

Notices to Members

YEAR 2000 UPDATE



July 1999

Year 2000: Will Your Firm Be Compliant?

Recognizing the importance of ensuring the Year 2000 readiness of the securities industry, the Securities and Exchange Commission (SEC) has taken key steps to encourage active compliance efforts by broker/dealers. The first of these actions required broker/dealers to submit two Form BD-Y2K progress reports under Rule 17a-5 of the Securities and Exchange Act of 1934. These progress reports were generally intended to:

- increase firm awareness of the Year 2000 issue;
- facilitate coordination of industry-wide testing, implementation, and contingency planning; and
- provide information on the overall readiness of the securities industry with respect to the Year 2000 issue.

The first of the Form BD-Y2K reports was due on August 31, 1998, and disclosed a firm's individual progress as of July 15, 1998. An updated Form BD-Y2K report was due on April 30, 1999, and, for certain firms, included a "Part III" Public Accountant's Report requesting external attestation of the firm's Year 2000 efforts. **Preliminary selected summary results of this information will be available on the Year 2000 Web Pages of www.nasd.com and www.nasdr.com.**

Also, in March 1999, the SEC published for comment proposed rules relating to operational capability. The proposed rules address the meaning of operational capability in the context of Year 2000 and would require a firm with a material Year 2000 problem on or after August 31, 1999, to file a notice with the National Association of Securities Dealers, Inc. (NASD[®]) and the SEC. A firm would be presumed to have a material Year 2000 problem if the firm:

- does not have procedures designed to identify, assess, and remediate Year 2000 problems in mission-critical systems;
- has not conducted reasonable testing of its mission-critical systems;
- has not completed applicable Year 2000 testing requirements imposed by the NASD or other self-regulatory organizations; and
- has not remediated all exceptions noted by the independent public accountant in Part III: Statement of Position of the Form BD-Y2K.

A firm filing notice of a material Year 2000 problem would be prohibited from conducting business, unless it also provided the NASD and the SEC with a certificate stating, among other things, that it is remediating the problem. The proposed rules would require the firm to be Year 2000 compliant by October 15, 1999, in order to remain in business. The comment period for the SEC's proposed rules expired on April 12, 1999.

While the SEC has not yet adopted the proposed operational capability and Year 2000 compliance rules, there are several points that firms should consider when reviewing their business operations, not only in anticipation of any SEC Year 2000 rulemaking, but also to ensure that all firms promptly achieve Year 2000 readiness.

Point-To-Point Testing

Broker/dealers with electronic interfaces to exchanges, utilities, or service providers should test the "point-to-point" information transfer between their firms and their service providers in a Year 2000 environment. Point-to-point testing is important in gauging a particular service provider's compatibility after January 1. It also alerts the firm to any potential problems that may require attention over the next several months. If your firm has not yet completed this stage of preparation, suggested steps in this process include:

1. Identify mission-critical third parties with an electronic interface, including exchanges, utilities, clearing firms, and other service providers.
2. Schedule testing with these parties directly. Point-to-point testing with the NASD for certain Nasdaq[®] and NASD Regulation[®] applications is available through September. To schedule testing, call the NASD Year 2000 Program Office at (888) 227-1330.
3. Develop a test script or plan that includes procedures to be followed during the test. Many third-party providers have conducted tests with other firms and may have a standardized test script or procedure in place.
4. Review for the availability of proxy test results. These "proxy statements" attest a product's Year 2000 compliance.

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Internal Testing

Any mission-critical system with an embedded chip is likely to be date-sensitive and should be tested to ensure its Year 2000 compatibility. Examples of systems with embedded chips include:

- Trading and Quotation Systems
- Heating, Cooling, and Ventilating Systems
- Application Software
- Security and other Building Systems
- Personal Computers and Hardware
- Fax Machines and Telephones
- Telephone Exchanges and Switches (PBXs)
- Other Firm-Specific Systems

These systems, particularly those that perform mission-critical functions, should be tested in a Year 2000 environment. Reconfigure the product's date to simulate a date after January 1, 2000, and check to see that the product functions, and that expected outputs are accurate. Testing methods range from in-house testing to externally developed software applications and specialized third-party consultants. For vendor-supplied systems, you should check with the appropriate vendor to verify that testing has been completed.

During the internal testing process, remember these tips:

1. Do not simply test the functionality of a given product; you should also test the product to ensure that it does not report corrupt or erroneous data. Undetected false data can often lead to greater problems than those caused by systems that simply do not function.
2. Do not assume that because a given business product was purchased recently, it is Year 2000 compliant. Review product documentation to ensure the vendor/manufacturer has certified that it has been tested.
3. Before testing a particular product, remember to back-up all important data files to an external storage device (*e.g.*, floppy disk or tape drive).
4. Use your resources. Several widely used date-sensitive systems and products have been tested by other users. Talk to your peers and review external information to see if the results of their testing are appropriate for your firm. Be sure to retain all relevant documentation. Internet Sites such as the NASD (www.nasd.com), the General Services Administration (www.gsa.gov), and ZD net (www.zdnet.com/enterprise/zdy2k) offer vendor databases that can be particularly helpful.

Contingency Planning

Contingency plans document alternative procedures, strategies, and operations to be used to continue normal business functions in the event of Year 2000 complications. Depending upon the size and complexity of a given firm, an appropriate contingency plan can range from two to 200 pages. However, all plans should generally include the following:

- Senior level approval;
- Areas of responsibility and communication;
- Prioritized failure scenarios and alternative business plans for each scenario;
- Trigger dates or situations that will activate alternative business plans;
- Infrastructure issues such as power, building, and security; and
- Target compliance dates for critical third parties.

Investor Communication

Effective investor communication is critical to ensuring the industry's smooth transition into 2000. While not specifically addressed on the Form BD-Y2K, investor communication is an area where many individual firms have expressed concern. Effective communication challenges the firm to address its clients' increasing Year 2000 concerns while continuing to provide honest, reliable, and timely information about the Year 2000.

To help guide firms in meeting this challenge, the NASD, the SEC, and the Securities Industry Association (SIA) have developed an Investor Information Kit which provides educational information and practical guidance about the Year 2000 issue. Reprints of certain sections of this Kit are available to send to customers either separately or with other mailings, such as customer statements. Refer to www.nasdr.com or www.nasd.com to review the Kit online, or call the Year 2000 Program Office at (888) 227-1330.

Year 2000 Education And Events

The NASD Year 2000 Program Office is continuing to offer Virtual Workshops—conference call-in sessions. The NASD strongly encourages registration for these sessions by calling (888) 567-0578. After placing the call, listen to the greeting, and provide the following information when prompted: firm name, Broker/Dealer #, and workshop date. On the day of the session, call (800) 857-7323 and indicate the password and confirmation number provided for the specific workshop. See below for a list of these specific workshops organized by date of session, as well as a brief summary of the issues to be discussed.

July 20 Legal Issues & Year 2000

Password: Legal
Conf. #: 3117340

Issues to be covered:

- ◆ Due diligence efforts for broker/dealers
- ◆ Litigation helpful hints
- ◆ Recent developments in disclosure

July 22 Certification and Compliance

Password: Certification
Conf. #: 3117355

Issues to be covered:

- ◆ New rules pertaining to guidelines
- ◆ How the rules affect the broker/dealer community
- ◆ Helpful hints on compliance issues

July 29 Exchanges and Utilities Update

Password: Exchanges
Conf. #: 3117514

Issues to be covered:

- ◆ State of exchanges & utilities
- ◆ Upcoming developments
- ◆ Related broker/dealer developments

August 5 Contingency Strategies for Small Firms

Password: Strategies
Conf. #: 3117421

Issues to be covered:

- ◆ Overview of typical small firm contingency planning challenges
- ◆ Trends in contingency planning
- ◆ Timeline vs. impact
- ◆ External/internal contingency planning

August 10 Peer Review of Best Practices II

Password: Practices
Conf. #: 3117455

Issues to be covered:

- ◆ Case studies of broker/dealers' Year 2000 best practices

August 19 Investor Communication "Best Practices"

Password: Communication
Conf. #: 3117463

Issues to be covered:

- ◆ Frequent problems
- ◆ Disclosure issues
- ◆ Best practices

August 24 Contingency Strategies for Large Firms

Password: Strategies
Conf. #: 3117500

Issues to be covered:

- ◆ Overview of typical large firm contingency planning challenges
- ◆ Trends in contingency planning
- ◆ Timeline vs. impact
- ◆ External/internal contingency planning

Sept. 14 Certification of Year 2000 Compliance

Password: Certification
Conf. #: 3117560

Issues to be covered:

- ◆ Certification and the Year 2000 issue
- ◆ Latest developments in certification
- ◆ Best practices for all types of firms

Sept. 21 Peer Review of Best Practices III

Password: Practices
Conf. #: 3117592

Issues to be covered:

- ◆ A year review of the biggest challenges faced by broker/dealers of all sizes
- ◆ Summary of the top 10 best practices to managing the Year 2000 issue

October 12 State of Utilities and Other Critical Services

Password: Utilities
Conf. #: 3117608

Issues to be covered:

- ◆ State of utilities and recent guidelines
- ◆ Other services
- ◆ Possible impact on brokers and dealers
- ◆ Best practices in dealing with uncertainty

October 19 State of the Industry

Password: Industry
Conf. #: 3117632

Issues to be covered:

- ◆ Industry summary and overview
- ◆ A look at clearing firms
- ◆ A look at Market Makers
- ◆ A look at introducing firms
- ◆ In-depth look at where your firm should be in achieving Year 2000 readiness

October 26 Legal Review for Brokers and Dealers

Password: Review
Conf. #: 3117647

Issues to be covered:

- ◆ A review of legal issues for 1998 and 1999
- ◆ Current broker/dealer trends reviewed
- ◆ Checklist of what your firm may need to do with the little time remaining

Year 2000 Education And Events

NASD Year 2000 Event Calendar

Topic	Location	Date	Time
Legal Issues & Year 2000	Virtual	July 20	11:00 a.m., ET
Certification and Compliance	Virtual	July 22	11:00 a.m., ET
Exchanges and Utilities Update	Virtual	July 29	11:00 a.m., ET
Contingency Strategies for Small Firms	Virtual	Aug. 5	11:00 a.m., ET
Peer Review of Best Practices II	Virtual	Aug. 10	11:00 a.m., ET
Investor Communication "Best Practices"	Virtual	Aug. 19	11:00 a.m., ET
Contingency Strategies for Large Firms	Virtual	Aug. 24	11:00 a.m., ET
Certification of Year 2000 Compliance	Virtual	Sept. 14	11:00 a.m., ET
Peer Review of Best Practices III	Virtual	Sept. 21	11:00 a.m., ET
State of Utilities and Other Critical Services	Virtual	Oct. 12	11:00 a.m., ET
State of the Industry	Virtual	Oct. 19	11:00 a.m., ET
Legal Review for Brokers and Dealers	Virtual	Oct. 26	11:00 a.m., ET

More Information/Questions

NASD Year 2000 Program Office

e-mail: y2k@nasd.com

phone: (888) 227-1330

NASD Notice to Members 99-53

NASD Regulation Offers Guidance To Members Forwarding Mini Tender Offers To Their Customers

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

Recent press coverage of “mini tender offers” has highlighted a practice that may be generating significant confusion among National Association of Securities Dealers, Inc. (NASD[®]) members and public customers, and may result in monetary losses to customers. NASD Regulation, Inc. (NASD Regulation[®]) is publishing this *Notice* to alert members to the practice and to discuss the steps members can take to reduce the risk that customers and others tendering shares in a mini tender offer will be victimized.

Questions regarding this *Notice* may be directed to Elliott Curzon, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8451.

Background

In a mini tender offer, the offeror makes an offer directly to an issuer's shareholders to purchase a small number or percentage (under five percent of the total shares outstanding) of an issuer's securities, often at a price below the current market price, by a certain day. The offer also contains a promise to pay for the tendered shares within a specified period.¹ When the offeror obtains tendered shares, the offeror resells the shares in the open market, pays the tendering shareholder, and retains the difference as profit.

Because the offers are for five percent or less of the outstanding shares, the offerors presently are not required to comply with the disclosure, filing, and transmission requirements of the Securities and Exchange Commission's (SEC) tender offer rules in Regulation 14D. They are, however, subject to the general tender offer anti-fraud prohibitions in SEC Regulation 14E.

A mini tender offer is solicited when the offeror forwards offering material describing the terms of the offer to the Depository Trust Company (DTC) or directly to shareholders.² DTC sets up an account where acceptances of tendering shareholders are recorded and where payments by the offeror will be made in exchange for the tendered shares. DTC then notifies its participants (NASD members) of the offer. DTC's participant banks and broker/dealers that tender on behalf of their customers pay a small fee to DTC in connection with the tender. As discussed below, participants that receive these notices sometimes forward them to their customers.

Discussion

There may be legitimate reasons for mini tender offers, such as providing liquidity for very illiquid securities or permitting institutions to dispose of block positions without moving the market price for the security. Nevertheless, NASD Regulation is concerned that some shareholders may be disadvantaged by such offers if they agree, either through mistake or lack of sophistication, to tender their securities at prices that are lower than those they could obtain if they offered their securities for sale in the open market.

Moreover, NASD Regulation notes that there is no statute or rule that requires members to forward tender offer information to their customers.³ Currently, some members forward all such offers to their customers without regard to the merits or terms of the offers.

In order to address concerns about shareholders tendering by mistake or as a result of lack of knowledge about the effect of an offer, NASD Regulation believes that members that forward information to customers concerning mini tender offers may wish to consider including

the following disclosures as appropriate in the circumstances:

(1) If the member has not reviewed the offer:

(a) that by forwarding the offer to the customer, the member is not endorsing or recommending the offer, and the terms of the offer have not been reviewed to determine if accepting the offer would be in the customer's interest; and

(b) the customer is not required to accept the offer.

(2) If the member has reviewed the offer:

(a) whether the member is endorsing or recommending acceptance of the offer;

(b) whether the member is providing other information to the customer to assist the customer

in making an informed decision about the offer; and

(c) the customer is not required to accept the offer.

(d) Information that could be supplied to the customer could include, for example: an indication of the current or recent market price for the security, *e.g.*, either the most recent closing price or the trading range for a recent period such as the previous week or month; recent news about the issuer or announcements from the issuer; or a statement that there are no news reports or announcements.

such offers can be expensive and time consuming relative to the size of the offer. Nevertheless, we understand that some offerors are resorting to direct solicitation in order to avoid a recently instituted \$2,700 DTC mini-tender offer processing fee designed to cover DTC's costs in mini tender offers. (See Exchange Act Release No. 41032 (February 9, 1999).)

³The NASD's Rule governing the Forwarding of Proxy and Other Materials (Rule 2260) does not cover information relating to tender offers. In addition, the SEC Rules governing tender offers (Regulations 14-D and 14-E) do not require broker/dealers to forward tender offer information to shareholders.

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Endnotes

¹SEC Rule 14e-1(c) requires offerors to pay for tendered securities promptly.

²The offeror can attempt to provide offering material directly to shareholders; however, obtaining and using shareholder lists for

NASD Notice to Members 99-54

NASD Regulation Seeks Comment On Issues Relating To Arbitrator-Ordered Expungements Of Information From The Central Registration Depository; **Comment Period Expires July 30, 1999**

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

NASD Regulation, Inc. (NASD Regulation[®]) is seeking comment from National Association of Securities Dealers, Inc. (NASD[®]) members and other interested parties on issues relating to the expungement of information from the Central Registration Depository (CRDSM) that is ordered by arbitrators. In *Notice to Members 99-09*, NASD Regulation announced that it was imposing a moratorium on the expungement of certain information from the CRD system based on a directive contained in an arbitration award. Under the terms of the moratorium, which became effective January 19, 1999, NASD Regulation is not expunging information from the CRD system that is ordered by arbitrators in an award rendered in a dispute between a public customer and a registered representative or a firm unless the award has been confirmed by a court of competent jurisdiction.

Questions concerning this *Notice* may be directed to Ann E. Bushey, Assistant Director, CRD/Public Disclosure, NASD Regulation, at (301) 590-6389; Mary M. Dunbar, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8252; or Richard E. Pullano, Associate Director and Counsel, CRD/Public Disclosure, NASD Regulation, at (301) 212-3789.

Request For Comment

NASD Regulation is seeking comment on the issues of arbitrator-ordered expungements and the moratorium on such expungements imposed in January 1999. NASD Regulation encourages all interested parties to comment on this matter. Comments should be mailed to:

Joan C. Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500

or e-mailed to:

pubcom@nasd.com

Important Note: The only comments that will be considered are those submitted in writing or via e-mail.

Comments must be received by July 30, 1999. Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the Securities and Exchange Commission (SEC).

Background And Discussion

The CRD system is an electronic registration and licensing system that contains information used by the SEC, NASD, other self-regulatory organizations (SROs), and state securities regulators to make licensing and registration decisions, among other things. The information on the CRD system includes criminal information (*e.g.*, indictments and convictions for certain criminal offenses), disciplinary information (*e.g.*, sanctions imposed by regulators), customer complaints and arbitration awards that meet specified criteria, certain categories of employment terminations, and other information.

Generally speaking, the information on the CRD system is submitted by registered broker/dealers and regulatory authorities (*e.g.*, SEC, state securities regulators, and SROs) in response to questions on forms that are designed to elicit and collect information that is relevant to regulators in connection with their licensing and enforcement activities and to investors who are considering whether to do business with a firm or an associated person. NASD Regulation recognizes that accurate and complete reporting on these forms is an important aspect of investor protection.

As noted in *Notice to Members 99-09*, during this moratorium, NASD Regulation is continuing to execute court-ordered expungements, including any expungement order contained in an arbitration award that is confirmed by a court of competent jurisdiction.

In addition, NASD Regulation is continuing to expunge information from the CRD system based on expungement directives in arbitration awards rendered in disputes between firms and current or former associated persons, where arbitrators have awarded such relief based on the defamatory nature of the information in the CRD system. To qualify for this exception from having an award confirmed in court, the dispute must be **between a firm and a current or former associated person and arbitrators must clearly state in the "Award" section of the award that they are ordering expungement relief based on the defamatory nature of the information in the CRD system.** (Arbitrators, however, are not required to state explicitly in the award that they have found that all of the elements required to satisfy a claim in defamation under governing law have been met.)

As discussed in *Notice to Members 99-09*, NASD Regulation imposed this moratorium after discussions with the North American Securities Administrators Association (NASAA). NASD Regulation operates the CRD system in accordance with an agreement with NASAA. Although this agreement expressly addresses court-ordered expungements, it does not specifically address arbitrator-ordered expungements. NASD Regulation believes that expungement of information from the CRD system that is ordered by an arbitrator and contained in an award should be afforded the same treatment as a court-ordered expungement. NASAA disagrees with this position and has informed NASD Regulation that it does not believe that arbitrator-ordered

expungements should be afforded the same treatment as court-ordered expungements. NASAA has informed NASD Regulation that, in its opinion, according to various state laws, information submitted to the CRD system is deemed to have been filed with each state in which the subject person or entity seeks to be registered.

Therefore, according to NASAA, information in the CRD system that may be the subject of an arbitrator-ordered expungement is in many cases a state record, and some state laws currently do not recognize the authority of an arbitrator to expunge a state record or do not otherwise permit such expungements because of state recordkeeping requirements. NASAA has provided one attorney general opinion that it believes supports its view. See Advisory Legal Opinion issued by Robert A. Butterworth, Attorney General of the State of Florida, AGO 98-54 (August 28, 1998) regarding records obtained from the securities dealers association's central depository.¹

NASD Regulation is seeking comment on possible approaches that would address the interests of parties to an arbitration in having an arbitrator's expungement order effected (or given some meaningful effect), which ordinarily requires erasing or physically removing information on the CRD system, while at the same time complying with any applicable state recordkeeping laws and maintaining the integrity of the CRD system. Several such approaches are described in this *Notice*.

NASD Regulation recognizes that the information on the CRD system has important investor protection implications, provided it is complete and accurate. Therefore, such information should not be expunged without good reason (e.g., a finding that expungement relief is necessary because information on the CRD system is defamatory in nature, misleading, inaccurate, or

erroneous). Accordingly, NASD Regulation also seeks comment on an approach that contemplates the establishment of standards for arbitrators to consider in ordering expungement. Under this approach, the arbitrators' award would have to state the basis for the expungement order before NASD Regulation would expunge the information from the CRD system in the absence of a court order.

NASD Regulation requests comment on these approaches, suggestions for other alternatives, and comment from members and other interested parties on all of the issues implicated by arbitrator-ordered expungements.

Should consent awards (i.e., those containing expungement directives) be treated differently than awards issued after full consideration of the merits of the dispute?

As a threshold matter, NASD Regulation specifically seeks comment on the treatment of "consent awards" or "stipulated awards" that contain expungement directives. These are awards that essentially reflect the parties' settlement of a dispute. Parties then request that arbitrators capture the terms of the settlement in an award that arbitrators issue by consent of the parties. In such cases, arbitrators typically are issuing an award at the parties' (joint) request and have not made any finding on the merits of the dispute.² NASD Regulation seeks comment on whether expungement directives contained in these awards should be given the same treatment as awards that are rendered by arbitrators after full consideration of all of the pleadings, evidence, arguments, etc. NASD Regulation requests that commenters consider whether it is appropriate to establish standards that would have to be met before NASD Regulation would execute consent awards similar to the standards discussed in *Approach Four* on the following page.

Approach One: *Could the interests of parties in arbitration be met if there were no disclosure of the information ordered expunged through the NASD's Public Disclosure Program?*

Under this approach, information that is ordered expunged by arbitrators would remain on the CRD system, but would not be disclosed through the NASD's Public Disclosure Program. Since the information remains on the CRD system, however, and because it would be deemed by some states to be a state record notwithstanding the expungement order, it may still be disclosed by a state pursuant to that state's public records law, which is a state's equivalent of the federal Freedom of Information Act statute.³ Some states' public records laws are very broad in scope, and permit release of all information contained in state records – including all CRD records, even if they have been ordered expunged by an arbitrator.

Approach Two: *Could the interests of parties in arbitration be met if a "legend" were placed on information that has been ordered expunged by arbitrators?*

Under this approach, information that is ordered expunged by arbitrators would remain on the CRD system, but would clearly be identified as information that has been ordered expunged by an arbitrator or a panel of arbitrators through the use of a standard legend (*e.g.*, the legend might state "A panel of arbitrators has determined that the above information is factually inaccurate, defamatory, or without merit and has ordered the information expunged from the CRD system."). A state that has determined that it must disclose the information, notwithstanding the arbitrators' expungement order, may continue to disclose the information; however, under this approach, the information would carry a legend indicating that it had been ordered expunged from the CRD system.

The NASD, on the other hand, consistent with its practice before the moratorium, would not disclose this information through its Public Disclosure Program.⁴

Approach Three: *Could state recordkeeping requirements be satisfied through the use of alternate media?*

This approach contemplates satisfying certain state recordkeeping requirements through the use of a hard copy equivalent, microfilm, or other medium. Under this approach, NASD Regulation would propose to provide an equivalent copy of any CRD record that a state is required to keep if that record is the subject of an expungement order issued by an arbitrator. Once the equivalent of the CRD record has been provided to a state, NASD Regulation would execute the expungement order and physically remove the relevant information from the CRD system.

NASD Regulation seeks comment on this alternative, because it appears that some states may have flexibility in the form or medium in which they maintain records that are required to be retained. *See, e.g.*, Cal. Corp. Code Sect. 31506 (1997), which provides the Securities Commissioner with the discretion to maintain copies of records "on microfilm or in other form" provided those records are certified by the Commissioner. This statutory section further indicates that such records will be "accepted for all purposes as equivalent to the original" when so certified by the Commissioner. NASD Regulation requests that commenters provide specific support for this or any other proposed approach involving the use of alternative or equivalent records.

Approach Four: *Could resolution of this issue be facilitated by the establishment of standards to be followed by arbitrators before they order information expunged from the CRD system?*

This approach contemplates the establishment of standards that would have to be satisfied before NASD Regulation would execute an arbitrators' awards directing the expungement of information from the CRD system. This proposed approach differs from the approaches discussed above in that it contemplates that NASD Regulation would execute arbitrators' expungement orders (*i.e.*, physically remove information from the CRD system) provided certain prescribed standards were met. The objectives of this alternative would be to provide some parameters for arbitrator-ordered expungements to ensure that investor protection is not compromised, and to give some indication of the arbitrators' reasons for granting such relief. Such an approach also would enhance the integrity of the CRD system by providing an additional mechanism to remove misleading, inaccurate, or erroneous information from the system. Because of the state record retention issues described above, this approach may have to be combined with *Approach Three* above for those states that are required to maintain all CRD records.

It is widely accepted that arbitrators should have the authority to award equitable relief.⁵ NASD Regulation believes that ordering expungement of information from the CRD system that is found to be defamatory, misleading, inaccurate, or erroneous, is equitable in nature and within an arbitrator's authority. Currently, however, neither the NASD's Code of Arbitration Procedure nor the arbitrator training materials explicitly address the granting of the equitable relief of expungement of information from the CRD system.⁶

Under this approach, NASD Regulation would establish standards for arbitrators to consider in ordering expungement. The arbitrators' award would have to state the basis for the expungement order before NASD Regulation would

expunge the information from the CRD system in the absence of a court order. For example, the standards could provide that arbitrators may include as equitable relief in an arbitration award an order directing that information be expunged from the CRD system provided that the arbitrators found, after considering the merits, that the claim against the person/firm was frivolous or groundless (*i.e.*, had no basis in fact), or was brought for an improper purpose (*e.g.*, to damage the reputation of the named person/firm). Such standards might also require that the named party specifically seek the expungement relief and that arbitrators not grant such relief on their own.

NASD Regulation seeks comment on these proposed standards and whether there are other standards that should be considered. Commenters may want to address whether any of the above approaches should be combined with another or with other approaches that may be suggested by a commenter.

Endnotes

¹This letter can be obtained from the State of Florida's Web site at: <http://legal.firn.edu/opinions/index.html>.

²While parties may request an arbitrator to embody their settlement agreement in an award, the Code of Ethics for Arbitrators In Commercial Disputes, in Canon V(D), states that an arbitrator is not bound to sign a consent award "unless [the arbitrator is] satisfied with the propriety of the terms of the settlement."

³In this regard, the information would not truly be expunged because expungement typically requires the physical destruction or erasure of the record in question. Therefore, a true expungement would not leave any record in the CRD system that would be susceptible to disclosure to the public (either through the NASD's Public Disclosure Program or by a state under its public records laws) because the record would be physically removed from the CRD system. Moreover, because this approach would not result in the physical destruction of the CRD record, NASD Regulation may also be required to produce the full CRD record (including the information ordered expunged by arbitrators) in response to a subpoena.

⁴However, as discussed in note three above, NASD Regulation may also be required to produce the full CRD record (including the information ordered expunged by arbitrators) in response to a subpoena.

⁵See *Southland Corp. v. Keating*, 465 U.S. 1, 13 (1984).

⁶Training materials designed to educate arbitrators about the issues discussed in *Notice to Members 99-09* have been prepared and will be used in the next round of arbitrator training sessions administered by NASD Regulation.

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NASD Notice to Members 99-55

Questions And Answers Relating To Non-Cash Compensation Rules

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

This *Notice to Members* addresses questions regarding the application of amendments recently adopted by the National Association of Securities Dealers, Inc. (NASD®) to NASD Rules 2820 (Variable Contracts Rule) and 2830 (Investment Company Rule). Generally, the new rules regulate compensation arrangements for the sale and distribution of variable products and investment company securities. To further facilitate member compliance with these rules, this *Notice* addresses questions that have been raised with respect to particular circumstances covered by the new rules.

Questions regarding this *Notice* may be directed to Joseph Savage, Counsel, Advertising/Investment Companies Regulation, NASD Regulation, Inc., (NASD Regulation®), at (202) 728-8233; Lawrence N. Kosciulek, Assistant Director, Advertising/Investment Companies Regulation, NASD Regulation, at (202) 728-8329; and Stephanie M. Dumont, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8176.

Background

The Securities and Exchange Commission (SEC) approved the non-cash amendments on July 15, 1998. The new rules became effective January 1, 1999, under the implementation plan described in *Notice to Members 98-75* (*NtM 98-75*). Generally, the rules limit the manner in which members may pay or accept non-cash compensation for the sale or distribution of variable contracts and investment company securities.

Specifically, the rules:

- with limited exception, prohibit an associated person from accepting

compensation from any person other than the member with which the person is associated;

- prohibit the payment of securities as compensation;
- prohibit the acceptance of cash compensation by a member from an offeror for the sale of investment company securities unless the compensation is disclosed in a prospectus;
- permit receipt of certain *de minimis* types of non-cash compensation gifts and gratuities;
- permit, under certain conditions, payment or reimbursement in connection with training and education meetings; and
- permit non-cash compensation arrangements that are based on concepts of total production and equal weighting, are organized and run by the member, and comply with certain recordkeeping requirements.

After the publication of the non-cash rules in *NtM 98-75*, some members requested advice from NASD Regulation on how the rules would apply in particular situations. The following questions and answers are published in order to address some of these particular situations and provide additional guidance. However, the guidance contained herein is intended to be general in nature and is not intended to provide an exhaustive analysis of all non-cash arrangements subject to the rules. The facts and circumstances of various arrangements will differ, and members should feel free to seek additional advice from NASD Regulation by contacting the names listed in the Executive Summary above.

Frequently Asked Questions

Non-Cash Arrangements

Question #1: May a member conduct a non-cash contest that includes the sale of mutual funds, variable annuities, and new assets under management, where all three product categories will be included and the contest is based on total production and no preferential credits are given?

Answer: Yes. The contest is permissible provided that the member complies with all of the applicable provisions under Rule 2820(h)(4)(D) and Rule 2830(l)(5)(D). In particular, the member must ensure that the non-cash award is calculated on the basis of the equal weighting requirements of Rule 2820(h)(4)(D)(ii) and Rule 2830(l)(5)(D)(ii).

Question #2: An insurance affiliated broker/dealer sponsors and funds the costs of an annual sales meeting for its top producing 125 representatives. Production is determined by equal weighting of all variable life and annuity products sold by the representatives, with the exclusion of a proprietary variable universal life product. Instead, this product will be the basis for qualifying for a separate sales meeting sponsored by the broker/dealer's parent life insurance company. Is this permissible?

Answer: No. It would be impermissible for the broker/dealer and its parent life insurance company to conduct separate contests in the manner described, and the proposed arrangement would clearly contradict one of the basic goals of the rules, to prohibit product-specific contests. Whether the contest is sponsored by the broker/dealer or its parent life insurance company, Rule 2820(h)(4)(D) requires that the

contest include all variable products distributed by the member.

Question #3: Continuing with the same fact pattern in Question #2, if credit for the sales of fixed products was included in the non-cash arrangement, would either the member or the insurance company be required to include all fixed products and ensure that the credit given for the fixed products is equally weighted?

Answer: No. The rules do not apply to the sale of fixed insurance products.

Question #4: A salesperson is licensed to sell insurance with a life insurance company that offers proprietary variable products. The salesperson is also separately licensed to sell securities with a broker/dealer that is unaffiliated with the life insurance company. The salesperson sells the life insurance company's proprietary variable products through his broker/dealer pursuant to a dealer agreement with the company. May the salesperson attend a non-cash compensation trip sponsored by the life insurance company for the sale of its variable products?

Answer: No. Rule 2820(h)(4) prohibits an associated person from accepting non-cash compensation unless an exception applies. Rule 2820(h)(4)(D) provides an exception that permits non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an *affiliated* member. In this case, the salesperson is an associated person of an *unaffiliated* member.

Question #5: May non-cash credits to registered representatives be based on gross dealer concessions?

Answer: Yes, if the contest meets all the requirements of the rules, including the equal weighting requirement. In particular, the amounts of non-cash credits for representatives based on dealer concessions must be equally weighted among different funds.

Question #6: *NtM 98-75* states that, because of the substantial differences in design, purpose, cost structure, commission payouts, and target audience for variable annuity and variable life products, they do not need to be combined in the same incentive arrangement. Could separate contests be designed for different product categories such as non-IRA individual variable annuity products, IRA individual variable annuity products, or Roth IRA individual variable annuity products?

Answer: No. The differences in the suggested categories would not justify permissible non-cash arrangements for just those product categories.

Training And Education

Question #7: May an offeror conduct and pay for a training and education meeting for registered representatives of unaffiliated dealers that sell the offeror's products?

Answer: Yes. This arrangement is permissible so long as neither the attendance at the meeting nor the payment for the meeting is pre-conditioned on the achievement of a sales target, and approval from the member is obtained prior to the meeting.

Question #8: May attendance at training or education meetings held by an offeror be pre-conditioned on achieving certain overall targets not exclusively tied to the sale of specific mutual funds, such as gathering of a certain level of assets or opening a particular number of new accounts?

Answer: No. Rule 2830(l)(5)(C)(ii) prohibits preconditioning attendance at a training and education meeting held by an offeror "...on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (l)(5)(D)."

Question #9: May a member reimburse its associated persons for the expenses of their guests that attend training and education seminars?

Answer: Yes. However, Rules 2820(h)(4)(C)(iv) and 2830(l)(5)(C)(iv) preclude an *offeror* from making payments to reimburse guests of associated persons attending training and education seminars.

Application To Senior Management

Question #10: Do the non-cash compensation rules apply to officers or managers of the broker/dealer who are not involved in "point of sale" activities?

Answer: Yes. The non-cash compensation rules apply to *any associated person*, including officers and managers of members, if they receive, directly or indirectly, such compensation in connection with the sale and distribution of variable contracts or investment company securities.

Payment In Securities

Question #11: May an associated person receive stock (or options to purchase stock) in the publicly-traded parent of the associated person's broker/dealer?

Answer: Yes. Rule 2820(h)(2) and Rule 2830(l)(2) prohibit members and associated persons of members from receiving compensation from an offeror in the form of securities of any

kind. However, these provisions were not intended to prohibit an associated person from receiving stock or stock options of the member's parent company as compensation.

Question #12: May insurance company wholesalers receive stock options of the insurance company's parent holding company as compensation for reaching certain production levels?

Answer: Yes, as long as the specified production levels are in compliance with the equal weighting and total production requirements of Rule 2820(h)(4)(D) or Rule 2830(l)(5)(D).

Gifts And Occasional Meals, Tickets, Or Other Entertainment

Question #13: How are holiday parties, receptions, and other local events where local transportation and dinners may be provided to associated persons by offerors (and which are not organized specifically for training or educational purposes) treated?

Answer: Such items of value must be treated either as occasional meals, tickets, or comparable entertainment or as gifts and therefore subject to the limitations of Rule 2820(h)(4)(A) or (B), or Rule 2830(l)(5)(A) or (B).

Question #14: May an offeror provide a registered representative business development and educational enhancement items, such as software packages containing fund data for broker use or prospecting lists?

Answer: Yes. The provision of such items that are utilized by registered representatives for business purposes is permitted, provided that these items are not preconditioned on the achievement of a sales target.

Question #15: May an offeror reimburse a registered representative's "prospecting trip" expenses, such as travel and lodging expenses, meals during the trip, the cost of renting rooms or space for the purpose of meeting with prospects, or the cost of marketing materials to promote investment company or variable contracts sales meetings with prospects at centralized locations?

Answer: Yes, as long as the payment is made through the member and complies with the recordkeeping requirements of Rule 2820(h)(3) and 2830(l)(3) and, with respect to investment company securities, the prospectus disclosure requirements of Rule 2830(l)(4).

Question #16: Are gifts of a personal nature, such as wedding gifts or congratulatory gifts for the birth of a child, permissible?

Answer: Yes. The rules do not apply to these types of gifts.

Question #17: Are promotional items of nominal value that display the offeror's logo, such as golf balls, shirts, towels and pens, subject to the \$100 annual gift limit?

Answer: No. The rules do not apply to these types of nominal promotional items.

Prospectus Disclosure

Question #18: Rule 2830(l)(4) prohibits members from accepting cash compensation from offerors unless it is disclosed in the prospectus. In 1998, the SEC adopted amended Form N-1A as part of its effort to improve mutual fund disclosure. Under the N-1A amendments, much of the narrative disclosure regarding distribution arrangements, such as Rule 12b-1 fees, sales charges, sales charge waivers, broker allowances, multi-class plans, and master-feeder

arrangements, is now required to be placed in the Statement of Additional Information (SAI), which is incorporated into the prospectus by reference and made available to customers upon request. May members satisfy the prospectus disclosure requirement of Rule 2830(l)(4) by placing such disclosure in the SAI?

Answer: Yes. To the extent that various cash compensation arrangements would qualify as the types of distribution arrangements now required to be disclosed in the SAI, disclosure in the SAI would satisfy the NASD disclosure requirements.

Recordkeeping

Question #19: An offeror provides cash or non-cash compensation to registered representatives of its affiliated member. May the offeror maintain on behalf of its affiliated member the records required under Rule 2820(h)(3) and Rule 2830(l)(3), so long as the records are made accessible to the member, and in

turn made available to NASD Regulation for examination?

Answer: Yes, the offeror may perform this ministerial function on behalf of its affiliated member.

Miscellaneous

Question #20: May a member contribute to a non-cash compensation program sponsored by a bank?

Answer: Yes. Rule 2830(l)(5)(E) permits contributions by a member to a non-cash arrangement of a non-member, such as a bank, provided that the arrangement conforms to the criteria in Rule 2830(l)(5)(D), including the total production and equal weighting requirements. Thus, the member making the contribution must establish procedures through which it could be reasonably assured that the non-cash arrangement of the non-member conforms to the required criteria.

Question #21: May a registered representative receive commissions

or any compensation directly from an unaffiliated product manufacturer?

Answer: Generally no. Rules 2820(h)(1) and 2830(l)(1) require that registered representatives only accept compensation from the member with whom they are associated unless, among other things, an interpretive or no-action letter specifically permits such an arrangement.

Question #22: May a member structure a non-cash arrangement that is limited only to a specific division of the firm, such as an institutional sales division that offers only certain products?

Answer: Yes, as long as any such arrangement is based on the entire universe of products that the specific division is authorized to sell and otherwise complies with the equal weighting and total production requirements of Rule 2820(h)(4)(D) or Rule 2830(l)(5)(D).

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NASD Notice to Members 99-56

NASD Regulation
Announces CRD "System
Transition Period"
Immediately Preceding
The Deployment Of Web
CRD

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

The new Internet-based Central Registration Depository system, Web CRDSM, will be deployed in August 1999. As NASD Regulation, Inc. (NASD Regulation[®]) transitions from the current CRD system to Web CRD, there will be a two-week period—System Transition Period—beginning on July 31 and ending August 15, 1999, when neither system will be available to process form filings and other registration-related transactions. This "System Transition Period" is necessary principally to allow NASD Regulation to perform the final conversions of data from the current CRD system to Web CRD. The System Transition Period also will permit NASD Regulation to receive, capture, and review the final form filings submitted on the Interim Forms, which will be replaced by the new Forms U-4, U-5, BD, and BDW. (The Securities and Exchange Commission (SEC) is considering proposed revisions to the Forms U-4, U-5, and BD; the proposed new forms are expected to become effective on or about August 1, 1999. The SEC adopted revised Form BDW with an effective date of August 1, 1999.)

Member firms should read this *Notice* carefully to fully understand the implications of the System Transition Period and thereby avoid problems with associated person registration, transfer, regulatory reporting, and examination scheduling. The System Transition Period will affect both member firms and their registered representatives in many ways. Most significantly, NASD Regulation will **not** accept new registration requests submitted on paper Interim Forms after July 29. Member firms that are Firm Access Query System (FAQS) subscribers and Electronic File Transfer (EFT) filers will be able to submit (through

the existing interface) the following filings through July 30 electronically:

- Forms U-4: Pages One and Two only – FAQS subscribers and EFT filers
- Forms U-5 – FAQS subscribers and EFT filers
- Forms BD: Schedule E only – FAQS subscribers only

Member firms that are not FAQS subscribers or EFT filers must hold all new registration requests after July 29 (including requests for registration in additional states) for submission on the revised forms to Web CRD once it is deployed on August 16.

In addition, as discussed in detail on the following pages, the System Transition Period will change the way member firms transact business with the CRD/Public Disclosure Department in a number of ways.

NASD Regulation is committed to keeping all interested parties aware of developments regarding the deployment of Web CRD. For the latest information and updates on the System Transition Period and Web CRD deployment, member firms should check the Web CRD Internet Pages at:
www.nasdr.com/3400_web.htm.

Questions concerning this *Notice* may be directed to Ann E. Bushey, Assistant Director, CRD/Public Disclosure, NASD Regulation, at (301) 590-6389; Mary M. Dunbar, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8252; or Richard E. Pullano, Associate Director and Counsel, CRD/Public Disclosure, NASD Regulation, at (301) 212-3789.

Registration Activities Affected By The System Transition Period

- *Form U-4 Filings or Requests for Additional Registrations and Jurisdictions*

NASD Regulation will not accept paper Interim Forms U-4 after July 29, 1999. FAQs subscribers and EFT filers can file Pages 1 and 2 of Form U-4 through July 30, 1999. After July 29, member firms that are not FAQs subscribers must hold all Form U-4 filings until August 16 for electronic filing via Web CRD.

- *Form U-5 Filings Reporting Full Termination*

→ Member firms should submit paper Forms U-5 during the System Transition Period (*i.e.*, after August 1, 1999) to report a **full termination** (*i.e.*, termination of all registrations and licenses).

→ Paper Form U-5 filings reporting full terminations must be on the version of the Form U-5 expected to be approved by the SEC in June 1999. Interim Form U-5 (the version with an 11/97 revision date) will not be accepted after July 29, 1999 (see "Interim Forms Become Obsolete" on page 362).

→ After Web CRD is deployed, NASD Regulation staff will perform data entry for paper Forms U-5 received during the System Transition Period.

→ During the System Transition Period, NASD Regulation will return any paper Forms U-5 if the Form is reporting a partial termination or if it is the old version (*i.e.*, 11/97 version) of the Form.

Note: If a member firm's 30-day deadline for submitting a Form U-5 reporting a full termination falls on July 29, 30, or 31, the member firm should ensure that NASD Regulation receives the paper Interim Form U-5 no later than July 29.

- *Form U-5 Filings Reporting a Partial Termination*

NASD Regulation will not accept Form U-5 filings requesting a partial termination during the System Transition Period. Member firms must withhold partial termination requests until electronic filing begins on August 16.

- *Form Amendments*

→ Member firms cannot file amendments to Forms U-4, U-5, or BD during the System Transition Period. Beginning on August 16, NASD Regulation will accept amendments to the Forms U-4, U-5, and BD submitted electronically through Web CRD.

→ NASD Regulation will convert the data in the current CRD system to the Web CRD system with the exception of certain Form BD data. Registered broker/dealers will be required to electronically re-file a substantial part of their Form BD information after Web CRD is deployed.

Note: The timing and other details of the Form BD re-file are expected to be finalized with the adoption by the SEC of the revised Form BD. Please visit the Web CRD Internet Pages at: www.nasdr.com/3400_web.htm for the most current

developments on the Form BD re-file.

- *Form BDW Filings*

NASD Regulation will accept paper Form BDW filings reporting full terminations during the System Transition Period. Broker/dealers must use the Form BDW adopted by the SEC on May 3, 1999, which becomes effective on August 1, 1999. See *SEA Release No. 41356*. The new Form BDW is available on the SEC and NASD Regulation Web Sites (www.sec.gov and www.nasdr.com).

- *Taking an Examination*

→ The System Transition Period will not affect NASD-authorized exam centers. Individuals can take examinations scheduled prior to but administered during the System Transition Period. However, registered representatives cannot request additional examinations during the System Transition Period. If an examination window is open prior to the System Transition Period, the candidate can schedule and take an examination.

→ Passing an examination does not equate to being licensed or registered. With the exception of Transition Temporary Agent Transfers (TATs) (see next page), jurisdictions and self-regulatory organizations (SROs) cannot grant a registration or license through CRD from August 3 through August 15. Therefore, even if a person successfully completes an examination during the transition period, the license or registration applied for cannot be made effective until August 16 at the earliest.

- *Satisfaction of Continuing Education Requirements*

→ The System Transition Period will not affect the delivery of most Continuing Education sessions at NASD-authorized exam centers. If a Continuing Education window is open, an individual can schedule and sit for a Regulatory Element session during the System Transition Period.

Exception: Persons who take the Regulatory Element after July 28 and do not complete it will not be able to reschedule a new appointment until after August 16.

→ NASD Regulation is granting a 30-day extension to individuals whose windows for fulfilling their Continuing Education requirement expire on July 29 through August 15 to prevent them from becoming inactive for failure to satisfy the Regulatory Element during the System Transition Period.

- *Transition Temporary Agent Transfers (Transition TAT)*

→ Member firms can request the transfer of a registered representative's license during the System Transition Period if the person: (1) has no reportable disclosure information; and (2) has left his or her previous member firm employer no more than seven days prior to the request.

Note: Because of changes in the questions on the new Form U-4, member firms should thoroughly review the new Form prior to certifying that the registered representative has no reportable disclosure information.

→ To effect a Transition TAT, member firms must fax a "Transition TAT Request Form" to CRD/Public Disclosure (fax number (301) 212-9158). CRD/PD will then contact the member firm to confirm receipt of the form. To finalize the agent transfer, the member firm must submit a new, non-deficient Form U-4 electronically to Web CRD within 21 days of the Transition TAT request and, at that time, fax to CRD/PD a "Notification of Form U-4 Filing Transition TAT Form." These two transitional forms will be available on the NASD Regulation Web Site before the System Transition Period begins.

Note: NASD Regulation understands that all states have agreed to participate in the Transition TAT Program; however, as of the date of publication of this Notice, NASD Regulation is awaiting the written confirmation of five states. Please visit the Web CRD Internet Pages at: www.nasdr.com/3400_web.htm for the complete list of participating states.

- *Depositing Funds into CRD Accounts*

→ The NASD Finance Department must receive all wired or mailed funds by July 29, 1999, to have those deposits show as a credit to a firm's account when Web CRD is deployed on August 16. Member firms should anticipate the funds needed to process the filings that may accrue during the transition period to ensure they have an appropriate account balance for Web CRD deployment on August 16.

→ CRD Accounting will continue to process funds received after July 29, but a firm's CRD account will not reflect these deposits until August 16, 1999, at the earliest. Funds credited on August 16, 1999, are not available to pay for transactions until the following day.

- *Mass Transfers*

For a number of operational and legal reasons, NASD Regulation may not be able to process mass transfer requests shortly before and immediately after the System Transition Period.

Consequently, any member that is aware of, or is contemplating, a mass transfer request anytime after the publication of this Notice should contact the CRD/Public Disclosure Department as soon as possible.

Other Important Notes Regarding The System Transition Period

- *Deficient Registration Requests*

NASD Regulation will purge all registration requests that are "Form" or "Data" deficient on July 31, 1999. Member firms may want to order a roster from CRD/PD to identify registration requests that are currently Form or Data deficient and cure the deficiency by July 29. Any registration requests that are purged due to a Form or Data deficiency must be re-requested electronically after Web CRD deployment.

- *Pending Registrations*

Jurisdictions have until August 2 to approve pending registration

requests filed before the beginning of the System Transition Period. For these final approvals, NASD Regulation will continue to mail blue sheets to notify member firms of approved registrations and Legacy CRD will still be available to run queries. Jurisdictions will not be able to approve through CRD registrations still pending on August 2 until August 16 at the earliest.

- *Interim Forms Become Obsolete*

NASD Regulation anticipates that the Interim Forms (*i.e.*, the

11/97 version of Forms U-4 and U-5 and the 2/98 version of Form BD) will be replaced by the revised forms. Any **paper** filing made on an Interim Form after July 29 will not be accepted; member firms that are FAQs subscribers or EFT filers may submit **electronically** on the Interim Forms through July 30. The limited paper filings permitted during the System Transition Period (*i.e.*, Forms U-5 reporting full termination, full BDWs, and initial Form BD applications) and all electronic Web CRD filings must be submitted on the new forms.

- *TATs Initiated, But Not Completed, Before July 29, 1999*

The filing of a non-deficient Form U-4 is a TAT requirement for a registered representative to obtain a permanent license in a jurisdiction. A conditional registration granted through TAT, prior to the System Transition Period, will terminate as of August 1, 1999, if NASD Regulation does not receive the required non-deficient Form U-4 on, or before, July 29, 1999.

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NASD Notice to Members 99-57

SEC Approves Rule Amendments Governing Clearing Firms And Their Introducing Firm Clients' Relationship; **Effective Date: July 19, 1999**

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

On June 2, 1999, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD[®] or Association) Rule 3230, which governs clearing agreements between members, with respect to: (1) the handling of customer complaints about introducing firms that are received by their clearing firms; (2) exception and other reports clearing firms make available to their introducing firm clients to assist them in their supervisory obligations; and (3) clearing firms granting their introducing firm clients check writing privileges on the clearing firm's account.

The amendments, which are substantially the same as amendments to New York Stock Exchange (NYSE) Rule 382 which were also approved on June 2, 1999, will take effect on July 19, 1999; however, members will be given up to 90 days to comply with certain provisions. The deadlines are discussed in more detail below.

Questions regarding this *Notice* may be directed to Samuel Luque, Associate Director, Compliance Department, (202) 728-8472; or Elliott R. Curzon, Assistant General Counsel, Office of General Counsel, (202) 728-8451.

Background

Recent concerns about questionable sales practices and potentially fraudulent activity by certain introducing firms, and the handling of customer complaints about those firms by their clearing firms, caused NASD Regulation, Inc. (NASD Regulation[®]) and the NYSE to examine the relationship between clearing firms and their client introducing firms. The resulting amendments are included in this

Notice. The NASD's and NYSE's amendments address the content and approval of clearing agreements to specify requirements for handling customer complaints; providing, requesting, and retaining exception reports; and issuing checks.

The amendments establish limited requirements to enable the introducing member to carry out its responsibilities under its clearing or carrying agreement with the clearing member, but they are not intended to change the fundamental nature of the relationship between introducing and clearing firms, or otherwise affect any existing rights, responsibilities, or liabilities under law or contract.

Description Of Rule Change

Customer Complaints. It is generally the practice of clearing firms to forward to introducing firms customer complaints they receive relating to matters that are the responsibility of the introducing firm. Under NASD Rule 3070, a member is required to report to the Association any written customer complaint against it involving allegations of theft or misappropriation of funds or securities or of forgery. The failure of introducing firms to comply in a timely manner with the requirements of Rule 3070 when their clearing firms forward customer complaints to them may prevent the Association from receiving reports in a timely manner. Since there is no mechanism other than Rule 3070 designed to provide this information to NASD Regulation, such late reporting undermines the purpose of Rule 3070, which is to provide NASD Regulation with early warning indicators to generate a regulatory response to problems. In addition, receipt by clearing firms of large numbers of complaints regarding introducing firms may be indicative of sales practice problems requiring prompt regulatory attention.

To address this concern, new paragraph (b) states that when a clearing firm receives a customer complaint about an introducing firm relating to the functions and responsibilities of the introducing firm, the clearing firm must forward the complaint to the introducing firm and send a copy of the complaint to the introducing firm's Designated Examining Authority (DEA). The requirement may provide an early warning to the DEA of potential problems at introducing firms. The amendment also provides that the clearing agreement must expressly direct and authorize the clearing firm to forward complaints in this way. In addition, the amendment requires that the clearing firm must notify the customer in writing that the complaint was received, and was forwarded to the introducing firm and to the introducing firm's DEA.

Members will be expected to begin handling customer complaints in accordance with these amendments on the effective date of the amendments (July 19, 1999). NASD Regulation's copy of customer complaints should be directed to:

Rule 3230(b) Coordinator
Member Regulation Department
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Exception Reports. All NASD member firms are required under NASD and federal regulations to establish, maintain, and enforce supervisory systems and procedures that are designed to address all areas of a member's business. A key aspect of these supervisory procedures is exception and other compliance reports that a member creates to help meet these supervisory responsibilities. In a fully disclosed clearing arrangement, the clearing member generally provides exception reports that are available to assist the introducing member in carrying out its supervisory

obligations. In addition, officers and managers of introducing members should be on notice of the reports and information that were available to them in meeting their supervisory and monitoring obligations. Paragraph (c) of the amendments addresses these issues.

New paragraph (c)(1) requires the clearing firm to provide each introducing firm, both at the commencement of the introducing/clearing arrangement and annually thereafter (can be a single date for all agreements instead of the anniversary date of each agreement), a list or description of all exception or other reports that it offers to the introducing firm to assist it in supervising its activities, monitoring its accounts, and carrying out its functions and responsibilities under the clearing agreement. Paragraph (c)(1) also requires the introducing member to notify promptly the clearing member, in writing, of those specific reports offered by the clearing member that the introducing member requires to supervise and monitor its customer accounts. Failure to provide notification would not only be a violation of Rule 3230, but also of Rule 3010, which requires that members establish and maintain proper supervisory systems.

The staff recognizes that some clearing firms do not create such reports, but instead provide data and data formatting software to their introducing clients that allow the introducing firms to prepare their own reports. Clearing firms can comply with this provision where they communicate with their introducing firms about the data and data formatting the clearing firms can provide so that the introducing firms can determine which reports they will need to create in order to meet their supervisory and monitoring needs.

Paragraph (c)(2) requires the clearing firm to retain, as part of its books and records, copies of any

reports requested or provided to the introducing firm. The provision permits a clearing firm to meet the requirement if it retains the data that was used to prepare the report, but only if the clearing member, at the request of the DEA, can recreate the report or provide the data and data formatting that was used to prepare the report. Similarly, if the clearing firm provided data and report formatting to the introducing firm, the clearing firm could provide this to the DEA to fulfill this requirement.

Paragraph (c)(3) requires that each year, no later than July 31, the clearing member must notify the introducing member's chief executive and compliance officers of the reports offered to the introducing member pursuant to paragraph (c)(1), and the reports requested by or supplied to the introducing firm as of such date. The clearing member must also provide a copy of the notice to the introducing firm's DEA. This provision is designed to make the responsible principals of the introducing firm aware of the reports and data available from the clearing firm to assist the introducing firm in meeting supervisory and other functions and responsibilities under the clearing agreement, and to alert the DEA.

Clearing firm members and their introducing firm clients will be expected to provide notice of the exception reports available, the reports they are requesting, and the notices specified under the provisions of paragraphs (c)(1) and (c)(3) 90 days after the effective date of these amendments, or October 18, 1999.

Finally, new paragraph (c)(4) grants the staff of NASD Regulation the authority to grant exemptions from the requirements of the rule for good cause shown in instances in which the clearing and introducing firms are affiliated, and compliance with the rule could disrupt established integrated compliance systems.

Check Writing. Under new paragraph (d), the clearing agreement may permit the introducing firm to issue checks to the introducing firm's customers that are drawn on the clearing member's account upon written representation from the introducing firm that it has established, and will maintain and enforce, supervisory procedures with respect to the issuance of negotiable instruments. This provision is not intended to affect any liability that a clearing firm may otherwise have in connection with checks for which the clearing firm acts as drawer or maker. Instead, the rule simply requires introducing firms to establish clear safeguards and procedures that are satisfactory to the clearing member when the introducing member issues checks to customers drawn on the clearing member's account.

Clearing firm members will be required to comply with the requirements of paragraph (d) with respect to all new agreements on the effective date of the amendments (July 19, 1999). With respect to all existing agreements, as of October 18, 1999, members will be required to revoke check writing privileges unless the requirements of paragraph (d) have been complied with.

Finally, NASD Regulation notes that an interpretation regarding the introducing broker's ability to issue checks or drafts on behalf of the clearing firm was issued by the SEC's Division of Market Regulation to the NASD in 1993 and is summarized under the "Customer Protection Rule" section in the NASD's publication entitled *NASD Guide To Rule Interpretations*. The interpretation states that a firm that meets the requirements of Exchange Act Rule 15c3-3(k)(2)(ii) may issue checks or drafts on behalf of the clearing firm so long as:

- (i) the bank account is in the name of the clearing firm;

- (ii) the written contract between the two firms specifies that the introducing firm is acting as agent for the clearing firm; and
- (iii) the clearing firm does not debit customer brokerage accounts for checks issued by the introducing firm and drawn on the account until the checks clear (as an alternative to not debiting a customer's account, members are permitted to reduce debits in their Reserve Formula by an amount equal to outstanding customer checks).
- (8) whether, for purposes of the Commission's financial responsibility rules adopted under the Act, and the Securities Investor Protection Act, as amended, and regulations adopted thereunder, customers are customers of the clearing member; and
- (9) the requirement to provide customer notification under paragraph [(d)] (g) of this Rule.
- (b) (1) In order for the introducing member to carry out its functions and responsibilities under the agreement, each clearing member must forward promptly any written customer complaint received by the clearing member regarding the introducing member or its associated persons relating to functions and responsibilities allocated to the introducing member under the agreement directly to: (A) the introducing member; and (B) the introducing member's examining authority designated under Section 17 of the Act ("DEA") (or, if none, to its appropriate regulatory agency or authority). The clearing or carrying agreement must specifically direct and authorize the clearing member to do so.

Text Of Amendments

(Note: New text is underlined; deletions are in brackets.)

3230. Clearing Agreements

(a) All clearing or carrying agreements entered into by a member, except where any party to the agreement is also subject to a comparable rule of a national securities exchange, shall specify the respective functions and responsibilities of each party to the agreement and shall, at a minimum, specify the responsibility of each party with respect to each of the following matters:

- (1) opening, approving and monitoring customer accounts;
- (2) extension of credit;
- (3) maintenance of books and records;
- (4) receipt and delivery of funds and securities;
- (5) safeguarding of funds and securities;
- (6) confirmations and statements;
- (7) acceptance of orders and execution of transactions;
- (2) The clearing member must also notify the customer, in writing, that it has received the complaint, and that the complaint has been forwarded to the introducing member and to the introducing member's DEA (or, if none, to its appropriate regulatory agency or authority).
- (3) Pursuant to the 9600 Series, the Association may exempt a member or person associated with a member from the requirements of this paragraph for good cause shown in instances where the introducing organization is an affiliated entity of the carrying organization.

(c) (1) A clearing member, when it enters into a clearing agreement, must immediately, and annually thereafter, provide the introducing member a list or description of all reports (exception and other types of reports) which it offers to the introducing member to assist the introducing member in supervising its activities, monitoring its customer accounts, and carrying out its functions and responsibilities under the clearing agreement. The introducing member must notify promptly the clearing member, in writing, of those specific reports offered by the clearing member that the introducing member requires to supervise and monitor its customer accounts.

(2) The clearing member must retain as part of its books and records required to be maintained under the Act and the Association's rules, copies of the reports requested by or provided to the introducing member. For purposes of this Rule, the clearing member will be in compliance with the requirements of this paragraph if it retains the data from which the original report was produced, provided, the clearing member can, at the request of the DEA (or, if none, to its appropriate regulatory agency or authority), either (A) recreate the report; or (B) provide the data and the data formatting that was used to prepare the report.

(3) Each year, no later than July 31, the clearing member must notify in writing the introducing member's chief executive and compliance officers of the reports offered to the introducing member pursuant to paragraph (c)(1) and the reports requested by or supplied to the introducing member as of such date. The clearing member must also provide a copy of the notice to the introducing member's DEA (or, if none, to its appropriate regulatory agency or authority).

(4) Pursuant to the 9600 Series, the Association may exempt a member or person associated with a member from the requirements of this paragraph for good cause shown in instances where the introducing organization is an affiliated entity of the carrying organization.

(d) The clearing or carrying agreement may permit the introducing member to issue negotiable instruments directly to the introducing member's customers using instruments for which the clearing member is the maker or drawer. The clearing member may not grant the introducing member the authority to issue negotiable instruments until the introducing member has notified the clearing member in writing that it has established, and will maintain and enforce, supervisory procedures with respect to the issuance of such instruments that are satisfactory to the carrying organization.

[(b)] (e) Whenever a clearing member designated to the Association for oversight pursuant to Section 17 of the Act, or a rule of the Commission adopted thereunder, amends any of its clearing or carrying agreements with respect to any item enumerated in subparagraphs (a)(1) through (a)(9) or enters into a new clearing or carrying agreement with an introducing member, the clearing member shall submit the agreement to the Association for review and approval.

[(c)] (f) Whenever an introducing member designated to the Association for oversight pursuant to Section 17 of the Act, or a rule of the Commission adopted thereunder, amends its clearing or carrying agreement with a clearing member designated to another self-regulatory organization for oversight with respect to any item enumerated in subparagraphs (a)(1) through (a)(9) enters into a new clearing agreement with another clearing member, the introducing member shall submit the agreement to its local Association district office for review.

[(d)] (g) Each customer whose account is introduced on a fully disclosed basis shall be notified in writing upon the opening of his account of the existence of the clearing or carrying agreement.

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NASD Notice to Members 99-58

SEC Grants Exemption From Rule 15c2-11 For Securities Being Removed From The OTCBB Pursuant To The NASD Eligibility Rule

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

The Securities and Exchange Commission (SEC) issued a letter on June 3, 1999, granting an exemption from SEC Rule 15c2-11 under the Securities Exchange Act of 1934 (Exchange Act) for securities that were quoted on the OTC Bulletin Board® (OTCBB) on or before January 4, 1999, that will no longer be eligible to be quoted on the OTCBB due to the phase-in implementation of National Association of Securities Dealers, Inc. (NASD®) Rule 6530 (the Eligibility Rule).¹ A copy of the SEC's letter is attached to this *Notice*.

Questions regarding this *Notice* may be directed to the OTC Compliance Unit at (301) 208-2802.

Discussion

On January 4, 1999, the SEC approved amendments to NASD Rules 6530 and 6540 (Rules) to limit quotations on the OTCBB to the securities of companies that report their current financial information to the SEC, banking, or insurance regulators.² The new Rules are intended to ensure that investors in OTCBB securities have access to reliable and current information about the issuers of these securities.

The new Eligibility Rule was effective immediately for securities not quoted on the OTCBB on January 4, 1999. Issuers whose securities were quoted on the OTCBB as of January 4, 1999, and have continued to be quoted will be required to comply with the Eligibility Rule according to a phase-in schedule starting in July 1999 and continuing through June 2000 (see *Notice to Members 99-43* to view the phase-in schedule). The delayed effectiveness of the Rule is designed to enable broker/dealers, investors, and issuers to take appropriate action.

The Eligibility Rule provides that, in order for a domestic issuer to continue being quoted on the OTCBB, the issuer must be required to make periodic filings with the SEC, or with banking or insurance regulators, and be current with those filings. The NASD will affix a modifier "E" on the security symbol of any security issuer that does not meet the requirements of the Eligibility Rule. The addition of the modifier will be publicly reported on the OTCBB Daily List, which is available on the OTCBB Web Site at www.otcbb.com. The "E" also will be evident to the quoting broker/dealers when they access the security on the Nasdaq Workstation II®.

Once an issuer is deemed not to be in compliance with the Eligibility Rule, the security may continue to be quoted on the OTCBB for a 30- or 60-calendar day grace period from date the "E" modifier was appended on the security symbol, depending on the type of issuer.³ After the grace period, quotations in non-compliant securities will not be permitted on the OTCBB, and member firms will be prohibited from quoting the issuer's security on the OTCBB. The NASD announced approval of the OTCBB Eligibility Rule and the phase-in schedule in *Notice to Members 99-15*, and announced a modified phase-in schedule in *Notice to Members 99-43*.

The exemption granted by the SEC from Rule 15c2-11 will permit broker/dealers to publish or submit quotations in other quotation media, including the National Quotation Bureau's Pink Sheets, for securities being removed from the OTCBB pursuant to NASD Rule 6530 subject to the following conditions:

1. A broker or dealer must have in its records the information specified in paragraphs (a)(5)(i), (a)(5)(ii), and (a)(5)(viii) of Rule 15c2-11;

2. The security was quoted in the OTCBB from January 4, 1999, until the date of its removal⁴;
3. The NASD has appended the covered security's symbol to indicate that it is not compliant with Rule 6530; and
4. A broker or dealer must have published quotations in the covered security in the OTCBB on at least 12 business days during the preceding 30 calendar days, with no more than four consecutive business days without quotations.

The exemption will expire when the implementation of the Eligibility Rule is complete.⁵

To publish or submit quotations for a security pursuant to this exemption, a broker/dealer must comply with NASD Rule 6740 and, during the 30- or 60-day period that the security's symbol reflected on the OTCBB is appended with the "E" modifier, complete and mail the Exemption Form to:

OTC Compliance Unit
 NASD Regulation, Inc.
 9513 Key West Avenue
 Rockville, MD 20850
 or fax it to (301) 208-2806

A copy of the Exemption Form is attached to this *Notice* and is also available on the OTCBB Web Site.

The form must be received by the OTC Compliance Unit during the 30- or 60-calendar day grace

period commencing after the "E" is appended on the security symbol.

15c2-11 Exemption Request Form - Eligibility Rule

The information that must be provided on this form includes:

- The issuer's name and the issuer's predecessor in the event of a merger or reorganization within the previous 12 months;
- The issuer's address;
- A contact name and telephone number for the issuer;
- The nature of the issuer's business;
- The symbol(s) for the security(ies); and
- The security's CUSIP number (if applicable).
- If a broker/dealer is initiating a quotation with a priced entry, the firm must specify the basis for determining the price and the factors considered in making that determination.
- If the broker/dealer's initial quotation does not include a priced entry, the firm must supplement its filing before inserting a priced entry.
- The form must be signed by a principal of the member firm.

Endnotes

¹Letter from Larry E. Bergmann, Senior Associate Director, SEC, to Alden S. Adkins, General Counsel, NASD Regulation, Inc., dated June 3, 1999.

²See Release No. 34-40878 (January 4, 1999), 64 FR 1255 (January 8, 1999) (File No. SR-NASD-98-51).

³Issuers that file with the SEC will have a 30-day grace period before they can no longer be quoted on the OTCBB; issuers that file with other regulators will have a 60-day grace period.

⁴Therefore, if the SEC suspends trading in the security pursuant to Section 12(k) under the Exchange Act, this exemption does not apply to that security.

⁵After that time, broker/dealers that wish to publish a quotation in another quotation medium in an OTCBB security that becomes ineligible for the OTCBB system will be required to comply with Rule 15c2-11. The SEC has recently repropounded amendments to Rule 15c2-11. See Release No. 34-41110 (February 25, 1999), 64 FR 11124 (March 8, 1999). Broker/dealers would be required to comply with any new provisions of Rule 15c2-11, and this exemption may be modified or revoked upon adoption of any amendments.

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DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 3, 1999

Mr. Alden S. Adkins
Executive Vice President and General Counsel
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

Re: Exemption Request from Rule 15c2-11
File No. 99-162

Dear Mr. Adkins:

In your letter dated June 3, 1999, as supplemented by conversations with the staff, you request an exemption from Rule 15c2-11 (Rule 15c2-11 or Rule) under the Securities Exchange Act of 1934 (Exchange Act) to permit brokers or dealers to publish quotations in other quotation mediums¹ for securities that are no longer eligible to be quoted on the Over-the-Counter Bulletin Board (OTCBB) due to the implementation of National Association of Securities Dealers, Inc. (NASD) Rule 6530 (Eligibility Rule) without complying with certain provisions of Rule 15c2-11. This response is attached to the enclosed photocopy of your correspondence.

On January 4, 1999, the Commission approved amendments to NASD Rule 6530 to limit the securities that a member can quote on the OTCBB, operated by the NASD, to the securities of issuers that are registered under Section 12 of the Exchange Act, certain insurance companies, banks, savings associations, and registered closed-end investment companies, but only if they are current in their reporting obligations.² The Commission also approved amendments to NASD Rule 6540 to prohibit a member from quoting a security on the OTCBB unless the security is eligible under Rule 6530 and the issuer is current in its reporting obligations.³ The new Eligibility Rule was effective immediately for securities not quoted on the OTCBB on January 4, 1999. Issuers whose securities were quoted on the OTCBB on January 4, 1999, and have continued to be quoted, will be required to comply with the Eligibility Rule according to a phase-in schedule starting on July 1, 1999 and continuing through June 2000. Thus, starting on July 1, 1999, a potentially large number of securities will no longer be eligible for quotation on the OTCBB.

¹ Rule 15c2-11 governs the publication of quotations for securities in a quotation medium other than a national securities exchange or Nasdaq. Quotation medium is defined in section (e)(1) of the current Rule. Quotation mediums include the Over-the-Counter Bulletin Board (OTCBB) and the Pink Sheets operated by the National Quotation Bureau L.L.C.

² See Release No. 34-40878 (Jan. 4, 1999).

³ Id.

Mr. Alden S. Adkins
Executive Vice President and General Counsel
NASD Regulation, Inc.
June 3, 1999
Page 2

You request a limited exemption for brokers or dealers that are quoting the securities of companies that would have remained eligible to be quoted on the OTCBB if Rule 6530 had not been adopted. The exemption would permit brokers or dealers that have been quoting these securities on the OTCBB to quote these securities in other quotation mediums without interruption immediately following removal from the OTCBB.

Response:

Rule 15c2-11 prohibits a broker or dealer from publishing any quotation for an OTC security (covered security), or from submitting any such quotation for publication, in any quotation medium, unless such broker or dealer has in its records and reviews the information specified in the Rule regarding the security and its issuer, or unless an exception or exemption from the Rule's requirement is available. Paragraph (d) of the Rule requires the broker or dealer submitting a quotation to an interdealer quotation system for any security of an issuer included in paragraph (a)(5) of Rule 15c2-11 to furnish the information described in paragraph (a)(5) to the interdealer quotation system, in the form prescribed by that system, at least three business days before the quotation is published or submitted.

Based upon your representations and the facts presented, the Commission, except as stated below, hereby grants an exemption from Rule 15c2-11, pursuant to paragraph (h), to permit broker-dealers to publish or submit quotations in other quotation mediums for covered securities being removed from the OTCBB pursuant to Rule 6530. This exemption is subject to the following conditions:

1. Each broker or dealer relying upon this exemption must have in its records information specified in paragraphs (a)(5)(i), (a)(5)(ii), and (a)(5)(viii) of Rule 15c2-11;
2. The security was quoted in the OTCBB from January 4, 1999, until the date of its removal;⁴
3. The NASD has appended the covered security's symbol to indicate that it is not compliant with Rule 6530;

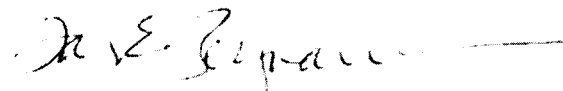
⁴ Therefore, if the Commission suspends trading in a covered security pursuant to Section 12(k) under the Exchange Act, this exemption does not apply to that security.

Mr. Alden S. Adkins
Executive Vice President and General Counsel
NASD Regulation, Inc.
June 3, 1999
Page 3

4. Each broker or dealer relying upon this exemption must have published quotations in the covered security in the OTCBB on at least 12 business days during the 30 calendar days preceding its removal from the OTCBB, with no more than four consecutive business days without quotations; and
5. This exemption will expire when the implementation of the Eligibility Rule is complete.⁵

This exemption from Rule 15c2-11 is based solely on the facts and circumstances described above and is strictly limited to the application of Rule 15c2-11 to the quotations described above. The publications or submission of quotations by a broker or dealer in a quotation medium for a security based upon the foregoing exemption should be discontinued if any material change occurs concerning any of those facts or representations. In addition, brokers or dealers are directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 10(b) and 15(c) and Rules 10b-5 and 15c1-2 thereunder. Responsibility for compliance with these and any other applicable provisions of the federal securities laws must rest with the brokers or dealers. We express no view with respect to any other questions that the proposed transactions may raise, including, but not limited to, the applicability of any other federal or state laws to the proposed transactions.

For the Commission, by the
Division of Market Regulation,
pursuant to delegated authority,



Larry E. Bergmann
Senior Associate Director

⁵ After that time, broker or dealers that wish to publish a quotation in another quotation medium in an OTCBB security that becomes ineligible for the OTCBB system will be required to comply with Rule 15c2-11. The Commission has recently repropounded amendments to Rule 15c2-11. See Securities Exchange Act Release No. 34-41110 (March 8, 1999). Broker-dealers would be required to comply with the provisions of Rule 15c2-11 in effect at that time, and this exemption may be modified or revoked upon adoption of any amendments.

EXEMPTION FORM

Rule 15c2-11 Exemption Request Form (NASD Eligibility Rule 6530)

On June 3, 1999, the Securities and Exchange Commission (SEC) granted an exemption from SEC Rule 15c2-11 for securities that were quoted on the Over-the-Counter Bulletin Board* (OTCBB) on or before January 4, 1999. These are securities that will no longer be eligible to be quoted on the OTCBB due to the phase-in implementation of NASD Rule 6530 (the Eligibility Rule). Broker/dealers that meet the exemption conditions are required to submit this form to the OTC Compliance Unit of the NASD Regulation, Inc., Market Regulation Department (Unit) in order to be considered for the exemption.

Please complete this form as outlined below, then mail the completed form to: OTC Compliance Unit, NASD Regulation, Inc., 9513 Key West Avenue, Rockville, MD 20850; or fax it to (301) 208-2806. This form must be received by the OTC Compliance Unit during the 30- or 60-calender day grace period commencing after the "E" is appended on the security symbol.

If you have questions about filing this form or the conditions surrounding this exemption, please call the Unit at (301) 208-2802.

If after review, the Unit clears the broker/dealer to publish or submit quotations in another quotation medium, the Unit will notify the quotation medium you specify below that you are permitted to enter quotations on the security(ies) requested in this form on the date it is removed from quotation on the OTC Bulletin Board.

Check the applicable quotation medium(s): Pink Sheets Other (specify) _____

Provide the required information requested below (please submit a separate form for each issuer):

1. Exact name of issuer and predecessor (if any) _____
2. Address of principal executive offices

3. Telephone number of principal executive offices _____
4. Name and title of issuer contact _____
5. Nature of the issuer's business _____
6. Security Symbol(s) Complete Title and Class of Security(ies) to be Quoted CUSIP (if assigned)

¹ Therefore, if the Commission suspends trading in the covered security pursuant to Section 12(k) under the Exchange Act, this exemption does not apply to that security.

7. Price of initial resumed quotation entry:

Bid _____ Ask _____ ___ No price at this time

If you are entering a bid and/or ask price now, you must also provide a clear statement of the following information:

The basis upon which the priced entry was determined:

The factors considered in making that determination:

Certification:

The undersigned, by signing below, affirms that (i) the broker/dealer filing this form has in its records the information specified in paragraphs (a)(5)(i), (a)(5)(ii), and (a)(5)(viii) of Rule 15c2-11; (ii) the security(ies) listed on this form was(were) quoted in the OTCBB from January 4, 1999, until the date of its removal¹, (iii) the security's symbol has been appended with an "E" modifier to indicate that it is not compliant with Rule 6530; (iv) the broker/dealer filing this form published quotations in the covered security in the OTCBB on at least 12 business days during the preceding 30 calendar days, with no more than four consecutive business days without quotations; and (v) that the information supplied in this form is reasonably current. Detailed information regarding this exemption from Rule 15c2-11 is available by calling the OTC Compliance Unit at (301) 208-2802.

Name and signature of member firm principal overseeing the submission of this form:

Name: _____ Title: _____

Signature: _____ Date: _____

Firm Name: _____

Telephone Number: _____ MPID: _____

NASD Notice to Members 99-59

NASD Will No Longer Impose Censures For Some Violations

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Executive Representatives
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

Executive Summary

On June 10, 1999, the National Adjudicatory Council (NAC) adopted a new policy that provides that censures will no longer be imposed for certain designated violations when the total monetary sanction is \$5,000 or less, and when bars or suspensions are imposed. Members are directed to attach this *Notice to Members* as an amendment to their *NASD Sanction Guidelines*.

Questions concerning this new policy may be directed to Shannon Lane, Attorney, Office of General Counsel, NASD Regulation, Inc., at (202) 728-6904.

Background

The National Association of Securities Dealers, Inc. (NASD® or Association) may impose sanctions on member firms and persons associated with member firms for violations of the federal securities laws, rules of the Municipal Securities Rulemaking Board (MSRB), and the Association's rules.

When disciplining members for such violations, the NASD may impose any fitting sanction including monetary sanctions (*e.g.*, fines, disgorgement, and restitution) and non-monetary sanctions (*e.g.*, censures, suspensions, bars, and expulsions). The *NASD Sanction Guidelines* recommend a range of monetary and non-monetary sanctions for particular violations.

This *Notice to Members* is issued to inform the membership of a new censure policy adopted by the NAC at its June 10, 1999 meeting. Under this new policy, the NASD has identified certain violations for which it will no longer impose censures when relatively low monetary sanctions are imposed. Accordingly, the NASD will not impose censures when the total monetary sanction for any disciplinary action, regardless of the number of violations alleged, is \$5,000 or less (including any fine, or order of restitution or disgorgement)¹ and the violation(s) at issue consist solely of one or more of the violations listed below.²

Violations that will no longer be subject to censure when monetary sanctions of \$5,000 or less are imposed

Quality of Markets violations

- ACT Violations - Rule 6100 Series
- Backing Away
- Best Execution and Interpositioning
- Confirmation of Transactions (SEC Rule 10b-10)
- ECN Display Rule
- Failure to Display Minimum Size in Nasdaq® Securities, CQS Securities, and OTC Bulletin Board Securities
- Fixed Income Pricing System - Trade Reporting and Participant and Quotation Obligations
- Limit Order Display Rule
- Limit Order Protection Rule
- Locked/Crossed Market
- Options Exercise and Positions Limits
- Options Positions Reporting - Late Reporting and Failing to Report
- Passive Market Making
- SelectNet™ Text Messages
- Short Sale Violations
- SOES™ Rules
- Trades Executed During a Trading Halt
- Trade Reporting - Late Reporting; Failing to Report; Inaccurate Reporting

Violations that will no longer be subject to censure when monetary sanctions of \$5,000 or less are imposed (continued)

Qualification and Membership violations

- Continuing Education - Firm Element
- Continuing Education - Regulatory Element
- Registration Violations

Reporting/Provision of Information violations

- FOCUS reports - Late Filing
- Form BD-Y2K Reports - Late Filing
- Forms U-4/U-5 - Late Filing; Failure to File; Inaccurate Forms or Amendments
- MSRB Rule G-36 - Untimely Filing of Offering Documents With MSRB; Late Filing; Failure to File
- MSRB Rules G-37/G-38 Reporting - Late Filing; Failing to File
- Regulation M Reports - Late Filing; Failing to File
- Reportable Events Under Conduct Rule 3070 - Late Reporting; Failing to Report; Inaccurate Reports
- Request for Automated Transmission of Trading Data (Blue Sheets) - Failure to Respond in a Timely and Accurate Manner

Financial and Operational Practices violations

- Consumer Protection Rule
- Net Capital Violations
- Recordkeeping Violations
- Violations of SEC Rule 17a-11 (Notification Provisions for Broker/Dealers)

Supervision violation

- Supervisory Procedures - Deficient Written Supervisory Procedures³

In addition, because bars and suspensions are severe sanctions that already signify the Association's official disapproval of a respondent's conduct, censures will not be imposed in cases where the respondent is barred or suspended in any capacity regardless of the nature of the violation.

The new policy applies to all Letters of Acceptance, Waiver, and Consents and Offers of Settlement executed by respondents beginning on June 11, 1999, and to all NAC

and Office of Hearing Officer decisions decided and issued on or after June 11, 1999.

Members are directed to attach this *Notice to Members* as an amendment to their *NASD Sanction Guidelines*.

Endnotes

¹Censures will be imposed, however, when fines above \$5,000 are reduced or eliminated due to a respondent's demonstrated inability to pay or bankruptcy.

²This list largely consists of violations as found in the *NASD Sanction Guidelines*. To the extent that a particular guideline indicates that its application is appropriate for violations of an analogous rule, violations of that analogous rule will not be subject to censure when monetary sanctions of \$5,000 or less are imposed.

³In addition, censures will not be imposed for violations disposed of under the Minor Rule Violation Plan pursuant to NASD Procedural Rule 9216(b) and IM-9216.

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NASD Notice to Members 99-60

Fixed Income Pricing System Additions, Changes, And Deletions As Of May 24, 1999

Suggested Routing

- Senior Management
- Advertising
- Continuing Education
- Corporate Finance
- Government Securities
- Institutional
- Insurance
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registered Representatives
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training
- Variable Contracts

As of May 24, 1999, the following bonds were added to the Fixed Income Pricing SystemSM (FIPS[®]).

Symbol	Name	Coupon	Maturity
AEC.GA	Associated Estates Realty Corp.	8.375	04/15/00
AEC.GB	Associated Estates Realty Corp.	7.100	11/15/02
AEN.GE	AMC Entertainment Inc.	9.500	02/01/11
AES.GG	AES Corporation	9.500	06/01/09
ALIL.GA	Alliance Laundry Sys LLC/Corp.	9.625	05/01/08
AMAX.GA	American Axle & Mfg. Inc.	9.750	03/01/09
AMSN.GA	American Standard Inc.	8.250	06/01/09
ARCH.GA	ARCO Chem Co.	9.800	02/01/20
ARCH.GB	ARCO Chem Co.	9.900	11/01/00
ARCH.GC	ARCO Chem Co.	10.250	11/01/10
ARCH.GD	ARCO Chem Co.	9.375	12/15/05
BDGM.GE	Building Materials Corp.	8.000	12/01/08
BGFW.GB	Big Flower Press Holdings Inc.	8.625	12/01/08
COUC.GA	Continental Resources Inc.	10.250	08/01/08
COVD.GB	Covad Communication Group Inc.	12.500	02/15/09
DOAP.GA	Doane Pet Care Co.	9.750	05/15/07
FRO.GA	Frontier Corp.	7.250	05/15/04
GALU.GA	Golden Northwest Aluminum Inc.	12.000	12/15/06
GHV.GD	Genesis Health Ventures Inc.	9.875	01/15/09
HPK.GA	Hollywood Park Inc. Series B	9.250	02/15/07
LPHH.GA	Lifepoint Hospital Holdings Inc.	10.750	05/15/09
MFNX.GA	Metromedia Fiber Network Inc. Ser B	10.000	11/15/08
MHTG.GA	Mohegan Tribal Gaming Authority	8.750	01/01/09
MHTG.GB	Mohegan Tribal Gaming Authority	8.125	01/01/06
NXLK.GD	NextLink Communications Inc.	12.250	06/01/09
NXLK.GE	NextLink Communications Inc.	10.750	11/15/08
NXLK.GF	NextLink Communications Inc.	10.750	06/01/09
OSG.GA	Overseas Shipholding Group Inc.	8.000	12/01/03
OSG.GB	Overseas Shipholding Group Inc.	8.750	12/01/13
PDE.GA	Pride International Inc.	10.000	06/01/09
PZN.GA	Prison Realty Trust Inc.	12.000	06/01/06
QWST.GF	Quest Communications Intl Inc. Ser B	7.250	11/01/08
RTHL.GA	Rain Tree Healthcare Corp.	11.000	01/01/03
SFS.GA	Santa Fe Snyder Corp.	8.050	06/15/04
SFXE.GB	SFX Entertainment Inc.	9.125	12/01/08
THC.GG	Tenet Healthcare Corp.	7.625	06/01/08
THC.GH	Tenet Healthcare Corp.	8.125	12/01/08
UGLY.GA	Ugly Duckling Corp.	12.000	10/23/03

As of May 24, 1999, the following bonds were deleted from FIPS.

Symbol	Name	Coupon	Maturity
AFNP.GA	Affiliated Newspaper Invts Inc.	13.250	07/01/06
AZR.GA	Aztar Corp.	11.000	10/01/02
BOR.GB	Borg-Warner Security Corp.	9.625	03/15/07
KOGC.GA	Kelley Oil & Gas Corp.	13.500	06/15/99

Symbol	Name	Coupon	Maturity
MUOP.GA	Muse Air Corp.	16.875	06/15/99
NWCG.GA	NWCG Holdings Corp.	13.500	06/15/99
RVSU.GC	Revlon Consumer Products Corp.	9.500	06/01/99
SFR.GA	Santa Fe Energy Resources Inc.	11.000	05/15/04
TCOM.GC	Tele-Communications Inc.	11.125	10/01/03
TWA.GE	Trans World Airlines Inc.	10.250	06/15/03
VIA.GA	Viacom Inc.	8.000	07/07/06
WAX.GD	Waxman Industries Inc.	13.750	06/01/99

As of May 24, 1999, changes were made to the symbols of the following FIPS bonds:

New Symbol	Old Symbol	Name	Coupon	Maturity
BWS.GA	BG.GB	Brown Shoe Inc.	9.500	10/15/06
COVD.GA	CVDU.GA	Communication Group Inc. Series B	13.500	03/15/08
TWRS.GA	CWNI.GA	Crown Castle Int. Inc.	10.625	11/15/07
TWRS.GB	CWNI.GB	Crown Castle Int. Inc.	9.000	05/15/11
TWRS.GC	CWNI.GC	Crown Castle Int. Inc.	10.375	05/11/11

All bonds listed above are subject to trade-reporting requirements. Questions pertaining to FIPS trade-reporting rules should be directed to Stephen Simmes, Market Regulation, NASD Regulation®, at (301) 590-6451.

Any questions regarding the FIPS master file should be directed to Cheryl Glowacki, Nasdaq® Market Operations, at (203) 385-6310.

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