

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

August 4, 1980

I M P O R T A N T

OFFICERS, PARTNERS, PROPRIETORS

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

RE: Request for Comment on Proposed Amendments
to the By-Laws Concerning Composition of the
Association's Board of Governors

COMMENT PERIOD CLOSES ON: September 3, 1980

The National Association of Securities Dealers, Inc. ("NASD") is publishing for comment proposed amendments to Article IV of the By-Laws concerning the composition of the Board of Governors. Comments are invited from all members and other interested persons. The text of Article IV, showing the changes, is attached to this notice. A discussion of the background and purpose of the amendments appears below.

Background and Purpose

The overall management and administration of the affairs of the NASD is vested in its Board of Governors ("Board") consisting of a total of 27 persons including the President. Under present Article IV of the By-Laws, the composition of the Board is established so that a total of 21 members are required to be elected by the membership and 5 are elected by the Board and are designated Governors-at-Large. The President is a member of the Board by virtue of his office.

The present composition of the Board reflects a process of evolution in response to changing conditions in the investment banking and securities business. In 1964 the membership approved amendments to the By-Laws authorizing the Board to elect the first Governor-at-Large from among underwriter members of investment company shares. In 1969 the membership approved further amendments providing for a second Governor-at-Large from among insurance company members and insurance company affiliated members. In 1970 the membership authorized the Board to elect 3 additional Governors-at-Large who do not necessarily have to be from member firms. These positions have been filled by a number of distinguished persons having unique expertise and other special qualifications and who have been engaged in such fields as law, business, academics and government. A number of persons representing

NASDAQ companies have served in these positions. Governors-at-Large have assisted immeasurably in the Board's deliberations on many important issues.

The proposal would further change the present composition of the Board by authorizing the Board to elect 4 additional Governors-at-Large who do not necessarily have to be associated with members. The Association believes that increasing the number of Board members which the Board may choose from within or without the membership offers substantial benefits to the Association and the membership as a whole. First, it should strengthen the Association's ability to respond to the interests and importance of various groups not directly related to the membership, but whose activities can be expected to affect members and who are also affected by the Association's activities. For example, although for several years the Board has selected a Governor-at-Large from among companies whose securities are quoted in the NASDAQ System, the proposal would permit appointment of more than one such Governor-at-Large if an evaluation of the relationship of this group to the Association leads to the conclusion that additional appointments would be mutually beneficial to such companies and the membership. In addition, the Association would be given greater flexibility to assure representation on the Board of persons having expertise in newer and more specialized areas of member activities such as direct participation program securities, municipal bonds and options. The expansion in the number of Governors-at-Large should improve the Association's ability to obtain the services of outstanding persons both from within and outside the membership who for a variety of reasons often have not been available through the existing election procedures.

The Association in proposing the amendments has thoroughly considered the possible impact upon continuation of membership control over the Association's affairs. The statutory standard which Association requirements concerning representation on the Board must meet are contained in Section 15A(b)(4) [(former Section 15A(b)(6)] of the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975, which provides that the Association must assure a fair representation of its members in the selection of Board members and in the administration of the affairs of the Association. The statute also provides that one or more representatives shall be representatives of issuers and investors and shall not be associated with any member of the Association. The Association's Board believes that, as a matter of sound policy and consistent with the requirements of the statute, it is imperative that the Association continue to maintain voting control of its affairs in the hands of its members. This would continue to be the case since 21 out of 31 members would be elected by and from the membership. The Association believes that the proposal would advance the interests of members and the industry in terms of the Association's ability to continue to attract outstanding individuals to dedicate their talents and services as Board members and the benefits to be gained from a Board representing the broadest possible range of expertise.

Proposed By-Law Amendments

The proposal would be accomplished by amending Article IV, Section 3(h) of the By-Laws to increase from three (3) to seven (7) the number of Governors-at-Large elected by the Board from among groups of persons who may be affiliated or unaffiliated with members. A conforming amendment to Article IV, Section 2(a) of the By-Laws would provide that the Board shall consist of 31 members reflecting the increased number of Board members and to correct certain references to the provisions of Section 3.

It is intended that the Board should be given maximum flexibility in filling the four new Governors-at-Large positions to enable them to phase in the new members based upon an evaluation of industry needs at any given time. Thus, amended Article IV, Section 3(h) would provide that each new Governor-at-Large shall be elected by the Board at such time as the Board in its discretion deems appropriate. It is contemplated at the present time, however, that two of the new positions would be filled upon effectiveness of the proposal and that one will be filled each year during the following two years.

Finally, the reference in present Article IV, Section 3(h) to the years in which the existing three Governor-at-Large positions shall be filled is deleted as no longer necessary.

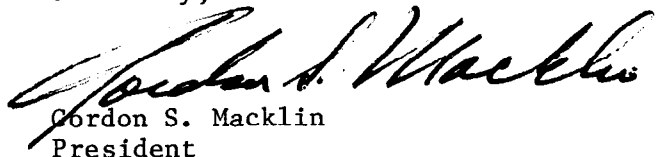
The Association's Board of Governors has authorized publication of the proposed amendments for comment. After the close of the comment period, the proposed amendments must again be reviewed by the Board taking into consideration the comments received. Thereafter, the proposal must be submitted to the membership for a vote and, if approved, must be submitted for approval to the Securities and Exchange Commission.

All comments should be addressed to the following:

David P. Parina, Secretary
National Association of Securities
Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Any comments must be received by September 3, 1980 and will be available for public inspection.

Sincerely,


Gordon S. Macklin
President

Text of Proposed Amendments to
Article IV, Sections 2 and 3 of the By-Laws
(Deleted language is stricken; new language is underlined)

ARTICLE IV OF BY-LAWS

Sec. 2(a)

The management and administration of the affairs of the Corporation shall be vested in a Board of Governors, which shall be composed of ~~twenty-seven~~ thirty-one members, twenty-one to be elected by the members of the various districts in accordance with the provisions of Section 3(a) through ~~(d)~~ (e) of this Article, ~~five~~ nine to be elected by the Board of Governors in accordance with the provisions of Section 3~~(e)~~, ~~(f) and (g) and~~ (h) of this Article, and the President of the Corporation to be selected by the Board of Governors in accordance with the provisions of Article V, Section 2.

Sec. 3(h)

~~Three~~ Seven members of the Board of Governors shall be elected by the Board of Governors 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.~~ Any Governor-at-Large initially filling a Governor-at-Large office shall be elected at such time as the Board of Governors in its discretion deems appropriate.

Notice-to-Members: 80-39
Notices to Members should
be retained for future
reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

August 11, 1980

I M P O R T A N T

OFFICERS, PARTNERS AND PROPRIETORS

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

RE: Request for Additional Comments on Proposed Revisions
to Schedule E to the Association's By-Laws

COMMENT PERIOD CLOSES ON: September 5, 1980

The National Association of Securities Dealers Inc. (the "Association") is publishing for additional comment proposed amendments to Schedule E to the Association's By-Laws. Schedule E relates to member activities in underwriting their own securities or those of affiliates. Comments are invited from all members and other interested persons. The text of Schedule E showing the proposed changes is attached to this notice. A section-by-section analysis of the proposed changes appears below.

Background

Schedule E to the Association's By-Laws was adopted in the early 1970's to regulate underwriting by Association members of their securities and securities of affiliates. Since that time, various amendments have been made to Schedule E, but no overall revision of the rule has been made.

Schedule E was adopted at a time when the public distribution of members' securities was a new phenomenon and many of the rule's provisions reflect concern over potential harm which could result from abuse of the self-underwriting process. In recent years, however, there has been a growing concern that some of the more restrictive provisions of Schedule E may no longer serve a useful regulatory purpose and may create impediments to capital raising by broker/dealers at a time when many believe that such capital raising should be facilitated so as to improve the capital base of the securities industry.

Late last year, the Association, through its Corporate Financing Committee, completed a thorough review of all provisions of Schedule E. In the course of that review, it was noted that the securities markets have adjusted over the past ten years to the concept of publicly-owned broker/dealers, that extensive research information is available on the securities industry and that many of the concerns expressed in the early 1970's have failed to materialize. The continuing need to assure a stable capital base for member firms and to facilitate their capital raising was also noted. The Association concluded, therefore, that many of the regulatory concerns reflected in Schedule E are no longer as relevant as they once were and that changes in the Schedule are in order.

Proposed revisions to Schedule E which would have removed or liberalized a number of its provisions were published for comment in Notice to Members: 80-3 (January 18, 1980). Copies of that notice are available upon request from the Corporate Financing Department at telephone number (202) 833-7240. All of the comments received in response to Notice to Members: 80-3 favored liberalization of Schedule E. Many of the comments, however, suggested that the proposed changes did not go far enough in liberalizing the Schedule. Some of the comments suggested that virtually all of Schedule E be eliminated.

The Association has considered all of the comments received and has concluded that further revisions to Schedule E should be proposed. The Association is therefore publishing herewith proposed revisions to Schedule E which would eliminate many of the rule's present requirements and liberalize many of the remaining provisions. The specific changes being proposed are shown in the attached text of Schedule E and are explained in the section-by-section analysis which follows.

Comment Procedure

The Association's Board of Governors is given the authority to adopt changes to Schedule E (without a vote of the membership) by Article IV, Section 2(c) of the Association's By-Laws. The Board contemplates adopting the proposed revisions pursuant to that authority.

The Association is requesting comments on the proposed revisions prior to final Board consideration. All comments received during this comment period will be reviewed by the Association's Corporate Financing Committee and changes to the proposed revisions will be recommended as deemed appropriate. The Board of Governors will then consider the proposed revisions again. If the Board approves the revisions, they must be filed

proposed revisions will be recommended as deemed appropriate. The Board of Governors will then consider the proposed revisions again. If the Board approves the revisions, they must be filed with, and approved by, the Securities and Exchange Commission before they become effective.

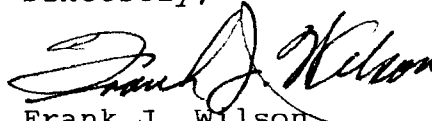
All written comments should be addressed to the following:

David P. Parina, Secretary
National Association of Securities Dealers Inc.
1735 K Street, N.W.
Washington, D.C. 20006.

All comments must be received by September 5, 1980. All comments received will be made available for public inspection.

Any questions regarding this Notice may be directed to Dennis C. Hensley, Vice President, Corporate Financing Department, telephone number (202) 833-7240.

Sincerely,



Frank J. Wilson
Senior Vice President
and General Counsel

Attachment

Section-by-Section Explanation of
Proposed Revisions to Schedule E to
the Association's By-Laws

A section-by-section explanation of the proposed revisions to Schedule E follows. This explanation compares the proposed changes with the text of Schedule E as presently in effect. In a few instances, reference is also made to changes proposed earlier in Notice to Members: 80-3 (January 18, 1980).

The text of Schedule E, showing the proposed revisions, follows this section-by-section explanation.

Proposed New Section 1 - General

This new section has been inserted to clarify the general applicability of Schedule E.

Section 1 [Proposed New Section 2] - Definitions

Several definitions would be deleted and others revised. An explanation of each follows.

Subsection 1(a) [Proposed New Subsection 2(a)] - Definition of "Affiliate"

This subsection defines those entities which are deemed to be affiliated with a member, thereby requiring issues of their securities to comply with Schedule E. The language of the subsection would be completely revised in an attempt to clarify its terms. The scope of the definition would be significantly narrowed and exemptions expanded so that the number and types of offerings subject to Schedule E would be substantially reduced. Differences in the treatment of partnerships and corporations would also be removed.

The definition of "affiliate" would continue to be based on a presumption of control, but control would be presumed to exist only in those instances of beneficial ownership of 25 percent or more of the outstanding voting securities or partnership interests. This contrasts with the present provisions of Schedule E which deem control to exist wherever an ownership interest of 10

percent or more is present. This change is being proposed as a result of comments received which suggested that the present criteria is unrealistically restrictive.

Under the proposed changes, the exemptions from the definition of "affiliate", and therefore the applicability of Schedule E, would be continued except in the instance of direct participation programs. The present exemption for non-debt offerings of direct participation programs would be expanded to exempt all offerings by such programs. The latter change is being proposed in response to comments which suggested that there was little regulatory benefit to be gained by applying the constraints of Schedule E to debt offerings by direct participation programs.

Subsection 1(b) [Proposed New Subsection 2(b)] - Definition of "Bona Fide Independent Market"

This definition sets forth criteria which are intended to describe a market of such depth and duration as to constitute an efficient pricing mechanism. The only changes proposed are of a clarifying nature. It has been pointed out, however, that the definition as presently proposed does not relate directly to a market in debt securities. Comments and suggestions are invited, therefore, as to a means of properly defining a "bona fide independent market" for debt securities which relates to the depth and duration of such a market and its efficiency as a pricing mechanism.

Subsection 1(c) [Proposed New Subsection 2(c)] - Definition of "Bona Fide Independent Market Maker"

The sole purpose of this definition is to elaborate upon the concept of an independent market. The term "bona fide independent market maker" is used only in defining the term "bona fide independent market."

The only change proposed to this subsection is a deletion of one of the specified criteria. The Association concluded that the concept of "a reasonable average rate of inventory turnover" lacks specificity and is unnecessary in view of the other applicable criteria.

Proposed New Subsection 2(d) - Definition of "Company"

This new subsection would define "company" along lines similar to that utilized in the federal securities statutes, particularly the Investment Company Act of 1940. This definition is being proposed for insertion as a result of comments which noted the frequent use of the term "company", especially in the proposed definition of "affiliate".

Subsection 1(d) - Definition of "Direct Participation Program"

This subsection presently defines the term "direct participation program" to parallel the definition contained in recently adopted Article III, Section 34 of the Rules of Fair Practice.

The proposed revision would delete this definition as superfluous in view of language being proposed in new Section 2(a)(3)(iv).

Subsection 1(e) [Proposed New Subsection 2(e)] - Definition of "Effective Date"

No change is proposed to this definition other than a redesignation as subsection 2(e).

Subsections 1(f) through (k) - Definitions of "Financial Statements," "Immediate Family," "Member," "Parent," "Person," and "Public Director"

These subsections presently define the terms indicated. All of these definitions are proposed to be deleted because proposed deletions in the substantive provisions of Schedule E would make these definitions superfluous.

Subsection 1(l) [Proposed New Subsection 2(f)] - Definition of "Public Offering"

This subsection defines "public offering" and, therefore, the type of securities distributions to which Schedule E applies. The definition was intended to assure broad application of Schedule E and that intention remains with respect to this term.

The only substantive change proposed for this subsection is an expansion of the current exemption for offerings made pursuant to Section 4(2) of the Securities Act of 1933 ("1933 Act"). The proposal would also exempt offerings made pursuant to Section 4(1) of the 1933 Act. Section 4(1) permits offerings by "any person other than an issuer, underwriter, or dealer." This change is being proposed as a result of comments received and reflects the Association's views that these offerings do not present a serious threat of abuse.

Subsection 1(m) [Proposed New Subsection 2(g)] - Definition of "Qualified Independent Underwriter"

This subsection defines "qualified independent underwriter" in terms of past activity and profitability in the securities business and experience of management. The definition was intended to establish criteria which would assure that any functions performed pursuant to Schedule E would be performed by persons possessing certain minimum levels of experience and expertise. The test of profitability in paragraph (2) is restricted to operations of a broker/dealer so as to preclude the reliance upon non-securities income and the requirement for profitability in three of the last five years was intended to reflect the cyclical nature of the securities industry. The requirement for five years' experience by the firm and a majority of its management personnel is intended as a measure of experience and expertise.

The proposed amendments to paragraphs (1) and (2) would codify existing practice that the pro forma combined operations of predecessor broker/dealer entities will be utilized in determining compliance with the experience and profitability tests in instances of merger or acquisition. Other minor language changes are intended only to clarify existing requirements.

Although the Association is proposing changes to the experience and profitability standards to be met by firms issuing their own securities, it was felt that no relaxation was appropriate with respect to firms charged with the responsibility of performing the functions of a qualified independent underwriter. These criteria therefore remain unchanged.

Subsection 1(n) [Proposed New Subsection 2(h)] - Definition of "Registration Statement"

This subsection defines the specified term by reference to the 1933 Act and enumerated documents.

The proposal to incorporate documents required to be filed by federal or state agencies is intended to clarify that documents filed with federal banking agencies, for example, may be subject to Association review if a member participates in a distribution. The remaining changes are minor clarifications in language.

Subsection 1(o) - Definition of "Restricted Securities"

"Restricted securities" is presently defined by means of a description of types of securities.

Proposed deletions to the substantive provisions of Schedule E remove any references to restricted securities, thereby rendering this definition unnecessary. It is therefore proposed that the definition be deleted.

Subsection 1(p) [Proposed New Subsection 2(i)] - Definition of "Settlement"

This subsection defines "settlement" as the distribution of net proceeds. No substantial change is proposed.

Section 2 - Offerings by a Member
of Its Own Securities

Section 2 presently sets forth criteria which apply to public offerings of an issue of a member's own securities. Except for those subsections relating to the escrow of proceeds, net capital computation, certain possible circumventions of the Schedule, and disclosure for intra-state offerings, Section 2 is proposed to be deleted. This proposal reflects the Association's view that the provisions of Section 2 are no longer needed to assure protection of public investors and have become possible impediments to capital raising by members. A brief analysis of each subsection follows.

Subsection 2(a) - Financial Statements

This subsection presently specifies the type of financial statements which must be filed with the Association and disclosed in offering documents for public offerings by members of their own securities. The requirements of this subsection also presently apply to affiliates of members pursuant to subsection 4(a)(4) of Schedule E. The financial disclosure required by subsection 2(a) goes beyond requirements under the 1933 Act.

This subsection would be eliminated by the proposed revisions. The Association has concluded that members and their affiliates should not be subject to any more stringent financial disclosure requirements than other issuers registering offerings under the 1933 Act.

Subsections 2(b), (c) and (d) - Restrictions on Sale of Securities by Stockholders

Subsections 2(b), (c) and (d) of Schedule E presently place various restrictions upon the disposition of members' securities held by specified classes of persons. Subsection 2(b)(1)a prohibits the offering of more than 25 percent of stockholders' equity in specified types of offerings. Subsection 2(b)(1)b imposes a one-year "lock-up" on securities retained by stockholders after an initial offering. Subsection 2(b)(1)c places a one-year "lock-up" on restricted securities held by persons associated with a member in other types of offerings. Subsection 2(b)(1)d prohibits any person active in the management of a member and other specified persons from selling any portion of his ownership interest in an offering unless a bona fide independent market exists for the securities and various other requirements are met. Subsection 2(b)(2) imposes a three-month "lock-up" on restricted securities held by persons associated with a member in the case of other offerings. Subsection 2(b)(3) requires that securities restricted by the other provisions bear a prescribed legend.

Subsection 2(c) prohibits a person associated with a member from offering his securities as part of an offering unless he has owned them for at least one year or they were acquired pursuant to specified conditions. Subsection 2(d) provides that relief may be given from the specific restrictions in subsections (b) and (c) in "exceptional and unusual circumstances" upon a showing to the Association.

These restrictions reflect the apparent concern at the time Schedule E was adopted that owners of member firms would utilize the public offering mechanism to "bail out" from unstable firms, taking unfair advantage of public investors. Where sales were permitted, reliance was placed on the safeguard of an existing bona fide independent market to assure that information on the issuer would be publicly available and prices established by the marketplace.

The proposed revision of Schedule E would eliminate all of the restrictions now contained in these subsections.

The experience gained by the Association in administering Schedule E has led to the conclusion that these provisions may be unnecessarily restrictive and that many of the dangers for which they were initially enacted have proven not to exist. The Association is also mindful of the liberalization in recent years of Rule 144 under the 1933 Act, and is of the view that the action proposed here is consistent with the Commission's steps to facilitate the disposition of securities held by insiders. The Association believes that no regulatory purpose is served in this instance by imposing greater restrictions upon stockholders of broker/dealers than are imposed upon the holders of interests in other types of firms.

Subsection 2(e) - Restrictions on Subsequent Offerings

Subsection 2(e) now prohibits a member from making a subsequent public offering for a period of at least one year following the initial offering of its securities (except for enumerated employee-benefit programs). The purpose of this subsection was to prevent members from quickly diluting ownership interests recently distributed or from circumventing other restrictions on the size of offerings through repeated public offerings.

This restriction is deleted in the proposed amendments. The Association has concluded that this provision is unnecessarily restrictive under current market conditions, especially in view of mergers and acquisitions, and is of limited regulatory purpose.

Subsection 2(f) - Restriction on Total Dollar Amount of Offering

Subsection 2(f) limits the total dollar amount of an offering by a member to three times its net worth, excluding subordinated capital. This restriction was intended to prevent broker/

dealers from incorporating with a minimum capital commitment and thereafter going to the public for a substantial increase in capital.

This restriction is eliminated in the proposed amendments. The Association notes that market conditions have changed since the provision was originally adopted and that competitive market forces may be expected to determine the relative size of an offering which can be successfully distributed.

Subsection 2(g) - Completion of Offerings Within 60 Days

Offerings of members' securities are required by subsection 2(g) to be completed within sixty days.

The limit on offering periods is eliminated in the proposed amendments, since such a time limit has proven to serve little regulatory purpose. The apparent danger against which the provisions was adopted, manipulation of capital computations, has not been a serious problem.

Subsection 2(h) [Proposed New Section 3] - Escrow of Proceeds

Subsection 2(h) requires that proceeds from sales of a member's securities be placed in an escrow account and not released until net capital has been computed. The requirement was intended to assure that an offering was completed and net capital requirements satisfied before a member could utilize the proceeds.

Only minor language clarifications are made in the proposed amendments and the subsection is redesignated Section 3.

Subsection 2(i) [Proposed New Section 4] - Net Capital Computation

Subsection 2(i) requires members to file a net capital computation with the Association upon termination of an offering and specifies minimum net capital ratios which must be satisfied.

Only minor clarifying language changes are proposed for this subsection. The subsection would be redesignated new Section 4. The Association concluded that this subsection should be retained to assure continued net capital compliance by members issuing securities. It is also believed that this subsection does not impose an onerous burden on members.

Subsections 2(j), (k) and (l) - Establishment of Audit Committee and Election of Public Director

Subsections 2(j) and (k) presently require a member (or its parent) issuing securities to establish an audit committee of its board and elect a public director, both within twelve months following the offering. Subsection 2(l) set dates when these requirements became effective.

Subsections 2(j) and (k) would be deleted by the proposed revisions. These proposed deletions should not be seen as a reflection of any overall Association posture on the desirability of public directors or audit committees. The Association's Board of Governors recently urged companies whose securities are quoted in the NASDAQ System to provide for public directors and audit committees. The proposed deletion of subsections 2(j) and (k) instead reflects the Association's view that any requirements for public directors and audit committees should be applied to general classes of issuers and that members issuing securities should not be subjected to any greater requirements than other similarly situated issuers. The Association is not aware of any evidence suggesting that broker/dealers should be subjected to any more stringent standards in this area than other issuers.

Subsection 2(l) would be deleted because the dates specified therein have expired.

Subsection 2(m) - Periodic Reports to Investors

Members who have distributed securities to the public are required by subsection 2(m) to send periodic reports to their securityholders. This requirement is similar to that for affiliates of members under subsection 4(a)(5).

Subsection 2(m) would be deleted by the proposed revisions. The Association concluded that the periodic reporting requirements of the Securities Exchange Act of 1934 ("1934 Act") are adequate to provide continuing information on members issuing securities. This proposed revision also reflects the view that broker/dealers issuing securities should not be subjected to uniquely restrictive requirements of this nature.

Subsection 2(n) - Filing of FOCUS Report

Subsection 2(n) requires that a member making a public distribution of its own securities file specified parts of Form X-17A-5 ("FOCUS" Report) and other specified information with the Association in certain circumstances.

This subsection would be deleted by the proposed revisions. It was concluded that the normal filing requirements for FOCUS reports are adequate to monitor firms issuing securities.

Subsection 2(o) [Proposed New Section 5] - Applicability of Schedule E to Certain Offerings

Under subsection 2(o), if any issuer directs proceeds from a public offering to an affiliated member and the member then has net worth in excess of ten percent of the net worth of the issuer, the offering will be presumed to have been made by the member and therefore subject to present Sections 2 and 3 of the Schedule. Subsection 2(o) was adopted to guard against circumvention of Schedule E.

The Association proposes to revise this subsection to clarify its application. As revised, the subsection, redesignated Section 5, would make it clear that public offerings whose proceeds are received by a member and public exchange offers for interests in members are subject to Schedule E. It would also be clarified that any other offering that results in the public ownership of a member would be subject to Schedule E. Language changes would clarify that affiliate status under Schedule E is to be determined both before and after a proposed offering.

Subsection 2(p) [Proposed New Section 6] - Registration Statements for Intrastate Offerings

Subsection 2(p) requires that registration statements for intrastate offerings contain information comparable to that suggested by the Commission. This subsection is proposed to be redesignated Section 6 without substantial change.

Most disclosure requirements of Schedule E would be deleted by the proposed revisions. In view of the differences among state disclosure practices, however, it was concluded that this provision should be retained to assure some uniform minimum standard of disclosure among intrastate offerings.

Sections 3 and 4 [Proposed New Section 7]
- Underwriting By Member of Issue of Its Own
Securities; Member Underwriting or Participating
In Distribution of Issues of Securities of an Affiliate

Section 3 of Schedule E specifies conditions to be met by a member seeking to underwrite or participate in the distribution of a public offering of its own securities. These conditions vary according to the type of participation by the member. In each instance, a member must satisfy the experience and financial stability criteria of subsection 3(a)(3). Generally, these require that the member has been actively engaged in the securities business for five years and has been profitable in three of the immediately preceding five years, and that its management consists of persons the majority of whom have at least five years experience in the securities business.

The remaining provisions of Section 3 specify different safeguards against conflicts of interest in the pricing of securities and preparation of offering documents. These safeguards vary according to the nature of involvement of the issuing member and the type of offering. Thus, subsections 3(a)(1) and (2) permit members to participate without limitation in the distribution if the price of the security is established by two qualified independent underwriters who participate in the preparation of the registration statement, exercise usual standards of "due diligence" and are represented by independent legal counsel who renders an opinion as to conformity with securities law. Subsection 3(b) permits the issuing member to participate in the distribution in an amount up to ten percent of the offering if the offering is managed by a qualified independent underwriter and is underwritten on a "firm commitment" basis. Subsection 3(c) permits the issuing member to participate without limitation in the distribution if a bona fide independent market exists for the class of securities or the securities are rated "BAA" or better by a recognized rating service.

Section 4 of Schedule E specifies those conditions to be met by a member seeking to participate in the distribution of a public offering of an affiliate's securities. The provisions of present Section 4 closely parallel those in Section 3 with certain additional requirements. The securities being offered must not be of an issuer which is a broker/dealer affiliate or a member unable itself to meet the provisions of Section 3, the issuer's financial statements must conform to the provisions of subsection 2(a) and the issuer must represent that it will provide certain periodic reports to securityholders.

The proposed revisions would replace the present provisions of Sections 3 and 4 with new Section 7. The purpose of the proposed revision is to clarify the requirements of Sections 3 and 4 and to liberalize those requirements in certain respects. Many of the present requirements would remain, however. This reflects the Association's view that serious conflicts of interest relating particularly to the pricing of the security and the performance of "due diligence" are present whenever a member participates in the distribution of its securities or those of an affiliate. The Association concluded that concern for investor protection dictates that regulatory safeguards be retained in those areas.

Proposed new Section 7 would apply equally to distributions by members and their affiliates. Proposed deletions of other provisions relating to periodic reports and financial statements have removed the present differences between the substantive requirements of Sections 3 and 4.

The present experience and financial stability requirements for members seeking to participate in a Schedule E distribution would be revised to remove requirements for past profitability or business history. The requirement that a majority of the member's management have five years experience in the securities industry would be retained in proposed subsection 7(a). These changes reflect the Association's belief that newly organized members or members without consistently profitable operations should not be precluded from participating in a distribution if other applicable safeguards are present. The Association believes that the marketplace will give appropriate consideration to a firm's history and profitability. On the other hand, the Association is concerned that members seeking to participate in offerings of their own securities subject to Schedule E should be managed by persons who have a working knowledge of the securities industry and, therefore, presumably a greater likelihood of success on behalf of their public investors.

Proposed new Section 7(b) would clarify that members seeking to participate in the distribution of their own securities would be subject to one of two types of criteria, depending upon the member's type of participation. Subsection 7(b)(1) would list three conditions under any one of which a member could fully participate in the distribution. Generally, these would require either that two independent underwriters price the securities and exercise "due diligence", or that a bona fide independent market exist for the securities, or that the securities be rated "Ba" or better by Moody's or "BB" or better by Standard and Poor's rating services.

It should be noted first that proposed subsection 7(b)(1)(i) imposes an additional requirement on members which have not been in business for at least five years. While the proposal in subsection 7(a) would no longer require a firm to have been in the securities business for five years to participate in the distribution of its securities, the Association concluded that certain safeguards should be retained where a newer firm is issuing securities for which there is no bona fide independent market and no minimum rating. Accordingly, proposed subsection 7(b)(1)(i) would permit a member which (itself or through a predecessor broker/dealer) has not been engaged in the securities business for five years to participate in an offering under that subsection only if the offering is managed by a qualified independent underwriter.

It is important to note secondly that the option of utilizing two independent underwriters contained in proposed subsection 7(b)(1) would no longer require the participation of counsel to such underwriters. The Association's experience in administering the present requirement in Schedule E for such counsel indicates that the additional regulatory benefit derived from the participation of such counsel is marginal in view of the fact that in most instances such persons are called upon only after offering documents have been prepared by others. It has also been suggested that the requirement for participation by such independent counsel results in additional legal expenses, thereby constituting a further impediment to capital raising. The Association has concluded, therefore, that it would be in the public interest to delete this requirement.

It should also be noted that the proposed ratings ("Ba" by Moody's or "BB" by Standard and Poor's) are lower than the present requirements ("Baa" and "BBB" respectively), thereby reducing the number of offerings which will be subject to Schedule E. The Association concluded that the pricing mechanism of the marketplace can now be expected to properly evaluate offerings of this type. The minimum ratings which would be required to take advantage of subsection 7(b)(1)(iii) are nonetheless higher than that for an exemption from the Association's general filing requirements for public offerings, a minimum rating of "B" (see NASD Manual (CCH) at page 2025).

Proposed subsection 7(b)(2) would provide that a member may participate in an amount up to ten percent of the total dollar amount of an offering of its securities if the offering is a "firm commitment" underwriting managed by a qualified independent underwriter. This proposal does not represent any substantive change from the present provision.

Section 5 - Suitability

This section establishes suitability requirements for customers purchasing securities distributed pursuant to the provisions of Sections 3 or 4. Article III, Section 2 of the Association's Rules of Fair Practice imposes a general obligation upon members to assure the suitability of recommendations to customers. Present Section 5 of Schedule E imposes a somewhat more stringent standard of suitability and a requirement to maintain a record of the basis of a member's determination of suitability.

The Association is proposing to delete Section 5. The Association believes that it is no longer necessary to subject members to a unique suitability requirement for offerings made pursuant to Schedule E. It is believed that the investor protection provided by Article III, Section 2 of the Rules of Fair Practice is adequate and that retaining a separate requirement in Schedule E would be redundant.

Section 6 [Proposed New Section 8] - Discretionary Accounts

Section 6 prohibits the execution of a transaction in any security distributed pursuant to Section 3 or 4 in a discretionary account without written authority of the customer. A minor amendment is proposed to clarify that this requirement applies to all members, not only the affiliate of the issuer. The section would be redesignated Section 8.

Section 7 [Proposed New Section 9] - Sales to Employees

Section 7 provides that, notwithstanding the Association's "Free-Riding and Withholding" Interpretation (NASD Manual (CCH) p. 2039), a member may sell securities distributed pursuant to Section 2 or 3 to its employees and other specified classes of persons.

The proposed amendments would delete restrictions on the sale or transfer of securities acquired under this section for 12 months in some instances and 90 days in others. This proposal reflects the same concern of the Association discussed in connection with the proposed removal of similar restrictions from Section 2.

The section would also be redesignated Section 9.

Sections 8, 9, 10 and 11 [Proposed New Sections 10,
11, 12 and 13]

Sections 8, 9, 10 and 11 of Schedule E relate to the relationship of Schedule E to other Association requirements and explain the procedures for obtaining an exemption from Schedule E. Most of the proposed revisions to these sections consist only of minor language changes.

The proposed changes to Section 10 would provide the Corporate Financing Committee with authority to grant exemptions from Schedule E. Presently, only the Board of Governors is empowered to grant such exemptions. Experience has shown the Corporate Financing Committee to be competent to pass upon questions of exemption, with the Board of Governors rarely deviating from that Committee's recommendation. Board approval, however, must often be obtained under severe time constraints and cumbersome administrative procedures. The Association has therefore concluded that the interests of members, issuers, and the public could best be served by delegating authority to the Corporate Financing Committee to grant or deny requests for exemptions.

Proposed Amendments
To Schedule E
To the Association's By-Laws*

Schedule E

Distribution of ~~Issues of Members~~¹ Securities of
Members and Affiliates

Section 1 -- General

No member or person associated with a member shall participate in the distribution of a public offering of securities issued by the member or an affiliate of the member except in accordance with this Schedule.

Section ~~1~~ 2 -- Definitions

For purposes of this Schedule, the following words shall have the stated meanings:

(a) Affiliate--

~~(1)~~ a company which controls, is controlled by or

* Deleted language is stricken; new language is underlined.

is under common control with a member, or a person associated with such a company who is actively engaged in the management of its business and who is actively engaged in the management of a member's business or in a position to exercise control;

(2) a company which directly or indirectly owns, controls or holds with power to vote 10 per centum or more of the outstanding voting securities, or holds securities which provide the right to acquire 10 per centum or more of the outstanding voting securities of a member; or

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

(4) a partnership wherein any partner, general or limited, or, in the case of a sole proprietorship where the individual, has an interest in 10 per centum or more of the distributable profits or losses of a member, or a partnership in which a member, or person associated with a member who is actively engaged in the management of the member's business, has an interest in 10 per centum or more of the partnership's distributable profits or losses; or

(5) a company wherein an officer, or person active in the management of the company's business, has a direct or indirect interest in 10 per centum or more of the distributable profits or losses of a member partnership;

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, as amended, a separate account as defined in Section 2(a)(37) of the Investment Company Act of 1940, as amended, a real estate investment trust as defined in Section 856 of the Internal Revenue Code or a non-debt offering of a direct participation program.

(1) a company which controls, is controlled by or is under common control with a member.

(2) For purposes of subsection 2(a)(1) hereof,

(i) a company will be presumed to control a member if the company beneficially owns 25 percent or more of the outstanding voting securities of a member which is a corporation, or beneficially owns a partnership interest in 25 percent or more of the distributable profits or losses of a member which is a partnership;

(ii) a member will be presumed to control a company if the member and persons associated with the member beneficially own 25 percent or more of the outstanding voting securities of a company which is a corporation, or

beneficially own a partnership interest in 25 percent or more of the distributable profits or losses of a company which is a partnership;

(iii) a company will be presumed to be under common control with a member if:

(1) the same natural person or company controls both the member and company by beneficially owning 25 percent or more of the outstanding voting securities of a member or company which is a corporation, or by beneficially owning a partnership interest in 25 percent or more of the distributable profits or losses of a member or company which is a partnership; or

(2) a person having the power to direct or cause the direction of the management or policies of the member or the company also has the power to direct or cause the direction of the management or policies of the other entity in question.

(3) The provisions of paragraphs (1) and (2) hereof notwithstanding, none of the following shall be presumed to be an affiliate of a member for purposes of this Schedule E:

(i) an investment company registered with the Securities and Exchange Commission pursuant to the Investment Company Act of 1940, as amended;

(ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act of 1940, as amended;

(iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code;

(iv) a "direct participation program" as defined in Article III, Section 34 of the Rules of Fair Practice.

(b) Bona fide independent market--a market in a class of securities of a company security which:

(1) are is registered pursuant to the provisions of Sections 12(b), or Section 12(g) or 15(d) 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 those provisions of these Sections by the Securities and Exchange Commission;

(2) has an aggregate trading volume for the 12 months immediately preceding 12 months the filing of the registration statement of at least 100,000 shares;

(3) has outstanding for the entire twelve-month period immediately preceding the filing of the registration statement, a minimum of 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; and

(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) Company -- a corporation, a partnership, an association, a joint stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such.

(d) Direct participation program -- a program which provides flow through tax consequences 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), agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.

(e) Effective date--the date on which an issue of securities first becomes legally eligible for distribution to the public.

(f) 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.

(g) Immediate family--shall include parents, mother-in-law, father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, children, or any relative to whose support such persons contribute directly or indirectly.

(h) 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.

(i) Parent--any entity affiliated with a member from which member the entity derives the principal source (50% or more) of its gross revenues or in which it employs 50% or more of its assets.

(j) Person--any natural person, partnership, corporation, association, or other legal entity.

(k) Public director--a person elected from the general public to the board of directors of a member or its parent who has made a public distribution of an issue of its own securities. Such person shall not own or control with power to vote 5 per centum or more of the outstanding voting securities of the member or its parent and in no circumstances be in any way engaged in the investment banking or securities business or be an officer or employee of the member or its parent, or a member of the immediate family of an employee occupying a managerial position with a member or its parent.

(l)(f) Public offering--any primary or secondary distribution of securities made pursuant to a registration statement or offering circular including exchange offerings, rights offerings, offerings made pursuant to a merger or acquisition, straight debt offerings and all other securities distributions of any kind whatsoever except that it shall not include any offering made pursuant to an exemption under Section 4(1) or 4(2) of the Securities Act of 1933.

(m)(g) Qualified independent underwriter*-- a member which:

(1) has been is actively engaged in the investment banking or securities business and which has been so engaged, in its present form or through predecessor broker/dealer entities,

* In the opinion of the National Association of Securities Dealers and the Securities and Exchange Commission the full responsibilities and liabilities of an underwriter under the Securities Act of 1933 attach to a "qualified independent underwriter" performing the functions called for by the provisions of Sections 3 and 4 7 hereof.

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 net income from operations of the broker/dealer entity or from the pro forma combined operations of predecessor broker/dealer entities, exclusive of the extraordinary items, as computed in accordance with generally accepted accounting principles;

(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~~ of its board of directors or, if a partnership, a majority of its general partners, are ~~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;

e-b. 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 entity issuing securities pursuant to Section 7 of this Schedule; and

(6) has agreed in connection with the offering in respect to which he is acting as such to undertake the full legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in the provisions of Section 11 thereof.

~~(n)~~(h) Registration statement--shall have the meaning given to ~~that term~~ a registration statement as defined 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 other document, by whatever name known, initiating the a 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 federal or state agency.~~

(e) Restricted securities--securities held by any persons including any persons in a control relationship with the issuer or an affiliate of an issuer or an affiliate of an issuer subject to the provisions of Rule 144 of the General Rules and Regulations under the Securities Act of 1933 and securities in respect to which a registration statement must be filed and become effective before being sold to the public.

(p)(i) Settlement--the distribution of the net proceeds from an offering to the issuer company and/or selling stockholders.

Section 2 - Offerings by An Issuer-Member of Its Own Securities

Any member may make a public offering of an issue of its own securities. The following general criteria shall apply to all such offerings unless otherwise specified hereafter:

(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 (6) 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) Subject to the provisions of subparagraph d. of this paragraph (1) and 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.

d. A stockholder who is actively engaged in the conduct of an issuer member's investment banking or securities business, a member of his immediate family, or an affiliate of a member, shall not be permitted to sell any portion of his ownership interest in the issuer-member in any offering made pursuant to the provisions of Section 3 hereof unless a bona fide independent market exists for the securities and the provisions of Section 3(a)(1), (2) and (3) hereof are complied with.

(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 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 to the date of the termination of the offering.

(3) All securities which, pursuant to the provisions of this subsection (b), or of Section 7 hereof, are restricted as to sale or transfer, shall bear a legend stating clearly the commencement date of the period of restriction, the expiration date thereof and that after that date no restriction as to transferability of the security exists as a result of the provisions of this Schedule E.

(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 (6) months prior to the effective date of the offering. In computing the total dollar amount of an offering of securities with warrants attached, the issuer member shall include the exercise value of such warrants or prohibit for a period of twelve (12) months the exercise thereof.

(g) All offerings must be completed within a period of 60 days after the effective date thereof.

Section 3 -- Escrow of Proceeds

(h) All proceeds from sales of securities of an offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by a member in any manner until the member has complied with Section 4 hereof. settlement

has been effected and its net capital ratio, computed as prescribed in of paragraph (i) hereof, is 10-1.

Section 4 -- Net Capital Computation

(i) Every Any issuer- member offering its securities pursuant to this Schedule shall immediately notify the Association Corporation when ~~its~~ the offering has been terminated and settlement effected and it shall file with the Association Corporation 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~~ 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the provisions of Rule 15c3-1(f) are utilized in making such computation, the net capital is less than 7 seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, 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 the member has obtained from the Securities and Exchange Commission a specific exemption from the net capital rule. Proceeds from the sales of ~~such~~ securities of

the offering may be taken into consideration in computing net capital ratio for purposes of this paragraph section.

(j) Any member or its parent who makes a public offering of an issue of its own securities shall also be required to establish within twelve (12) months of the effective date of said offering an Audit Committee composed of members of the board of directors (except that it shall not include the chief accounting or chief financial officer of the member or its parent) the functions of which, among others, shall be the following:

(1) review the scope of the audit;

(2) review with the independent auditors the corporate accounting practices and policies and recommend to whom reports should be submitted within the company;

(3) review with the independent auditors their final report;

(4) review with internal and independent auditors overall accounting and financial controls; and

(5) be available to the independent auditors during the year for consultation purposes.

(k) Any member or its parent who makes a public offering of an issue of its own securities shall cause to be elected to its board of directors within twelve (12) months of the effective date of said offering a public director who shall serve as a member of the Audit Committee except where such election is inconsistent with the rules of

a national securities exchange.

(i) Any member who made a public offering of an issue of its own securities prior to April 17, 1974 was required by April 17, 1975 to have established and maintain an audit committee to be charged with the functions set forth in Subsection (j) hereof and have caused to be elected to its board a public director except where such election is inconsistent with the rules of a national securities exchange. In the case of any member's parent who has made a public offering of an issue of its own securities prior to May 19, 1977, such shall be required by May 19, 1978.

(m) Any member who has heretofore made, or hereafter makes, a distribution to the public of an issue of its securities, shall send to each of its shareholders or, in the case of debt offerings, to each of its investors:

(1) quarterly, a summary statement of its operations,
and

(2) annually, independently audited and certified
financial statements.

(n) After a member for whom the Corporation is the designated examining authority under Rule 17A-5(a)(4) has made distribution to the public of an issue of its securities, it shall file with the Corporation Part II or II A of the Securities and Exchange Commission Form X-17A-5 as required by the Board of Governors. 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 Form SR required by that rule to be filed with the Securities and Exchange Commission shall also simultaneously be filed with the Corporation.

Section 5 - Applicability of Schedule to Certain Offerings

(o) If an issuer ~~intends~~ proposes to ~~or does~~ direct all or part of the proceeds from a public offering of its securities to a subsidiary or affiliated broker/dealer-member which results in the member having a net worth in excess of 10% of the net worth of the issuer, or exchange securities by means of a public offering for an interest in a member and the member is, or as a result of the proposed transaction would be, an affiliate of the issuer, or proposes to engage in any offering which results in the public ownership of a member, the offering shall be deemed to be a distribution subject to the provisions of Sections 2 and 3 of this Schedule E.

Section 6 - Registration Statements for Intrastate Offerings

(p) In the case of an intrastate offering, Any member offering

its securities pursuant to an exemption under Section 3(a)(11) of the Securities Act of 1933 shall disclose in the registration statement must contain information at least comparable at a minimum to that information suggested by the Securities and Exchange Commission in Securities Act Release No. 5222 (January 3, 1972), entitled "Public Offerings of Registered Broker/Dealers."

Section 3 - Underwriting by Issuer-Member Of
Issue of Its Own Securities

(a) Any member may underwrite, participate as a member of the underwriting syndicate or selling group, or assist in the distribution of a public offering 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 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 operation;

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 managed by an underwriter who is a qualified independent 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 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, or if the offering is of a class of securities which are rated BAA or better by a recognized rating service.

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

(a) Any member may underwrite, participate as a member of the underwriting syndicate or selling group, or assist in the distribution

of a public offering 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 e. 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 offering 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, or in the case of debt offerings, to each of its investors:

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 managed by an underwriter who is a qualified independent underwriter in an amount not exceeding 10% of the total dollar amount thereof provided, however, that in any offering where a bona fide independent market for the securities does not exist, where more than one participating member is an equity owner of the issuer and their aggregate equity ownership is 10% or greater, the aggregate participation in the distribution by such members shall be limited to 10% of the total dollar amount of the offering, provided the requirements of Section 3(a)(3) have been fully satisfied by such participating members.

(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 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, or if the offering is of a class of securities which are rated BAA or better by a recognized rating service.

Section 7 -- Participation in Distribution
of Securities of Member or Affiliate

(a) No member shall underwrite, participate as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of a public offering of an issue of debt or equity securities issued or to be issued by the member or an affiliate of the member unless, in the case of a member which is a corporation, the majority of the board of directors, or in the case of a member which is a partnership, a majority of the general partners or, in the case of a member which is a sole proprietorship, the proprietor 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.

(b) In addition to the requirements of subsection 7(a) above, any member subject to this Schedule shall comply with either subsection 7(b)(1) or 7(b)(2) below, depending on the nature of the member's participation in the distribution.

(1) A member may underwrite, participate as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of a public offering of debt or equity securities subject to this Schedule without limitation as to the amount of securities to be distributed by the member provided that one or more of the following three criteria are met:

(i) the price at which an equity issue or the yield at which a debt issue is to be distributed to the public is established at a price no higher or yield no lower 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 similar document and each of whom shall exercise the usual standards of "due diligence" in respect thereto; provided, however, that an offering of securities by a member which has not been actively engaged in the investment banking or securities business, in its present form or as a predecessor broker/dealer, for at least the five years immediately preceding the filing of the registration statement

shall be managed by a qualified independent underwriter; or

(ii) the offering is of a class of securities for which a bona fide independent market exists as of the date of the filing of the registration statement and as of the effective date thereof; or

(iii) the offering is of a class of securities rated Ba or better by Moody's or BB or better by Standard & Poor's rating service.

(2) A member may participate as a member of the underwriting or selling group in the distribution of a public offering of debt or equity securities subject to this Schedule in an amount not exceeding ten percent of the total dollar amount of the offering provided that the offering is underwritten on a firm commitment basis and is managed by a qualified independent underwriter.

Section 5 -- Suitability

Every member underwriting an issue of its own securities, or of an affiliate, pursuant to the provisions of Section 3 or 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 8- 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 Section 3 or 4 hereof subject to this Schedule shall not be executed by any member in a discretionary account without the prior specific written approval of the customer.

Section 7 9-- Sales to Employees -- No Limitations

Notwithstanding the provisions of the Board of Governors' Interpretation With Respect To "Free-Riding And Withholding," an issuer a member may sell securities in an initial public offering which are

subject to the provisions of Section 2 or 3 hereof this Schedule to its employees; potential employees resulting from intended mergers, acquisitions, or other business combination of members resulting in one public successor corporation, or persons associated with it, and those members of the family residing with, or dependent for their support upon said employees the immediate family of such employees or associated persons without limitation as to amount and regardless of whether such persons have an investment history with the member as required by that Interpretation, provided, however, that the sale or transfer of such securities shall be restricted for a period of twelve (12) months except in the case of a bona fide gift of such securities in which case the period of restriction shall apply to the donee. Where a bona fide independent market exists for the securities of a public offering, all securities held or acquired by the above categories of persons shall be restricted for a period of ninety (90) days from the date of termination of the offering.

Section 8 10 -- Relationship Of Schedule E To Interpretation

With Respect To Review Of Corporate Financing

(a) Notwithstanding the provisions of the Interpretation of the Board of Governors -- 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 compensation.

(b) All offerings of securities included within the scope of this Schedule B ~~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 of the Board of Governors -- With Respect To Review Of Corporate Financing, and documents and filing fees relating to such offerings to the extent that it is not inconsistent herewith and all pertinent documents relating thereto shall be filed with the Association Corporation pursuant to the provisions thereof of that Interpretation. The responsibility for filing the required documents and fees shall be that of the ~~issuer~~-member issuing securities, or, 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 affiliated relationship with the issuer. Otherwise, the Filing Requirements of the referred to Interpretation shall prevail.~~

(e) All members including those members affiliated with an issuer making a public offering of its securities subject to the provisions of this Schedule are required to file the appropriate documents and filing fee referred to under the "Filing Requirements" contained in the Board of Governors' Interpretation relating to the "Review of Corporate Financing" notwithstanding the fact that the securities may otherwise be expressly exempted from filing thereunder.

Section 9 11

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 12

The Corporate Financing Committee of the Board of Governors, upon written request, may in exceptional and unusual circumstances, taking

into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of Schedule E which it deems appropriate. A hearing shall, unless waived by the party seeking an exemption, be held upon ~~such~~ a request ~~by~~ before the ~~Committee on~~ Corporate Financing Committee, or a Subcommittee thereof designated ~~by it~~ for that purpose~~7~~. whereupon, on the basis of the record before it~~7~~, a recommendation shall be made by the Committee on Corporate Financing to the Board of Governors of its action~~7~~.

Section ~~11~~ 13

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.