

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-44

## Number 88 - 44

**Route To:**

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
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- Syndicate
- Trading
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- Other

### IMPORTANT MAIL VOTE

**Subject: Proposed Rule Amendments: Supervision and the Definitions of "Office of Supervisory Jurisdiction" and "Branch Office"; Conforming Amendment To By-Laws—Last Voting Date: August 1, 1988.**

#### EXECUTIVE SUMMARY

NASD members are invited to vote on proposed amendments to Article III, Section 27 of the NASD Rules of Fair Practice and a conforming amendment to Article 1 of the NASD By-Laws. The amendments to Article III, Section 27 would (1) prescribe specific supervisory practices and procedures for all member firms and (2) revise the definitions of "office of supervisory jurisdiction" (OSJ) and "branch office." The conforming amendment would delete the present definition of "branch office" from the By-Laws. The texts of the proposed amendments follow this notice.

#### BACKGROUND

In recent years, the NASD has become increasingly concerned that some persons associated with members may be engaging in the offer and sale of securities to the public without adequate ongoing supervision. In particular, the potential for significant regulatory problems exists when registered representatives conduct business at locations that are not subject to regular examination by the member and operate without direct oversight of qualified supervisory personnel.

In addition to these concerns, the NASD has considered whether certain aspects of a firm's business

should be subject to on-site supervision by a registered principal so that the member can properly discharge its regulatory obligations. Further, the NASD has from time to time considered whether the definition of "branch office" in the By-Laws should be revised.

The NASD's concern about off-site employment was discussed in detail in Notice to Members 86-65 (September 12, 1986), which emphasized existing NASD rules that most directly apply to off-site employment. That notice stated that the NASD was continuing to study the need to revise requirements for designating offices of supervisory jurisdiction and branch offices and for on-site supervision by registered principals.

On June 29, 1987, the NASD issued Notice to Members 87-41, which requested comments on (1) proposed amendments to the definitions of "office of supervisory jurisdiction" and "branch office" and (2) proposed requirements for on-site registered principals at a business location based upon the number of persons and the extent to which such location was advertised or otherwise designated as an office of the member.

As a result of the comments received in response to these proposals, the NASD issued Notice to Members 88-11 on February 8, 1988, requesting comments on proposed amendments to Article III, Section 27 of the Rules of Fair Practice that set forth specific minimum requirements for supervisory practices and procedures for NASD members and redefinitions of "office of super-

visory jurisdiction" and "branch office."

The proposed amendments set forth herein are substantially similar to the proposals set forth in Notice to Members 88-11.

## PROPOSED AMENDMENTS

### Supervision Rules

The proposed amendments substantially expand the specificity of Article III, Section 27 of the NASD Rules of Fair Practice with respect to a member's supervisory obligations. The NASD believes that the new provisions will assist members in ensuring compliance with applicable laws, regulations, and rules by requiring that firms review their businesses and construct and document a supervisory system that is reasonably designed to achieve compliance with the securities laws and regulations and NASD rules applicable to the various areas of the securities business in which NASD members are engaged.

The proposals also contain certain minimum required supervisory procedures and practices that the NASD believes to be necessary in any firm, regardless of size or type, in order to supervise adequately an investment banking and/or securities business.

The amendments require each firm to establish and maintain supervisory procedures and practices that provide for, at a minimum, the following:

- (1) Establishment and maintenance of written supervisory and review procedures as specified in the proposed amendments;
- (2) Designation of appropriately registered principals for each type of business in which the firm engages to carry out the firm's supervisory obligations;
- (3) Designation as an OSJ for each location that meets the OSJ definition and any other locations for which such designation is appropriate to enable the firm to supervise properly, viewed in light of certain factors enumerated in the proposed amendments;
- (4) Designation of one or more appropriately registered principal(s) in each OSJ, including the main office, and one or more appropriately registered representative(s) or principal(s) in each branch office to carry out the supervisory responsibilities and activities assigned to that office by the member;
- (5) Assignment of each registered person to a supervisor;
- (6) Reasonable efforts to ensure that all supervisory personnel are properly qualified;
- (7) Participation of each registered representative, individually or collectively and not less than annually, at an interview or meeting at which compliance matters

relevant to the activities of such representative(s) are discussed;

(8) Designation and identification to the NASD of one or more principals who shall review the firm's supervisory practices and procedures and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations and with the rules of the NASD; and

(9) Establishment of a schedule for examining the firm's branch offices that takes into account the nature of the activity, volume of business, and number of persons at each office.

The proposed amendments would require that each firm maintain written supervisory procedures that describe the supervisory system implemented according to the above requirements and that list the titles, registration statuses, and locations of the required supervisory personnel and the specific responsibilities assigned to each. A copy of the member's supervisory procedures, or the relevant parts thereof, would be required to be kept and maintained at each OSJ and at each other location where supervisory activities are conducted on behalf of the member. The member would be required to amend its written supervisory procedures, as appropriate, within a reasonable time after changes occur in applicable laws, regulations, and rules, and in the firm's supervisory system, and to communicate these changes throughout its organization.

Members also would be required to conduct a review, at least annually, of the businesses in which it engages for purposes of detecting and preventing violations of, and achieving compliance with, applicable laws, regulations, and rules. At a minimum, this would include: (1) periodic examination of customer accounts to detect and prevent irregularities and abuses; (2) annual inspection of each OSJ; and (3) inspection of branch offices in accordance with a schedule to be set forth in the member's supervisory procedures. The member would be required to retain a written record of the dates upon which each inspection and review was conducted.

In addition to the foregoing, the amendments would also revise and clarify certain existing provisions of Section 27.

### Definitions of "Office of Supervisory Jurisdiction" and "Branch Office"

An "office of supervisory jurisdiction" (OSJ) is currently defined in Article III, Section 27 of the NASD Rules of Fair Practice as "...any office designated as directly responsible for the review of the ac-

tivities of registered representatives or associated persons in such office and/or any other offices of the member." Under the proposed amendments, an OSJ would be any business location of a member firm at which *one or more* of the following functions take place:

- (1) Order execution and/or market making;
- (2) Structuring of public offerings or private placements;
- (3) Maintaining custody of customers' funds and/or securities;
- (4) Final acceptance (approval) of new accounts on behalf of the member;
- (5) Review and endorsement of customer orders pursuant to the provisions of proposed Article III, Section 27(d);
- (6) Final approval of advertising or sales literature for use by persons associated with the member, pursuant to Article III, Section 35(b)(1) of the Rules of Fair Practice; or
- (7) Responsibility for supervising the activities of persons associated with the member at one or more other offices of the member.

The term "branch office" is currently defined in Article I, Section (c) of the NASD By-Laws as "... an office which is owned or controlled by a member, and which is engaged in the investment banking or securities business." An Explanation of the Board of Governors in Schedule C to the NASD By-Laws reiterates this definition and also provides that a place of business of a person associated with a member is considered a branch office if the member: (1) directly or indirectly contributes a substantial portion of the operating expenses of such place of business; and/or (2) authorizes a listing in any publication or other media, including a professional dealers digest or telephone directory, that designates a place as an office or if the member designates any such place as an office to another organization.

The proposed amendment would define "branch office" as any business location of the member identified to the public or customers by any means as a location at which the investment banking or securities business is conducted on behalf of the member, excluding any location identified solely in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the office of the member responsible for supervising the activities of the identified location.

#### Conforming Amendments to NASD By-Laws

Article I of the NASD By-Laws sets forth certain definitions applicable to terms used in the By-Laws and

the Rules of Fair Practice. Section (c) defines "branch office" and would be amended to reflect that the term is now to be defined Article III, Section 27 of the Rules.

#### Effective Date

If the foregoing proposals are approved by the membership and by the Securities and Exchange Commission (SEC), the Board of Governors believes that it is appropriate to provide members with a period of time following SEC approval to bring their supervisory practices and procedures into compliance. The Board has concluded, therefore, that the amendments will take effect six months following SEC approval.

#### Comments Received

The NASD received 44 comment letters in response to Notice to Members 88-11. After a review and discussion of the comments, the Board made certain modifications that are reflected in the attached text of the proposed amendments. The most significant of these are:

- (1) The enumeration of certain factors relevant to the determination of the need to designate additional OSJs for general supervisory purposes (*see* proposed Section 27(a)(3)).
- (2) Clarification of certain matters regarding the annual compliance meeting or interview required for all registered representatives (*see* proposed Section 27(a)(7)).
- (3) The deletion of the reference to a "compliance" principal in proposed Section 27(a)(8).
- (4) The substitution of "titles" for "names" of persons identified in the firm's written procedures as part of its supervisory "chain of command," with the addition of a requirement to make and keep a separate record of all persons designated as supervisory personnel (*see* proposed Section 27(b)(2)).
- (5) The codification of the NASD's position that the required review of all transactions and correspondence be conducted by a registered principal (*see* proposed Section 27(d)).
- (6) The deletion of approval of correspondence from the enumeration of functions giving rise to the OSJ definition (*see* proposed Section 27(f)(1)).
- (7) The addition of a requirement that telephone directory line listings, business cards, and letterhead identifying non-branch locations also set forth the address and telephone number of the firm's office responsible for supervising the identified location (*see* proposed Section 27(f)(2)).

The Board of Governors believes that the proposed

amendments are necessary and appropriate and recommends that members vote their approval.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to "The Corporation Trust Company." Ballots must be postmarked *no later than August 1, 1988*.

Questions concerning this notice can be directed to Dennis C. Hensley, NASD Vice President and Deputy General Counsel, at (202) 728-8245, or Jacqueline D. Whelan, Senior Attorney, NASD Office of General Counsel, at (202) 728-8270.

**PROPOSED AMENDMENTS TO ARTICLE III, SECTION 27 OF THE NASD RULES OF FAIR PRACTICE**

Note: New language is underlined; deleted language is in brackets.]

**Sec. 27.**

**[Written procedures**

(a) Each member shall establish, maintain and enforce written procedures which will enable it to supervise properly the activities of each registered representative and associated person to assure compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder and with the rules of this Association.]

**Supervisory system**

(a) Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the rules of this Association. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by paragraphs (b) and (c) of this Section.

(2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker-dealer is required.

(3) The designation as an office of supervisory jurisdiction ("OSJ") of each location that meets the definition contained in paragraph (f) of this Section. Each member shall also designate such other OSJs as it determines to be necessary in order to supervise its registered representatives and associated persons in accordance with the standards set forth in this Section, taking into consideration the following factors:

(i) whether registered persons at the location

engage in retail sales or other activities involving regular contact with public customers;

(ii) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;

(iii) whether the location is geographically distant from another OSJ of the firm;

(iv) whether the member's registered persons are geographically dispersed; and

(v) whether the securities activities at such location are diverse and/or complex.

(4) The designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.

(5) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.

(6) Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities.

(7) The participation of each registered representative, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the member at which compliance matters relevant to the activities of the representative(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative's(') place of business.

(8) Each member shall designate and specifically identify to the Association one or more principals who shall review the supervisory system, procedures, and inspections implemented by the member as required by this Section and who shall take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations, and with the rules of this Association.

**[Responsibility of member**

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

**Written procedures**

(b)(1) Each member shall establish, maintain and

enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable rules of this Association.

(2) The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to Section 27(a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the rules of this Association. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(3) A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the rules of this Association, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

**Written approval**

(c) Each member shall be responsible for keeping and preserving appropriate records for carrying out the member's supervisory procedures. Each member shall review and endorse in writing, on an internal record, all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction.]

**Internal inspections**

(c) Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with the rules of this Association. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected accord-

ing to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done and the number of associated persons assigned to the location. Each member shall retain a written record of the dates upon which each review and inspection is conducted.

**Review of activities and annual inspection**

(d) Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.]

**Written approval**

(d) Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction.

**Qualifications investigated**

(e) Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications and experience of any person prior to making such a certification in the application of such person for registration with this Association.

**"Office of supervisory jurisdiction"**

(f) "Office of supervisory jurisdiction" means any office designated as directly responsible for the review of the activities of registered representatives or associated persons in such office and/or in other offices of the member.]

**Definitions**

(f)(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

- (i) order execution and/or market making;
- (ii) structuring of public offerings or private placements;
- (iii) maintaining custody of customers' funds and/or securities;
- (iv) final acceptance (approval) of new accounts on behalf of the member;
- (v) review and endorsement of customer orders, pursuant to paragraph (d) above;
- (vi) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Article III, Section 35(b)(1) of the Rules of Fair Practice; or

(vii) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(f)(2) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding any location identified solely in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location is directly supervised.

**PROPOSED AMENDMENT TO ARTICLE I OF THE N  
BY-LAWS**

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

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

- .
- .
- .

(c) "branch office" means an office [located in the United States which is owned or controlled by a member, and which is engaged in the investment banking securities business;] defined as a branch office in Article III, Section 27 of the Rules of Fair Practice.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-45

## Number 88 - 45

### Route To:

- ✓ Senior Management
- ✓ Corporate Finance
- ✓ Government Securities

- ✓ Institutional
- ✓ Legal & Compliance
- ✓ Municipal
- ✓ Mutual Fund

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- ✓ Options
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- ✓ Research

- ✓ Syndicate
- ✓ Trading
- ✓ Training
- ✓ Other

### IMPORTANT MAIL VOTE

**Subject: Proposed New Rule: Outside Business Activities—Last Voting Date: August 1, 1988.**

#### EXECUTIVE SUMMARY

NASD members are invited to vote on a proposed new Section 43 to Article III of the NASD Rules of Fair Practice that would prohibit all persons associated with a member in any registered capacity from accepting employment or compensation from any other person as a result of business activity outside the scope of the employment relationship with a member unless prompt written notice to the member firm is provided. This provision will not apply to compensation from passive investments and activities subject to the requirements of Article III, Section 40 of the Rules of Fair Practice. The text of the proposed rule follows this notice.

#### BACKGROUND

On January 14, 1988, the NASD issued Notice to Members 88-5, which solicited comments on a proposed NASD Rule of Fair Practice prohibiting any person associated with a member firm from being employed by, or accepting compensation from, any other person based on any business activity outside the scope of the employment relationship with a member firm, unless such person had provided prior written notice to that firm.

When requesting comments concerning the proposed rule, the NASD Board of Governors observed

that the expansion of the financial services industry had provided increased business opportunities for persons associated with member firms, both within the scope of their employment with a member and otherwise. The Board noted that in recent disciplinary cases, prior notice to a member firm of an associated person's outside business activities might have prevented harm to the investing public or the firm's entanglement in legal difficulties. The Board further observed that the internal rules of many member firms already included limitations on outside business activities and notification requirements, and that both the New York Stock Exchange and the American Stock Exchange require associated persons of member firms to notify their firms of outside business activities.<sup>1</sup> The Board concluded that it was appropriate for member firms to receive prompt notification of all outside business activities of their associated persons so that the member's objections, if any, to such activities could be raised at a meaningful time and so that appropriate supervision could be exercised as necessary under applicable law.

#### SUMMARY OF COMMENTS

The NASD received 62 comments in response to Notice to Members 88-5. Of these, 13 generally supported the proposed rule, 17 supported the rule with modifications, and 29 opposed the rule on various grounds. Three commentators, while taking no position on the rule's adoption, suggested amendments.

Thirteen commentators suggested that the rule's scope be limited to cover only securities- or financial services-related outside business activities. Five commentators suggested that disclosure on Form U-4 be used either to satisfy the proposed rule's notification requirement or in lieu of the rule. Three commentators supported the establishment of a *de minimis* reporting threshold.

The NASD Board reviewed the comments and concluded that the proposed rule should be adopted with certain modifications limiting the rule's application to persons associated with a member in a registered capacity and exempting passive investments and activities subject to the requirements of Article III, Section 40 of the NASD Rules of Fair Practice from the proposed rule's notice requirements. The Board determined that prompt, rather than prior notice, should be required. The Board also concluded that the form of the written notice required under the proposed rule should be determined by the employer-member and could therefore include using the Form U-4.

The NASD Board of Governors believes that the adoption of the proposed rule would serve to protect investors and the public interest by involving member firms in the review of the outside business activities of their registered personnel. Thus, the Board believes that the proposed rule is necessary and appropriate and recommends that members vote their approval.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped en-

velope to "The Corporation Trust Company." Ballots must be postmarked *no later than August 1, 1988*.

Questions concerning this notice can be directed to Norman Sue, Jr., Senior Attorney, NASD Office of General Counsel, at (202) 728-8117.

### PROPOSED NASD RULE OF FAIR PRACTICE

#### Outside Business Activities

**Sec. 42.** No person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member. Such notice shall be in the form required by the member. Activities subject to the requirements of Article III, Section 40 of the Rules of Fair Practice shall be exempted from this requirement.

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<sup>1</sup>New York Stock Exchange Rule 346(b), (e), and Supplementary Material .10; American Stock Exchange Rule 342(a), (b), and Commentary .20. Both organizations also require persons in supervisory positions to devote their entire time during business hours to the business of their firms and allow such persons to obtain permission from the exchange to devote less than full time to the business of their firm when it will not impair the protection of investors or the public interest.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-46

## Number 88 - 46

**Route To:**

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Trading
- Training
- Other

**Subject: Adoption of Rule Amendment to Authorize Trading Halts in NASDAQ Securities.**

**EXECUTIVE SUMMARY**

The Securities and Exchange Commission (SEC) recently approved new Section 42 of Article III of the NASD Rules of Fair Practice. The section prohibits NASD members from effecting, directly or indirectly, over-the-counter transactions in a security in which a trading halt is currently in effect.

The SEC also approved an amendment to Schedule D of the NASD By-Laws that provides procedures to be used by the NASD to halt over-the-counter trading in a NASDAQ security pending the dissemination of material news by the issuer or to halt over-the-counter trading in a security listed on a national securities exchange during a trading halt imposed by the exchange to permit the dissemination of material news.

The text of new Section 42 and the amendment to Schedule D are attached.

**BACKGROUND**

On May 5, 1988, the SEC approved Section 42 of Article III of the NASD Rules of Fair Practice. The new section prohibits an NASD member from effecting any transactions in the over-the-counter market in a security subject to a trading halt called by the NASD.<sup>1</sup> The SEC also approved amendments to Schedule D to the NASD By-Laws to provide procedures to be used

by the NASD when a trading halt is called. These procedures stipulate that the NASD may call a trading halt pending the dissemination of material news by the issuer of a NASDAQ security or halt over-the-counter trading in a security listed on a national securities exchange during a trading halt imposed by the exchange to permit the dissemination of material news. Finally, the SEC also approved conforming amendments to the provisions of Part II of Schedule D to the NASD By-Laws relating to the "Notification to NASD of News Releases" that reflect the changes to Schedule D and to Article III relating to trading halts.

**EXPLANATION OF AMENDMENTS**

Article III, Section 42 of the NASD Rules of Fair Practice prohibits NASD members from effecting any over-the-counter transactions, directly or indirectly, in a security in which a trading halt is currently in effect.

Part II, Section 5 of Schedule D provides that the NASD may authorize the initiation of a trading halt in NASDAQ securities in the over-the-counter market pending the dissemination of material news or a trading halt in the over-the-counter market of a security listed on a national securities exchange during a trading halt imposed by the exchange to permit the dissemination of material news.

Procedures for initiating a trading halt are provided in the amendments to Schedule D. These procedures include notifying the NASD Market Surveillance Section by NASDAQ issuers of the release of any

material news.<sup>2</sup> Upon receipt of such information from a NASDAQ issuer, and in consultation with the issuer, the NASD will evaluate the information, estimate its potential impact on the market, and determine whether a trading halt in the security is appropriate.

If a trading halt is deemed appropriate, notice of the trading halt will appear on the NASDAQ NEWS frame. As soon as notice of a trading halt appears on the NASDAQ NEWS frame, members will be prohibited from effecting any transactions in the halted security. Trading in the halted security will resume as soon as adequate time to disseminate the news has been given and upon notice via the NASDAQ NEWS frame that the trading halt is no longer in effect.

If an exchange notifies the NASD that it has halted or will halt trading in a listed security pending the dissemination of material news, the NASD may halt over-the-counter trading in the security. Members will be notified of the commencement of the trading halt through the NASDAQ NEWS frame. When notice of a trading halt appears on the NASDAQ NEWS frame, members will be prohibited from effecting any over-the-counter transactions in the halted security. As soon as adequate time for dissemination of the news has been given, over-the-counter trading may resume, as indicated via the NASDAQ NEWS frame, notwithstanding an ongoing halt on the exchange for order imbalances or other non-regulatory reasons.

The amendments to Part II of Schedule D relating to "Notification to NASD of News Releases" merely conforms the provisions of this section to reflect the changes to Schedule D and to Article III of the Rules of Fair Practice relating to trading halts.

Trading halts will normally last for one-half hour after the news has been published. The provisions of Section 42 and amended Schedule D are effective immediately.

Questions regarding this notice can be directed to either Eneida Rosa, NASD Assistant General Counsel, at (202) 728-8284, or James M. Cangiano, Director, NASD Market Surveillance, at (202) 728-8186.

<sup>1</sup> See File No. SR-NASD-87-13, Securities Exchange Act Release No. 25669 (May 5, 1988).

<sup>2</sup> Subsequent to approval of the rule amendments discussed in this notice, the SEC approved additional amendments to Part II of Schedule D relating to the "Notification to NASD of News Releases" to require that NASDAQ companies notify the NASD of the release of material information no later than simultaneously with the companies' release of such information to the public through the press and recommends

that issuers provide such information at least 10 minutes prior to the release of the information. This amendment will be the subject of a separate notice to members in the near future. See File No. SR-NASD-88-16, Securities Exchange Act Release No. 25792 (June 9, 1988).

### ARTICLE III OF THE NASD RULES OF FAIR PRACTICE NEW RULE

Note: New language is underlined; deleted language is in brackets.]

#### Sec. 42.

No member or person associated with a member shall, directly or indirectly, effect any transaction in a security as to which a trading halt is currently in effect.

### AMENDMENT TO PART II OF SCHEDULE D TO THE NASD BY-LAWS

#### Sec 5.

##### A. Authority to Initiate Trading Halts

In circumstances in which the Association deems it necessary to protect investors and the public interest, the Association may, pursuant to the procedures set forth in paragraph B:

- (1) halt trading in the over-the-counter market of a security authorized for inclusion in the NASDAQ System pending the dissemination of material news; or
- (2) halt trading in the over-the-counter market of a security listed on a national securities exchange during a trading halt imposed by such exchange to permit the dissemination of material news.

##### B. Procedure for Initiating a Trading Halt

(1) The Board of Governors recommends that NASDAQ issuers notify the NASD of the release of any material news no later than simultaneously with the release of such information to the press as required by Schedule D of the NASD By-Laws.

(2) Notification shall be provided directly to the NASD Market Surveillance Section by telephone, telecopier, or other means of immediate notification.<sup>1</sup> Information communicated orally by authorized representatives of a NASDAQ issuer should be confirmed promptly in writing. Where public release of information occurs after 6:00 p.m. Eastern Time, telephone notification should be made by 8:30 a.m. the following trading day.

(3) Upon receipt of the information, the NASD, after consultation with the issuer, will promptly evaluate the information, estimate its potential impact on the market and determine whether a trading halt in the security is appropriate.

(4) Should the NASD determine that a trading halt pending the dissemination of material news to the

marketplace is necessary and in the public interest, the trading halt will become effective simultaneously with appropriate notice in the NASDAQ NEWS frame.

(5) Should a national securities exchange notify the NASD that it has halted or will halt trading in a security listed on that exchange pending the dissemination of material news, the NASD may halt trading in such security in the over-the-counter market. The commencement of the trading halt will be effective simultaneously with appropriate notice in the NASDAQ NEWS frame.

(6) Trading in a halted security shall resume upon notice via the NASDAQ NEWS frame that a trading halt is no longer in effect.

### NOTIFICATION TO NASD OF NEWS RELEASES

Schedule D requires NASDAQ companies to disclose promptly to the public through the press any material information which may affect the value of their securities or influence investors' decisions. [The Board of Governors recommends that NASDAQ companies notify the NASD of the release of any such information no later than simultaneously with its release to the public through the press. Notification may be provided directly to the NASD Market Surveillance Department by telephone (call 202 728-8204). Information communicated orally should be confirmed promptly in writing. Where public release of information occurs after 5:30 p.m. Eastern Time, notification should be made by 9:30 a.m. of the following trading day.]

The purpose of this recommendation is to assist in maintaining a stable and orderly market for NASDAQ securities. One of the methods used by the NASD to accomplish such is the institution of NASDAQ [quotation] trading halts. A [quotations] trading halt benefits current and potential shareholders by halting the [display of quotations through] trading of securities in the NASDAQ System until there has been an opportunity for the information to be disseminated to the public. This decreases the possibility of some investors acting on information known to them but which is not known to others. A [quotations] trading halt normally lasts [about one to two hours] one half hour after the appearance of the news on wire services, but it may last

longer if a determination is made that the news has not been adequately disseminated. A [quotations] trading halt provides the public with an opportunity to evaluate the information and consider it in making investment decisions. It also alerts the marketplace to the fact that news has been released.

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

Material information which might reasonably be expected to affect the value of the securities of a company or influence investors' decisions would include information regarding corporate events of an unusual and/or nonrecurrent nature. The following list of events, while not an exhaustive summary of all situations in which disclosure to the NASD should be considered, may be helpful in determining whether information is material. It should also be noted that every development that might be reported to the NASD in these areas would not necessarily be deemed to warrant a [quotations] trading halt.

- a merger, acquisition or joint venture;
  - a stock split or stock dividend;
  - earnings and dividends of an unusual nature;
  - the acquisition or loss of a significant contract;
  - a significant new product or discovery;
  - a change in control or a significant change in management;
  - a call of securities for redemption;
  - the public or private sale of a significant amount of additional securities;
  - the purchase or sale of a significant asset;
  - a significant labor dispute;
  - establishment of a program to make purchases of the company's own shares;
  - a tender offer for another company's securities;
- and
- an event requiring the filing of a current report under the Securities Exchange Act of 1934.

<sup>1</sup> The current telephone number is (202) 728-8221.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-47

## Number 88 - 47

### Route To:

Senior Management  
 Corporate Finance  
 Government Securities

Institutional  
 Legal & Compliance  
 Municipal  
 Mutual Fund

Operations  
 Options  
 Registration  
 Research

Syndicate  
 Trading  
 Training  
 Other

### REQUEST FOR COMMENTS

**Subject: Proposed Amendment: Short Sales—Last Date for Comment: August 1, 1988.**

#### EXECUTIVE SUMMARY

The NASD is requesting comment on a proposed amendment to the Board of Governors' Interpretation on Prompt Receipt and Delivery of Securities (Interpretation). The amendment would require a member to make an affirmative determination, before effecting a short sale for its own account, that the security will be borrowed or delivered prior to the settlement date. The requirement would not apply to market-making or hedging transactions. The text of the proposed amendment follows this notice.

#### BACKGROUND AND ANALYSIS

Over the last several years, the NASD Board of Governors has adopted rules providing for additional regulation of short-sale practices in the over-the-counter market. In addition, it has amended its Interpretation on Prompt Receipt and Delivery of Securities to establish requirements for accepting customer short-sale orders.

At its May 1988 meeting, the Board discussed the possible need for additional regulation of short-selling practices in the over-the-counter market, particularly with respect to broker-dealer proprietary transactions. The Board determined to publish for comment an amendment to its Interpretation.

The Interpretation currently prohibits members from accepting a short-sale order from a customer unless the member makes an affirmative determination that it will receive delivery of the security from the customer or that it can borrow the security on behalf of the customer for delivery by settlement date. The term "customer," as defined in Article II, Section 1(f) of the NASD Rules of Fair Practice, excludes brokers and dealers.

The Board is considering amending the Interpretation to impose a similar requirement upon members effecting short sales for their own accounts. Under the proposed amendment, a member would be prohibited from effecting a short sale for its own account in any security unless the member makes an affirmative determination that it can borrow the security or otherwise provide for delivery of the security by the settlement date. The proposed amendment would not apply to transactions in corporate debt securities, to transactions by a member in securities in which it is registered as a NASDAQ market maker, or to transactions which result in a fully hedged or arbitrated position.

The Board is also soliciting comment on whether the proposed amendment should be reformulated to impose upon members an affirmative obligation to borrow the securities by settlement date.

The NASD encourages all members and other interested persons to comment on the proposed amendment. Comments should be received *no later than August 1, 1988.*

Comments should be directed to:

Mr. Lynn Nelliuss, Secretary  
National Association of Securities Dealers, Inc.  
1735 K Street, N.W.  
Washington, D.C. 20006-1506

Questions concerning this notice can be directed to  
Therese M. Haberle, NASD Office of General Counsel,  
at 202-728-8287.

**PROPOSED AMENDMENT TO THE INTERPRETATION OF  
THE BOARD OF GOVERNORS ON PROMPT RECEIPT  
AND DELIVERY OF SECURITIES**

Note: New language is underlined.

- .
- .
- .

(2) "Short" Sales

(a) No member or person associated with a member shall accept a "short" sale order for any customer in any security unless the member makes an affirmative determination that it will receive delivery of the security from the customer or that it can borrow the security on behalf of the customer for delivery by settlement date. This requirement shall not apply, however, to transactions in corporate debt securities.

(b) No member shall effect a "short" sale for its own account in any security unless the member makes an affirmative determination that it can borrow the securities or otherwise provide for delivery of the securities by the settlement date. This requirement will not apply to transactions in corporate debt securities, to transactions by a member in securities in which it is registered as a NASDAQ market maker or to transactions which result in fully hedged or arbitrated positions.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-48

## Number 88 - 48

**Route To:**

- |   |   |                                       |                                    |
|---|---|---------------------------------------|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional      | <input type="checkbox"/> Operations   | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance            | <input type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options      | <input type="checkbox"/> Trading   |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal          | <input type="checkbox"/> Registration | <input type="checkbox"/> Training  |
|   | <input type="checkbox"/> Mutual Fund        | <input type="checkbox"/> Research     | <input type="checkbox"/> Other     |

### REQUEST FOR COMMENTS

**Subject: Proposed By-Laws Amendment Concerning Filling Vacancies on District Committees – Last Date for Comment: August 1, 1988.**

#### EXECUTIVE SUMMARY

The NASD requests comment on a proposed amendment to Article VIII, Section 5 of the NASD By-Laws that would expedite the filling of vacancies created by departures of District Business Conduct Committee (DBCC) members during their terms and avoid the necessity of holding interim elections.

The amendment would provide for appointment of a person by the DBCC to fill the departing Committee member's seat until the next regularly scheduled election. At that time, the normal election process would occur to elect a Committee member to serve for the duration of the departing Committee member's term.

The text of the proposed amendment follows this notice.

The current procedure under Sections 5(a) and (b) of Article VIII of the NASD By-Laws sets forth a two-step mechanism. If the unexpired term of the Committee member causing the vacancy is less than 12 months, the vacancy is to be filled by appointment, by the remaining members of the DBCC, of a representative of a member firm having a place of business in the same district. If the unexpired term of the Committee member causing the vacancy is 12 months or more, the vacancy is to be filled by election conducted in accordance with the provisions of Section 4 of Article VIII.

The NASD Board of Governors believes that the current procedure may be burdensome and unnecessary. The Board, upon the recommendation of the Advisory Council and the National Business Conduct Committee, is therefore proposing to implement one procedure for situations involving unexpired terms of any length that result in a vacancy on a DBCC. That procedure would involve the appointment, by the remaining members of the DBCC, of a representative of a member firm doing business in the same district to fill the departing Committee member's seat until the next regularly scheduled election. Pursuant to the normal election process, a Committee member would then be elected to serve for the duration of the departing Committee member's term.

In so proposing, the Board recommends that in each instance, the DBCC should seriously consider former DBCC members for the appointments. Because of prior experience, such persons would readily be able

#### BACKGROUND AND SUMMARY OF AMENDMENT

The NASD is concerned about practical problems encountered by its District Offices when vacancies on a DBCC occur due to departures of Committee members during their terms. Such problems, including the necessity for holding special interim elections, would be alleviated by the proposed amendment to Article VIII, Section 5 of the NASD By-Laws.

to assume such a position and make a meaningful contribution.

The NASD encourages all members and other interested persons to comment on the proposed amendment. Comments should be directed to:

Mr. Lynn Nellius  
Secretary  
National Association of Securities Dealers, Inc.  
1735 K Street, N.W.  
Washington, D.C. 20006-1506

Comments must be received *no later than August 1, 1988*. Comments received by this date will be considered by the NASD National Business Conduct Committee and NASD Board of Governors. Any changes to the NASD By-Laws that are approved by the Board must be voted upon by the membership and thereafter filed with, and approved by, the Securities and Exchange Commission before becoming effective.

Questions concerning this notice can be directed to Deborah F. McIlroy, Attorney, NASD Office of General Counsel, at (202) 728-8816.

**PROPOSED AMENDMENT TO ARTICLE VIII OF THE  
NASD BY-LAWS**

Note: New text is underlined; deleted text is in brackets.

**Filling of Vacancies on District Committees**

**Sec. 5. All vacancies in any District Committee other than those caused by the expiration of a Committee Member's term of office shall be filled as follows:**

[(a) If the unexpired term of the member causing the vacancy is for less than twelve months, such vacancy shall be filled by appointment by the remaining members of the District Committee of some member of the Corporation having a place of business in the same district.

(b) If the unexpired term of the member causing the vacancy is for twelve months or more, such vacancy shall be filled by election, which shall be conducted as nearly as practicable in accordance with the provisions of Section 4 of this Article.]

The District Committee shall appoint a representative of a member firm having a place of business in the same district to fill any vacancy resulting from the unexpired term of a departed Committee Member. Such appointment shall be effective until the next regularly scheduled election occurs, in accordance with the provisions of Section 4 of this Article. Following this election, the newly elected Committee Member will serve only the duration of the departed Committee Member's term.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-49

## Number 88 - 49

**Route To:**

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Trading
- Training
- Other

### REQUEST FOR COMMENTS

**Subject: By-Law Amendment: Prohibition of Concurrent Registration Under Schedule C; Last Date for Comment: August 1, 1988**

#### EXECUTIVE SUMMARY

The NASD requests comment on a proposed amendment to Schedule C to the NASD By-Laws that would prohibit a person associated with a member from being registered concurrently in any capacity with any other member. The amendment would exempt from the prohibition those associated persons registered concurrently with affiliated members. The text of the proposed amendment follows this notice.

#### BACKGROUND

Neither the NASD By-Laws, the Schedules to the By-Laws, nor the NASD Rules of Fair Practice prohibit associated persons from registering concurrently with more than one member firm. Concurrent registration is, however, prohibited by a number of states. The NASD has observed that concurrent registration may give rise to confusion among public investors as to which employer-member is responsible for supervising the various sales efforts undertaken by a concurrently registered person and may also present opportunities for the registered person to engage in activities of which neither employer is aware.

Further, concurrent registration can result in a failure to supervise certain activities because each employer is of the belief that the other employer is super-

vising the registered person. The NASD believes that these difficulties may well outweigh any benefits that may attach to concurrent registration and that they may not be remediable by adopting additional supervisory rules. Therefore, the NASD Board of Governors has determined to seek member comment as to whether concurrent registration should be prohibited, with an exemption provided for concurrent registration with affiliated members. For purposes of the proposed amendment, affiliation would exist when one member controls, is controlled by, or is under common control with another member.

The NASD believes that the exemptive provision for affiliated members is appropriate because the confusion among the investing public and concurrent employers is less likely to occur in affiliate arrangements. For example, many affiliates utilize common or substantially similar names, which reduces the likelihood of investor confusion. The exemption also recognizes that some members have formed separate broker-dealers to offer a variety of products.

#### PROPOSED AMENDMENTS

New paragraph (1)(f) of Part II of Schedule C to the NASD By-Laws would prohibit concurrent registration of registered principals, with the above-described exemptive provision for concurrent registrations with affiliated members.

New paragraph (1)(d) of Part III would prohibit concurrent registration of registered representatives,

with the above-described exemptive provision for concurrent registrations with affiliated members.

The NASD encourages all members and interested persons to comment on the proposed amendments.

Comments should be directed to:

Mr. Lynn Nellius  
Secretary  
National Association of Securities Dealers, Inc.  
1735 K Street, N.W.  
Washington, D.C. 20006-1506

Comments must be received *no later than August 1, 1988*. Comments received by this date will be considered by the NASD Board of Governors. If approved by the NASD Board, the proposal must be filed with and approved by the SEC before becoming effective.

Questions concerning this notice can be directed to either Frank J. McAuliffe, Vice President, NASD Qualifications at (301) 738-6694, or Jacqueline D. Whelan, Senior Attorney, NASD Office of the General Counsel, at (202) 728-8270.

**PROPOSED AMENDMENTS TO SCHEDULE C TO THE NASD BY-LAWS**

**II**

**REGISTRATION OF PRINCIPALS**

**(1) Registration Requirements**

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. .

**(f) Prohibition of Concurrent Registrations**

A person associated with a member as a Registered Principal shall not be concurrently registered in any capacity with another member. This prohibition shall not apply to persons concurrently registered in any capacity with members that are affiliated organizations. For purposes of this paragraph, members shall be affiliated organizations if one controls, is controlled by, or is under common control with the other.

**III**

**REGISTRATION OF REPRESENTATIVES**

**(1) Registration Requirements**

.  
. .

**(d) Prohibition of Concurrent Registrations**

A person associated with a member as a Registered Representative shall not be concurrently registered in any capacity with another member. This prohibition shall not apply to persons concurrently registered in any capacity with members that are affiliated organizations. For purposes of this paragraph, members shall be affiliated organizations if one controls, is controlled by, or is under common control with the other.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-50

## Number 88 - 50

**Route To:**

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Trading
- Training
- Other

**Subject: Registration of Persons Soliciting on Behalf of Members Under Schedule C of the NASD By-Laws.**

**EXECUTIVE SUMMARY**

In response to member inquiries, the NASD is publishing guidelines that apply to the employment of unregistered persons to contact prospective customers. Unregistered persons may extend invitations to firm-sponsored events and inquire whether the prospective customer wishes to discuss investments with a registered representative or receive investment literature from the firm, *provided that* the firm observes certain practices with regard to the qualification, training, compensation, and supervision of the unregistered persons.

**BACKGROUND**

Section (1)(b), Part III of Schedule C to the NASD By-Laws defines "representative" as:

"Persons associated with a member . . . who are engaged in the investment banking or securities business for the member, including the functions of supervision, solicitation or conduct of business in securities . . ."

In Notice to Members 85-48, dated July 17, 1985, the NASD reviewed the applicability of Schedule C to the employment of unregistered persons to solicit new accounts on behalf of a member. The notice stated:

"This definition has been consistently interpreted by the NASD to require registration of persons who engage in activities that only constitute a portion of

registered representatives' traditional dealings with public customers. Thus, for example, members are required to register persons who are hired to accept orders from public customers, even if these orders are unsolicited; persons who share in the commissions generated from customer accounts; and persons who solicit accounts on behalf of members, notwithstanding any limitation of such solicitations to prepared scripts discussing generic products and services offered by the member."

On March 30, 1988, the NASD issued Notice to Members 88-24 and emphasized that the registration requirement articulated above is not intended to "restrict a member's administrative personnel, in the normal course of their duties, from contacting customers regarding routine administrative matters involving customers' accounts or from extending invitations to the public to firm-sponsored events, such as investment seminars at which any substantive presentations and account or order solicitations will be made by appropriately registered personnel."

In response to inquiries from members resulting from Notice to Members 88-24, the NASD wants to clarify the circumstances under which a member may employ unregistered persons to contact prospective customers.

**PERMISSIBLE ACTIVITIES OF UNREGISTERED PERSONS**

Unregistered persons may contact prospective cus-

tomers for purposes of:

- extending invitations to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel;
- inquiring whether the prospective customer wishes to discuss investments with a registered person; and
- determining whether the prospective customer wishes to receive investment literature from the firm.

Firms employing unregistered persons to perform these functions should observe the following guidelines:

(1) Pursuant to Section (1)(b), Part II of Schedule C to the By-Laws, unregistered persons may not discuss general or specific investment products or services offered by the firm, pre-qualify prospective customers as to financial status and investment history and objectives, or solicit new accounts or orders.

(2) The member should provide unregistered persons with orientation and training that specifically addresses the limitations of such persons' activities, the regulatory consequences of exceeding these limitations, and the fact that such persons are associated persons of the member, subject to the rules of the NASD and its disciplinary authority.

(3) The member should conduct a reasonable investigation of such persons' backgrounds to determine that

they are not statutorily disqualified from becoming associated with the member.

(4) Unregistered persons are regarded as employees of the member and should not be compensated on any basis other than a salary or hourly wage.

(5) The member should take reasonable steps to assure that the activities of unregistered persons are consistent with applicable state statutes and rules and with the rules of other self-regulatory organizations.

(6) The member should be able, upon request, to demonstrate that its supervisory procedures include procedures reasonably designed to prevent violative conduct by unregistered persons.

As stated in Notice to Members 88-24, the registration requirements of Section (1)(b), Part II of Schedule C to the NASD By-Laws do not apply to a member's administrative personnel who, in the normal course of their duties, contact existing customers regarding clerical or ministerial matters affecting such customers' accounts.

Members are advised to review the activities of unregistered employees to ascertain that such persons are not functioning in a manner requiring registration.

Questions concerning this notice can be directed to either Frank J. McAuliffe, Vice President, NASD Qualifications, at (301) 738-6694, or Jacqueline D. Whelan, Senior Attorney, NASD Office of the General Counsel, at (202) 728-8270.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-51

## Number 88 - 51

**Route To:**

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Trading
- Training
- Other

**Subject: Registration of Foreign Branch Offices by August 1, 1988.**

**EXECUTIVE SUMMARY**

The NASD has amended its By-Laws to require that members register with the NASD all branch offices located outside the United States. Article I, Section (c) of the NASD By-Laws defines the term "branch office" to include any office that is owned or controlled by a member and that is engaged in the investment banking or securities business.

Recently, the Securities and Exchange Commission (SEC) approved<sup>1</sup> the NASD's adoption of an amendment to delete the phrase "located in the United States" from the definition of "branch office," which technically restricted the NASD's branch office registration requirements to branches located only in the United States. The text of the amendment, with deleted language in brackets, is as follows:<sup>2</sup>

**ARTICLE II  
DEFINITIONS**

(c) "branch office" means an office [located in the United States] which is owned or controlled by a member, and which is engaged in the investment banking or securities business.

Therefore, the NASD is requiring members to register all branch offices regardless of their location by August 1, 1988. Pursuant to Article III, Section 7 of the NASD By-Laws, the NASD must be promptly advised of the opening or closing of any branch office. Such advice must be filed with the NASD on Schedule E to Form BD, the Uniform Application for Broker-Dealer Application adopted by the SEC.

Branch offices located outside the United States are assigned to an NASD District Office for purposes of examination, elections and other district-level functions.

The amendment does not affect the availability of the "foreign associate" category of registration for persons associated with foreign branch offices.<sup>3</sup>

Questions concerning this notice can be directed to the NASD Membership Department at (301) 738-6715.

<sup>1</sup> SEC Release No. 34-25428 (March 9, 1988).

<sup>2</sup> This amendment is separate from the more extensive amendment to the definition of "branch office" published most recently in Notice to Members 88-11 (February 8, 1988). Those amendments will incorporate the change announced here.

<sup>3</sup> Part IX of Schedule C to the NASD By-Laws exempts associated persons of a foreign branch office from the requirement to pass a qualification examination under certain circumstances.

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-52

## Number 88 - 52

### Route To:

- Senior Management
- Corporate Finance
- Government Securities

- Institutional
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research

- Syndicate
- Trading
- Training
- Other

### Subject: Amendment to Rule: Testimonial Advertisements.

#### EXECUTIVE SUMMARY

The Securities and Exchange Commission recently approved an amendment to Article III, Section 35(d)(2)(D) of the NASD Rules of Fair Practice relating to testimonials used in members' communications with the public. The rule amendment limits application of the rule on testimonial advertisements to testimonials concerning the quality of a member's investment advice and requires the disclosure of compensation paid to the person making a testimonial only if the compensation is more than a nominal amount. The text of the amendment follows this notice.

Notice to Members 87-67, dated October 14, 1987).

To conform with NYSE Rule 472.40(8), the NASD thereafter amended Article III, Section 35(d)(2)(D) to limit the standards governing testimonials to those testimonials that concern the quality of a firm's investment advice. In addition, the amended rule limits the requirement to disclose compensation paid to the person giving the testimonial to those situations when the compensation is more than a nominal amount.

Questions can be directed to either Eneida Rosa, NASD Assistant General Counsel, at (202) 728-8284, or R. Clark Hooper, Director, NASD Advertising Department, at (202) 728-8330.

#### AMENDMENT TO ARTICLE III, SECTION 35 OF THE NASD RULES OF FAIR PRACTICE

**Note:** New language is underlined; deleted language is in brackets.]

#### Communications With the Public

#### Sec. 35.

- .
- .
- .

#### (d) Standards Applicable to Communications With the Public

#### (2) Specific Standards

- .
- .
- .

(D) Testimonials: [Testimonial material concerning the member or concerning any advice, analysis, report, or other investment or related service rendered

#### BACKGROUND AND SUMMARY OF AMENDMENT

Article III, Section 35 of the NASD Rules of Fair Practice relates to members' communications with the public and contains specific standards governing testimonials used in such communications. The rule's provisions were originally adopted in 1980 and were patterned after the rules of other self-regulatory organizations for purposes of consistency and reduction of unnecessary burdens on dual members. Because the New York Stock Exchange has amended its testimonial rule provisions since then, a conforming amendment to Article III, Section 35(d)(2)(D) was approved by the NASD Board of Governors at its meeting on September 15, 1987, and then sent for NASD member vote. (See

by the member must make clear that such experience is not necessarily indicative of future performance or results obtained by others. Testimonials must also disclose that compensation has been paid to the maker directly or indirectly, if applicable, and if they imply an experienced or specialized opinion, the qualifications of the maker of the testimonial should be given.]

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

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

(ii) The testimonial is not indicative of future performance or success.

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

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

# Notice To Members

July 1988

National Association of Securities Dealers, Inc.

Number 88-53

**Number 88 - 53****Route To:**

- |   |   |  |   |
|---|---|--|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional      | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate        |
| <input type="checkbox"/> Corporate Finance            | <input type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options               | <input type="checkbox"/> Trading          |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal          | <input type="checkbox"/> Registration          | <input type="checkbox"/> Training         |
|   | <input type="checkbox"/> Mutual Fund        | <input type="checkbox"/> Research              | <input checked="" type="checkbox"/> Other |

**Subject: SIPC Trustee Appointed:**

**Fitzgerald, DeArman & Roberts, Inc.,  
6400 South Lewis, Tulsa, Oklahoma 74170**

**Attn: Operations Officer, Cashier, Fail-Control Department**

On June 28, 1988, the United States District Court for the Northern District of Oklahoma appointed a SIPC trustee for the above 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) 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  
P. David Newsome, Jr., Esquire  
Conner & Winters  
2400 First National Tower  
Tulsa, Oklahoma 74130  
Telephone: (918) 586-8555

# Notice To Members

National Association of Securities Dealers, Inc.

July 1988 - Supplement 1

## Number 88 - 54

### Suggested Routing:\*

- |   |  |  |   |
|---|--|--|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Institutional                 | <input type="checkbox"/> Mutual Fund           | <input type="checkbox"/> Research             |
| <input type="checkbox"/> Corporate Finance            | <input type="checkbox"/> Internal Audit                | <input checked="" type="checkbox"/> Operations | <input checked="" type="checkbox"/> Syndicate |
| <input type="checkbox"/> Government Securities        | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options               | <input checked="" type="checkbox"/> Trading   |
|   | <input type="checkbox"/> Municipal                     | <input type="checkbox"/> Registration          | <input type="checkbox"/> Training             |

\*These are suggested departments only. Others may be appropriate for your firm.

**Subject: Implementation of Reporting Requirements for Non-NASDAQ OTC Securities; Effective September 1, 1988.**

### EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved new Schedule H to the NASD By-Laws that establishes an electronic system of mandatory price and volume reporting for principal transactions in OTC equity securities that are not part of the NASDAQ System. Under new Schedule H, members that are NASDAQ subscribers will be required to use their NASDAQ/ Harris terminals, NASDAQ Workstations, or authorized foreign-terminal emulations to report the price and volume data under the minimum reporting thresholds required by Schedule H.

Those members that use a computer-to-computer interface (CTCI) with NASDAQ, either directly or through service bureaus, will be permitted to use that interface to report price and volume data as required by

Schedule H. Those Members that are not NASDAQ subscribers will be required to report through a dial-up electronic reporting system for non-NASDAQ OTC securities developed by the NASD for this purpose.

Implementation of the new reporting requirements will proceed in two phases. During Phase I, which will become effective on September 1, 1988, all members will be required to report price and volume data for all non-NASDAQ OTC equity securities that are cleared through the National Securities Clearing Corporation (NSCC). The second phase, which is anticipated to go into effect at the beginning of 1989, will require price and volume reporting for all non-NASDAQ OTC equity securities whether or not the securities are cleared through NSCC. The text of Schedule H follows this notice.

### BACKGROUND

The SEC recently approved new Schedule H to the NASD By-Laws,<sup>1</sup> which establishes an electronic system of mandatory price and volume reporting for OTC securities that are not part of the NASDAQ System.

The NASD adopted new Schedule H to en-

hance its regulatory capabilities to routinely surveil for trading abuses in the non-NASDAQ OTC securities market and in response to directives from the SEC urging the NASD to develop a nationwide automated market surveillance program for non-NASDAQ OTC securities. To address these concerns, the NASD Market Surveillance

Committee considered possible approaches to the routine surveillance of this market ("pink-sheet" securities<sup>2</sup>) and subsequently made a series of recommendations relative to price and volume reporting to the NASD Board of Governors. The Board approved the recommendations of the Market Surveillance Committee at its meeting on September 14, 1987.

Prior to the NASD's initiation of its automated surveillance system of the non-NASDAQ market, no facility existed for gathering, disseminating, and electronically testing market information in non-NASDAQ OTC issues. This lack of readily available and reliable transaction information created a serious impediment to the systemic automated surveillance of the non-NASDAQ OTC market and in general, hampered NASD regulatory efforts in this area. The electronic non-NASDAQ reporting system provides the means for creating a centralized data base of price and transaction information that will be subjected to a computerized market surveillance system to detect the types of violative practices that have been a concern for OTC issues traded outside the NASDAQ System. This automated surveillance system will generate computerized regulatory reports for use in addressing abuses (in "pink sheet" stocks) such as manipulation, fraudulent pricing and markups, and other serious sales/trading practices.

The NASD's enhanced oversight of the non-NASDAQ OTC securities market was fully supported by the NASD's Regulatory Review Task Force (Task Force) in its Final Report. In its discussion of the NASD's efforts to develop the non-NASDAQ reporting system, the Task Force indicated, in pertinent part, that it favored compliance with the mandatory reporting requirements of Schedule H by all firms. The Task Force further stated that "[T]he goal should be the development of surveillance capabilities comparable to those that exist for the NASDAQ market."<sup>3</sup>

### EXPLANATION OF AMENDMENTS

New Schedule H to the NASD By-Laws defines the terms "non-NASDAQ security" and "non-NASDAQ reporting system" and establishes minimum threshold-reporting requirements for non-NASDAQ OTC equity securities.

Section 1 of Schedule H defines the term "non-NASDAQ reporting system" as any

electronic price- and volume-reporting system operated by the NASD for non-NASDAQ securities. The term "non-NASDAQ security" is defined as any equity security that is neither included in the NASDAQ System nor traded on any national securities exchange.

Section 2 of Schedule H requires members executing principal transactions in non-NASDAQ equity securities to provide price and volume data for both purchase and sale transactions if the member's aggregate daily volume of sales or purchases exceeds either a minimum of 50,000 shares or \$10,000. In addition, members must report price and volume data for both sides of the market if the aggregate share or dollar volume is reached on either side of the market. For example, if a member executes an aggregate purchase volume in a non-NASDAQ issue of 70,000 shares and has an aggregate sale volume of 20,000 shares, it will be required to report both the purchase and sale sides of the transaction, as well as price data, because the minimum threshold level was reached on the buy side of the market. (Additional examples of the minimum reporting levels accompany the rules as explanatory material.) If they choose to do so, members may report even if the minimum threshold levels established by Schedule H are not reached.

Members meeting the daily minimum reporting levels are also required to report the highest price at which the member sold the non-NASDAQ OTC equity security and the lowest price at which it bought the non-NASDAQ OTC equity security, and indicate whether these trades were executed with a customer or with another broker-dealer. The price to be reported on customer transactions is inclusive of markups or markdowns.

Finally, the new rules also amend the *Interpretation of the Board of Governors Execution of Retail Transactions in the Over-the-Counter Market* (the "Best Execution Interpretation") by adding a new paragraph (D) that requires members to check a minimum of three dealers (or all dealers in a security if three or less) prior to executing any transaction on behalf of a customer in a non-NASDAQ security.<sup>4</sup>

### IMPLEMENTATION OF SCHEDULE H

The NASD will implement the price and volume reporting requirements of Schedule H in

two phases. In Phase I, all NASD members are required to report price and volume data on transactions in non-NASDAQ OTC securities that are cleared through the NSCC and that meet the minimum threshold-reporting requirements of Schedule H.<sup>5</sup> Phase II will require price and volume reporting for all non-NASDAQ securities whether or not the securities clear through NSCC. From the beginning of Phase I, the following additional requirements apply:

- Members have the option to report price and volume data under new Schedule H either between the hours of 4 p.m. and 6:30 p.m. Eastern Time on trade date or between 7:30 a.m. and 9 a.m. on the next business day. Members experiencing technical problems in reporting their trades of non-NASDAQ securities may call (800) 321-NASD for assistance.

- Members that are NASDAQ subscribers (e.g., Level 2/3 or TARS-only subscribers) will be required to use their NASDAQ/Harris terminals, NASDAQ Workstations, CTCI (direct and through service bureaus), or authorized foreign-terminal emulations to report the price and volume data required by Schedule H.

- Members that do not subscribe to NASDAQ service will be required to report through a dial-up electronic reporting system for non-NASDAQ securities that is similar in function to the system currently provided to NASDAQ subscribers.

*All firms using the dial-up, non-NASDAQ reporting system will be required to subscribe to and pay for the Telenet public network and possess a terminal or PC and a modem.* Appropriate hardware specifications and information as to the method of subscribing to the Telenet service will be provided to users of the dial-up, non-NASDAQ reporting system responding to the questionnaire discussed below and attached to this Notice.

- To comply with the provisions of Schedule H, members must use an electronic reporting system to meet the requirements to report price and volume information on non-NASDAQ OTC securities. *There are no provisions for hard-copy reporting;* thus failure to report via electronic means will be contrary to the rule.

#### **Non-NASDAQ Subscribers Questionnaire**

Members that are not NASDAQ subscribers are required to report principal trades in non-

NASDAQ issues pursuant to Schedule H through the NASD's dial-up electronic reporting system. To determine the universe of NASD members that will be required to use this reporting system, the attached brief questionnaire has been developed. *All NASD members that do not subscribe to NASDAQ service that transact any business in non-NASDAQ OTC securities must complete and return this questionnaire no later than July 27, 1988,* to Elizabeth Wollin, Assistant Director, NASD Automated Reports, 9513 Key West Avenue, Rockville, Maryland 20850.

Questions regarding this notice can be directed to either Elizabeth Wollin, Assistant Director, NASD Automated Reports, at (301) 738-6887, or James M. Cangiano, Director, NASD Market Surveillance, at (202) 728-8186.

<sup>1</sup> File No. SR-NASD-87-55, Securities Exchange Act Release No. 25637 (May 2, 1988).

<sup>2</sup> Non-NASDAQ OTC securities are commonly referred to as "pink sheet" securities because information on many of the securities is published by the National Quotation Bureau in its *Pink Sheets*.

<sup>3</sup> *Final Report of the NASD Regulatory Review Task Force* at p. 14.

<sup>4</sup> The provisions of Schedule H and its approval by the SEC also were discussed in NASD Notice to Members 88-40 (June 1, 1988). That Notice also solicited NASD member vote on a proposed amendment to Article III, Section 21 of the NASD Rules of Fair Practice. The proposed amendment will require the marking of customer order tickets to reflect the dealers contacted by members and the quotations received to determine the best inter-dealer market as required by the new amendment to the NASD's "Best Execution Interpretation," recently approved by the SEC in conjunction with new Schedule H.

<sup>5</sup> Prior to implementation of Phase I, the NASD will publish a list that establishes, as of a specific date, all of the securities subject to price and volume reporting under Schedule H during Phase I. The NASD anticipates approximately 7,000 issues will be involved.

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### **NEW SCHEDULE H TO THE NASD BY-LAWS**

#### **Section 1 – Definitions**

For purposes of Schedule H, unless the context requires otherwise:

(a) "Non-NASDAQ security" means any equity security that is neither included in the National Association of Securities Dealers Automated Quotations System nor traded on any national securities exchange.

(b) "Non-NASDAQ Reporting System" means the electronic price and volume reporting system operated by the Association for non-NASDAQ securities.

**Section 2 – Price and Volume Reporting**

(a) On any day that principal transactions in the non-NASDAQ security exceed an aggregate daily volume of sales or purchases of either a minimum of 50,000 shares or a minimum of \$10,000, each member shall report through the Non-NASDAQ Reporting System (i) the highest price at which it sold and the lowest price at which it purchased any non-NASDAQ security; (ii) the total volume of purchases and sales executed by it in any non-NASDAQ security; and (iii) whether the trades establishing the highest price at which the member sold and the lowest price at which the member purchased the security represented an execution with a customer or with another broker-dealer. The price to be reported for principal sales and purchases from customers shall be inclusive of markup or markdown.

The following examples illustrate the minimum reporting levels established by paragraph (a) above.

1. Dealer A executes aggregate purchases of 70,000 shares of AAA stock and executes aggregate sales of 20,000 shares of AAA stock. Because the minimum reporting requirement is exceeded by the purchases, Dealer A is required to report aggregate purchases of 70,000 shares, aggregate sales of 20,000 shares of AAA stock, and the highest price at which it sold and lowest price at which it purchased AAA stock, even though the volume of sales did not reach the minimum requirement.

2. Dealer B executes aggregate purchases of 60,000 shares of BBB stock and does not execute any sales of BBB stock. Dealer B is re-

quired to report purchases of 60,000 shares, zero volume of sales, and the lowest price at which it purchased BBB stock.

3. Dealer C executes aggregate purchases of 40,000 shares for a total of \$8,000 in CCC stock and executes aggregate sales of 49,000 shares for a total of \$9,900 in CCC stock. CCC stock is not subject to reporting by Dealer C, as neither the volume nor price of aggregate purchases or sales of CCC stock exceed the minimum requirements for reporting.

4. Dealer D executes aggregate purchases of 45,000 shares in DDD stock for a total of \$11,000 and executes aggregate sales of 35,000 shares in DDD stock for a total of \$9,000. Dealer D is required to report aggregate purchases of 45,000 shares and sales of 35,000 shares of DDD stock, as well as the highest purchase price and lowest sale price of DDD stock, because the aggregate purchase price exceeds the minimum requirement.

(b) Members shall report the price and volume information required by Section 2(a) above through the Non-NASDAQ Reporting System between the hours of 4 p.m. and 6:30 p.m. Eastern Time on the trade date or between 7:30 a.m. and 9 a.m. Eastern Time on the next business day or, at such other time as determined by the Association.

**INTERPRETATION OF THE BOARD OF GOVERNORS – EXECUTION OF RETAIL TRANSACTIONS IN THE OVER-THE-COUNTER MARKET**

Add the following new section:

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- .

(D) In any transaction for or with a customer pertaining to the execution of an order in a non-NASDAQ security (as defined in Schedule H to the By-Laws), a member or person associated with a member, shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.