

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 23, 1971

To: All NASD Members and Interested Persons

Re: Proposed Amendments To By-Laws, Rules of Fair Practice and the Code of Arbitration Procedure

The Board of Governors of the Association has recently proposed certain amendments to the Association's By-Laws and Schedules of the By-Laws, Rules of Fair Practice Interpretations and Appendix A of the Rules of Fair Practice and the Code of Arbitration Procedure. They are being published by the Board at this time to enable all interested parties an opportunity to comment thereon. Such comments must be in writing and be received by the Association by August 23, 1971 in order to receive consideration. After the comment period has been closed, the proposals must again be reviewed by the Board. Thereafter, the proposed amendments to Article IV, Section 3 and Article VII, Section 3 of the By-Laws and Article III, Section 22 of the Rules of Fair Practice must be submitted to the membership for vote. Upon the completion of such, if approved, all of the proposals must be submitted to and not disapproved by the Securities and Exchange Commission prior to becoming effective.

Explanation of Proposed Amendments

The proposed amendments would change the geographical boundaries and the number of members of certain Districts of the Association, alter the representation on the Board of Governors from these Districts, establish a requirement of members to disclose their financial condition to any capital contributor, establish margin maintenance standards for over-the-counter securities, amend various provisions of the "Free-Riding and Withholding" Interpretation and amend the Code of Arbitration Procedure in several respects the most important of which would require the submission of a dispute to arbitration at the instance of a member or a public customer.

The amendment to Article IV, Section 3 of the By-Laws would decrease the representation of District No. 8 on the Board of Governors from three members to two and increase the representation on the Board of Governors of District No. 13 from one member to two. This change is being made to more properly conform the representation on the Board of Governors to the distribution of members among the Districts. Conforming technical changes will be made throughout the By-Laws.

The amendment to Schedule B of Article IV, Section 1 of the By-Laws would have the effect of decreasing the membership in Districts No. 1 and 12 and increasing the membership in Districts No. 8, 11 and 13. This change is necessary to alleviate the workloads of those Districts and to provide a more equal distribution of the membership among the Districts.

The amendment to Article III, Section 22 of the Rules of Fair Practice would require the disclosure of a member's financial condition to any person contributing new capital to such member. The requirement covers the contribution of any form of new capital including but not limited to subordinated capital, limited partnership interests or privately placed equity securities. In addition, the amendment would require the member receiving such capital and making such disclosure to keep and preserve a written statement from the contributor of such new capital stating that such disclosure was made to him.

A new Appendix A of Article III, Section 30 of the Rules of Fair Practice is proposed which would establish margin maintenance standards. When the Federal Reserve Board allowed certain over-the-counter securities to be purchased on margin, the Association adopted Article III, Section 30 of the Rules of Fair Practice which was favorably voted on by the membership. Article III, Section 30 authorizes the Board of Governors to establish minimum amounts of initial and maintenance margin requirements and other specific requirements or prohibitions. Pursuant to Article III, Section 30, the Board of Governors has approved certain standards under which margin accounts are to be carried by the membership and these standards are specified in Appendix A, the Association's Margin Maintenance Rule, which will become a part of Article III, Section 30.

Appendix A will apply to firms carrying margin accounts which are not members of a national securities exchange named in subsection (a) of Section 1. Members of those exchanges are governed by at least an equally comprehensive maintenance rule.

The most immediate effect on the general membership will be caused by Section 5. In special cash accounts of public customers (excepting those accounts specifically exempted), this Section will require minimum deposits of 5% of the principal amount of each purchase of U. S. Government obligations, and 15% of the principal amount of 25% of the market value, whichever is lower, of each purchase of municipal obligations, if full payment is not made promptly, i. e., by settlement date. Also, purchases of "when issued" securities by customers in special cash accounts will require minimum deposits of 25% of the market value or \$2,000 whichever is higher.

The transactions covered in Section 5 were included in the Margin Rule because "exempts" and "when issued" securities have no margin requirements under Regulation T and the Board of Governors felt that for the financial safety of members, purchases of such securities should not be without minimum protective coverage.

Subsection (d) of Section 2 requires a deposit equal to 50% of the market value of a security subject to any put or call option, or 50% of the exercise price of the option, whichever is higher, if the customer's account is not long or short the underlying securities. Such options are commonly referred to as "naked" or "bare" options.

Subsection (c) of Section 3 gives the Association authority to require higher initial or maintenance margin for specific securities as circumstances warrant. Presently, there are no OTC marginable securities covered by this subsection. When this subsection is invoked a notice describing the security and the higher requirements will be sent to the general membership.

Section 7 allows no value for any put or call option for the purpose of computing margin in a customer's account. It should be pointed out that the difference between the exercise price of the option and the market value of the underlying securities is of value only when considering maintenance margin for the particular put or call.

In Section 10, the Association recognizes that the member carrying the omnibus account is acting only as clearing agent for the member carrying customer accounts. Because the member carrying customer accounts is the responsible party and must keep all the required records and information concerning the customer accounts included in the omnibus account, it will not be necessary for the member carrying the omnibus account to duplicate these records.

Section 12 gives recognition to the similarities existing between Specialists on an Exchange and "OTC Market Makers." Because of this, OTC Market Makers are allowed the same latitude in negotiating maintenance charges with carrying members as Specialists are, without rigidly imposed percentages which might operate to hamper their ability to maintain a liquid market.

Finally, the attention of firms carrying margin accounts is directed to Section 11 which imposes a requirement on members to maintain certain records with respect to each margin account carried for its customers.

There are three proposed amendments to the "Free-Riding and Withholding" Interpretation. The word "securities" is to be substituted for the word "shares" wherever it appears in the Interpretation. This substitution is being made to clarify the intent of the Interpretation which is to apply to all new issues including public offerings of securities which are normally not referred to as shares i. e., convertible debentures.

Paragraph 7(d) of the "Free-Riding and Withholding" Interpretation is being deleted because the supervisory requirements of this paragraph are also required under Article III, Section 27 of the Rules of Fair Practice and the Board feels that this requirement need not be restated in the Interpretation.

The amendment to the "Violations by Recipient" paragraph of the "Scope and Intent of Interpretation" Section is intended to remove the mandatory violation by a person associated with a member when the recipient of the "hot" issue is a member of the immediate family of such person and to provide that a member or person associated with a member who causes, directly or indirectly, the distribution of securities to a restricted person be deemed to be in violation of the Interpretation.

The proposed amendment to Article VII, Section 3(d) of the Association's By-Laws would authorize the Board to require members to submit controversies to arbitration when such controversies arise between members or between members and customers. Section 3(d) presently gives the Board authority to prescribe arbitration procedures; the proposed amendment would provide explicit authority for the Board's requiring submission of controversies to arbitration.

Proposed Section 2 - Required and Voluntary Submissions

The proposed Section 2 (the present Section 2 would be redesignated Section 5) designates those controversies which must and those controversies which may be submitted for arbitration. Consistent with the overall limitations on the applicability of the Code, this section deals only with controversies "arising out of and relating to securities transactions," and provides in subsection 2(a)(1) that when such controversies arise between members they shall be submitted to arbitration. The section also provides, in subsection 2(a)(2), that such controversies arising between a member and a public customer shall be submitted to arbitration if the customer institutes such proceedings. Subsection 2(a)(3) would permit a member to require a customer to arbitrate a controversy where the two parties have properly executed an enforceable agreement to do so.

Subsection 2(b) clarifies that all controversies arising prior to the effective date of these amendments shall be arbitrated on a voluntary basis; the proposed amendments would require arbitration only of those disputes arising after the amendments are approved by the membership.

Subsection 2(b) would require that persons executing a submission agreement are thereafter bound by such agreement to arbitrate the dispute in question.

Deletion of Section 3 - Informal Arbitration

Section 3 presently provides for the submission to arbitration of controversies arising between members under the Uniform Practice Code. As proposed presently Section 3 would be deleted in its entirety. It is anticipated that a new Section 3 containing procedures for the arbitration of disputes arising between members and the National Clearing Corporation will be considered by the Association's Board of Governors in the near future and will be presented to the membership for comment shortly thereafter.

Proposed Section 4 - Hearing Requirements

The proposed Section 4 (present Section 4 would be deleted in view of new Section 2) would provide a simplified procedure for arbitrating disputes involving relatively small sums of money. Under subsection 4(a), any dispute arising between members involving \$5,000 or less would be resolved without a hearing solely on the basis of the pleadings and documents filed by the parties. Each of the parties would be afforded the right to a hearing, however, upon request to the Director of Arbitration. The arbitrators may, however, pursuant to proposed subsection (e), by a majority vote of the panel call a hearing in any dispute. That subsection also provides that an individual arbitrator can call for additional evidence in any proceeding.

Similar procedures for simplified arbitration are provided by subsection 4(b) for disputes involving public customers or others including non-member broker/dealers, when the dispute involves an amount of \$2,000 or less. As in the case of member disputes, however, each party is given the right to a hearing on request, a majority of the arbitrators may call for a hearing and an arbitrator may request additional evidence pursuant to subsection (e).

Disputes between the National Clearing Corporation and its clearing members are excepted from these provisions. They will be dealt with in Section 3 reserved for that purpose.

In simplified arbitration the number of arbitrators is reduced by subsection 4(c). In disputes involving only members, the panel shall be made up of at least one but not more than three arbitrators all of whom are from the securities industry. Under ordinary arbitration procedure, such a panel would consist of from three to five arbitrators from the industry. Simplified arbitration involving members of the public will be conducted by a panel of three arbitrators, at least two of whom are

from outside the securities industry. This contrasts with a panel of five arbitrators, three of whom come from outside the securities industry, under normal procedure.

Awards made pursuant to simplified arbitration shall be rendered within 30 business days under proposed subsection 4(f). This corresponds to the time period provided in present Section 34 for all other awards.

Subsection (d) requires a hearing in all formal arbitration proceedings unless specifically waived. This contrasts to the procedures in subsections (a) and (b) where a hearing must be demanded.

Section 7 (Present Section 6) - National Arbitration Committee

Section 7 provides for the appointment of members of the National Arbitration Committee and for the selection by that Committee of arbitrators. The proposed amendment to this section would allow the Committee to extend the term of service of an arbitrator beyond the 3 years specified in the Section.

Section 9 (Present Section 8) - Denial of Arbitration

The proposed amendment to this section, which gives the Director of Arbitration authority to decline to permit arbitration under certain circumstances, would remove certain standards presently included in that section and give the Director of Arbitration broader discretion in denying arbitration.

Section 11 - Settlements

Section 11 represents a revision of old Section 10 which has been deleted. It provides a procedure whereby a dispute submitted to arbitration may be settled. To reflect the deletion of Section 18, which presently provides for the revocation of submissions, the proposed Section 11 requires that any settlement reached following the initiation of a hearing be at the consent of the arbitrators and upon such terms and conditions as they direct.

Section 14 (Present Section 13) - Designation of Number of Arbitrators

Under the proposed changes, Section 14 would be amended to eliminate any contradiction with proposed Section 4 as to the number of arbitrators necessary to constitute an arbitration panel. Section 4 provides for reduced numbers of arbitrators in simplified arbitration proceedings and, therefore, would conflict with this section which designates the number of arbitrators for "all arbitration matters" if it is not amended.

Deletion of Present Section 18 - Revocation of Submissions

The proposed amendments to the Code would delete in its entirety the present Section 18 which allows a party initiating an arbitration proceeding or a party made respondent to such proceeding to revoke the submission of the matter within 10 business days. This deletion is necessary since the present language of Section 18 contradicts the provision of proposed Section 2 which requires the submission of certain controversies to arbitration.

Section 18 (Present Section 17) - Initiation of Proceedings

The proposed amendment to subsection (b) would reduce from ten to eight the number of business days allowed for the filing of a Submission Agreement following the service of the Statement of Claim. This amendment is intended to expedite to the extent reasonably possible the overall arbitration process and to thereby reduce the total amount of time required for final disposition of an arbitration proceeding. Subsection (c) would also be amended to reduce from ten to eight the number of business days allowed for the filing of the Statement of Reply; the number of copies required of the Statement would also be increased from one to two.

Proposed new subsection (e) gives any member who is made a party to an arbitration proceeding under this Code the right to proceed against any other member upon a claim directly related to the dispute in question, if otherwise eligible for submission to arbitration, and to obtain relief against such other member in the same hearing. Ultimate determination of whether a claim is related to the proceeding is left to the arbitration panel. Preliminary determinations could be made by the Director of Arbitration or the Executive Committee of the National Arbitration Committee.

Section 19 - Designation of Time and Place of Hearings

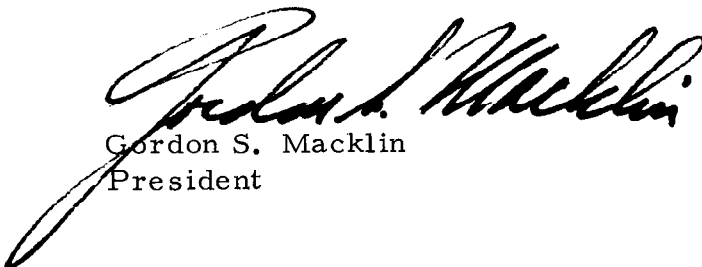
Section 19 gives the Director of Arbitration the authority to designate the time and place of the initial hearing in an arbitration proceeding. The Section presently provides that the Director of Arbitration shall deliver a notice of the initial hearing at least 10 business days prior to the date set for such hearing. The proposed amendment would reduce this period to eight business days to thereby reduce the overall time required for an arbitration proceeding.

Section 22 - Failure to Appear

The proposed amendment to Section 22, reserves the existing standard so as to make clear the arbitrators' authority to proceed with arbitration and make a determination without a party who has received due notice of the proceeding.

All interested persons are invited to submit their views and comments to Mr. Donald H. Burns, Secretary, National Association of Securities Dealers, Inc., 1735 K Street, N. W., Washington, D. C. 20006, on or before August 23, 1971. All communications will be considered available for inspection.

Very truly yours,

A handwritten signature in black ink, appearing to read "Gordon S. Macklin". The signature is written in a cursive style with a large, sweeping initial "G".

Gordon S. Macklin
President

Proposed Amendments To The By-Laws, Rules of Fair Practice And
Code of Arbitration Procedure
Of The
National Association of Securities Dealers, Inc.

It is proposed that the following sections of the By-Laws, Rules of Fair Practice and Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. be amended by deleting the words which are lined out and by adding the words which are underlined, as set forth below.

I. Article IV, Section 3 of By-Laws

(b) ~~Three~~ Two members of the Board of Governors shall be elected from and by the members of the Corporation having places of business in District No. 8;

(d) Two members of the Board of Governors shall be elected from and by the members of the Corporation having places of business in District No. 13.

~~(d)~~(e) One member of the Board of Governors shall be elected from and by the members of the Corporation having places of business in each of the remaining districts not referred to in paragraphs (a), (b), ~~and (c)~~ and (d) of this Section.

~~(e)~~(f) One member of the Board of Governors shall be elected by the Board of Governors from among the principal underwriter members of investment company shares, and he shall be designated Governor-at-Large.

~~(f)~~(g) One member of the Board of Governors shall be elected by the Board of Governors from among insurance company members or insurance company affiliated members of the Association and he shall be designated Governor-at-Large.

~~(g)~~(h) Three members of the Board of Governors shall be elected from the membership generally and they shall be designated Governors-at-Large. One such Governor-at-Large shall be elected by the Board of Governors in 1970 to take office in 1971. One such Governor-at-Large shall be elected by the Board of Governors in 1971 to take office in 1972. One such Governor-at-Large shall be elected by the Board of Governors in 1972 to take office in 1973.

~~(h)~~(i) The Board of Governors shall, from time to time, consider the fairness of the representation of the various districts on the Board of Governors, and whenever it finds any unfairness in such representation to exist, it shall recommend appropriate changes in these By-Laws to assure fair representation of all districts.

II. Schedule B of Article IV, Section 1 of By-Laws

District No. 1 States of Alaska, Idaho, Montana, ~~North Dakota~~, Oregon ~~South Dakota~~ and Washington.

District No. 8 States of Illinois, Indiana, Iowa, Michigan, Minnesota North Dakota, South Dakota and Wisconsin.

District No. 11 The States of Delaware, Pennsylvania, West Virginia and ~~in the State of New Jersey, the Counties of Burlington and Ocean and the remainder of said State lying south of such Counties~~ except for the Counties of Bergen, Essex, Hudson, Passaic and Union.

District No. 12 ~~States of Connecticut, New York~~ In the State of New York the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester and the five Boroughs of New York City, and, in the State of New Jersey, the Counties of Mercer and Monmouth and the remainder of said State lying north of such Counties Bergen, Essex, Hudson, Passaic and Union.

District No. 13 States of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont and New York with the exception of the Counties of Nassau, Orange, Putnam, Rockland, Suffolk and Westchester and the five Boroughs of New York City.

III. Article III, Section 22 of the Rules of Fair Practice

(b) Any member who receives new capital in any form, including but not limited to subordinated capital, limited partnership interests or privately placed equity securities must provide the contributor of such new capital with a statement of such member's financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice and/or as required by any State or Federal securities laws, or any rule or regulation thereunder.

(c) Any member who receives new capital in any form, including but not limited to subordinated capital, limited partnership interests or privately placed equity securities must keep and preserve a written statement from the contributor of such new capital stating that the disclosures required in paragraph (b) of this rule have been made to such contributor.

(b)(d) As used in paragraph (a) of this rule, the term "customer" means any person who, in the regular course of such member's business, has cash or securities in the possession of such member.

IV. Appendix A of Article III, Section 30 of the Rules of Fair Practice

Section (1)

(a) Members of the American Stock Exchange, Midwest Stock Exchange, New York Stock Exchange, Pacific Coast Stock Exchange, and the Philadelphia-Baltimore-Washington Stock Exchange are exempt from the provisions of any part of this Rule.

(b) Any member who effects a securities transaction, including transactions in "when issued" securities, for a customer in a margin account must obtain initial margin in an amount in accordance with Regulation T of the Board of Governors of the Federal Reserve System (Regulation T) and the requirements of Section (2) of this Rule, with a minimum equity in the account of \$2,000, except that cash need not be deposited in excess of the cost of any security purchased. Special subscriptions accounts maintained in accordance with Section 4(h) of Regulation T are exempt from the requirement of a \$2,000 minimum equity.

(c) Withdrawals of cash or securities in accordance with Regulation T may be made from any account provided that such withdrawal does not reduce the equity in the account below \$2,000 or the amount required by Section (2) of this Schedule, whichever is greater.

Section (2)

The Margin which must be maintained in the margin account of a customer is as follows:

(a) 25% of the market value of all securities "long" in the account, except securities exempted under Section (2)(g) of Regulation T; plus

(b) \$2.50 per share or 100% of the market value, whichever is greater, of each stock "short" in the account with a market value of less than \$5.00 per share; plus

(c) \$5.00 per share or 30% of the market value, whichever is greater, of each stock "short" in the account with a market value of \$5.00 per share or above; plus

(d) 50% of the market value of any security subject to any put or call option or 50% of the exercise price of any such option, whichever is higher, sold by such customer to or through the member if the customer's account does not contain the corresponding long or short positions in the securities upon which the options are written; plus

(e) 5% of the principal amount or 30% of the market value, whichever is greater, of each debt security "short" in the account, except securities exempted under Section 2(g) of Regulation T; plus

(f) 15% of the principal amount or 25% of the market value, whichever is lower, on each long and short position in securities exempted under Section 2(g) of Regulation T, except as covered in subsection (g); plus

(g) 5% of the principal amount of each long or short position in obligations issued or unconditionally guaranteed as to principal or interest by the United States Government, except that the Association may authorize lower requirements with respect to particular issues.

Section (3)

Notwithstanding the foregoing, the minimum margin requirement is 10% of the market value of the "long" securities in the following situations:

(a) When a security carried in a "long" position is exchangeable or convertible within a reasonable time and without restriction other than payment of money, into a security carried in a short position; or

(b) When there are offsetting "long" and "short" positions in the same security. In such cases "short" positions must be marked to the market in determining the required minimum margin.

(c) The Association may, for specific securities when it deems circumstances warrant, either at the time of establishing the special initial margin or thereafter, require special initial margin of up to 100% to be deposited in all margin accounts on new transactions within 5 business days of the trade date.

Section (4)

(a) For purposes of this Rule, the minimum amount of margin on any transaction or net position in each "when issued" security shall be the same as if such security were issued.

(b) Each position in a "when issued" security must be computed separately, and any unrealized profit shall be applied only to the amount of margin required on the position in the particular security.

(c) When an account has both a "short" position in a "when issued" security and a long position in the securities in respect of which the "when issued" security may be issued, such "short" position must be marked to the market and the balance in the account adjusted for any unrealized loss.

Section (5)

Transactions of the following types in special cash accounts are subject to the margin requirements of this Rule except when the account is that of a broker/dealer, bank, trust company, investment company, investment trust, insurance company, charitable or non-profit educational institution, or similar fiduciary type account:

(a) Purchases of issued securities exempted under Section 2(g) of Regulation T where payment is not made promptly after the trade date, except that the \$2,000 minimum equity requirement does not apply; and

(b) Transactions in "when issued" securities when payment is not made promptly.

Section (6)

For purposes of this Rule, securities must be valued at current market prices determined by a reasonable and consistent method.

Section (7)

(a) No put or call option carried for a customer shall be considered value for the purpose of computing the margin required in the account of such customer.

(b) A put or call sold or written by a customer shall be considered as a security transaction subject to Section (1) of this Rule .

(c) For the purpose of Section (2) of this Rule such puts and calls shall be considered as if they were exercised. Each such put or call shall be margined separately and any difference between the market price of the underlying securities and the exercise price of a put or call shall be considered to be of value only in providing the amount of margin required on that particular put or call.

(d) If both a put and a call for the same number of shares of the same security are written or sold by a customer, the amount of margin required shall be the margin on the put or call whichever is greater.

(e) When a member issues or guarantees an option to receive or deliver securities for a customer, such option shall be margined as if it were a put or call.

Section (8)

Any account guaranteed by another account of a public customer, in writing, may be consolidated with the other account and the required margin may be computed on the net position of both accounts, provided the guarantee permits the member, without restriction to use the money and securities in the guaranteeing account to carry the guaranteed account or to pay any deficit therein; provided that the guaranteeing account is not owned directly or indirectly by (a) a partner or a stockholder in the organization carrying the account, or (b) a member, partner or stockholder therein having a definite arrangement for participating in the commissions earned on the guaranteed account. However, the guarantee of a limited partner or of a stockholder if based upon his resources other than his capital contribution to or other than his interest in a member organization, is not affected by the foregoing prohibition, and such a guarantee may be taken into consideration in computing margin in the guaranteed account.

Section (9)

When two or more accounts are carried for the same person or entity, the required margin may be computed on the net position of such accounts, provided the customer has consented in writing that the money and securities in each of the accounts may be used to carry or pay any deficit in all such accounts.

Section (10)

No member shall permit a customer to engage in a course of conduct of effecting transactions requiring margin and then either deferring the payment of margin beyond regular settlement date, or meeting such demand for margin by the liquidation of the same or other commitments in the account, except that the provisions of this Section shall not apply to any account maintained for another broker/dealer in which are carried only the commitments of public customers of the other broker/dealer, provided that the latter has agreed in writing that he will maintain a record in accordance with Section (11) of this Rule.

Section (11)

Any member carrying securities margin accounts for customers must make a daily record of each case in which initial or additional margin must be obtained in a customer's account because of transactions in the account on that day. The record shall show, for each account, the amount of margin as required and the time when, and the manner in which, such margin is obtained.

Section (12)

The account of a member in which are effected only transactions in securities in which he is an "OTC Market Maker", as defined in Rule 17a-12 under the Securities Exchange Act of 1934, may be carried upon a margin basis which is mutually agreeable to the market maker and the carrying member.

V. "Free-Riding and Withholding" Interpretation

Delete the word "shares" and replace it with "securities" wherever it appears in the Interpretation.

~~7(d)- Normal-supervisory procedures of the member provide for a close follow-up and review of all transactions entered into with the referred-to domestic bank, trust companies or other conduits for undisclosed principals to assure that the ultimate recipients of shares so sold are not persons enumerated in paragraphs (1) through (6)-hereof.~~

Violations by Recipient

In those cases where a member or person associated with a member, ~~or a member of the immediate family thereof~~, has been the recipient of shares of a public offering to the extent that such violates the Interpretation, the member or person associated with a member shall be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation as well as the member who sold the shares since their responsibility in relation to the public distribution is equally as great as that of the member selling them. In those cases where a member or a person associated with a member has caused, directly or indirectly, the distribution of securities to a person falling within the restrictive provisions of this Interpretation he shall also be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation. Receipt by a member

or a person associated with a member of shares of a "hot issue" which is being distributed by an issuer itself without the assistance of an underwriter and/or selling group is also intended to be the subject of the provisions of this Interpretation.

VI. Arbitration

1. Amend the By-Laws of the Association as follows:

A. Delete Article VII, Section 3(d) thereof.

B. Amend Article IV, Section 2(b) of the By-Laws as follows:

(b) The Board of Governors shall be the governing body of the Corporation and, except as otherwise provided by these By-Laws, shall be vested with all powers necessary for the management and administration of the affairs of the Corporation, and for the promotion of the Corporation's welfare, objects and purposes. In the exercise of such powers, the Board of Governors may, (1) adopt for submission to the membership, as hereinafter provided, such By-Laws, Rules of Fair Practice and changes or additions thereto as it deems necessary or appropriate; (2) make such regulations, issue such orders, resolutions, interpretations and directions, and make such decisions as it deems necessary or appropriate; and (3) prescribe maximum penalties for violations of the provisions of these By-Laws, the rules and regulations of the Corporation, for neglect or refusal to comply with orders, directions and decisions of the Board of Governors or of any District Committee or other Committee, or for violation of any rule or regulation adopted by any District Committee, as provided in Section 2 of Article VII hereof.-; and (4) prescribe a code of arbitration procedure providing for the required or voluntary arbitration of controversies between members and between members and customers or others as it shall deem necessary or appropriate to the extent consistent with law.

2. Amend the Code of Arbitration Procedure as follows:

A. Redesignate Section 2 as Section 5.

B. Insert a new Section 2 as follows:

SECTION 2 - DISPUTES ARISING FROM SECURITIES
TRANSACTIONS

a. Required Submissions

Any dispute, claim, or controversy, subject to arbitration under this Code arising on or after the effective date of this Section shall be submitted to arbitration pursuant to this Code at the instance of:

- (1) a member against another member,
- (2) a public customer against a member, or
- (3) a member against a public customer if the submission to arbitration of the dispute, claim or controversy is permitted by a duly executed and enforceable agreement to arbitrate.

b. Voluntary Submissions

- (1) All submissions of existing disputes, claims, or controversies subject to arbitration under this Code arising prior to the effective date of this Section shall be voluntary.
- (2) Upon the filing of a properly executed Submission Agreement with the Office of the Director of Arbitration, all parties to a dispute, claim or controversy shall be required to arbitrate such pursuant to the provisions of this Code.

C. Delete Section 3 - Informal Arbitration

- ~~a. This Code shall not preclude the submission to arbitration of any existing dispute, claim or controversy arising solely between members and relating exclusively to matters encompassed under the Uniform Practice Code of this Association.~~
- ~~b. All submissions conducted pursuant to such arbitration shall be governed solely by such rules and procedures as are now or may be adopted by the National Uniform Practice Committee.~~

D. Reserve Section 3 under heading - National Clearing Corporation

E. Delete Section 4 - Voluntary Proceedings

~~All submissions for arbitration pursuant to this Code upon existing disputes, claims or controversies shall be voluntary between consenting parties as witnessed in a properly executed Submission Agreement.~~

F. Insert a new Section 4 as follows:

Section 4 - Hearing Requirements

a. Member Controversies - Simplified Procedure

With the exception of controversies arising between the National Clearing Corporation and its clearing members, any dispute, claim or controversy arising between or among members submitted to arbitration under this Code involving a dollar amount not exceeding \$5,000, exclusive of attendant costs, shall be resolved by an arbitration panel constituted pursuant to the provisions of subsection (c) hereof solely upon the pleadings and documentary evidence filed by the disputants, unless one of the parties to the proceeding files with the Office of the Director of Arbitration within eight (8) business days following the filing of the last pleading a request for a hearing of the matter.

b. Public-Member Controversies - Simplified Procedure

With the exception of controversies arising between the National Clearing Corporation and its clearing members, any dispute, claim or controversy arising between a public customer or others, including non-member broker/dealers, and a member or members submitted to arbitration under this Code involving a dollar amount not exceeding \$2,000, exclusive of attendant costs, shall be resolved by an arbitration panel constituted pursuant to the provisions of subsection (c) hereof solely upon the pleadings and documentary evidence filed by the disputants unless one or more of the parties files with the Office of the Director of Arbitration within eight (8) business days following the date of the filing of the last pleading a request for a hearing of the matter.

c. Composition of Panels - Simplified Procedure

In any proceeding pursuant to subsection (a) hereof, an arbitration panel shall consist of at least one but not more than three arbitrators, all of whom shall be from within the securities industry. In any proceeding pursuant to subsection (b) hereof an arbitration panel shall consist of three arbitrators, at least two of whom shall be from without the securities industry.

d. Formal Procedure - Hearing Rights

With the exception of controversies between the National Clearing Corporation and its clearing members, any dispute, claim, or controversy submitted to arbitration under this Code involving a dollar amount, exclusive of attendant costs, in excess of the amount specified in subsection 3(a) or (b) above, whichever is applicable, shall require a hearing unless all of the parties to the proceeding expressly waive their right to such hearing and file with the Office of the Director of Arbitration a request that the matter be resolved solely upon the pleadings and documentary evidence filed by the disputants. Arbitration panels for such hearings shall be constituted in accordance with the provisions of Section 14 of this Code.

e. Authority of Arbitrators

Notwithstanding the provisions of this Section, any member of an arbitration panel shall be authorized to request the submission of further documentary evidence in a proceeding before that panel and any such panel may by majority vote call and conduct a hearing if such is deemed to be necessary.

f. Awards

All awards rendered in proceedings pursuant to subsection (a) or (b) hereof shall be made within thirty (30) days from the date the arbitrators review all of the written statements, documents and other evidentiary material filed by the parties and declare the matter closed. Section 34 of this Code shall govern awards made in connection with all other proceedings.

G. Delete existing Section 10 - Settlements

~~Subsequent to the time period permitted for the revocation of a submission, no settlement(s) shall be permitted except upon the consent of the arbitrators and upon such terms and conditions as they may direct.~~

H. Renumber Sections 5 through 9 of this Code as Sections 6 through 10, respectively.

I. Amend the following renumbered sections of the Code as indicated:

(i) Section 7 (Old Section 6) - National Arbitration Committee

The Board of Governors of the Association, following the annual

election of members to ~~its~~ the Board, shall appoint a National Arbitration Committee which shall consist of 15 members. The membership of the Committee shall be representative of all Districts of the Association with each District having at least one member. The ratio of representation of the Districts on the Committee shall be determined by the Board of Governors and the Chairman of the Committee shall be named by the Chairman of the Board. The said Committee shall establish and maintain a pool of arbitrators composed of persons from within and without the securities industry for a term of three (3) years from the date of their appointment. , or for such further periods as the Committee may deem appropriate.

The Committee shall have the authority to establish appropriate rules, regulations and procedures to govern the conduct of all arbitration matters before the Association. All rules, regulations and procedures, and amendments thereto, promulgated by the Committee must be by a majority vote of all of the members of the said Committee. It shall also have such other power and authority as is necessary to effectuate the purposes of this Code of Arbitration.

The Committee shall meet at least once each year and at such other times as are deemed necessary by the Committee.

(ii) Section 9 (Old Section 8) - Denial of Arbitration

The Director of Arbitration, upon approval of the Executive Committee of the National Arbitration Committee, or the National Arbitration Committee, may decline to permit ~~the arbitration of any dispute, claim or controversy which in his opinion, having due regard for the purposes of the Association, and the intent of this Code of Arbitration Procedure, is not a proper subject matter for arbitration under this Code,~~ in any case to permit the use of the arbitration facilities of this Association.

J. Delete Section 18 - Revocation of Submission

- (a) ~~The initiating party shall have the right to revoke the submission of a matter without the consent of the other party for a period of ten business days from the date of receipt of the responding party's answer.~~
- (b) ~~The responding party shall have the right to revoke the submission of a matter without the consent of the other party for a period of ten business days from the date of receipt of the Statement of Claim or the Reply, whichever is later.~~

K. Redesignate Sections 11 through 17 as Sections 12 through 18, respectively.

L. Insert a new Section 11 as follows:

Section 11 - Settlements

All settlements upon any matter submitted shall be at the election of the parties. Subsequent to the initiation of a hearing, settlements will require the consent of the arbitrators subject to such terms and conditions as they may direct.

M. Amend the following redesignated Sections of the Code as indicated:

(i) Section 14 (Old Section 13) - Designation of Number of Arbitrators

Except as otherwise provided herein, 1 in all arbitration matters involving public customers, an arbitration panel shall consist of five arbitrators, at least three of whom shall not be from the securities industry. In all arbitration matters involving only broker/dealer members, a panel shall consist of no less than three nor more than five arbitrators, all of whom shall be from the securities industry. The individuals who shall serve on a particular arbitration panel shall be determined by the Director of Arbitration. The Director of Arbitration shall name the chairman of all panels.

(ii) Section 18 (Old Section 17) - Initiation of Proceedings

Introductory sentence and subsection (2) remained unchanged.

Answer -- Defenses and/or Counterclaims

(b) ~~The responding party, should it desire to proceed with the arbitration within ten business days thereafter, shall execute and file a copy of the bilateral Submission Agreement served upon him and two copies of the answer with the Director of Arbitration.~~ Two (2) copies of the duly executed Submission Agreement and two (2) copies of the Answer shall be filed with the Office of the Director of Arbitration within eight (8) business days from the date of service of the Statement of Claim. The Director of Arbitration shall thereupon serve one copy of the Answer upon the initiating party by certified or registered mail. The Answer shall contain and clearly designate all available defenses to the initiating party's claim and may in addition set forth any related counterclaim denominated

as such which the responding party may have against the initiating party upon any dispute, claim or controversy arising as prescribed under this Code.

The Reply

- (c) The initiating party may thereupon file a two (2) copies of the Statement of Reply with the Director of Arbitration containing all available defenses to the responding party's counterclaim within ~~ten~~ eight (8) business days from the receipt of the responding party's answer containing such counterclaim.
- (d) Unchanged.

Joining and Consolidating

- (e) (1) In respect to any dispute, claim or controversy arising on or after the effective date of this subsection and submitted to arbitration under this Code, any member who is made a party in connection therewith shall have the right to proceed against any other member in the same hearing upon any claim directly related to such dispute which would otherwise be eligible for submission to arbitration under this Code.
- (2) In respect to any dispute, claim or controversy arising before the effective date of this subsection and submitted to arbitration under this Code, any member who has voluntarily agreed to arbitrate may request of any other member that it become a party in the same hearing upon any claim directly related to such dispute which would otherwise be eligible for submission to arbitration under this Code.
- (3) For purposes of this Section, the Director of Arbitration and/or the Executive Committee of the National Arbitration Committee shall be authorized to determine preliminarily whether a claim is directly related to the securities transaction in dispute and to join any other party to the dispute and to consolidate the matter for hearing and award purposes.
- (4) All final determinations relating to whether a claim is directly related to the securities transaction in dispute, to the joinder of other parties or the consolidation of matters for hearing and award purposes shall be made by the arbitration panel presiding.

N. Amend the following sections as indicated:

Section 19 - Designation of Time and Place of Hearings

Unless the law directs otherwise, the time and place of the initial hearing shall be determined by the Director of Arbitration and for each ensuing hearing thereafter by the arbitration panel presiding. Notice of the initial hearing shall be delivered at least ~~ten~~ eight (8) business days prior to the date fixed for hearing by registered or certified mail to each of the parties and for each hearing thereafter as the panel of arbitrators shall determine; unless parties shall by their mutual consent waive the notice provisions provided under this Section.

Section 22 - Failure to Appear

The arbitrators shall be empowered to direct that arbitration of a matter continue without the presence of a party, who, after due notice, fails to appear and does not obtain an adjournment. Notwithstanding the provisions of this Section, all awards shall be ~~rendered upon the merits of each matter submitted~~, as if each party entered an appearance in the matter submitted.

DP

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

August 13, 1971

To All NASD Members:

(This notice should be directed to operational officers)

Operational departments of NASD member firms should be aware that sometime in 1972 CUSIP numbers may be required on certain documents submitted to the several clearing corporations and on documents transmitted between brokers and banks.

Eleven major banks belonging to the New York Clearing House Association have indicated their intention to make CUSIP numbers mandatory by April 1, 1972, on all documents relating to securities transactions received or processed by the banks. These New York banks are also requesting their correspondent banks to show the CUSIP number on all securities instructions which are sent after April 1, 1972. In addition, the American Bankers Association has also recently indicated that it will recommend to all of its members that they follow the steps taken by the New York Clearing House banks so that there is a definite possibility that most bank clearing houses in large financial centers throughout the country will need CUSIP numbers on all documents submitted to them by as early as April 1, 1972.

The various banking and security industry organizations represented on BASIC, which includes the NASD, are in general agreement with making CUSIP numbers mandatory on certain securities transaction documents, in addition to the stock certificates which now carry the CUSIP number as a result of a program undertaken with the cooperation of stock transfer agents throughout the nation.

While the NASD would prefer to give its members more time (December 31, 1972) to set up internal procedures and training programs in connection with the mandatory use of CUSIP on securities transaction documents, it would appear that this may not be possible in view of the April 1, 1972, date established by the American Bankers Association. Therefore, Association members should plan now to begin changing over to the CUSIP system to avoid confusion and operational problems which could arise in the spring of next year.

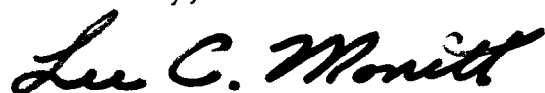
Some smaller NASD members have expressed concern about the mandatory CUSIP requirement resulting in additional expense because of the yearly cost of the

CUSIP directory published by Standard & Poors. Smaller firms with few transactions could obtain CUSIP numbers from other subscribing firms and banks in their area; or, when only a few trades each day are involved, the local NASD office may be able to supply appropriate CUSIP numbers.

Broker/dealers that are not CUSIP subscribers and wish to obtain this service should contact the Director of Marketing, CUSIP Service Bureau, Standard Statistics Company, Inc., 345 Hudson Street, New York, New York 10014.

NASD members will be notified in the near future as to a more definitive start-up date for the mandatory use of CUSIP numbers on securities transaction documents and the exact nature of these documents will be clarified.

Sincerely,

A handwritten signature in black ink that reads "Lee C. Monett". The signature is written in a cursive, slightly slanted style.

Lee C. Monett
Vice President - Member Operations

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

MAIL VOTE

IMPORTANT!

OFFICERS * PARTNERS * PROPRIETORS

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

Date: August 20, 1971

Re: Mail Vote Concerning Certain Changes in the By-Laws
Notification of Proposed Schedule E
Notification of Proposed Schedule F

LAST VOTING DATE IS September 19, 1971

Enclosed herewith are proposed amendments to Article IV and Article XVII of the Association's By-Laws which, pursuant to the provisions of Article IX thereof, must be approved by the membership before they can become effective. Also enclosed are proposed Schedules E and F to amended Articles IV and XVII, respectively. Schedule E relates to the public distributions of issues of members' securities and affiliates thereof. Schedule F relates to rights of procedural due process for persons aggrieved by actions of the National Clearing Corporation. These Schedules do not have to be voted upon by the membership but are being sent to you at this time so you will be informed of the proposals the Board contemplates enacting if the amendments to Articles IV and XVII are approved by the membership.

The proposed amendment to Article IV of the By-Laws and an earlier draft of Schedule E were submitted to the membership on May 8, 1971, for comment. Since that time the appropriate committees of the Association have met and after reviewing the many letters of comment received, have recommended certain changes to the Board of Governors of the Association. The Board also subsequently met and considered the earlier proposals in view of the letters of comment and made appropriate changes as will be explained hereafter.

Explanation of Proposals

1. Proposed Amendment to Article IV of By-Laws

The proposed amendment to Article IV has not changed in substance over that which was submitted for comment in May; however, there have been minor language changes. This amendment would authorize the Board of Governors to promulgate a system of procedures and regulations governing the distribution of issues of members' securities and affiliates thereof. As was explained in the May 8 release, the Board believes there are certain conflicts of interest and other dangers to the public interest inherent in such distributions. Close regulation of such conflicts is, therefore, essential in the public interest. The Board also believes that Article III, Section 1 of the Association's Rules of Fair Practice covers many of the conflicts referred to and thus prevents members from underwriting or participating in the distribution of issues of their own securities (self-underwritings) or of affiliates thereof (affiliate underwritings). Such have in the past, therefore, been prohibited by Board interpretation of that section.

Conflicts properly regulated, however, are not contrary to the public interest. The Board believes that the system being proposed and which is embodied in Schedule E regulates such conflicts in a manner which more than adequately protects the public. It believes, however, that since definitive standards and regulations beyond the prohibition on self and affiliate underwritings required by Section 1 would be imposed if the proposals become effective, explicit authority from the membership to the Board is required. Thus, the proposed amendment would grant to the Board the authority to do so and to, in the future, alter, amend, supplement or modify, when appropriate, such regulations as are established. If the membership votes in the affirmative on this By-Law amendment the Board of Governors will then be authorized to adopt Schedule E which will be attached to and become part of the By-Laws. The Board recommends your affirmative vote on this proposal.

2. Proposed Schedule E

The concepts embodied in Schedule E as contained in the May 8 release have not changed; however, a number of important changes in the provisions relating thereto have been made and are embodied in proposed Schedule E submitted herewith. The major changes will first be discussed and then each section will independently be summarized.

First, it should be noted that basic to the self and affiliate underwriting proposals is the concept of two qualified independent underwriters recommending the offering price to the issuer after the full performance by each of the due diligence function. The Board believes that the public is entitled to additional measures of protection when members are selling their own securities or those of affiliates. Such is reflective of that premise as are all of the other provisions of Schedule E.

Probably the most important change from the proposals made on May 8 relates to the elimination of the requirement for pricing recommendations by two qualified independent underwriters in those situations where there is a bona fide active independent market in the class of securities currently being offered. This change relates to both affiliate and member offerings, thus both Sections 3 and 4 have been changed accordingly by adding a new subsection (c) in each. In this connection, the Board reasoned that if a bona fide active independent market exists no real need remains for the independent underwriters since the price at which the issue would be offered to the public would be reflective of the current market price and could be considered, presumptively at least, proper. Section 1(b) contains a definition of "bona fide active independent market" all of the provisions of which must be met before a member may take advantage of the new provision. Since the provisions thereof require in the case of over-the-counter securities three bona fide independent market makers, that term is defined in Section 1(c).

Another major change in both Sections 3 and 4 relates to permitting participation in the distribution by a member without the pricing recommendations of two qualified independent underwriters when an offering is on a firm commitment basis by a single managing underwriter. A number of members have urged that when a firm commitment underwriting is being made the issuer-member should be permitted to participate in the underwriting syndicate or selling group to an unlimited degree and that there should be no requirement for a second qualified independent underwriter for purposes of recommending price. The proponents urge, in view of the firm commitment which the underwriter would undertake, there is a high likelihood the price would be proper because their funds would have been committed. The Board believes, however, that this suggestion cuts across and would seriously erode the concept of two qualified independent pricing underwriters. As noted, that concept presumes that both such underwriters will perform fully the due diligence function prior to making a recommendation of price to the issuer. In this connection, the Board considers the performance of the due diligence function by both of the pricing underwriters

a key element of this whole package of proposals. The Board also believes as a general proposition that the greater the amount of participation by a member in a distribution, even in the case of a firm commitment underwriting, the independency of the price ultimately established would be diminished accordingly. Nevertheless, the Board does not believe participation by a member in such a distribution should be totally prohibited and, therefore, participation to the extent of 10% of the total amount of the offering would be permitted in the case of a firm commitment underwriting by a single managing underwriter.

Another important change relates to Section 2(b) which in the earlier proposal restricted the distribution of the equity interest of existing stockholders to 25% in any offering and imposed a one year lockup after the date of the termination of the offering on all retained shares. This has been revised so that those restrictions would remain in the case of an initial offering but not in the case of subsequent offerings if a bona fide active independent market existed for the class of securities being offered as of the date of the filing of the registration statement and as of the effective date of the current offering. The 25% limitation would apply, however, in a situation where a prior offering had been made but in respect to which securities there is currently no bona fide active independent market and restricted securities retained by persons associated or in a control relationship with the member would thereafter be restricted for a period of one year after termination of the offering.

Some situations have been called to the attention of the Board which have caused other changes in this section. Illustrative is the case of a broker/dealer which is a publicly owned corporation with securities actively traded but which has never made a public offering of securities. In any such offering neither the 25% limitation nor the 12-month restriction upon sale or transfer would apply if a bona fide active independent market existed for the securities but a three month lockup after the date of the termination of the offering would be imposed on restricted stock retained by persons associated or in a control relationship with the member. A similar restriction would be imposed in respect to second and all other subsequent offerings if a bona fide active independent market exists.

The definition of "affiliate" in Section 1(a) has also been changed from the May 8 proposal in which 5% ownership of the outstanding voting securities of a company would have resulted in the existence of an affiliate relationship. That percentage has been increased to 10% except where a control relationship exists as specified in subsection (1) thereof. This definition also excludes variable contracts, real estate investment trusts, mutual funds and tax sheltered programs.

Significant changes have been made in the provisions relating to tax sheltered programs. Initially, the definition of "tax sheltered

program", Section 1(m), has been substantially changed and real estate investment trusts have been eliminated from the definition of such. The new definition places emphasis on flow-through tax benefits as being the important factor in determining whether the offering in question is a tax sheltered program.

The new proposal in respect to tax shelters (which has been redesignated Section 7 from Section 8) would change the previous proposal requiring five years' expertise in both the securities industry and the industry represented by the tax sheltered program before a member-manager of a program could participate in the distribution of those securities to requiring only five years' expertise in the industry represented by the tax sheltered program. There is a further major departure from the previous proposal, however, in that that expertise would not have to be "in house" as long as it was readily available to the member, i. e., under contract, in the corporate complex, or otherwise. This recognizes the practical situation which some companies find themselves in, i. e., their tax shelter management subsidiary may not have the industry expertise "in house" but such is available to it within the company's corporate complex and is, in fact, drawn upon in managing the program in question. It also recognizes a situation where the manager (defined in Section 1(f) and replacing the term "sponsor" used in the May 8 release) of a program will contract for such expertise. A good example of this would be a cattle operation where an experienced ranch manager would provide the day-to-day management function under contract with the general partner.

Another significant change involves Section 4, affiliate distributions. In order for a member to underwrite or participate in the distribution of such securities certain requirements, including the participation of two qualified independent underwriters in establishing price, were specified. The following proposals contained in the May 8 release as Section 4(a)(3) and (4) have been deleted:

- (3) the issuer (a) has been actively engaged in business for at least the five year period immediately preceding the filing of the registration statement; and (b) in at least three of the five years immediately preceding the filing of the registration statement, has operated at a profit;
- (4) the affiliate relationship has existed for a period of at least one year prior to the filing of the registration statement.

These paragraphs were inserted originally to make requirements for affiliate distributions substantially consistent with member-distributions. Various comments pointed up practical business situations which the Board believes justify deletion of these paragraphs. It also believes the public interest will not be adversely affected by this action. In this connection, two qualified independent underwriters will still be required for purposes of establishing price thereby insuring its correctness to the extent reasonably possible. The deletions will enable a company to make a public offering of securities of a newly organized affiliate which would not be permissible under the proposals as previously written. The Board is aware of business considerations which would justify such action.

Various other changes have been made which will be discussed in the summary below.

Section-by-Section Summary

A summary of each of the sections follows.

Section 1 contains a series of definitions of words used throughout Schedule E and is self-explanatory. A number of new definitions have been added over those which were contained in the May 8 release as follows: bona fide active independent market, bona fide independent market maker, person, restricted securities and settlement. In addition to the definition of "tax sheltered program" and "affiliate" discussed above, a number of other definitions have had minor, non-substantive changes from the May 8 release.

Section 2 prescribes a series of criteria which would have to be adhered to in connection with all offerings of securities of a corporate member to the public whether self-underwritten or not. The Board believes requirements such as these are appropriate and in the public interest in view of the responsibility to the investing public a member has merely by virtue of its being engaged in the investment banking and securities business. The Board believes that such status imposes upon a member responsibilities and obligations greater than those which are an ordinary issuer's. A higher standard of regulation is, therefore, essential.

In this connection, Section 2(a) would require that financial statements for three years, or less if the member hasn't been in existence for three years, be filed with all registrations of issues of a member's securities regardless of whether they are a Regulation A or an intrastate offering. The financials for the last full year and any

subsequent partial period in excess of six (6) months would have to contain an independently audited and certified balance sheet. Normally an audit and certification for the partial period is not required. Certification is also not usually required in connection with Regulation A offerings and many intrastate offerings. The six month partial period audit requirement represents a change over the earlier proposals which would have required an audit of any partial period.

As discussed above, Section 2(b)(1) would prohibit more than 25% of the equity interests of the stockholders as of the date of the filing of the registration statement from being offered as part of the issue in the case of an initial offering or an offering by a member of a class of securities which as of the date of the filing of the registration statement and as of the effective date does not have a bona fide active independent market. All retained shares in the case of an initial offering and all restricted securities held by persons associated or in a control relationship with a member, in the case of a subsequent offering of a class of securities without a bona fide active independent market, would have to be held for a period of at least one year after the termination date of the offering before they could be sold.

Section 2(b)(2) would permit in all other offerings unlimited distribution of stockholders' equity interests but would require a three month holding period on all restricted securities retained by persons associated or in a control relationship with the member. Provisions for gift or transfer by operation of law are included in Section 2(b).

Section 2(c) would prohibit the sale by a person associated or in a control relationship with a member of securities in an offering unless they had been owned by him for a period of one year prior to the filing of the registration statement except in the limited situations referred to therein.

Section 2(d) provides for the lifting of the subsection (b) and (c) restrictions on securities in exceptional and unusual circumstances.

Section 2(e) provides for a one year time lag between an initial offering and a subsequent offering by a member of an issue of its securities to the public. This changes the earlier proposal which would have required a one year wait between all offerings by members. This subsection also excludes offerings made solely to employees during the one year period after the initial offering.

Section 2(f) restricts the size of the offering by a member (exclusive of those securities attributable to selling stockholders) to no larger than three times net worth (exclusive of subordinated capital) as reflected in the most recent balance sheet of the member as of a date not more than 90 days prior to the filing of a registration statement and six months prior to the effective date of the offering. This changes the proposal in the May 8 release which specified only that the offering could be no larger than twice net worth with no reference to the selling stockholders' shares.

Section 2(g) limits all members' offerings to a period of 60 days. This is a new requirement which was not contained in the earlier proposals but which the Board believes is important because it does not believe offerings of this type should be of unlimited duration.

Sections 2(h) and (i) represent a rewrite of Sections 2(f) and (g) in the May 8 release. Section 2(h) makes clear that all proceeds from a member offering shall be placed in escrow and not released until settlement has been effected and net capital ratio is 10-1. "Settlement" is defined in Section 1(l) and is intended to include the release from escrow.

Section 2(i) requires an issuer-member to immediately notify the Association when its offering has been terminated and settlement effected, and requires the filing with the Association of a computation of its net capital as of the settlement date. It also makes clear that the proceeds from the offering can be taken into consideration in computing net capital ratio for purposes of this provision. The provision incorporates an exception from the 10-1 requirement for members who have received a specific exemption from the Securities and Exchange Commission from the net capital rule. Stock Exchange members are specifically not intended to be excluded from the provisions of the 10-1 requirement by virtue of the exclusionary language. In all cases the provision would require that if the 10-1 capital ratio had not been achieved all money from the sales of securities must be returned in full to the purchasers and the offering withdrawn.

Section 2(j) requires that quarterly statements of operations and certified financial statements be sent to investors and subsection (k)

requires the filing of certain other reports with the Association. Such would serve on the one hand to periodically inform investors of the status of a member's operations and on the other hand to provide additional information to the Association for regulatory purposes.

Section 3 relates solely to underwritings by members of issues of their own securities and would impose requirements in addition to those in Section 2 which apply to all members' offerings whether self-underwritten or not. This Section, in subsection (a), would require that the price at which a self-underwritten issue is to be distributed to the public be established by the issuer-member at a price no higher than that recommended by two qualified independent underwriters, as defined, each of whom shall exercise fully the usual standards of due diligence in respect to the offering and who would be required to be represented by independent legal counsel for the purpose of issuing an opinion as to compliance with federal securities laws and, in the case of an intrastate offering, the laws of the state with jurisdiction.

The definition in Section 1(i) of "qualified independent underwriter" enunciates a number of prerequisites for qualifying as such. These prerequisites make clear that a background of underwriting experience, stability of operations and experienced management is necessary. This definition has been modified slightly from the May 8 release in that the earlier release required that the qualified independent underwriter be "completely independent of the issuer-member in every respect." That has been changed to a requirement that the qualified independent underwriter not be "an affiliate [as defined] of the issuer-member." In sum, the Board believes that the provision requiring the establishment of the price of the offering on the basis of the independent recommendations of two qualified independent underwriters hurdles the most difficult barrier found in connection with permitting self-underwritings, that is, the lack of arms'-length bargaining in establishing the price at which the issue should be distributed to the public.

A "track record" and experience in the securities business would be required of a self-underwriting member by Section 3(a)(3). Thus, a member would had to have been in the securities business for at least five years immediately preceding the filing of the registration statement, in three of the last five years it would had to have had a profit from operations and the majority of the board of directors would had to have been actively engaged in the securities business for the five year

period immediately preceding the filing of the registration statement. The Board believes these requirements and those relating to qualified independent underwriters provide a large measure of protection to the public from marginal or inexperienced firms, especially when combined with the provisions of Section 2, and that the restrictions imposed are fair and reasonable to the membership as a whole.

Sections 3(b) and (c) are new and have been discussed in detail above.

Section 4 would impose criteria in connection with the underwriting or participation in the stream of distribution by members of issues of affiliates, as defined, which are substantially similar to those imposed by Section 3 for self-underwritten issues. As noted above, the "track record" requirement for the issuer-affiliate contained in the May 8 release has been deleted as has the requirement that the affiliate relationship must have existed for a period of at least one year prior to the filing of the registration statement. The Board believes that the requirements of Section 4 are necessary because many of the conflicts inherent in self-underwritings also exist when members participate in the distribution of their affiliate's securities. These provisions are, therefore, appropriate in the public interest.

Higher than normal suitability requirements are contained in proposed Section 5 in connection with Section 3 and 4 offerings. This section would require that a member retain in its files the basis for and reasons upon which the determination of suitability was made as to each customer. Such detailed record-keeping for suitability purposes is not required in connection with transactions in securities of other offerings and would be required in connection with these offerings only because of the significantly different nature thereof.

Section 6 would require specific written approval by the customer before securities of a Section 3 or 4 offering could be placed in a discretionary account. The reasons for this requirement should be obvious to everyone. The provision further demonstrates the Board's desire to eliminate as much as is reasonably possible the existence of questionable transactions.

Section 7 relates to requirements dealing with the distribution of tax sheltered programs and has been discussed above.

Pursuant to the provisions of the Association's Interpretation With respect to Review of Corporate Financing, additional underwriting compensation results in certain cases when securities are received by an underwriter within a 12-month period prior to the filing of a registration statement. Section 8(a) of Schedule E would make clear that such would not occur where a successor corporation is formed to a previously existing partnership or sole proprietorship and securities are issued to the principals as a result. Subsection (b) thereof states that the Corporate Financing Interpretation will apply to all offerings made under Schedule E to the extent that it is not inconsistent with the Schedule.

Section 9 would require that Schedule E prevail in case of an inconsistency with any other rules, resolutions or By-Laws of the Association and Section 10 makes conduct contrary to Schedule E a violation of Article III, Section 1 of the Association's Rules of Fair Practice and notes that, depending upon the circumstances, other rules could also possibly be violated.

The May 8 release also indicated that certain paragraphs of the Interpretation With respect to Review of Corporate Financing were proposed to be deleted in order to conform that Interpretation with the provisions of Schedule E. The Board of Governors of the Association has subsequently approved the deletion of those paragraphs which are as follows:

Equity Positions of Underwriter and Others Participating
in the Issue (page 2031 of the Manual)

Members Underwriting Own Securities (page 2031 of the
Manual)

Excessive Compensation--Change of Underwriters (page
2033 of the Manual.)

The Board has also approved the addition of the following paragraph to the Interpretation with respect to Review of Corporate Financing which will appear immediately after the section entitled "Issuer Reserved or Directed Securities" (page 2030 of the Manual) and will be entitled "Conflict of Interest--Lack of Arms'-Length Bargaining":

In those cases where a potential conflict of interest
or lack of arms'-length bargaining exists between a

member and an issuer, and the provisions of Section 3 or 4 of Schedule E of the By-Laws are not complied with or cannot be met, it would be inappropriate for that member to participate in any way in the stream of distribution of an issue of that issuer's securities.

The May 8 release also proposed an amendment in the Interpretation With Respect To "Free-Riding And Withholding" which would have changed the existing restriction prohibiting the sale of more than 10% of an issue of a member's securities to employees of the member to allowing unlimited amounts of the issue to be sold to employees provided that such securities were restricted as to sale or transfer for a period of 18 months. The Board has reviewed that proposal on the basis of comments received and has approved an amendment to the "Free-Riding" Interpretation which would permit the unlimited sale of securities of an issue to employees but which would reduce the period of restriction upon sale or transfer to 12 months after the termination date of the offering.

3. Proposed Amendment to Article XVII of By-Laws

This amendment is unrelated to self and affiliate underwritings discussed above.

Article XVII of the By-Laws provides the regulatory framework for the clearance of securities through the National Clearing Corporation, a subsidiary of the Association. The proposed changes would add a new subsection (c) to Section 1 thereof whereby transactions or classes of securities would be excluded from the clearing requirements if rules established by the National Clearing Corporation so provided.

A technical language change in Section 2 is proposed. Such will not affect the substance of that section. It is intended only to make it clearer and more readable.

A proposed new Section 3 would authorize the Board of Governors of the Association to establish regulations and procedures to be followed in cases of complaints by persons aggrieved by the action of the National Clearing Corporation in situations where binding and final arbitration had not been provided for. Details in respect thereto would be contained in Schedule F to be attached to and made a part of the By-Laws. The Board would have the authority to adopt, alter, amend, supplement or modify the provisions of Schedule F.

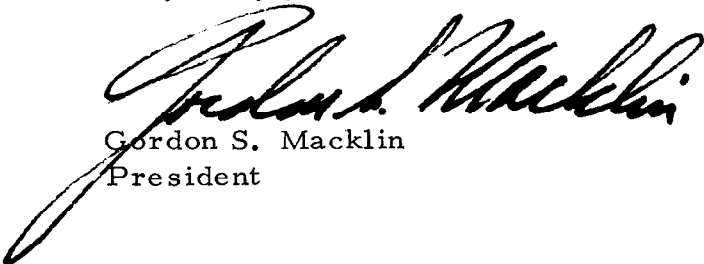
4. Proposed Schedule F

Schedule F, attached hereto, is proposed to be adopted by the Board upon affirmative vote by the membership of the By-Law change. It would establish provisions in relation to the form of complaint, request for hearing, hearing, initial decision, review by the Board, findings of the Board on review, and application to the Commission for review. These provisions are self-explanatory. In sum, they establish rights of procedural due process, including the right to be heard and be represented by counsel, for persons aggrieved by actions of the National Clearing Corporation where binding and final arbitration has not been provided for.

These amendments to the By-Laws are important and merit your immediate attention. Please mark the ballot according to your convictions and return it in the enclosed stamped envelope to "The Corporation Trust Company." Ballots must be postmarked no later than September 19, 1971.

The Board of Governors believes these amendments to the By-Laws are necessary and appropriate and recommends members vote their approval.

Very truly yours,



Gordon S. Macklin
President

Proposed Amendments To By-Laws And Proposed Schedule E
Relating To Establishment Of Regulations And Procedures
Governing The Public Distribution Of Securities Of
Members And Affiliates Thereof

I. Amendment to Article IV of By-Laws

Redesignate subsection 2(c) of Article IV of the By-Laws as subsection (d) and insert a new subsection (c) as follows:

- (c) The Board of Governors shall have the authority to establish rules and procedures to be followed by members in connection with the distribution of issues of securities in a member corporation and affiliates thereof as defined by the Board of Governors. Such rules and procedures shall be incorporated into Schedule E to be attached to and made a part of these By-Laws. The Board of Governors shall have the power to adopt, alter, amend, supplement or modify the provisions of Schedule E from time to time without recourse to the membership for approval as would otherwise be required by Article IX hereof and Schedule E, as adopted, altered, amended, supplemented or modified shall become effective as the Board of Governors may prescribe unless disapproved by the Securities and Exchange Commission.

II. Schedule E

SCHEDULE E

Public Distribution of Issues of Members'
Securities and Affiliates Thereof

This Schedule has been prepared pursuant to the provisions of Section 2(c) of Article IV of the Corporation's By-Laws and contains the rules and procedures to be followed by members in connection with the distribution of issues of securities, whether debt or equity or a combination thereof, in a member corporation and affiliates of members.

Section 1 -- Definitions -- For purposes of this Schedule, the following words shall have the stated meanings:

- (a) Affiliate -- a company:
- (1) which controls, is controlled by or is under common control with a member;

- (2) which directly or indirectly owns, controls, or holds with power to vote 10 per centum or more of the outstanding voting securities of a member; or
- (3) in which a member, or a person associated with a member, directly or indirectly owns, controls, or holds with power to vote 10 per centum or more of the outstanding voting securities;

provided, however, that the term "affiliate" shall not be deemed to include an investment company registered as such with the Securities and Exchange Commission pursuant to the provisions of the Investment Company Act of 1940, a variable contract as defined by Article III, Section 29(a) of the Rules of Fair Practice, a real estate investment trust as defined in Section 856 of the Internal Revenue Code or a tax sheltered program.

(b) Bona fide Active Independent Market -- a market in a class of securities of a company which:

- (1) are registered pursuant to the provisions of Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934, unless the company, or an industry of which a company is part, has specifically been exempted from the registration provisions of those Sections by the Securities and Exchange Commission;
- (2) has a minimum trading volume for the immediately preceding 12 months of 100,000 shares;
- (3) has outstanding 250,000 publicly held shares of the class of securities being offered; and
- (4) in the case of over-the-counter securities, has had at least three bona fide independent market makers for a period of at least 30 days immediately preceding the filing of the registration statement and the effective date of the offering.

(c) Bona fide Independent Market Maker -- a market maker which:

- (1) continually maintains a net capital as determined by Rule 15c3-1 of the General Rules and Regulations under the Securities Exchange Act of 1934 of \$50,000 or \$5,000 for each security in which it makes a market, whichever is less;

- (2) regularly publishes bona fide competitive bid and offer quotations in a recognized interdealer quotation system;
 - (3) furnishes bona fide competitive bid and offer quotations to other brokers and dealers on request;
 - (4) stands ready, willing and able to effect transactions in reasonable amounts, and at his quoted prices, with other brokers and dealers, and
 - (5) has a reasonable average rate of inventory turnover.
- (d) Effective date -- the date on which an issue of securities first becomes legally eligible for distribution to the public.
- (e) Financial statements -- balance sheet, profit and loss statement or statement of income and expense, a statement of source and application of funds, and a statement of retained earnings.
- (f) Manager -- a person who acts as general partner, manager or management company of a tax sheltered program.
- (g) Member -- any individual, partnership, corporation or other legal entity admitted to membership in the Association under the provisions of Article I of the By-Laws, whose membership is currently effective and who continues to be actively engaged in the investment banking or securities business.
- (h) Person -- any natural person, partnership, corporation, association, or other legal entity.
- (i) Qualified Independent Underwriter -- a member which:
- (1) has been actively engaged in the investment banking or securities business for at least five years immediately preceding the filing of the registration statement;
 - (2) in at least three of the five years immediately preceding the filing of the registration statement has had a profit from its operations;
 - (3) as of the date of the filing of the registration statement and as of the effective date of the offering:
 - a. if a corporation, has a majority on its board of directors of persons who have been actively

engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement;

- b. if a partnership, the majority of its general partners has been actively engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement;
 - c. if a sole proprietorship, the proprietor has been actively engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement;
- (4) has actively engaged in the underwriting of public offerings of securities for at least the five year period immediately preceding the filing of the registration statement; and
- (5) is not an affiliate of the issuer-member.
- (j) Registration statement -- shall have the meaning given to that term by Section 2(8) of the Securities Act of 1933; provided, however, that such term as used herein shall also include a notification on Form 1A filed with the Securities and Exchange Commission pursuant to the provisions of Rule 255 of the General Rules and Regulations under the Securities Act of 1933 and, in the case of an intrastate offering, any document, by whatever name known, initiating the registration or similar process by whatever name known for an issue of securities which is required to be filed by the laws or regulations of any state.
- (k) Restricted securities -- securities in respect to which a registration statement must be filed and become effective before being sold to the public.
- (l) Settlement -- the distribution of the net proceeds from an offering to the issuer company and/or selling stockholders.
- (m) Tax sheltered program -- a program in which flow-through tax benefits are a material factor regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, real estate syndications

(except real estate investment trusts), citrus grove developments, cattle programs and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.

Section 2 -- Offerings By An Issuer-Member Of Its Own Securities

Any corporate member may make a public offering of an issue of its own securities. The following general criteria shall apply to all such offerings whether primary or secondary in nature, or a combination thereof, unless otherwise specified herein:

- (a) Notwithstanding that the registration may be for an intrastate offering or in an amount which would otherwise qualify pursuant to the provisions of Regulation A under the Securities Act of 1933 or otherwise:
 - (1) financial statements for the immediately preceding three years must be filed therewith and be disclosed in the prospectus, offering circular or other comparable document;
 - (2) financial statements for the entire period of its existence must be so filed and so disclosed if the issuer has not been in existence for three years;
 - (3) the most recent financial statements must be as of a date not more than 90 days prior to the filing of the registration statement and not more than six months prior to the effective date of the offering; and
 - (4) the financial statements for the last calendar or fiscal year, as the case may be, or less if the member has not been in existence for one year, must contain an independently audited and certified balance sheet. If there is an updated balance sheet covering a period in excess of six (6) months subsequent to the last full calendar or fiscal year, such must also be independently audited and certified.
- (b) (1) a. Except as provided in paragraph (2) hereof, in the case of an initial offering, or an offering by a member of a class of securities which as of the date of the filing of the registration statement for the current offering, and as of the effective date thereof, does not have a bona fide active independent market, no

more than 25% of the equity interest of the stockholders thereof as of the date of the filing of the registration statement may be offered as part of the issue;

- b. In the case of an initial offering, all securities retained by stockholders of the issuer shall, except in the case of a bona fide gift or transfer by operation of law, be restricted as to sale or transfer for a period of at least one (1) year after the termination of the offering;
- c. In the case of an offering by a member of a class of securities which as of the date of the filing of the registration statement for the current offering, and as of the effective date thereof, does not have a bona fide active independent market, other than an initial offering, all restricted securities which are held by persons associated with the member, or any other person in a control relationship with a member, which were not part of the offering shall, except in the case of a bona fide gift or transfer by operation of law, be restricted as to sale or transfer for a period of at least one (1) year after the termination of the offering.

- (2) In all other offerings, including any offering of a class of securities in respect to which a bona fide active independent market exists as of the date of the filing of the registration statement of the current offering, and as of the effective date thereof, there shall be no limitation on the percentage of stockholders' equity interest which may be distributed but all restricted securities which are held by persons associated with the member, or any other person in a control relationship with a member, which were not part of the offering shall, except in the case of a bona fide gift or transfer by operation of law, be restricted as to sale or transfer for a period of at least three (3) months after the termination of the offering;

provided, however, in the case of a bona fide gift or transfer by operation of law, the periods of restriction on sale or transfer referred to in paragraphs (1) and (2) hereof shall apply to the donee or transferee and shall be measured as of the date of the termination of the offering.

- (c) A stockholder who is a person associated with a member, or any other person in a control relationship with a member, may not offer any of his securities as part of an offering if they have not been owned by him for a period of at least one (1) year prior to the filing of the registration statement unless:
- (1) they were acquired during the referred to one (1) year period as a result of the formation of a successor corporation to a preexisting sole proprietorship or partnership in respect to which he was either the sole proprietor or a partner prior to the previous one year period; or
 - (2) they were acquired during the referred to one (1) year period as a result of a bona fide stock dividend, stock split, recapitalization, merger or some other like event.
- (d) Notwithstanding the provisions of subsections (b) and (c) hereof the sale or transfer of securities which are the subject thereof shall not be prohibited in exceptional and unusual circumstances such as, but not necessarily limited to, a sale by an estate or by a person whose financial circumstances, taking into consideration all relevant factors, requires such; provided, however, justification for such must first be demonstrated to the Corporation.
- (e) After an initial offering has been made by a member to the public of an issue of its securities, no other offering to the public, primary or secondary, may be made by that member of its securities for a period of at least one year after the termination of the offering; provided, however, offerings made solely to employees during that period such as employee stock option, stock purchase or other similar type offerings, shall not be prohibited.
- (f) The total dollar amount of an offering by an issuer-member of its securities (exclusive of those securities attributable to selling stockholders) shall be no larger than three times the net worth (exclusive of subordinated capital) of the issuer-member as reflected in the most recent balance sheet as of a date not more than 90 days prior to the filing of the registration statement and six months prior to the effective date of the offering.

- (g) All offerings must be completed within a period of 60 days after the effective date thereof.
- (h) All proceeds from sales of securities of an offering shall be placed in escrow and shall not be released therefrom or used by a member until settlement has been effected and its net capital ratio, computed as prescribed in paragraph (i) hereof, is 10-1.
- (i) Every issuer-member shall immediately notify the Association when its offering has been terminated and settlement effected and it shall file with the Association a computation of its net capital computed pursuant to the provisions of Rule 15c3-1 of the General Rules and Regulations under the Securities Exchange Act of 1934 (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10-1, all monies received from sales of securities of the offering must be returned in full to the purchasers thereof and the offering withdrawn, unless a member has obtained from the Securities and Exchange Commission a specific exemption from the net capital rule. Proceeds from the sales of such securities may be taken into consideration in computing net capital ratio for purposes of this paragraph.
- (j) After a member has made a distribution to the public of an issue of its securities, it shall send to each of its shareholders:
 - (1) quarterly, a summary statement of its operations; and
 - (2) annually, independently audited and certified financial statements.
- (k) After a member has made a distribution to the public of an issue of its securities, notwithstanding that it would not otherwise be required to do so, it shall periodically file with the Corporation Part III of NASD Form 17A-10 as required by resolutions of the Board of Governors appearing

at paragraphs 4194 and 4196 of the NASD Manual. If the offering is subject to the provisions of Rule 463 of the General Rules and Regulations under the Securities Act of 1933, copies of the forms required by that rule to be filed with the Securities and Exchange Commission shall also simultaneously be filed with the Corporation.

Section 3 -- Underwriting By Issuer-Member Of Issue Of Its Own Securities

- (a) Any corporate member may underwrite or participate as a member of the underwriting syndicate or selling group in the distribution of an issue of its own securities only if:
- (1) the price at which the issue is to be distributed to the public is established by the issuer-member at a price no higher than that recommended by two qualified independent underwriters who shall also participate in the preparation of the registration statement and the prospectus, offering circular, or other comparable document, and each of whom shall exercise the usual standards of due diligence in respect thereto;
 - (2) the referred to two qualified independent underwriters are represented by a legal counsel independent of the issuer-member who shall review the information contained in the registration statement and the prospectus, offering circular, or other comparable document, and issue an opinion as to whether they conform to all requirements of the federal securities laws and, in case of an intrastate offering, whether they conform to all of the requirements of the state with jurisdiction;
 - (3) the following criteria relating to experience and financial stability are met:
 - a. the member (or its predecessor member if the corporate member is a newly formed corporation) has been actively engaged in the investment banking or securities business for at least five years immediately preceding the filing of the registration statement;
 - b. the member in at least three of the five years immediately preceding the filing of the registration statement has had a profit from its operations;

- c. the majority of the board of directors holding office as of the date of the filing of the registration statement and as of the effective date of the offering has been actively engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement.
- (b) Notwithstanding the provisions of subsections (a)(1) and (2) hereof, a member may participate as a member of the underwriting or selling group in the distribution of an issue of its own securities which is the subject of a firm commitment underwriting by a single managing underwriter in an amount not exceeding 10% of the total dollar amount thereof, provided the requirements of subsection (a)(3) hereof have been fully satisfied in all respects.
- (c) Notwithstanding the provisions of subsections (a)(1) and (2) and subsection (b) hereof, any member who satisfies in all respects the provisions of subsection (a)(3) may underwrite or participate in the distribution of an issue of its own securities without the pricing recommendations of two qualified independent underwriters if the offering is of a class of securities for which a bona fide active independent market exists as of the date of the filing of the registration statement for the current offering, and as of the effective date thereof.

Section 4 -- Member Underwriting Or Participating In The Distribution Of Issue Of Securities Of An Affiliate

- (a) Any member may underwrite or participate as a member of the underwriting syndicate or selling group in the distribution of an issue of securities of an affiliate only if:
 - (1) the offering price is established pursuant to the provisions of Section 3(a)(1) and the provisions of Section 3(a)(2) are complied with;
 - (2) the member-underwriter complies in all respects with the provisions of Section 3(a)(3) except that in lieu of paragraph c. thereof:
 - a. if the member-underwriter is a partnership, a majority of its general partners as of the date of the filing of the registration statement and as of the effective date of the offering shall have

been actively engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement; or

- b. if the member-underwriter is a sole proprietorship, the proprietor shall have been actively engaged in the investment banking or securities business for the five year period immediately preceding the filing of the registration statement.
- (3) the securities being offered are not of an issuer which is a broker/dealer affiliate of the member which is unable itself to meet the provisions of Section 3(a)(3) hereof;
 - (4) the financial statements of the issuer conform in all respects with the provisions of Section 2(a) hereof;
 - (5) the issuer represents that it will after the distribution to the public send to each of its shareholders:
 - a. quarterly, a summary statement of its operations; and
 - b. annually, independently audited and certified financial statements.
- (b) Notwithstanding the provisions of subsection (a) hereof, a member may participate as a member of the underwriting or selling group in the distribution of an issue of an affiliate-issuer's securities which is the subject of a firm commitment underwriting by a single managing underwriter in an amount not exceeding 10% of the total dollar amount thereof, provided the requirements of Section 3(a)(3) have been fully satisfied by the member.
 - (c) Notwithstanding the provisions of subsections (a) and (b) hereof, any member who satisfies in all respects the provisions of Section 3(a)(3) hereof may underwrite or participate in the distribution of an issue of securities of an affiliate without the pricing recommendations of two qualified independent underwriters if the offering is of a class of securities for which a bona fide active independent market exists as of the date of the filing of the registration statement for the current offering and as of the effective date thereof.

Section 5 -- Suitability

Every member underwriting an issue of its own securities, or of an affiliate thereof, pursuant to the provisions of Sections 3 and 4 hereof, who recommends to a customer the purchase of a security of such an issue shall have reasonable grounds to believe that the recommendation is suitable for such customer on the basis of information furnished by such customer concerning the customer's investment objectives, financial situation, and needs, and any other information known by such member. In connection with all such determinations, the member must maintain in its files the basis for and reasons upon which it reached its determination.

Section 6 -- Discretionary Accounts

Notwithstanding the provisions of Article III, Section 15 of the Corporation's Rules of Fair Practice, or any other provisions of law, a transaction involving securities governed by the provisions of Sections 3 and 4 hereof shall not be executed in a discretionary account without the prior specific written approval of the customer.

Section 7

A member which underwrites or participates in the distribution of units of a tax sheltered program may act as manager of that program only if it has expertise in the industry represented by the program of five (5) years or more or if such expertise is directly and readily available to it within its corporate complex, under contract, or otherwise.

Section 8 -- Relationship Of Schedule E To Interpretation With Respect To Review Of Corporate Financing

- (a) Notwithstanding the provisions of the Interpretation With Respect To Review Of Corporate Financing relating to factors to be taken into consideration in determining underwriter's compensation, the value of securities of a new corporate member succeeding to a previously established partnership or sole proprietorship member acquired by such member or person associated therewith, or created as a result of such reorganization, shall not be taken into consideration in determining such.
- (b) All offerings of securities included within the scope of this Schedule E including but not limited to those which are subject to the provisions of Regulation A under the Securities Act of 1933, and those which are purely intrastate in nature, shall

be subject to the provisions of the Interpretation With Respect To Review Of Corporate Financing to the extent that it is not inconsistent herewith and all pertinent documents relating thereto shall be filed with the Association pursuant to the provisions thereof. The responsibility for filing the required documents shall be that of the issuer-member. In the case of an issue of an affiliate, the responsibility for filing the required documents shall be that of the managing underwriter or, if there is none, that of the member in the affiliate relationship with the issuer. Otherwise, the Filing Requirements of the referred to Interpretation shall prevail.

Section 9

If the provisions of this Schedule E are inconsistent with any other provisions of the Corporation's By-Laws, Rules of Fair Practice or Uniform Practice Code, or of any interpretation thereof or resolution of the Board of Governors, the provisions of this Schedule shall prevail.

Section 10

A violation of the provisions of this Schedule shall constitute conduct inconsistent with high standards of commercial honor and just and equitable principles of trade and a violation of Article III, Section 1 of the Corporation's Rules of Fair Practice and possibly other sections, especially Sections 2 and 18, as the circumstances of the case may dictate.

Proposed Amendments To Article XVII Of By-Laws And
Proposed Schedule F Relating To Securities Transactions
Cleared Through National Clearing Corporation And
Establishment Of Aggrievement Procedures

III. Amendment to Article XVII of By-Laws

Article XVII of the By-Laws shall be amended as indicated by lining out (deleted material) and underlining (new material).

Section 1

All over-the-counter transactions in securities between members shall be cleared and settled through the facilities of National Clearing Corporation, a subsidiary of the Corporation unless:

- (a) the security involved in the transaction shall not have been qualified for clearance by the Board of Directors of National Clearing Corporation under the standards established by the rules of National Clearing Corporation, ~~or~~
- (b) one or more of the members involved in the transaction shall not have been qualified as a Clearing Member by the Board of Directors of National Clearing Corporation pursuant to standards established by the rules of National Clearing Corporation, or
- (c) the rules of the National Clearing Corporation provide that the transaction shall not be cleared through the facilities of the National Clearing Corporation.

Section 2

All transactions in securities between members which are cleared or settled through the facilities of National Clearing Corporation shall be subject to the rules of National Clearing Corporation as such rules shall be adopted and from time to time amended by the Board of Directors of National Clearing Corporation, approved by the Board of Governors of the Corporation and not disapproved by the Securities and Exchange Commission. ~~Such rules shall be approved by the Board of Governors of the Corporation and shall not be disapproved by the Commission, and shall become effective on such date as is designated by the Board of Directors of the National Clearing Corporation,~~ or amendments shall become effective on such date as is prescribed by the Board of Directors of National Clearing Corporation, unless such date is extended by the Board of Governors of the Corporation.

Section 3

Members and other persons aggrieved by action taken or authorized by the Board of Directors of the National Clearing Corporation in applying such rules, qualifications, criteria, standards, and charges, or in any way ensuing out of the operation of the national clearing system shall, in any case for which binding and final arbitration has not been provided by the rules of the National Clearing Corporation, upon filing a complaint with the Board of Governors of the Corporation, be entitled to a hearing thereon, if requested, decision and review by the Board of Governors in accordance with procedures specified by the Board. Such rules for the filing of a complaint with the Board and the hearing, decision and review by the Board shall be incorporated into Schedule F to be attached to and made a part of these By-Laws. The Board of Governors shall have power to adopt, alter, amend, supplement, or modify the provisions of Schedule F from time to time without recourse to the membership for approval as would otherwise be required by Article IX hereof and Schedule F, as adopted, altered, amended, supplemented, or modified shall become effective as the Board of Governors may prescribe unless disapproved by the Commission.

IV. Schedule F

SCHEDULE F

This Schedule has been prepared pursuant to the provisions of Section 3 of Article XVII of the Corporation's By-Laws and contains the rules and procedures to be followed in connection with complaints filed with the Board of Governors of the Corporation by members of the National Clearing Corporation and other persons aggrieved by action taken or authorized by the Board of Directors of the National Clearing Corporation in the operation of its nationwide system for clearing and settling over-the-counter transactions in securities other than those which are required to be submitted to arbitration under the rules of the National Clearing Corporation.

Section 1 -- Form of Complaint

All complaints shall be in writing, on a form to be supplied by the Board of Governors, and specify in reasonable detail the source and nature of the aggrievement and the form of redress requested. If the complaint consists of several matters or items, each matter or item shall be stated separately. All complaints must be signed and shall be directed to the Board. Counsel for the Corporation shall file a response to each complaint, in writing, within a reasonable time and send a copy thereof to the complainant.

Section 2 -- Request for Hearing

If a hearing is desired, a complainant must so request at the time of the initiation of his complaint. If requested, a hearing shall be held after reasonable notice to complainant. In the absence of a request for a hearing, the Board of Governors may, in its discretion, direct that a hearing be held if it deems such action necessary or appropriate.

Section 3 -- Hearing

If a hearing is held pursuant to Section 2 hereof, it shall be before a person or persons designated by the Board of Governors in a place reasonably convenient to complainant. Complainant shall be entitled to be heard in person and by counsel and to submit any relevant matter which he may desire to present. Counsel for the Corporation and for the National Clearing Corporation or other designated Corporation personnel and National Clearing Corporation personnel may participate in such hearing and be entitled to submit any relevant matter which they may desire to present in response. In any such proceeding a record shall be kept.

Section 4 -- Initial Decision

Decisions on complaints shall be in writing and a copy sent by mail to the complainant. Where there is no hearing, the decision shall be by a person or persons designated by the Board of Governors. Where there is a hearing, the decision shall be by the person or persons conducting the hearing. The written decision shall contain the reasons supporting the decision maker's conclusions.

Section 5 -- Review by Board

The initial decision shall be subject to review by the Board of Governors on its own motion within thirty (30) days after issuance. Any such decision shall also be subject to review upon application of any person aggrieved thereby, filed within fifteen (15) days after issuance. The institution of a review, whether on application or on the initiative of the Board, shall not operate as a stay of the action complained of.

Section 6 -- Findings of Board on Review

Upon consideration of the record, and after such further hearings as the Board of Governors shall order, if the Board shall find that the initial decision is incompatible with the nature and purposes of the Corporation or the National Clearing Corporation, or with their duties, rules and

regulations, or with applicable statutes and governmental regulations, the Board shall in writing, modify, amend, or reverse such decision or remand the matter for further findings and decision consistent with its instructions. Otherwise the Board shall affirm the initial decision. The Board shall set forth the specific grounds upon which its determination is based. The complainant shall be notified promptly and be sent a copy of any written decision by the Board of Governors on review.

Section 7 -- Application to Commission for Review

In any case where a complainant feels aggrieved by any decision of or action taken by and/or approved by the Board of Governors in relation to the National Clearing Corporation, and the statute permits appeal, the complainant may make application for review to the Securities and Exchange Commission in accordance with Section 15A of the Securities Exchange Act of 1934, as amended.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

August 24, 1971

Attention Operational Officers

To All NASD Members:

The Board of Governors of the Association has recently adopted amendments to Section 56 of the Uniform Practice Code concerning reclamations. The amendments will become effective September 1, 1971. A copy of the new section is attached.

Paragraph (a) has been substantially rewritten to expand the scope of former paragraph (a) which related only to delivery of a wrong security. The amended paragraph (a) also establishes a 30-month time limitation on the right of reclamation in all "irregular delivery" situations. Previously, there was no time limitation in this paragraph. "Irregular Delivery" has been defined to include the delivery of the wrong securities, duplicate deliveries, misdirected deliveries and the over-delivery of securities.

In paragraph (b) the time limitation for reclamations where transfer has been refused by a transfer agent has been extended from 2 years to 30 months after settlement date.

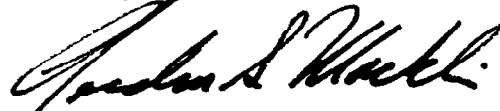
Paragraph (c) previously dealt with stolen bearer securities only. The Board feels that the right of reclamation should also be extended to all lost or stolen securities. Paragraph (c) has been amended to reflect this change. It also increases from 2 years to 30 months the period during which reclamations in such situations must be made.

In all cases the Uniform Practice Committee has discretion, upon good cause shown in respect to a particular transaction, to extend the 30 month period.

The most substantial effect of the amendments will be that members desiring to reclaim securities in all situations covered by Section 56 must do so within 30 months of the settlement date of the contract. This corrects the previous inconsistency within Section 56 which provided for a 2 year limitation in most situations and no limitation in connection with wrong deliveries. The Board feels that the liability attached to reclamations should not be unlimited as it was in connection with wrong deliveries and that it should be uniform in all situations. Thirty (30) months is considered a sufficient period of time for members to correct the situation. Essentially, this allows a period of time during which two audits would be performed.

In addition, the Board believes that as a general ethical practice any member who discovers securities in its possession to which it is not entitled should make reasonable attempts to ascertain and promptly notify the true owner of such securities and to take whatever other affirmative steps are necessary to correct the situation. Failure to do so could result in an extension of time within which reclamation of such securities may be made and may result in a violation of Article III, Section 1 of the Association's Rules of Fair Practice.

Sincerely,

A handwritten signature in black ink, appearing to read "Gordon S. Macklin". The signature is written in a cursive style with a large initial "G".

Gordon S. Macklin
President

Attachment

Irregular Delivery - Transfer Refused -
Lost or Stolen Securities

Section 56

Irregular delivery

(a) Reclamation, by reason of the fact of an irregularity in the delivery of a security, shall be within 30 months after the settlement date of the contract unless for good cause shown the Committee determines that a longer period would be appropriate. For purposes of this section, the term "irregular delivery" shall include, among other things, wrong, duplicate, misdirected and over-delivery.

Transfer refused

(b) Reclamation, by reason of the fact that a specific certificate tendered in settlement of a contract has been presented for transfer and transfer thereof has been refused by the transfer agent, shall be within 30 months after the settlement date of the contract unless for good cause shown the Committee determines that a longer period would be appropriate.

Lost or stolen securities

(c) Reclamation, by reason of the fact that a security is lost or stolen, shall be within 30 months after the settlement date of the contract unless for good cause shown the Committee determines that a longer period would be appropriate.