of a public issue of securities is an area of great concern to the Association and, therefore, under appropriate circumstances, purchases made even prior to the previous twelve month period by the aforementioned persons may be reviewed in accordance with the above criteria particularly, but not only, when questions relating to arm's-length bargaining or conflicts of interest are present.

The transfer or assignment of stock or convertible securities, or the exercise of options and warrants or the resale, transfer and assignment of the shares underlying the options, warrants or debt securities, acquired by an underwriter, and related persons whether such was acquired prior to, at the time of, or after, but which is determined to be in connection with or related to the offering shall be restricted for a minimum period of one year from the effective date of the registration statement or definitive offering circular. Generally where the purchase of stock has been or is to be made on installment terms or in some method of payment other than cash in full, such restrictions shall apply to the transfer and assignment of the stock during the period of installment payment and for a minimum of one year from date of final payment provided, however, the installment terms themselves are reasonable.

In exceptional or unusual cases upon good cause shown, a period shorter than that stated in the preceding paragraph may be considered more appropriate. Likewise, in instances where

circumstances lend themselves to a potentially undesirable degree of involvement, market-wise or otherwise, on the part of the holders of the securities, and/or the spread (the difference between the cost and the offering price) is deemed high, or the number of shares so obtained are substantial, a longer period of restriction may be required. In any event, the burden of demonstrating that exceptional or unusual circumstances exist shall be upon the person advocating a period shorter than the normal one year restriction period. In those cases where the Committee believes a longer than normal restriction period should be required, the burden is likewise upon the person advocating a deviation from that position to justify such.

Assignment may be made of securities prior to the expiration of the period of restriction by a managing underwriting firm, in those cases where such securities have been received by it as described above, to officers or partners of that firm or an underwriting or selling group firm or officers or partners thereof; however, such assignees shall be bound by all of the aforementioned restrictions.

Stock Numerical Limitations on Securities Received or to be Received:

Shares of stock underlying warrants, options or convertible securities and/or all stock acquired directly by an underwriter and related persons whether acquired prior to, at the time of, or after, but which is determined to be in connection with or related to, the offering shall not in the aggregate be more than ten (10%) percent of the total number of shares being offered in the proposed offering. The maximum limitation in the case of "best efforts" underwritings or participation shall be on the basis of no more than one (1) share received for every ten (10) shares actually sold. For purposes of this paragraph:

> (1) Over-allotment shares and shares underlying warrants, options, or convertible securities which are part of the proposed offering are not to be counted as part of the aggregate number of shares being offered against which the 10% limitation is to be applied.
>
> (2) In an exceptional or unusual case involving an offering of convertible securities of a company whose stock already has a public market and where the circumstances require, taking into consideration the conversion terms of the publicly offered securities and the terms of the securities to be received by the above persons, the receipt of underlying shares by such persons aggregating the above referred to 10% limitation

may be considered improper and a lesser amount considered more appropriate.

(3) In an exceptional or unusual case, where a large number of shares of a company are already outstanding and/or the purchase price of the securities, risk involved or the time factor as to acquisition or other circumstances justify, a variation from the above limitations may be permitted but in all such cases the burden of demonstrating justification for such shall be upon the person seeking the variation.

Any purchase or receipt of securities by an underwriter and related persons, or a member of the selling or distribution group which are excessive in nature must be returned to the company, or the source from which they were originally received at the original cost. The arrangements, terms and conditions of the distribution shall be considered unfair and unreasonable if this is not done. Only in exceptional and unusual circumstances upon good cause shown, will a different arrangement or procedure be considered acceptable. In all such cases the burden of demonstrating that exceptional and unusual circumstances exist shall be upon the person advocating such.

Issuer Reserved or Directed Securities:

While no exact limitations on company reserved or directed securities are used as guidelines by the Association, the number of such shares shall be reasonable in amount under the prevailing circumstances, shall bear a reasonable relationship to the total number of shares being offered publicly at that time, and shall be reserved only for those persons who are directly related to the conduct of the issuer's business. The contractual purchase commitment for any company directed stock must, however, be made by the designated recipients by the close of business on the business day following the effective date of the offering and payment therefor must be made in accordance with established requirements. Securities directed to persons covered by the Association's Interpretation With Respect To "Free-Riding And Withholding" must be disclosed to the Association at the time of filing the required documents with it. Such disclosure in no way relieves such persons from the provisions of that Interpretation.

Compensation Factors

The following items are included in determining underwriter's compensation: the gross amount of the underwriter's discount; total expenses payable by the issuer, whether accountable or non-accountable, to or on behalf of the

underwriter which normally would be paid by the underwriter; underwriter's counsel's fees and expenses; finder's fees; financial consulting and advisory fees, and any other items of value accruing to the underwriter and related persons. Such other items of value include, but are not necessarily limited to, stock, options, warrants, and convertible and other debt securities, when deemed to have been received in connection with or in relation to the proposed offering, and when given by or acquired from the issuer, seller or persons in control or in common control of the issuer, or related parties of the issuer or such other persons. Expenses normally borne by the issuer, such as printing costs, registration fees, blue sky fees, and accountant's fees, are excluded from compensation even if paid through the underwriter.

The standard of appropriate overall allowable compensation that is applied to initial offerings of a company is not necessarily the same standard that is applied to other than initial offerings.

Stock acquired or to be acquired by an underwriter and related persons, any other broker/dealer participating in the financing, and persons associated with such broker/dealers, which has been acquired in connection with or related to or in relation to the proposed offering (hence, part of the compensation paid in connection therewith) shall be valued for compensation purposes by taking into consideration the differences between the cost of such stock and the proposed public offering price or, in the case of securities with a bona fide independent market, the cost of such stock and price of the stock on the market on the date of purchase, and other relevant factors. If, however, there is a binding obligation to hold such stock for a substantial period of time, an adjustment in such valuation is usually made.

Options or warrants acquired to to be acquired by an underwriter and related persons, any other broker/dealer participating in the financing, and persons associated with or related to such broker/dealers, which have been acquired in connection with or in relation to the proposed offering (hence, part of the compensation paid in connection therewith) shall be valued for compensation purposes by taking into account the number and the terms of the warrants; the cost of acquiring such; their lowest exercise price; the date at which they beome exercisable, assignable or transferable, and other relevant factors. However, if such options or warrants are for terms in excess of five (5) years or are exercisable below the initial public offering price, such will constitute an unfair and unreasonable underwriting arrangement. In cases where the exercise price is above the public offering price or where the

exercise of the options or warrants or the sale, assignment or transfer of the underlying stock are restricted for an extended period of time in excess of the provisions outlined above, a lesser value will generally result.

Convertible securities acquired or to be acquired by an underwriter and related persons, any other broker/dealer participating in the financing, and persons associated with or related to such broker/dealers, which have been acquired in connection with or in relation to the proposed offering (hence, part of the compensation paid in connection therewith) shall be valued for compensation purposes on the basis of the spread between the conversion price and the price of the stock on the market on the date of purchase, and other relevant factors.

Additional Compensation--Changes in Market Value:

In connection with issues of companies in which there are already outstanding securities being traded, an increase in the market value thereof between the time of the initial review by the Committee on Corporate Financing and the effective date of the issue may have the effect of increasing the amount of compensation attributable to stock, warrants or options received. The policy of the Association, therefore, is to reserve the right to re-examine such issues at a time immediately prior to the effective date of the issue. It shall be the responsibility of the managing underwriter, or other persons responsible for filing the required documents, to call such changes in market value to the attention of the Corporate Financing Department for reconsideration and re-examination so as not to allow the underwriting arrangements, terms or conditions to become unfair or unreasonable at the time the issue becomes effective because of an increase in the compensation level caused by the increase in the market price. The same responsibility shall apply to changes in any other relevant factors after the initial review.

## Conclusion

The aforementioned Guidelines are intended to serve only as a measure of guidance for members of the Association, its Committees, and the Board of Governors. As noted above, they should not be considered binding rules nor should they be considered exhaustive in scope since each issue must be reviewed on its own merits and a determination made in respect thereto taking into consideration all surrounding circumstances and relevant factors regardless of whether they are delineated herein in detail.

It should also be noted that while this Interpretation with Respect to the Review of Corporate Financing, and the Filing Requirements and Guidelines here published as a part thereof, to assist members in adhering to the proscriptions of that Interpretation, has been adopted by the Board of Governors of the Association, the Board has delegated to the Committee on Corporate Financing specific authority to adopt additional guidelines to the extent considered necessary to a proper implementation thereof.

NOTICE TO MEMBERS: 81-17
Notices to Members should be retained for future reference.

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

April 15, 1981

MEMORANDUM

TO: All NASD Members and Other Interested Persons

RE: Clarification of Filing Requirements and Standards of Fairness Applied to Members' Participation in Public Offerings

As a result of recent developments relating to members' participation in public offerings of securities, the Association has concluded that there is a need to clarify certain requirements which apply to such activity. The principal Association requirements relating to public offerings appear in the Interpretation of the Board of Governors--Review of Corporate Financing ("Corporate Financing Interpretation" or "Interpretation") adopted under Article III, Section 1 of the Rules of Fair Practice (NASD Manual (CCH) ¶2151). Requirements relating to public offerings of securities of members or affiliates appear in Schedule E to Article IV, Section 2 of the Association's By-Laws ("Schedule E") (NASD Manual (CCH) ¶1402).

The purpose of this Notice is to clarify certain Association requirements and policies which are the subject of frequent questions. These relate to the type of offerings which must be filed, the procedures for filing, and the amount and nature of securities which may be received as underwriting compensation. Members are urged to study the explanations below carefully. In many instances, familiarity with Association policies can expedite the review of an offerings.

It should be noted that the Association is publishing

today for comment a proposed rule which would replace the present Corporate Financing Interpretation. (See Notice-to-Members 81-16 (April 15, 1981).) Many of the policies and procedures discussed herein will be codified into that proposed rule. Except as otherwise set forth in Notice-to-Members 81-16, however, few substantive changes will be made by the new rule.

## Filing Requirements

The increased volume of public offerings over the past several months has prompted numerous inquiries from members and their counsel concerning Association filing requirements. With the exceptions noted below, all public offerings of securities, both inter- and intrastate, in which a member or an associated person participates in any capacity are required to be filed with the Association's Corporate Financing Department ("Department") for review of the proposed underwriting terms and arrangements. Failure to make prescribed filings in a timely manner may constitute grounds for disciplinary action.

More specifically, the following types of offerings, with the exceptions noted below, are required to be filed:

1. any public offering registered with the Securities and Exchange Commission ("Commission" or "SEC");

2. any intrastate offering which is considered to be a public offering in the state in which it is offered; and

3. any public offering of securities issued by a bank, savings and loan association, church or other charitable institution, or common carrier even though such offering may be exempt from registration with the Commission.

The following offerings are exempt from the Association's filing requirements and need <u>not</u> be submitted for review:

1. securities which are defined as "exempt securities" in Section 3(a)(12) of the Securities Exchange Act of 1934, as amended ("1934 Act");

2. private offerings which are exempt from registration under Section 4(2) of the

Securities Act of 1933, as amended ("1933 Act");

3. nonconvertible debt securities which are rated "B" or better by a rating agency recognized by the Association;

4. securities of investment companies registered under the Investment Company Act of 1940, as amended, except securities of a management company defined as a "closed-end company" in Section 5(a)(2) of that Act;

5. variable contracts as defined in Article III, Section 29(b)(1) of the Rules of Fair Practice;

6. "shelf" registrations filed with the Commission on Form S-16 which do not involve an underwriting agreement; and

7. offerings of municipal securities as defined in Section 3(a)(29) of the 1934 Act.

A few observations concerning these requirements may be helpful. The determination of an exempt security for purposes of Association filing requirements is based on the definition of that term in the 1934 Act, not the 1933 Act. For example, savings and loan conversions which involve a public offering of securities are required to be filed although such offerings are not registered with the SEC. A member which is involved in any capacity in a public offering which is subject to the requirements is responsible for assuring that the offering is filed. For example, members which provide consulting services or who engage in the solicitation of mergers or acquisitions which involve a public offering of securities must assure that those offerings are filed. Similarly, members which execute stand-by agreements for rights offerings or savings and loan conversions are required to file. (An exception to this rule has been provided for redemption standby arrangements registered on Form S-16. The Corporate Financing Committee has concluded that the restrictions on the use of Form S-16 and the circumstances usually surrounding such arrangements make review by the Association unnecessary.)

For the Association's filing requirements to apply, however, there must be a public offering of securities. Thus, a cash tender offer need not be filed.

Association filing requirements apply only to public offerings. Offerings made in compliance with Sections 4(1) or 4(2) of the 1933 Act or Rule 146 under that Act are not required to be filed. Regulation A offerings, however, must be filed.

Members should note that in some instances the filing requirements of Schedule E relating to self-underwriting are broader than those under the Corporate Financing Interpretation. The fact that an offering is exempt from filing under the Interpretation does not affect its status under Schedule E.

Irrespective of the nature of the offering, it is important that it be filed with the NASD at the same time it is submitted to the SEC or other state or federal agency. This helps to assure that the Association will have completed its review of the offering by the time the other reviewing agencies are ready to declare the offering effective. Under Guide 17 of the Guides for the Preparation of Registration Statements (and proposed changes to Rule 401), the SEC will not declare an offering effective unless the underwriting arrangements have been reviewed by the Association. To coordinate the processing of offerings, the Association's staff routinely informs the Commission's staff of the status of the Association's review.

Some state securities administrators also seek to coordinate their processing of offerings with the Association's review. Upon the request of any member, the Association will provide ongoing information on the status of an offering to state administrators designated by the member. To institute this process, the member should specifically request such coordination and provide a list of states to receive the information.

Members should be aware of certain procedures which can significantly expedite Association review of an offering, especially during periods of high volume. First, as discussed above, the offering should be filed with the Association at the same time it is filed with the SEC or other reviewing agency. Second, the filing should include all required documents and be accompanied by an accurately computed filing fee. (See pages 2024-27 and 1087 to 1087-2 of the NASD manual for details on filing of documents and calculation of fees respectively.)

Thirdly, questions which are likely to arise regarding the offering should be anticipated and responded to in the initial filing. If an exemption from a particular requirement is

going to be necessary, a request for the exemption and supporting arguments may be included in the initial filing.

Where a similar offering (e.g. an earlier direct participation program by the same sponsor) has been reviewed by the Corporate Financing Department, it is helpful for documents to be marked to show changes from documents for the earlier offering.

Lastly, the staff of the Corporate Financing Department may be contacted to resolve any procedural questions before an offering is filed. The Department stands ready to assist members in understanding and complying with Association filing requirements wherever possible. A conference with the staff prior to the time of filing can often alleviate problems and expedite processing of the offering.

## Securities Received as Underwriting Compensation

The Association has recently received several inquiries relating to the receipt by members of warrants or other securities as compensation for the distribution of public offerings. These inquiries frequently relate to offerings of units containing both warrants and other debt or equity securities.

The Corporate Financing Interpretation places certain restrictions on securities which are deemed to be received in connection with a public offering. The Interpretation generally limits the amount of such securities to ten percent of the number of securities being offered to the public. (See NASD Manual (CCH) at p. 2030.)

This standard is readily understood when warrants to purchase common stock are received as compensation for distributing common stock. Questions arise, however, when the security received by the underwriter is different than that sold to the public.

The Association believes that in some instances it is advantageous to an issuer to compensate an underwriter with warrants or other securities. The use of non-cash compensation may be particularly beneficial to smaller issuers. Accordingly, the Association has concluded that the criteria used to compute such compensation should be clarified.

First, the Association does not require securities received as underwriting compensation to be the same as, or exercisable or convertible into, the security offered to the public. The receipt of common stock warrants for the distribution of units, for example, is permissible.

As noted above, however, the Interpretation requires that the amount of securities received as compensation must be no greater than ten percent of the amount of securities sold. Where the securities received as underwriting compensation are exercisable or convertible into the securities offered to the public, calculation of the ten percent limit shall be based on the number of securities which would result from exercise or conversion, i.e. the number of underlying securities. Where the securities received by the underwriter are different than those being offered to the public, the calculation shall be based on relative dollar amounts, with the value of any equity securities being computed at the then current market value of the securities or the underlying securities. Where no market exists, the securities' value will be determined by the Association on a case-by-case basis, taking into account book value and other relevant factors.

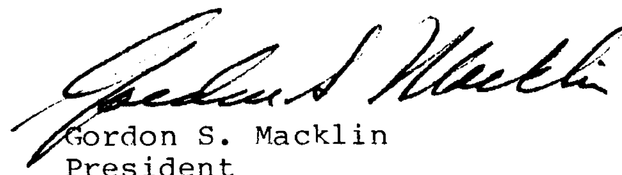
By way of example, common stock warrants received for the distribution of a debt issue would be limited to that number of warrants exercisable into common stock having a market value equal to ten percent of the dollar amount of debt sold.

Notwithstanding possible benefits of non-cash compensation, two types of arrangements for such compensation are viewed by the Association as unfair and unreasonable. The receipt by an underwriter of warrants or options which are exercisable below the initial public offering price of the underlying security or which are for terms in excess of five years from the effective date of the offering is considered unfair. Because the Association believes that an underwriter generally should not negotiate more favorable terms for itself than for its customers, securities received as compensation should not be exercisable or convertible on more favorable terms than securities being offered to the public.

* * * * *

Any questions concerning this Notice may be directed to Dennis C. Hensley or Harry E. Tutwiler of the Association's staff at telephone number (202) 833-7240.

Sincerely,



Gordon S. Macklin
President

NOTICE TO MEMBERS: 81-18
Notices To Members should
be retained for future reference.

# NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

## MEMORANDUM

TO: All NASD Members

FROM: John H. Hodges, Jr.

DATE: May 11, 1981

SUBJECT: Expansion of Computer Assisted Execution (CAE) System Pilot

On February 20, 1981, the Computer Assisted Execution (CAE) System began operating on a pilot basis. In general, CAE enables firms to direct orders in exchange-listed securities to off-board market makers for automatic execution.

Enclosed is a list of the seventeen firms currently participating in CAE as order entry firms and/or market makers. Exchange member firms that are participating as market makers are trading 19c-3 eligible securities.

As a result of the initial success of the pilot, the NASD Market Services, Inc. Board of Directors, which oversees CAE, has approved a limited expansion of the pilot to include additional members desiring to participate as order entry firms or as both order entry and market maker firms. Order entry firms may connect to CAE either through a computer interface with their own internal systems or through the new Harris-built terminal that is used for NASDAQ Service and CQS (with printer). Market makers will utilize their new Harris terminal (with printer). There are no fees associated with participating in the pilot.

Members that are interested in learning more about participating in the pilot should write to John H. Hodges, Jr. at the NASD in Washington, D.C.

Enclosure

* * *

# CAE PILOT PARTICIPANTS

| Participant | Role |
|---|---|
| Blunt Ellis & Loewi, Inc.<br>225 E. Mason Street<br>Milwaukee, Wisconsin 53202 | Order Entry (Terminal) |
| B. C. Christopher & Co.<br>4800 Main Street<br>Kansas City, Missouri 64112 | Order Entry (Terminal)<br>Market Maker |
| A. G. Edwards & Sons, Inc.<br>One N. Jefferson Avenue<br>St. Louis, Missouri 63178 | Order Entry (Computer Interface) |
| Elkins & Co.<br>1700 Market Street<br>Philadelphia, PA 19103 | Order Entry (Terminal) |
| Merrill Lynch, Pierce, Fenner & Smith, Incorporated<br>One Liberty Plaza<br>165 Broadway<br>New York, NY 10006 | Order Entry (Computer Interface)<br>Round Lot Market Maker<br>Odd Lot Market Maker |
| Piper, Jaffray & Hopwood, Inc.<br>Multifoods Bldg.<br>733 Marquette<br>Minneapolis, Minnesota 55402 | Order Entry (Terminal)<br>Market Maker |
| Prescott, Ball & Turben<br>900 National City Bank Bldg.<br>Cleveland, OH 44114 | Order Entry (Terminal)<br>Market Maker |

| | |
|---|---|
| American Securities Corporation<br>25 Broad Street<br>New York, NY 10004 | Market Maker |
| Amswiss International Corporation<br>30 Montgomery Street<br>Jersey City, NJ 07302 | Market Maker |
| Atlantic Capital Corporation<br>40 Wall Street<br>New York, NY 10005 | Market Maker |
| Bernard L. Madoff<br>110 Wall Street<br>New York, NY 10005 | Market Maker |
| Cantor, Fitzgerald & Co., Inc.<br>232 N. Canon Drive<br>Beverly Hills, CA 90210 | Market Maker |
| First Southwest Company<br>Mercantile Bank Bldg.<br>Dallas, TX 75201 | Market Maker |
| Jerry Williams, Inc.<br>709 N. Florida Avenue<br>Tampa, FL 33602 | Market Maker |
| M. A. Schapiro & Co., Inc.<br>1 Chase Manhattan Plaza<br>New York, NY 10005 | Market Maker |
| Sherwood Securities Corp.<br>30 Montgomery Street<br>Jersey City, NJ 07302 | Market Maker |
| M. S. Wien & Co., Inc.<br>30 Montgomery Street<br>Jersey City, NJ 07302 | Market Maker |

26 May, 1981

NOTICE TO MEMBERS: 81-21
Notices to Members should be retained for future reference.

TO: All members of the: American Stock Exchange
Chicago Board Options Exchange
Midwest Stock Exchange
National Association of Securities Dealers
New York Stock Exchange
Pacific Stock Exchange
Philadelphia Stock Exchange
and all brokers or dealers subject to the rules of the Municipal Securities Rulemaking Board

RE: Availability of a Study Outline for the General Securities Sales Supervisor Qualification Examination (Test Series 8)—A Proposed New Category of Principal Registration

ATTN: TRAINING DIRECTORS AND REGISTRATION PERSONNEL

The purpose of this notice is to inform general securities broker/dealers subject to the jurisdiction of the above organizations of new developments in the registration of certain supervisory persons. A Study Outline for the General Securities Sales Supervisor Qualification Examination (Test Series 8) is now available from the participating Self Regulatory Organizations (SRO's).

## Background

For a number of years, certain supervisory persons in general securities broker/dealers, mainly branch office managers and regional and national sales supervisors, have been required to qualify for their positions with the SRO's by passing individual qualification examinations. Newly appointed general securities branch office managers, for example, would normally be required to pass four examinations: the Registered Options Principal Examination (Test Series 4) for the Options Exchanges, the Municipal Securities Principal Examination (Test Series 53) for the Municipal Securities Rulemaking Board, the General Securities Principal Examination (Test Series 24) for the National Association of Securities Dealers, and the Branch Office Managers Examination (Test Series 12) for the New York Stock Exchange. Recognizing the amount of duplicative testing on a common core of regulatory material on these tests, a committee composed of representatives of the industry and the various SRO's began work in 1980 to develop a new examination designed to eliminate this duplication and provide for a consolidated qualifying program. The new Series 8 examination will also eliminate material which is being tested in the separate principal examinations dealing with regulatory matters other than sales supervision that are subject to main office direction.

The joint industry/SRO committee began by determining the duties normally performed by a principal supervising securities salespersons. The

committee then identified the industry regulations that are applicable to sales supervisory situations and constructed a Study Outline of the material that such a principal would need to know to supervise general securities registered representatives. The construction of a test question bank by the industry/SRO committee is nearly completed and it is expected that this examination will be implemented in the summer of 1981 following approval by the Securities and Exchange Commission.

## Persons to Whom this Examination Applies

The General Securities Sales Supervisor Qualification Examination (Test Series 8) is designed to test new sales supervisory principals, primarily branch office managers. It is not a requalification program for currently registered principals. A branch office manager or other general securities sales supervisor who has already completed one or more of the separate principal examinations has the option of completing the others which may apply, or of qualifying by passing this new examination. Under the rules of the various SRO's, the Series 8 examination may not qualify a candidate to function at a senior management level or to supervise functions other than sales, such as underwriting, trading or overall firm compliance. Furthermore, the Series 8 examination will not qualify an individual to function as a Senior Registered Options Principal (SROP) or as a Compliance Registered Options Principal (CROP). Should a sales supervisor who passes this test later move to a position in a firm involving the supervision of areas other than sales or become designated as a SROP or CROP, that person may then be subject to the individual principal examinations required by the appropriate SRO's. Reference is made to the qualification rules of the SRO's for specifics on the supervisory responsibilities such persons can assume.

## Structure of the Examination

The General Securities Sales Supervisor Qualification Examination consists of 200 questions and a candidate must answer 70% of the questions correctly to achieve a passing score. The tests will be administered on the PLATO System at Control Data Learning Centers. The test will be divided into two parts of 100 questions each. Each part will have an allowed testing time of three hours. Part I is divided into two sections: the first dealing solely with options; the second, only with municipal securities. Part II will cover all the remaining material in the outline. Part I must be taken before Part II can begin. The examination score will appear at the end of Part II only.

* * *

Availability of the Study Outline

The Study Outline is offered at this time to allow training directors sufficient time to consolidate their training programs for the separate principal examinations in order to meet the standards of the proposed Sales Supervisor Qualification Examination. Copies of the study outline are available from the SRO's listed below.

Prior to implementing the examination, certain of the SRO's must receive Securities and Exchange Commission approval of rule changes allowing for this new category of registration. As mentioned above, it is anticipated that the required rule changes will be effective by the summer of 1981 and that the program can be implemented at that time.

Questions regarding this notice may be directed to the persons designated below representing each of the participating Self Regulatory Organizations.

| | | |
|---|---|---|
| (AMEX) | Howard A. Baker | (212) 938-2470 |
| (CBOE) | Michael Satz | (312) 431-5730 |
| (MSE) | Craig Long | (312) 368-2279 |
| (MSRB) | Peter H. Murray | (202) 223-9347 |
| (NASD) | David Uthe | (202) 833-7273 |
| (NYSE) | Rebecca Swaim | (212) 623-6948 |
| (PHLX) | Christian Huber | (215) 546-9434 |
| (PSE) | Margaret Johnson | (415) 393-4114 |

NOTICE TO MEMBERS 81-22
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 1, 1981

TO: All NASD Members

RE: Interpretation of the Term "Fair Market Price at the Time of Purchase" Contained in Article III, Section 8(a) of the Rules of Fair Practice

Numerous inquiries have been received from the membership concerning the precise time at which a determination of fair market price should be made under Section 8(a) with respect to securities taken in trade for shares which are part of a public offering.

Section 8 (a) provides:

> (a) A member engaged in a fixed price offering, who purchases or arranges the purchase of securities taken in trade, shall purchase the securities at a fair market price at the time of purchase or shall act as agent in the sale of such securities and charge a normal commission therefor. (emphasis added)

Many swap transactions, and the prices at which they are to be effected, are arranged at the time of pricing of the fixed price offering. This usually occurs on the afternoon prior to effectiveness of the offering, whereas the transaction is not consummated until the following day upon effectiveness of the offering.

The inquiries received have expressed the view that for purposes of determining the fair market price of the securities taken in trade, the price should be determined as of the time the terms of the "swap" are arranged, rather than the time the purchase is legally consummated.

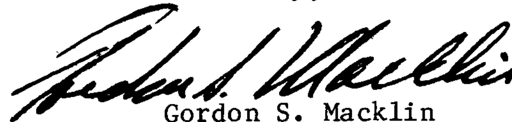
If it were required that the fair market price of the swapped securities be determined as of the time of effectiveness, the members taking the securities in trade would risk engaging in an inadvertent overtrade in violation of Section 8(a) because of the potential for market change as to the swapped securities between the time the terms of

the swap are arranged and the time the transaction is legally consummated. The Association believes this result would have no valid regulatory purpose and that the proper interpretation of Section 8(a) permits the determination of the fair market price of the securities taken in trade to be as of the time the terms of the swap are arranged, generally at the time of pricing of the offering, rather than at the time of effectiveness of the offering.

As indicated by the attached correspondence, the staff of the Securities and Exchange Commission has no objection to the concept embodied in the Interpretation. Accordingly, the Interpretation below makes clear that the term "fair market price at the time of purchase" means the price at the time the arrangement was made to swap the securities. This Interpretation is effective immediately. Of course, as to swaps agreed upon at a time after effectiveness of the offering, fair market price of the swapped security must be determined as of the time the transaction is legally consummated.

If there are any questions with respect to this matter, please contact Robert E. Aber, Assistant General Counsel, at (202) 833-7259.

Sincerely,



Gordon S. Macklin
President

Attachment

* * * *

The INTERPRETATION OF THE BOARD OF GOVERNORS to Article III, Section 8 of the Rules of Fair Practice is amended by the addition of the following new topical paragraph.

<u>Fair Market Price at the Time of Purchase</u>

Swap transactions that are arranged before the effectiveness of a fixed price offering are not generally viewed as being legally consummated until effectiveness of the fixed price offering. Nonetheless, the fair market price of securities taken in trade in such situations is normally determined at the time of the pricing of the fixed price offering, which occurs on the day before effectiveness usually in the afternoon, and the swap is arranged on the basis of that price. In such cases, for purposes of Section 8(a), the determination of the "fair market price at the time of purchase" of the security to be taken in trade may be made as of the time of pricing of the fixed price offering. As to swaps agreed upon at a time after effectiveness of the offering, fair market price of the swapped securities must be determined as of the time the transaction is legally consummated.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

May 8, 1981

Mr. Frank J. Wilson
Senior Vice President Regulatory Policy
and General Counsel
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Frank:

In your letter of March 23, 1981, you inquired whether I had any objection to an interpretation that you wish to make known to members with respect to new Section 8 of Article III of the Rules of Fair Practice of the National Association of Securities Dealers, Inc. (the "NASD"). On the basis of your letter, our telephone conversation on that date, and my meeting on March 25, 1981 with you and other members of the NASD staff, I understand the facts to be as follows.

Section 8, as approved by the Commission on December 12, 1980, 1/ provides, in part, "A member, engaged in a fixed price offering, who purchases or arranges the purchase of securities taken in trade shall purchase the securities at a fair market price at the time of purchase . . . ." There may be several reasons why securities are "taken in trade," or swapped, in connection with underwritten offerings, particularly debt offerings. For example, a swap may enable an institutional customer to purchase a security being distributed when the institution does not have available cash to pay for it or, for other reasons, does not wish to pay cash.

The NASD has received inquiries from its members as to what date would be considered "the time of purchase" for purposes of determining "fair market price" of a security taken in trade in the case of swaps where the price of the security to be taken in trade is determined at the time of pricing of the offered security but before the effective date of the offering. You state that the price of the security to be taken in trade is determined at the time of the pricing of the offering, usually around 4:00 p.m. on

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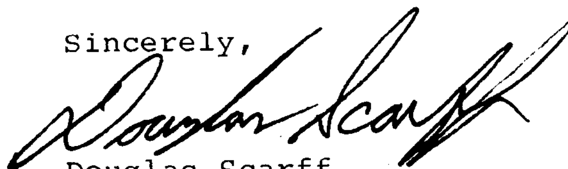
1/ Securities Exchange Act Release No. 17371 (December 12, 1980).

the day before the offering is planned to become effective. With respect to the securities to be taken in trade it is your view that "the time of purchase" is the time at which the price of those securities is determined. 2/ We do not have any objection to your advising your members of that interpretation. We do believe, however, that it should be filed with the Commission for immediate effectiveness under Section 19(b)(3)(A)(i) of the Act as a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of Article III, Section 8 of the NASD's Rules of Fair Practice. If you should have any questions about any of the foregoing, please consult Roger D. Blanc or Jeffrey L. Steele of this Division.

Sincerely,



Douglas Scarff
Director

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2/ Although the price of the security to be swapped is set at the time of pricing of the underwritten security, the swap transaction, like the transaction in the underwritten security, "is not legally consummated until effectiveness of the offering."

NOTICE TO MEMBERS NO. 81-23
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 1, 1981

IMPORTANT

PLEASE DIRECT THIS NOTICE
TO ALL
FINANCIAL AND OPERATIONAL OFFICERS AND PARTNERS

TO: All NASD Members

RE: SEC Staff Amends Interpretation Concerning Item Two of the Formula for Determination of Reserve Requirement Under Rule 15c3-3

Recently the staff of the Securities and Exchange Commission advised the Association that an interpretation issued subsequent to the adoption of Rule 15c3-3 (the "Rule") has been amended.

The interpretation concerns monies borrowed by a broker-dealer which are collateralized by securities carried for the accounts of customers. Since the adoption of the Rule, the staff of the Commission had interpreted this portion of the Rule to mean that securities which are not offset by corresponding proprietary long positions and which are used to collateralize a bank loan are deemed to be considered customer securities. This conclusion required that the market value of such securities be included as a credit in the Reserve Formula under Item 2 thereof.

The interpretation presumed that all securities in bank loan for which the broker-dealer did not have a corresponding proprietary long position were customer securities. However, in some instances, securities in firm bank loan allocate to the account(s) of a partner, a director or an officer of the broker-dealer who is a "customer" as that term is defined in paragraph (a)(1) of Rule 15c3-3.

Accordingly, the staff of the SEC has amended the interpretation to provide for the exclusion of securities maintained in the accounts of partners, directors, and officers who are not customers from Item 2 of the Reserve Formula, as follows:

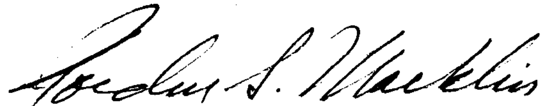
> "The market value of securities loaned in firm bank loan for which the broker or dealer does not have a corresponding proprietary long position and which do not allocate to the account of a

partner, a director or officer of the broker or dealer who is not a customer under paragraph (a)(1) of Rule 15c3-3 (17 CFR 240.15c3-3) shall be included as a credit in Item two of the formula." (changes underlined)

A copy of the new interpretation is enclosed for your convenience.

If you have any further questions concerning this interpretation, please call either John J. Cox, Assistant Director, or Donald J. Catapano, Research Analyst, Department of Policy Research at (202) 833-7320 or (202) 833-7209, respectively.

Sincerely,



Gordon S. Macklin
President

Enclosure

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

May 5, 1981

Mr. Douglas Parrillo
National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Parrillo:

As you know, Item two of the Formula for Determination of Reserve Requirement for Brokers and Dealers under Rule 15c3-3 (17 CFR 240.15c3-3) adopted pursuant to the Securities Exchange Act of 1934 includes "[m]onies borrowed collateralized by securities carried for the account of customers." That item was interpreted by the Division shortly after the adoption of Rule 15c3-3 as follows:

> The market value of securities lodged in firm bank loan for which the broker or dealer does not have a corresponding proprietary long position shall be included as a credit in Item-two of the formula. *
>
> Securities Exchange Act Release No. 9922 (January 2, 1973) p. 4.

That interpretation created a presumption that all securities in firm bank loan for which the broker or dealer did not have a corresponding proprietary long position were customer securities. It appears, however, that in some cases, securities in firm bank loan allocate to the accounts of partners or officers of the broker or dealer, who are not included within the definition of "customer" in Rule 15c3-3. Hence inclusion of their securities in the interpretation seems inappropriate.

Accordingly, the Division of Market Regulation has amended the interpretation quoted above as follows:

---

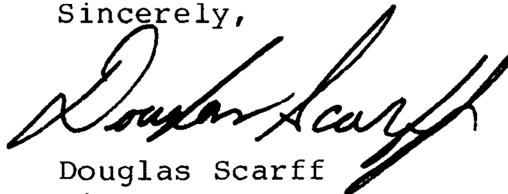
* See also the discussion in the Release as to the term "customer".

> "The market value of securities lodged in firm bank loan for which the broker or dealer does not have a corresponding proprietary long position and which do not allocate to the account of a partner, a director or officer of the broker or dealer who is not a customer under paragraph (a)(1) of Rule 15c3-3 (17 CFR 240.15c3-3) shall be included as a credit in Item two of the formula."

As part of the Commission's review of its financial responsibility rules relating to broker-dealers, comments were received suggesting that the substance of the above interpretation be extended to situations where the securities of another broker-dealer are commingled temporarily in a bank loan with firm securities. While we understand that such commingling may occur through operational error, and is corrected promptly in most cases, it is nonetheless a violation of the Commission's hypothecation rules for the duration of any commingling.

Before this issue can be resolved we need to clarify conflicting definitions currently in Rules 8c-1 and 15c2-1 and Rule 15c3-3 applicable to this situation. We believe that this conflict should be resolved first in order to address this proposal properly. We will respond to this point in the course of our general financial responsibility review.

Sincerely,



Douglas Scarff
Director

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

June 19, 1981

TO: All NASD Members and Municipal Securities Bank Dealers

ATTN: All Operations Personnel

RE: Independence Day Trade Date - Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Friday, July 3, 1981, in observance of Independence Day. "Regular-Way" transactions made on the business days 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 | 25 | July | 2 | July | 7 |
| | 26 | | 6 | | 8 |
| | 29 | | 7 | | 9 |
| | 30 | | 8 | | 10 |
| July | 1 | | 9 | | 13 |
| | 2 | | 10 | | 14 |
| | 3 | Independence Day Observance | | | — |
| | 6 | | 13 | | 15 |

The foregoing settlement dates should be used by brokers, dealers and municipal securities dealers for purposes of clearing and settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice. Questions regarding this notice should be directed to the Uniform Practice Department of the NASD at (212) 938-1177.

Sincerely,

Gordon S. Macklin
President

* Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 4(c)(6), make application to extend the time period specified. The date by which members must take such action for the trade is shown in the column entitled "Regulation T Date."

**American Stock Exchange, Inc.**
**Chicago Board Options Exchange, Inc.**
**Midwest Stock Exchange, Incorporated**
**National Association of Securities Dealers, Inc.**
**Pacific Stock Exchange Incorporated**
**Philadelphia Stock Exchange, Inc.**

# IMPORTANT

PLEASE DISTRIBUTE THIS MEMORANDUM TO
THE SENIOR REGISTERED OPTIONS PRINCIPAL,
THE COMPLIANCE REGISTERED OPTIONS PRINCIPAL, AND
OTHER REGISTERED OPTIONS PRINCIPALS

June 1, 1981

## M E M O R A N D U M

TO: Members of Two or More of the Above-Referenced Self-Regulatory Organizations

RE: The Agreement of the Above-Referenced Self-Regulatory Organizations ("SRO") to Reduce Options Regulatory Duplication

Recently, the self-regulatory organizations having options programs developed a plan to reduce regulatory duplication and overlap relative to options-related sales practice matters for a large number of firms currently belonging to two or more participating organizations. The plan, which has been formalized in an agreement filed for approval with the SEC, covers your firm.

The plan provides for a council which will be composed of representatives of the American, Midwest, Pacific and Philadelphia Stock Exchanges, the Chicago Board Options Exchange and the National Association of Securities Dealers.

The plan was developed in accordance with SEC Rule 17d-2 and is generally described as an "allocation plan." Under the plan, one of the self-regulatory organizations of which your firm is a member will examine areas of options-related sales practice activity which are of regulatory concern. This examining function will include responsibility for the following:

- conducting options examinations and inspections;
- investigating options-related customer complaints; and,
- investigating options-related terminations for cause.

The organization designated to perform those functions is known as a firm's "Designated Options Examining Authority," or "DOEA."

Periodically, reallocation of firms subject to the plan will take place, i.e., there will be some form of rotation among the self-regulatory organizations for participating member firms. This rotation process will not pose any problems for your firm, inasmuch as its operations will remain unchanged by the reallocation process.

The plan deals only with options-related sales practice rules. It does not affect the financial and operational or reporting aspects of a firm. Accordingly, FOCUS Part I and Part II filings should continue to be filed by a firm in accordance with current procedures.

The plan does not relate to membership services; thus, the status quo relative to the registration process remains in effect. All applications submitted on behalf of persons seeking to become associated, or to change the nature of their association with your firm should be filed in the same manner as such are currently handled. The same is true of termination notices which are required to be filed on behalf of persons no longer associated with your firm.

While the plan provides that a firm's DOEA will check registration requirements and investigate terminations for cause, the registration process in effect at each participating SRO remains unchanged.

Your firm also retains the right, under the plan, to file advertising and sales literature with any of those SROs it chooses, i.e., such material need not be filed with the firm's DOEA unless it chooses to so do. The DOEA will, in the course of its routine examination program, check that your firm has complied with the advertising rules of each relevant SRO.

A more detailed summary of the manner in which the plan will affect your firm will be distributed following SEC approval of the plan.

This plan will reduce unnecessary regulatory duplication by allocating to a single self-regulatory organization the responsibility for performing most options-related sales practice investigative and disciplinary functions for each participating member which otherwise would have to be performed by each self-regulatory organization. It represents a more efficient and effective use of facilities and staff and will reduce, significantly, the cost common members must bear.

The particular self-regulatory organization which is your firm's DOEA will notify you of this in a separate mailing.

* * * *

NOTICE TO MEMBERS 81-25
Notices to Members should be retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

June 26, 1981

MEMORANDUM

TO: All NASD Members

RE: NASD Guide to Information and Services

To assist members and others with questions concerning any of the various regulatory programs administered by the Association or any of the services it provides, the enclosed 1981 edition of the NASD Guide to Information and Services has been prepared. The Guide contains the names and telephone numbers of the various Association staff members who work most closely with the rules, regulations and services listed.

For your information, copies of this Directory are being sent to all main and branch offices of members. Additional copies can be obtained by sending a self-addressed mailing label, together with the number of copies requested, to:

National Association of Securities Dealers, Inc.
Attention: Office Services
1735 K Street, N. W.
Washington, D. C. 20006

The enclosed Guide is a new publication which the Association intends to update on a yearly basis. Any comments and suggestions for improving subsequent editions of the Guide are indeed welcome and should be directed to Thomas P. Mathers at (202) 833-4827.

Sincerely,

Gordon S. Macklin
President

Enclosure

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

July 1, 1981

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

RE: Group Fidelity Bond Buying Program

In March 1974, the NASD adopted a fidelity bonding rule which applies to all members with employees who are required to be members of the Securities Investor Protection Corporation (SIPC). The rule was developed in response to a request from SIPC that broker/dealer losses caused by fraud or dishonesty be excluded from the risks assumed by that corporation.

The application of the fidelity bonding rule has caused considerable irritation, concern and difficulty for many NASD members, particularly those who are required to carry relatively small amounts of coverage. Members have experienced problems in acquiring a bond because only a few insurance companies issue such a bond. Some members have had their bonds cancelled because their insurer has withdrawn from the market. Also, there is a wide disparity in premium rates for members with similar risk exposures and apparently little attention is paid in setting rate levels to the different risk exposures in the various categories of member firms, e.g., self clearing v. introducing members. In addition, applications for bonds are complex and contain many questions which are unrelated to the securities activities of many members. Some members have spent countless hours searching for a company which will write a bond and shopping for coverage which appears, at times, to be almost impossible to obtain.

The Fidelity Bonding Committee has frequently discussed these problems of availability and inequity and is well aware of the frustrations members have experienced in the fidelity bonding area. The Committee has reached the conclusion that a group buying program may be the best available solution to many of these problems assuming, of course, that the specifications of such a program will be compatible with the interests of the membership and the proper insurance industry support can be obtained.

The objective of such a program would be to provide the minimum coverage an NASD member is required to carry under the provisions of the NASD fidelity bonding rule (Article III, Section 32 NASD Rules of Fair Practice) at

a fair and equitable cost based upon the nature of the member's risk exposure, with a maximum limit of coverage per member firm in the range of $200-$500,000 (the precise limit has yet to be decided).

The Committee believes that the following benefits could result from such a program:

1. Setting a maximum limit of coverage per member firm would limit the program's exposure to extreme catastrophic loss and yet would enable most NASD members to meet their minimum fidelity bonding requirements within the program. This could have a favorable impact on overall premium rate levels.

2. Premium rates would be uniform for members with similar risk exposures. Association access to statistical information about the operation of the program would help to ensure that premium rates are fair and equitable for the different categories of members.

3. Membership in the NASD would automatically qualify members for inclusion in the program, thus, the problems experienced by some members in obtaining bonds would be obviated. In this connection, we would hope to streamline application and billing procedures and provide automatic coverage and renewal for NASD members in good standing.

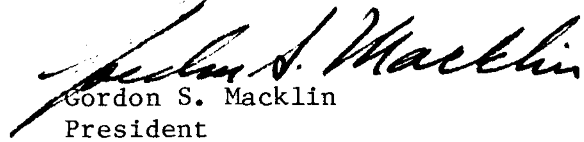
The Board of Governors, on the recommendation of the Fidelity Bonding Committee, has appointed a nationally known insurance brokerage and consulting firm to design and implement a group buying program. As a first step, it has asked the NASD to collect various items of information about member operations and fidelity bond experience so it can commence to design specifications and set rate levels.

Each member who is subject to the NASD fidelity bonding rule (i.e., sole NASD members who are required to be members of SIPC) should complete and return the attached form to the Variable Contracts Department, National Association of Securities Dealers, Inc., 1735 K Street., N.W. Washington, D.C. 20006.

Questions about the program or the questionnaire should be directed to A. John Taylor, Vice President, Variable Contracts (202) 833-7318. Members who are required, by the provisions of the rule, to carry bonding coverage in excess of $500,000 need not complete the questionnaire.

From preliminary inquiries of several insurance companies made by our insurance consultant it is apparent that if a group program is to be successful, most eligible NASD members must participate. A question has been included in the attached form which asks each member to indicate its interest in the proposed program. The number of positive answers to this question will have a great influence on whether we can proceed with the development of the program. Please complete and return the questionnaire by July 24, 1981.

Sincerely,



Gordon S. Macklin
President

**SAMPLE**

**NASD**

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

CCC1X
NASD EXECUTIVE OFFICE
D F PARRILLO (PR)
1735 K ST NW
WASHINGTON DC 20006

# NASD FIDELITY BOND SURVEY — 1981

**MEMBER INFORMATION**

1). Sole Proprietorship: ☐ Partnership: ☐ Corporation: ☐

2). Number of Associated Persons:
Officers and Employees: ________ Independent Contractor Registered Representatives: ________

3). Number of Branch Offices: ________

**FIDELITY BOND INFORMATION:**

1). (a) Name of your Fidelity Bond Insurance Company: ________________

(b) Fidelity Bond Form (e.g. Form 14, Form B): ________________

2). Annual premium for your current Fidelity Bond: $ ________________
(If 3 yr. pre-paid divide by 3).

3). Next renewal date is (month/day/year): ________________

(Over)

4). Limits of Insurance:

| Insuring Agreements | Present Coverage | Minimum Coverage Required by NASD Rule (If different from present coverage) |
|---|---|---|
| Basic | $ ______ | $ ______ |
| D-Forgery (1) | $ ______ | $ ______ |
| E-Securities (2) | $ ______ | $ ______ |
| Fraudulent Trading | $ ______ | $ ______ |
| Extortion | $ ______ | $ N/A |
| Deductible | $ ______ | $ ______ |

Note (1) — Also known as Insuring Clause 5 — Forgery or Alteration.
Note (2) — Also known as Insuring Clause 6 — Extended Forgery.

5). Does your bond contain a rider covering independent contractor registered representatives?

Yes: ☐ No: ☐

6). Does your bond contain a rider excluding principal owners?

Yes: ☐ No: ☐

**LOSS EXPERIENCE:**

7). List each loss covered by your bond which occurred during the last three years:

| Type (Employee Dishonesty, Securities Loss, etc.) | Gross Amount | - Deductible | = Covered Amount | Circle One | |
|---|---|---|---|---|---|
| | | | | Paid | Pending |
| 1. ______ | $ ______ | $ ______ | $ ______ | 1 | 2 |
| 2. ______ | $ ______ | $ ______ | $ ______ | 1 | 2 |
| 3. ______ | $ ______ | $ ______ | $ ______ | 1 | 2 |

8). List dishonesty losses caused by independent contractor registered representatives during the last three years, whether or not covered by your bond:

**Gross Amount**

1. $ ______
2. $ ______
3. $ ______

9). Please indicate whether your firm would participate in a Group Fidelity Bond Program.

Yes: ☐ No: ☐

______ Member

______ Principal

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

July 17, 1981

TO: All NASD Members

RE: The Investment Bankers, Inc.
1634 Welton Street
Denver, Colorado 80202

ATTN: Operations Officer, Cashier, Fail-Control Department

On Wednesday, July 15, 1981, the United States District Court for the District of Colorado appointed a SIPC trustee for the above captioned firm. 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:

SIPC Trustee

James H. Turner, Esquire
Gorsuch, Kirgis, Campbell, Walker and Grover
1200 American National Bank Building
Denver, Colorado 80202
Telephone: (303) 534-1200

* * * *

NOTICES TO MEMBERS 81-28
Notices to Members should be
retained for future reference

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON, D.C. 20006 • (202) 833-7200

July 30, 1981

TO: All NASD Members

RE: Sebag (Joseph) Incorporated
523 W. Sixth Street
Los Angeles, California 90014

ATTN: Operations Officer, Cashier, Fail-Control Department

On Monday, July 27, 1981, the United States District Court for the Central District of California appointed a SIPC trustee for the above captioned firm. 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:

<u>SIPC Trustee</u>

Eugene W. Bell, Esquire
Jones, Bell, Simpson, Gansinger & Abbott
800 Wilshire Boulevard
Los Angeles, California 90017
Telephone: (213) 485-1555

NOTICES TO MEMBERS 81-29
Notices to Members should be retained for future reference

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

July 30, 1981

TO: All NASD Members

RE: First State Securities Corp.
1350 N. E. 125th Street
North Miami, Florida 33161

ATTN: Operations Officer, Cashier, Fail-Control Department

On Friday, July 24, 1981, the United States District Court for the Southern District of Florida appointed a SIPC trustee for the above captioned firm. 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:

SIPC Trustee

John L. Britton, Esquire
Britton, Cohen, Kaufman, Benson & Shantz
Southeast First National Bank Building
Miami, Florida 33131
Telephone: (305) 371-5192

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST · WASHINGTON, D.C. 20006 · (202) 833-7200

July 31, 1981

PLEASE DIRECT TO

COMPLIANCE AND OTC TRADING DEPARTMENTS

TO: All NASD Members

RE: Matters Relating to SEC Suspension of Trading in Triad Energy Corporation

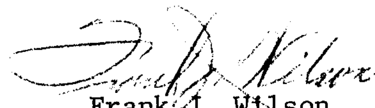
On July 22, 1981, the Securities and Exchange Commission instituted a ten-day trading suspension in Triad Energy Corporation (NASDAQ Symbol TRUE) because of a lack of adequate and accurate information regarding the financial condition of the company. Enclosed is a copy of the Commission's Order of Suspension of Trading and Release No. 34-17957 which describe in greater detail the basis for the SEC's trading suspension. The suspension terminates at midnight on July 31, 1981.

Effective with the termination of the SEC trading suspension, and pursuant to the request of Triad Energy Corporation, the Company's securities will no longer be quoted in the NASDAQ System.

Members should pay particular attention to the last paragraph in the Commission's Release No. 34-17957 which deals with the applicability of SEC Rule 15c2-11. Due to the absence of adequate and accurate financial information, members are advised that no quotations for Triad Energy Corporation may be entered in any quotations medium unless compliance with all provisions of SEC Rule 15c2-11 can be demonstrated.

Should you have any questions regarding the above, please contact either Christopher Franke or Michael Callahan in the Association's Market Surveillance Section at (202) 833-4889.

Sincerely,



Frank J. Wilson
Executive Vice President
and General Counsel

Enclosure

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

July 22, 1981

| | |
|---|---|
| In the Matter of Trading in the Securities of<br><br>Triad Energy Corporation<br>File No. 500-1<br><br>Securities Exchange Act of 1934<br>Section 12(k) | ORDER OF SUSPENSION OF TRADING |

It appearing to the Securities and Exchange Commission that there is a lack of adequate and accurate information concerning the financial condition of Triad Energy Corp., that Triad Energy Corp. has been unable to locate certain of its checkbooks, financial records and assets and currently has no information as to the whereabouts of Samuel F. McNell, the company's President, who had been personally managing Triad's day-to-day operations, the Commission is of the opinion that the public interest and the protection of its investors require a suspension of trading in the securities of Triad.

THEREFORE, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that the suspension of trading of such securities will be effective at 2:00 p.m. (EDT) on July 22, 1981, and terminating at midnight (EDT) on July 31, 1981.

By the Commission.

George A. Fitzsimmons
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Securities Exchange Act of 1934
Release No. 34-17957

The Securities and Exchange Commission announced, pursuant to Section 12(k) of the Securities Exchange Act of 1934 ("Exchange Act"), the single ten-day suspension of exchange and over-the-counter trading for the period commencing at 2:00 p.m. (EDT) on July 22, 1981, and terminating at midnight (EDT) on July 31, 1981, of the securities of Triad Energy Corporation ("Triad"), a Delaware corporation, with principal executive offices located at 111 Broadway, New York, NY.

The Commission suspended trading in the securities of Triad at the request of the company because of a lack of adequate and accurate information concerning the financial condition of the company. Specifically, Triad has been unable to locate certain of its checkbooks, financial records, and assets and currently has no information as to the whereabouts of Samuel F. McNell, the company's President who had been personally managing Triad's day to day operations and, as previously announced by Triad, has been missing since last week.

The Commission cautions brokers, dealers, shareholders and prospective purchasers that they should carefully consider the foregoing information along with all other currently available information and any information subsequently issued by the company.

Furthermore, brokers and dealers should be aware of the fact that, pursuant to Rule 15c2-11 under the Exchange Act, at the termination of the trading suspension, no quotation may be entered unless and until they have strictly complied with all the provisions of such rule. If any broker or dealer has any questions as to whether or not he has complied with such rule, he should not enter any quotation but immediately contact the staff of the Division of Enforcement in Washington, D.C. If any broker or dealer is uncertain as to what is required by Rule 15c2-11, he should refrain from entering quotations relating to the securities in question until such time as he has familiarized himself with such rule and is certain that all of its provisions have been met. If any broker or dealer enters any quotation which is in violation of such rule, the Commission will consider the need for prompt enforcement action.