NOTICE TO MEMBERS: 78-21
Notices to members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 15, 1978

I M P O R T A N T

MAIL VOTE

OFFICERS * PARTNERS * PROPRIETORS

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

RE: Mail vote on Amendments to the By-Laws Concerning Volume Reporting by Members in NASDAQ Securities

LAST VOTING DATE IS JULY 17, 1978

Enclosed herewith are proposed amendments to Article III, Section 2 and Article XVI, Section 3 of the Association's By-Laws which the Board of Governors is presenting to the membership at this time for vote.

A description of the proposed amendments and their text is attached. Also attached, for your information, is a proposed amendment to Schedule D of the By-Laws which the Board intends to adopt if the proposed amendments to the By-Laws are approved. Amendments to Schedule D do not require membership approval.

These proposals were published for comment in Notice to Members 78-8, dated March 2, 1978. Comments were received and were considered by the Board of Governors at its May, 1978 meeting. The Board determined to modify the amendment to Schedule D as a result of the comments received from the membership. The By-Law amendments are being submitted to the membership as originally proposed. Should the membership approve these amendments, they must be submitted to the Securities and Exchange Commission for final approval before becoming effective.

Background and Explanation of the Proposed Amendments

NASDAQ market makers are required to report, through the NASDAQ System, their daily volume in those securities in which they are registered market makers. Volume in NASDAQ securities which does not involve registered market makers is presently not required to be reported, however, the Board of Governors believes that volume reports as to block-size transactions is meaningful information for investors which should be incorporated into the NASDAQ volume data released for publication.

The amendments to Article III, Section 2 and Article XVI, Section 3 of the By-Laws would give the Board of Governors specific authority to require members to report information related to NASDAQ securities.

The proposed amendment to Schedule D would require all members who are not registered market makers to telephone, Telex or TWX, their purchases and sales of block-size to the NASDAQ Department in New York City. The volume would be entered into the System and the data would be included in the individual security statistics, the aggregate NASDAQ statistics and the NASDAQ regulatory reports.

Members would report only that volume involved in principal or agency transactions of block-size executed with others who, at the time of execution of the transaction, were not registered market makers in the NASDAQ security. A block is defined as a transaction involving 10,000 shares or more executed at a price of $1 or more. In the case of a convertible debenture, a block would be $300,000 face amount, or more. This minimum requirement for reporting of convertible debentures has been raised from $100,000 in the original proposal as a result of comments from members.

For each transaction that meets or exceeds the definition of block-size a firm would report the following information:

1. Security name and NASDAQ symbol;

2. Number of shares;

3. Whether the transaction was a purchase or sale;

4. Whether the transaction was executed as principal, agent or dual agent; and

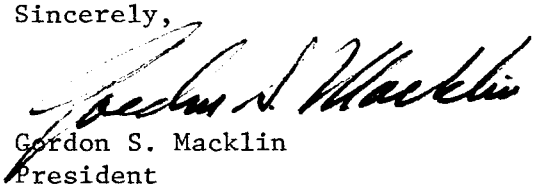
5. The name of the contra-broker/dealer or if the contra-side is a retail account, the symbol, "RA".

Members would be required to report their block purchases and sales by 4:30 p.m. Eastern Time in order to have the data entered into the System prior to the 4:45 p.m. Eastern Time volume cutoff deadline.

The Board of Governors has also proposed a technical amendment to Article XVI, Section 3 of the By-Laws to reflect the acquisition of the NASDAQ System by the Association. The amendment would delete a reference to the responsibility of the operator of the NASDAQ System to collect charges from subscribers since this function is now performed by the Association.

The proposed By-Law amendments are important and merit your immediate attention. The Board of Governors believes the proposed amendments to Article III, Section 2 and Article XVI, Section 3 of the Association's By-Laws are necessary and in the public interest and recommends that members vote their approval. Please mark your ballot according to your conviction and return it in the enclosed, stamped envelope to "The Corporation Trust Company." Ballots must be postmarked no later than July 17, 1978.

Sincerely,



Gordon S. Macklin
President

Enclosures

NOTICE TO MEMBERS: 78-22
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 16, 1978

TO: All NASD Members

RE: Covington Knox, Inc.
3223 Smith Street, Suite 101
Houston, Texas 77006

ATTN: Operations Officer, Cashier, Fail-Control Department

A temporary receiver was appointed for the above captioned SECO firm. Since the firm is not a member of the Association or the National Securities Clearing Corporation, please direct any questions regarding this firm to the temporary receiver.

Temporary Receiver

Percy D. Williams, Esquire
Williams & Shanks
1609 First City National Bank Building
Houston, Texas 77002
Telephone: 713-652-0732

Bradford M. Patterson
Financial Specialist

NOTICE TO MEMBERS: 78-23
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 16, 1978

TO: All NASD Members

RE: Qualification of Registered Options Principals and Registered Options Representatives

On December 23, 1977, the Association submitted a filing to the Securities and Exchange Commission pursuant to SEC Rule 19b-4, which contained a number of rule proposals designed specifically to regulate trading by Association members in conventional or over-the-counter options and the listed options activities of so-called "access firms" (i.e., NASD members which conduct a business in exchange-listed options but which are not members of a particular exchange upon which the option traded is listed). Essentially, this filing, hereinafter referred to as "the access firm proposal," consists of rule changes which were initially proposed in connection with the NASDAQ options program, including an Appendix E to Article III, Section 33 of the Rules of Fair Practice; amendments to Schedule C of the By-Laws governing registration of options principals and registered representatives; and, Uniform Practice requirements which would set standards for the exercise of option contracts and the delivery of and payment for underlying securities. SEC consideration of the NASDAQ options program has been delayed pending completion of an in-depth study of the options markets by the Commission-sponsored Special Options Study Group. Until such time as the Study Group is able to complete its investigation, the SEC has placed a moratorium on the review of any rule change proposal by a self-regulatory organization which could lead to the expansion of existing options programs or the creation of new ones.

Despite the moratorium, the Association and the staff of the Commission have been able to reach agreement on the fact that specialized rules are needed at this time to fill the regulatory void which exists with respect to the options activities of NASD member access firms. In this connection, the Association has worked closely with the SEC staff in the development of the access firm proposal and it now appears that the

Commission shortly will act on the filing. Subject to SEC approval, it is anticipated that the rule package will become effective in August, 1978.

As noted, one of the rules filed with the Commission is an amendment to Schedule C of Article I, Section 2(d) of the Association's By-Laws concerning the registration and qualification of Registered Options Principals (ROP's) and Registered Options Representatives (ROR's). The text of this rule is included at the end of this notice.

Schedule C of the By-Laws would be amended by adding two parts pertaining to options principals and one part pertaining to options representatives. Section (4) of Part I would require any member engaged in any put or call options activities, whether for the account of a public customer or for the account of the firm, to have at least one of its associated persons registered with the Association as a "Registered Options Principal." Section (4) would also require each person who is actively engaged in the management of the day-to-day options activities of a member to be registered with the Association as a ROP. This provision is designed to cover both individuals and firms who are engaged in conventional or traditional over-the-counter option transactions and transactions in exchange-listed options done on an access basis. Further, Section (4) would require members to designate a Senior Registered Options Principal and to inform the Association of that person's identity. These are new provisions and will apply notwithstanding that a firm has previously, or is presently, engaged in option transactions.

Section (5) of Part I would require that as a condition to becoming a ROP, a person associated with a member must pass an appropriate qualification examination for Registered Options Principals, or an equivalent examination acceptable to the Association. Section (5) would also specify that a person shall not qualify as a ROP for both put and call options unless he has passed an examination which tests for both put and call options.

Section (4) of Part II would require that associated persons of members whose activities include the solicitation and/or sale of options contracts be certified as ROR's. This section also states that as a condition to becoming a ROR, a person associated with a member must pass an appropriate certification examination for Registered Options Representative, or an equivalent examination acceptable to the Association. Section (4) would also specify that a person shall not qualify as a ROR for both put and call options unless he has passed an examination which tests for both put and call options.

The Association is mindful that the qualification of options principals and the certification of options representatives has been an

important facet of the regulatory structure of the existing options exchanges. It is not the intent of the Association, therefore, to add a level of duplicative requirements in the qualification of such persons where such a requirement would add little to the protection of public investors and the maintenance of orderly securities markets. The Association believes that these interests can be served by coordinating its qualification and certification requirements with the existing requirements of the options exchanges. In order to meet this objective, the Association will implement its ROP and ROR requirements in the following manner:

Grandfathering of Exchange Registered Options Principals and Options Representatives

The Association intends to grandfather those persons associated with its members who have qualified by examination as ROP's or who have been certified as ROR's with one or more of the options exchanges. The Association believes that no regulatory purpose would be served by requiring exchange-qualified ROP's and ROR's to sit for an additional qualification or certification examination. The specific procedures to be followed in effecting the registrations of exchange-qualified ROP's and ROR's with the Association will be the subject of another notice to members following SEC approval of the amendments to Schedule C.

Pre-Qualification of NASD Registered Options Principals

As was previously stated in Notice to Members No. 77-14, dated April 22, 1977, the proposed amendments to Schedule C do not provide a basis for grandfathering any person who is not qualified by examination with an options exchange nor do they provide a grace period following the effective date during which time a member could engage in options activities without first having qualified at least one person as a ROP. Once again, the Association strongly recommends that persons who will assume the responsibilities of ROP's take steps prior to the effectiveness of the new ROP provisions to meet the requirement to pass a written qualification examination. This requirement will be satisfied by passing the existing ROP examination of the options exchanges which the Association administers. It is currently anticipated that the access firm rules will become effective in August. Request forms for the ROP examination can be obtained from the Qualifications Department at the Association's Executive Office or any one of its 14 District Offices.

Certification of Registered Options Representatives

The Association has informed the SEC that it intends to provide a period of up to 90 days following the effective date of the access firm proposal during which time members may certify options representatives.

The certification program to be used by the Association will be similar to that employed by the various options exchanges. Under the program, member firm ROP's will be permitted to administer a certification test to those representatives qualified prior to May, 1977, as General Securities Representatives who have not otherwise been certified for puts and calls by one or more of the options exchanges. The cut-off date of May, 1977, will be used because the General Securities Examinations administered after that date have included questions covering both put and call options contracts. Therefore, registered representatives who have taken and passed the General Securities Examination after May, 1977, will be considered certified as ROR's. Requests for copies of the certification examination for ROR should be made in writing by a member's Senior Registered Options Principal and directed to the Qualifications Department at the Association's Executive Office.

Questions regarding this notice and the availability of study material may be directed to David H. Uthe of the Qualifications Department at (202) 833-7273.

Sincerely,

Gordon S. Macklin
President

Attachment

PROPOSED AMENDMENTS TO
SCHEDULE C OF ARTICLE I, SECTION 2(d)
OF THE BY-LAWS

Part I, Section (4)

Registered Options Principals; Requirements For New and Existing Members

Every member of the Corporation which is engaged in, or which intends to engage in transactions in put or call options with the public, or for its own account, shall have at least one Registered Options Principal who shall have satisfied the requirements of Part I, Section (5) hereof. Each such member shall also designate a Senior Registered Options Principal and identify such person to the Corporation. A member which has a Registered Options Principal qualified in either put or call options shall not engage in both put and call option transactions until such time as it has a Registered Options Principal qualified in both such options. Every person actively engaged in the management of the day-to-day options activities of a member shall also be registered as a Registered Options Principal. In the event any Registered Options Principal ceases to act in such capacity, such fact shall be reported promptly to the Corporation together with a brief statement of the reasons therefor.

Part I, Section (5)

Registered Options Principal

(a) Each person required by Part I, Section (4) hereof to be a Registered Options Principal shall pass the appropriate qualification examination for Registered Options Principal, or an equivalent examination acceptable to the Corporation, for the purpose of demonstrating an adequate knowledge of options trading generally, the rules of the Corporation applicable to trading of option contracts and the rules of the Options Clearing Corporation, and be registered as such before engaging in the duties or accepting the responsibilities of a Registered Options Principal.

(b) A person shall not qualify as a Registered Options Principal for both put and call options unless he has passed an examination testing him with respect to both put and call options.

Part II, Section (4)

(f) Registered Options Representative

Each person associated with a member whose activities in the investment banking or securities business include the solicitation

and/or sale of option contracts shall be required to be certified as a Registered Options Representative and to pass an appropriate certification examination for such or an equivalent examination acceptable to the Corporation. Registered Options Representatives qualified in either put or call options shall not engage in both put and call option transactions until such time as they are qualified in both such options. Members shall be required to report to the Corporation the names of any associated persons certified as Registered Options Representatives pursuant to an examination approved by the Corporation. Registered Options Representatives of members that are members of a national securities exchange which has standards of approval acceptable to the Corporation may be deemed to be approved by and certified with the Corporation, so long as such representatives are approved by and registered with such exchange.

NOTICE TO MEMBERS: 78-24
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 16, 1978

TO: NASD Members

RE: Investment Advisers Act of 1940; Exemption from Requirement to Register for Certain Broker-Dealers to Expire on October 31, 1978

Introduction

On May 4, 1978, the Securities and Exchange Commission announced the final extension of temporary Rule 206A-1(T) under the Investment Advisers Act of 1940 (the "Advisers Act"). The rule, which first became effective on May 1, 1975, to coincide with the elimination of fixed commission rates, was adopted in order to exempt temporarily certain brokers and dealers from having to register as an investment adviser and to otherwise comply with the Advisers Act. The Commission has now determined that it is appropriate in the public interest and consistent with the protection of investors to permit the temporary exemption to expire on October 31, 1978, and to require all broker-dealers which fall under the definition of "investment adviser" to register as such with the SEC by that date.

Background

On May 1, 1975, SEC Rule 19b-3 became effective thereafter prohibiting the existence of fixed commission rates in the securities industry. As a result, and with the emergence of negotiated rates, the SEC believed that some broker-dealers would initiate new pricing policies by charging separately for brokerage business on the one hand and for research and investment advice on the other. It was also the Commission's view at the time Rule 19b-3 was adopted that if a broker or dealer were to charge separately for research and other investment advice such charges could constitute "special compensation." Because of this, the broker or dealer would be brought under the definition of "investment adviser" and therefore subject to the registration and compliance requirements of the Advisers Act. SEC Rule 206A-1(T) was adopted by the Commission as a temporary means to provide firms with an opportunity to adjust to their new pricing policies and to become familiar with the provisions of the Advisers Act.

Section 202(a)(11) of the Advisers Act defines the term "investment adviser" to mean, with certain exclusions ". . . any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." Section 202(a)(11)(C) provides an exclusion from the definition of investment adviser for ". . . any broker or dealer whose performance of such (investment advisory) services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore" (Emphasis added). When temporary Rule 206A-1(T) expires on October 31, 1978, a broker or dealer would still be excluded from the definition of "investment adviser" to the extent that his furnishing of research and other investment advisory services was "solely incidental to the conduct of his business as a broker-dealer and without special compensation therefore."

Opportunity to Comment

On May 4, 1978, the Commission published SEC Release No. 34-14714 (IA Release No. 626) which more fully explains and describes the background of Rule 206A-1(T) and the reasons for the SEC temporarily exempting certain broker-dealers from the Advisers Act. A reproduction of that publication is attached to this notice and should be carefully studied by every member who, as a result of its pricing policies with respect to research and investment advice, may be required to register as an investment adviser. In the release, the Commission solicits the views and comments of interested parties on the meaning of the term "special compensation" as such has application to the furnishing of investment advisory services and, on the question of whether broker-dealers who have discretionary authority over customer accounts should, per se, be considered investment advisers with respect to such accounts. All comments must be submitted to the SEC on or before June 30, 1978. In regard to the above, members are advised to thoroughly familiarize themselves with the requirements of the Advisers Act and, if appropriate, to take the necessary steps to timely register with the SEC as an investment adviser prior to November 1, 1978.

Should you have any questions concerning this matter, please contact Jack Rosenfield, Assistant Director, (202) 833-4828, Department of Regulatory Policy and Procedures, National Association of Securities Dealers, Inc., 1735 K St., N.W., Washington, D.C. 20006.

Sincerely,

Gordon S. Macklin
President

Attachment

[8010-01]

Title 17—Commodity and Securities Exchanges

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Release Nos. IA-626; 34-14714]

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

Final Extension of Temporary Exemption From the Investment Advisers Act for Certain Brokers and Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Final extension of temporary rule.

SUMMARY: Because some broker-dealers might have decided, as a result of the May 1, 1975 elimination of fixed commission rates on securities transactions, to impose charges for their investment advisory services which might have caused such broker-dealers to lose their exemption from the Investment Advisers Act of 1940 ("Advisers Act"), the Commission on a temporary basis exempted certain broker-dealers from the Advisers Act. The Commission now has determined that the temporary exemption will be allowed to expire at the end of an additional six-month period and that no permanent exemption will be adopted. Current staff views on the meaning of the term "special compensation" are also set forth and public comments are solicited on those views and on the question whether brokers or dealers who have discretionary authority over customers' accounts should, per se, be considered investment advisers with respect to such accounts.

DATES: Effective date of final extension—April 27, 1978; comments must be received on staff views on the meaning of "special compensation" and other issues on or before June 30, 1978.

ADDRESSES: Interested persons should submit their views and comments in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. All submissions should refer to File No. S7-740, and will be made available for public inspection at the Commission's Public Reference Section, Room 6101, 1100 L Street NW., Washington, D.C. 20005.

FOR FURTHER INFORMATION CONTACT:

Michael Berenson, Esq., Office of the Chief Counsel, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, 202-376-20549.

SUPPLEMENTARY INFORMATION:

I. SYNOPSIS

The adoption of Rule 19b-3 (17 CFR 240.19b-3)[1] under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) ("Exchange Act"), if followed by the "unbundling" of brokerage commission charges and charges for research and other investment advice, could cause those brokers or dealers who unbundle to become investment advisers as that term is defined in the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) ("Advisers Act"). Believing that the change from fixed to negotiated rates was itself a very significant change for brokers and dealers, the Commission adopted a series of temporary exemptions from the Advisers Act for certain brokers and dealers who had been registered pursuant to Section 15 of the Exchange Act prior to the May 1, 1975 effective date of Rule 19b-3 and who were not then registered as an investment adviser. The latest of such exemptions expires on April 30, 1978.

An adequate period has elapsed for broker-dealers to become familiar with the provisions of the Advisers Act and to adjust to the unfixing of commission rates. The Commission has considered the impact of the Advisers Act on all broker-dealers, including those previously exempt, and does not believe compliance with the Advisers Act is overly burdensome. This is especially true since the Commission has taken several actions since the temporary exemptions were first initiated to reduce the burdens regulation under the Advisers Act imposes on broker-dealers. In addition, the Commission believes that the Advisers Act provides individuals with certain protections not available under the Exchange Act. Accordingly, the Commission has concluded that neither a continuation of the temporary exemption, beyond a final extension to October 31, 1978, permitting broker-dealers to prepare for compliance with the Advisers Act, nor adoption of a permanent exemption from the Advisers Act for any or all broker-dealers is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act.

II. BACKGROUND

On April 23, 1975, the Commission published notice of the adoption of temporary Rule 206A-1(T) (17 CFR 275.206A-1(T)) under the Advisers Act[2] effective May 1, 1975, to coincide with the effective date of Rule 19b-3 under the Exchange Act. The rule was adopted in order to allow brokers and dealers to become familiar with the Advisers Act and to afford them an adequate period of time to develop and test new pricing practices after May 1, 1975, without at the same time having to register under and comply with the Advisers Act. The rule also was adopted to provide for a thorough consideration by the Commission and the public of questions related to the applicability of the Advisers Act to brokers and dealers. Registration under and compliance with the Advisers Act might otherwise have been required of a broker or dealer who made a separate charge for investment advice since by doing so he might lose the benefit of the exclusion from the definition of investment adviser in Section 202(a)(11) (15 U.S.C. 80b-2(a)(11)) of the Advisers Act[3] provided by Section

[1]Rule 19b-3 prohibits any national securities exchange from adopting or retaining any rule that requires, or from otherwise requiring, its members to charge fixed rates of commission for transactions executed on, or by the use of the facilities of, such exchange after May 1, 1975 (May 1, 1976 as to rules of an exchange relating to floor brokerage commissions).

[2]Securities Exchange Act Release No. 11368, Investment Advisers Act Release No. 455, 40 FR 18424 (April 28, 1975).

[3]Section 202(a)(11) of the Advisers Act defines the term "investment adviser" to mean, with certain exclusions—any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability

Footnotes continued on next page

202(a)(11)(C) (15 U.S.C. 80b-2(a)(11)(C)) for "any broker or dealer whose performance of such (investment advisory) services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."

Rule 206A-1(T) provided a four-month exemption from the Advisers Act for any broker or dealer who was registered as such on May 1, 1975 pursuant to Section 15 (15 U.S.C. 78*o*) of the Exchange Act and who was not then registered with the Commission as an investment adviser. On August 20, 1975, the exemptive period was extended to April 30, 1976, and at that time the exemption was narrowed to exclude after November 30, 1975, broker-dealers performing investment supervisory services or investment management services for special compensation or not solely incidental to their business as broker-dealers.[4] Subsequently, the Commission amended Rule 206A-1(T) to provide two additional extensions of the rule, expiring April 30, 1977,[5] and April 30, 1978.[6]

III. Statutory Protections Provided by the Advisers Act and the Rules Thereunder Which May Not Be Available Under the Exchange Act and the Rules Thereunder

Both the Advisers Act and the Exchange Act provide a regulatory framework designed to protect investors and the public interest while permitting the provision of professional services in the financial marketplace. While the two statutes are similar, there are some differences, particularly with respect to their antifraud provisions. Both investment advisers and broker-dealers are subject to general antifraud provisions under their respective Acts. In light of several recent Supreme Court decisions, however, the Commission believes that the protections afforded investors under Rule 10b-5 (17 CFR 240.10b-5), the general antifraud rule adopted pursuant to Section 10(b) (15 U.S.C. 78j(b)) of the Exchange Act, may not be so broad as those afforded under the comparable provisions in Section 206 (15 U.S.C. 80b-6) of the Advisers Act, particularly with regard to a person who is not a purchaser or seller of securities. These differences are appropriately related to the obligations of persons required to be registered under the Advisers Act.

Other provisions of the Advisers Act have no equivalents in the Exchange Act. There are not any general requirements under the Exchange Act comparable to the consent reqirement in Section 206(3) of the Advisers Act, nor are there specific provisions relating to contracts as in Section 205 (15 U.S.C. 80b-5) of the Advisers Act.[7]

IV. The Feasibility of Compliance by Brokers and Dealers With Both the Advisers Act and Exchange Act

A. General Burdens

Public commentators on Rule 206A-1(T) have stated that it would be burdensome for brokers and dealers to become subject to the Advisers Act. There are, however, currently over 300 firms which are dually registered, apparently including fourteen of the fifteen largest brokers and dealers doing a primarily public business. The number and size of the dual registrants suggest that registration under and compliance with the Advisers Act is not unduly burdensome. Furthermore, as indicated below, the Commission has significantly alleviated certain burdens which have been brought to its attention.

B. Specific Burdens

1. *Disclosures dual registrants must make in connection with securities transactions with clients.* A number of commentators on Rule 206A-1(T) suggested that it is not feasible for broker-dealers who are also investment advisers to comply with the standards set forth in two Commission pronouncements, Advisers Act Release No. 40, February 5, 1945, and *In the Matter of Arleen W. Hughes*, 27 SEC 629 (1948), *aff'd sub nom. Hughes* v. *S.E.C.*, 174 F. 2d 969 (D.C. Cir. 1949). In Advisers Act Release No. 40, the Commission set forth comprehensive disclosures it believed were necessary in circumstances to which Section 206(3) of the Advisers Act (15 U.S.C. 80b-6(3)) is applicable, i.e., when an investment adviser, acting as such, proposes either to act as principal, or as broker for another person, in a transaction with a client. The *Arleen Hughes* case was a proceeding based primarily on a broker-dealer/investment adviser's failure to make the disclosures required by Advisers Act Release No. 40.

The Commission has already recognized "that some modification is appropriate (of the position set forth in Release No. 40), which now appears inappropriate in light of the investment advisory business as it has evolved to the present time" and indicated that in any such situation the extent of the detailed disclosure required would depend on the facts of each case.[8]

Not only has the Commission adopted a more flexible approach concerning the disclosures a dual registrant must make when acting in a dual capacity in a transaction with a client, but, when persuasive arguments have been presented that Section 206(3) is unduly burdensome in particular circumstances, it has also adopted rules, such as Rules 206(3)-1 and 206(3)-2 (17 CFR 275.206(3)-1 and 206(3)-2) to eliminate those burdens.[9] The Commission would give serious and prompt consideration to providing further relief from any other undue burden that might be imposed by Section 206(3) or any other provision of the Advisers Act or the rules thereunder on brokers and dealers who are registered as investment advisers.

2. *Fiduciary Obligations of Brokers and Dealers who are Investment Advisers.* Another reason some broker-dealers have given for desiring an exemption from the Advisers Act is their

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Footnotes continued from last page
of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

[4]Securities Exchange Act Release No. 11607, Investment Advisers Act Release No. 471 (August 20, 1975), 40 FR 38157 (August 21, 1975).

[5]Securities Exchange Act Release No. 12297, Investment Advisers Act Release No. 506 (April 1, 1976), 41 FR 14507 (April 6, 1976).

[6]Securities Exchange Act Release No. 13454, Investment Advisers Act Release No. 581 (April 20, 1977), 42 FR 21769 (April 29, 1977).

[7]There are also advertising rules (Rule 206(4)-1 (17 CFR 275.206(4)-1)) and certain recordkeeping rules under the Advisers Act, e.g., Rules 204-2(a) (12) and (13) (17 CFR 275.204-2(a) (12) and (13)), for which there are no parallel provisions in the Exchange Act. Because of differences in the manner in which broker-dealers and investment advisers conduct their respective businesses, and because of certain common law protections and certain rules of self-regulatory organizations adopted pursuant to the Exchange Act, these differences may in some instances reflect alternative regulatory approaches under the two Acts and not necessarily differing levels of investor protection.

[8]Advisers Act Release No. 470 (August 20, 1975).

[9]Rule 206(3)-1 states that a broker or dealer will not be construed to be acting as an investment adviser with respect to a particular transaction (and therefore the disclosure obligations of Section 206(3) will not attach) if its advice has been furnished only by means of (1) publicly distributed written statements or publicly made oral statements; (2) statements or materials which are not directed to the needs of a specific individual; (3) statistical information which does not comment on the investment merits of a particular security; or (4) a combination of the foregoing services.

Rule 206(3)-2 provides an alternative means of compliance with Section 206(3) for those advisers who wish to effect agency cross transactions for their clients. The rule allows clients to provide advance consent authorizing such transactions for a period not exceeding one year, but requires the investment adviser to furnish the client certain disclosures concerning the compensation received in connection with such transactions on a transaction-by-transaction basis, as well as a cumulative basis, within thirty days prior to the expiration of the period covered by the blanket consent the rule envisions.

belief that an investment adviser, as such, may be held to have higher duties to his clients than does a broker or dealer to his customers. To the extent this may be true, no persuasive reason has been given to lower standards imposed by law. Moreover, since a dual registrant is not an investment adviser to brokerage clients to whom it provides advisory services on a solely incidental basis and without special compensation,[10] it does not appear that a dual registrant will owe such higher duties to any clients other than its advisory clients.

3. *ERISA.* Some commentators expressed concern that if broker-dealers were required to register as investment advisers, problems might arise with respect to the Employee Retirement Income Security Act of 1974 ("ERISA") (29 U.S.C. 1001 et seq.). In particular, those commentators were concerned that registration under the Advisers Act might bear on whether a broker-dealer would be deemed to be a "fiduciary" for purposes of ERISA. Determination of a broker-dealer's obligations under ERISA would not appear, however, to turn on whether the broker-dealer is also registered under the Advisers Act. The term "fiduciary" is defined in ERISA[11] and has been further refined in regulations adopted by the Department of Labor and the Internal Revenue Service.[12] The Commission will, of course, continue to work with the Department of Labor and the Internal Revenue Service regarding the interrelationship of ERISA and the federal securities laws.

4. *State regulation.* The Commission has also given attention to the concerns of some brokers and dealers that if they are required to register under the Advisers Act various states may impose their investment adviser regulations on such previously exempt brokers and dealers and that this will result in unnecessary, duplicative regulation. The Commission, of course, is anxious to avoid unnecessary regulatory burdens. It would be improper, however, for the Commission to conclude not to act in a manner neeessary for the protection of investors on the ground that some States, whose actions are beyond the Commission's scope of authority, may as a consequence apply regulations which members of the brokerage industry believe are unnecessary.

V. Scope of Exclusion Provided by Section 202 (a)(11)(C)

When the temporary rule expires, a broker or dealer would still be excluded from the definition of investment adviser to the extent he could meet the statutory standards in Section 202(a)(11)(c) relating to the furnishing of advisory services solely incidental to the conduct of his business as a broker-dealer and without special compensation therefor.

The relationship of a broker or dealer to his brokerage customers does not become an investment advisory relationship merely because the broker or dealer is registered as an investment adviser. A broker or dealer who is registered as an investment adviser is not by reason of that fact an investment adviser to those of his brokerage clients to whom he provides advisory services on a solely incidental basis and without special compensation.

As early as October 28, 1940, the Commission, in Investment Advisers Act Release No. 2, made known the opinion of its General Counsel as to the meaning of the term "special compensation" in various circumstances in which a broker-dealer provided investment advice solely incidental to the conduct of his business as a broker or dealer.

The examples treated in this release suggest that "special compensation" for investment advice is compensation to the broker-dealer in excess of that which he would be paid for providing a brokerage or dealer service alone. However, because the existence or non-existence of "special compensation" in any paricular circumstance may not be clear, the Commission considers it desirable that the current views of the Division of Investment Management on this subject be provided to broker-dealers for their guidance, while also calling for comment on this question.

The Division of Investment Management regards special compensation as existing only where there is a clearly definable charge for investment advice. This reflects the Division's position that a client who perceives that he is paying a charge specifically for investment advice is entitled to the protections of the Advisers Act.

The Division would not look outside the fee structure of a given firm to determine whether special compensation exists. That is, just because a "discount" firm offered lower rates than a "full-service" firm, the Division would not call the "full-service" firm's charges "special compensation."

If a firm negotiates different fees with its clients for similar transactions, the Division would not regard the differences in charges "special compensation" for investment advice since whether they were or were not based on the presence or absence of investment advice appears too hypothetical.

Nor would the Division regard as "special compensation" general differentials which exist because a firm provided, on the one hand, an unrestricted execution service and, on the other hand, a restricted execution service, such as one in which customers must have the necessary cash in their accounts at the time a purchase order is placed and must accept execution at the next day's opening price.

However, if a broker-dealer has in effect, either formally or informally, two general schedules of fees available to a customer, the lower without investment advice and the higher with investment advice and the difference is primarily attributable to this factor, or if a broker-dealer should separately bill a particular customer with a specific charge for investment advice, the Division would regard the extra charge as "special compensation" for investment advice. This is the position that was taken by the General Counsel in 1940 and it is the position that the Division believes would be taken by a court today. This would be the case even in a situation, currently nonexistent, in which a current "full-service" firm implements a "discount" or "execution-only" service. If the differential in general rate structure offered to a particular client could be said to be primarily attributable to the rendering of investment advice, the Division would deem at least part of the differential to be "special compensation" for investment advice.

The recently adopted Rule 11a2-2(T) under the Exchange Act (17 CFR 240.11a2-2(T)) in certain circumstances permits a broker-dealer (the "initiating broker-dealer") to retain compensation in connection with effecting transactions for an account as to which he exercises investment discretion. The rule requires the initiating broker-dealer to forward the orders to other broker-dealers for execution and also requires the initiating broker-dealer to furnish to a discretionary account at least annually a statement setting forth the total amount of transactional compensation retained by the initiating broker-dealer, exclusive of amounts paid to the executing broker-dealer.

The Division believes that, as indicated by Investment advisers Act Release No. 2, unless an initiating broker charged specifically for investment advice, the mere fact that he received compensation for advice and other services, in addition to the compensation paid to an executing broker, would not make such compensation "special compensation." Moreover, the mere report of such compensation should not cause such retained amounts to be "special compensation."

The views set forth above are the Division of Investment Management's current views on the meaning of the term "special compensation." The Commission requests comments and

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[10] See Section V, infra.

[11] Section 3(21)(A) of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002(21)(A) (1974).

[12] 29 CFR 2510.3-21 (1977).

suggestions from all interested persons on these views. The Commission also requests comments on whether the meaning of "special compensation" should be expanded or narrowed, by rule or interpretation, and the impact such action would have on brokers and dealers who would be affected thereby.

For example, on the one hand, the term "special compensation" might be interpreted to apply to a part of the fee negotiated between a broker-dealer and a customer if the fee is higher than the fee that would have been negotiated for an execution service alone and one reason the fee is higher is that it includes a fee for investment advice.[13] On the other hand, the meaning of special compensation might be interpreted as not including any charge for investment advice that is made on a transactional basis as part of a charge for a broker or dealer service.[14]

Under previous interpretations of the scope of the exclusion provided by Section 202(a)(11)(C) of the Advisers Act, broker-dealers who have exercised discretionary authority over the accounts of some of their customers were generally regarded as providing investment advice incidental to their business as a broker-dealer and were not considered subject to the Advisers Act with respect to these activities so long as the customers did not pay special compensation for these services.[15]

It appears, however, that relationships which include discretionary authority to act on a client's behalf have many of the characteristics of the relationships to which the protections of the Advisers Act are important. Accordingly, the Commission is considering whether it should take action, by rule or otherwise, to interpret the scope of the exclusion provided by Section 202(a)(11)(C) of the Advisers Act so that it is not available to a broker-dealer who exercises "investment discretion," as defined in Section 3(a)(35) of the Exchange Act[16] (15 U.S.C. 78c(a)(35)), and so that all customers of a broker-dealer whose accounts are managed on a discretionary basis would be considered advisory clients. The Commission requests comments on the advisability of such action and the effects such action would have on brokers and dealers.

VI. Conclusion

The Commission has considered the public comments received on Rule 206A-1(T) and has concluded that the temporary exemption from the Advisers Act should not be extended beyond October 31, 1978, and that no permanent exemption should be adopted. The Commission believes it is not onerous for an entity to register under and comply with the Advisers Act and it does not believe that those registered brokers or dealers who will be required to register as investment advisers will find the requirements of the Advisers Act unduly burdensome. Furthermore, the Advisers Act and the rules thereunder provide investors certain protections which are not available under the Exchange Act and the rules thereunder.

Authority

The amendment to Rule 206A-1(T) is adopted pursuant to Sections 206A, 211(a) and 211(b) of the Advisers Act (15 U.S.C. 80b-6a, 80b-11(a) and 80b-11(b)).

§ 275.206A-1(T) [Amended]

Accordingly, § 275.206A-1(T), paragraph (a), Part 275 of Chapter II of Title 17 of the Code of Federal Regulations is hereby amended to change the expiration date of the temporary exemption contained therein from April 30, 1978, to October 31, 1978.

The Commission finds, in accordance with the requirements of the Administrative Procedure Act (5 U.S.C. 553(d)), that notice of the amendment to Rule 206A-1(T) prior to adoption and public procedure thereon is unnecessary, and publication for 30 days prior to the effective date may be omitted, since the amendment continues an exemption from statutory requirements which otherwise would be applicable, and since it is in the public interest to facilitate compliance with the Advisers Act by those brokers and dealers who previously were exempt from the Advisers Act. Accordingly, the amendment to Rule 206A-1(T) shall become effective on the date hereof.

By the Commission.

George A. Fitzsimmons,
Secretary.

April 27, 1978.

[FR Doc. 78-12227 Filed 5-3-78; 8:45 am]

[13] This interpretation might most clearly give effect to the view that a person who clearly perceives that he is paying for investment advice should receive the protections of the Advisers Act.

[14] This interpretation might tend to reduce to the greatest extent any disincentive (because of potential Advisers Act regulation) for a "full-service" brokerage firm to introduce a discount service or for a discount house to introduce a "full-service" brokerage package.

[15] The staff of the Commission has taken the position that a broker-dealer whose business consists almost exclusively of managing accounts on a discretionary basis is not providing investment advice solely incidental to his business as a broker-dealer.

[16] Section 3(a)(35) states:

"A person exercises 'investment discretion' with respect to an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder."

NOTICE TO MEMBERS: 78-25

Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 16, 1978

TO: All NASD Members and Municipal Securities Dealers
Attention: All Operations Personnel

RE: Holiday Trade Date - Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Tuesday, July 4, 1978, in observance of Independence Day. "Regular-Way" transactions made on the business days immediately preceding that day will be subject to the following settlement date schedule.

Trade Date-Settlement Date Schedule
For "Regular-Way" Transactions

Trade Date		Settlement Date		*Regulation T Date	
June	26	July	3	July	6
	27		5		7
	28		6		10
	29		7		11
	30		10		12
July	3		11		13
	4	Independence Day			--
	5		12		14

*Pursuant to Section 4(c)(2) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven days of the date of purchase. The date upon which members must take such action for the trade dates indicated is shown in the column entitled "Regulation T Date."

The above settlement dates should be used by brokers, dealers and municipal securities dealers for purposes of clearing and settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board (MSRB) Rule G-12 on Uniform Practice.

Questions regarding this notice may be directed to the Uniform Practice Department at (212) 422-8841.

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NOTICE TO MEMBERS: 78-26
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

June 30, 1978

M E M O R A N D U M

TO: All NASD Members

RE: Extension of Filing Deadline for Securities Traded in California

On May 25, 1978, the Association notified all members and all companies whose securities are quoted in the NASDAQ System that a change in California registration requirements would become effective on July 1, 1978 which would require a prescribed form to be filed for many NASDAQ securities traded in the secondary market in California. The Association noted that such securities would be disqualified for secondary trading in California unless the prescribed form were filed with the California Department of Corporations by June 30, 1978. This filing deadline has now been extended to August 31, 1978.

Members are urged to refer to Notice to Members: 78-19 for details on this new requirement and procedures to be followed in order to assure that securities are properly qualified in California.

The Association recently obtained confirmation from the California Department of Corporations that an exemption is available from this filing requirement for NASDAQ securities meeting the standards of California's "blue chip" exemption (Regulation 260.105.17 under the California Corporate Securities Law of 1968). In summary, that regulation exempts from various California registration requirements any shares of common stock quoted in NASDAQ for which all of the following conditions are met:

1. The shares are issued by an issuer of a security registered under Section 12 of the Securities Exchange Act of 1934 (the "1934 Act") (or exempted from registration by Section 12(g)(2)(G) of the 1934 Act).

2. Shares of the class being sold have been offered for sale on at least 12 days within the last 30 calendar days and during such period the average closing bid price and the last closing bid price is at least $4.00 per share, and

trading in the shares has not been suspended. (Shares which have been quoted in NASDAQ for 30 days at the specified price would meet this requirement.)

3. The issuer of the shares:

   a. is a domestic corporation having authorized capitalization which includes not more than one class of common stock and that class is voting stock;
   b. has not defaulted in the past five years on any preferred dividend or debt service payments;
   c. has a net worth of at least $1,000,000; and
   d. has had net income (as defined) of either at least $500,000 for its last fiscal year and a total of $1,500,000 for its last five years, or at least $1,000,000 in each of its last two fiscal years.

A copy of Regulation 260.105.17 is enclosed for your information.

Members should note that the California Department of Corporations has not yet developed a precedure for including the names of issuers claiming the "blue chip" exemption on the Eligible Securities List.

The Association has also received confirmation from the California Department of Corporations that the new filing requirement does not apply to securities of issuers such as municipalities and public utilities which previously qualified for other specific exemptions from registration requirements.

Questions regarding this matter may be directed to Dennis C. Hensley, Vice President, Corporate Financing at (202) 833-7240 or Peter Pancione of the California Department of Corporations at (213) 736-2511.

Sincerely,

Gordon S. Macklin

Gordon S. Macklin
President

Regulation 260.105.17
under
California Corporate Securities Law of 1968

Exemption for Certain Publicly Traded Common Shares. There is hereby exempted from the provisions of Section 25110 [and] 25120 [requiring qualification of sales by issuers] and 25130 [requiring qualification of sales by nonissuers] of the Code as not being comprehended within the purposes of the Corporate Securities Law of 1968 and the qualification of which is not necessary or appropriate in the public interest or for the protection of investors, the offer or sale of nonassessable common shares, or any warrant or right to purchase or subscribe to any such shares, if on the business day preceding the date of sale of such shares, warrant or right, all of the following requirements are met:

(1) Such shares (or the shares issuable upon exercise of such warrant or right) are issued by a person which is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 or exempted from such registration by Section 12(g)(2)(G) of that Act;

(2) The shares to be offered or sold (or the shares issuable upon exercise of such warrant or right) are listed or approved for listing upon notice of issuance on a national securities exchange approved for the purpose of this section by rule or order of the Commissioner, or quotations for the class of such shares are reported by the automated quotations system operated by the National Association of Securities Dealers, Inc. or a subsidiary thereof or by any other quotation system approved by rule or order of the Commissioner pursuant to this Section;

(3) Shares of the class to be offered or sold (or shares of the class issuable upon exercise of such warrant or right) shall have been traded or (in the case of shares traded only over-the-counter) offered for sale on each of at least twelve (12) days within the thirty (30) calendar days preceding the date of sale of such shares, warrant or right and during such period (a) shares of such class shall not have been suspended from trading by order of the Commissioner or the Securities and Exchange Commission; and (b) the average closing sale price and the last closing sale price of shares of such class (exclusive of any sale price for the business day preceding the offering) as reported on any national securities exchange on which shares of such class are listed, or the average closing bid price and the last closing bid price of shares of such class (exclusive of any bid price for the business day preceding the offering), as reported by the quotation system referred to in clause (2) of

this Section, shall be at least $4 per share. Quotations appearing in the Wall Street Journal or any other publication approved by order of the Commissioner may be relied upon to satisfy the requirement of this clause (3);

(4) The issuer of such shares is a corporation organized under the laws of the United States or any state of the United States or the District of Columbia and meets all of the following requirements:

(A) Such corporation has an authorized capitalization which includes not more than one class of common shares, and such common shares are voting shares;

(B) Such corporation has not during the past five years, or during the period of its existence if shorter, defaulted in the payment of any dividend or sinking fund installment on preferred shares, or in the payment of any principal, interest or sinking fund installment on any indebtedness for borrowed money;

(C) Such corporation has a net worth on a consolidated basis of at least one million dollars ($1,000,000) according to (i) its most recent available audited financial statement which may not be over 15 months old and (ii) its most recent available audited or unaudited financial statement;

(D) Such corporation has had net income, after all charges, including taxes and extraordinary losses, and excluding extraordinary gains, of either (i) at least five hundred thousand dollars ($500,000) for its last fiscal year and one million five hundred thousand dollars ($1,500,000) in total for its last five fiscal years, or (ii) at least one million dollars ($1,000,000) in each of its last two fiscal years. The determination of net income herein required shall be based upon the corporation's financial statements which for the last two fiscal years shall be audited. In determining whether a corporation satisfies the requirements of this clause (d), there may be included the net income of any corporation to whose assets such corporation, or a successor of such corporation, has succeeded by merger, consolidation or acquisition of assets, if such net income of such predecessor corporation may, in accordance with generally accepted accounting principles, be consolidated with the income of such corporation.

NOTICE TO MEMBERS: 78-27
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 7, 1978

MEMORANDUM

TO: All NASD Members

RE: Securities and Exchange Commission Approval of Small Claims Proposals

SUMMARY

On June 23, 1978, the Securities and Exchange Commission approved the Association's recently filed rule change proposals for handling investors' disputes involving small claims. The new provisions, which were adopted by the Association's Board of Governors as an amendment to the NASD's Code of Arbitration Procedure, provide public customers with a simplified procedure for settling securities disputes involving claims of $2,500 or less for the nominal sum of $15. To the extent feasible, each such dispute will be resolved by a single arbitrator who is knowledgeable in securities matters without the claimant having to appear at a hearing and without the need for a protracted proceeding.

BACKGROUND

The procedures for handling investor disputes involving small claims were developed by the Securities Industry Conference on Arbitration (the "Conference"). The Conference, which includes representatives of the public as well as various securities industry organizations, was established in early 1977 by the Association and the New York Stock Exchange as a means of establishing a uniform arbitration system for the securities industry -- one which would include streamlined procedures for handling customer claims involving small dollar amounts. In large measure, this undertaking was an outgrowth of recommendations made by both organizations in their testimony before the Commission on a proposal the SEC staff had advanced for an "Integrated Nationwide System for the Resolution of Investor Disputes."

In testifying before the Commission, both the Association and the NYSE proposed that a securities industry task force be established to consider the matter of developing a uniform arbitration code and the means for establishing a more efficient and economic mechanism for resolving investors' disputes involving small sums of money. Both organizations said that the development of a uniform system of arbitration for use by the self-regulatory agencies would be in the interest of investors and the securities industry. They said, too, that the industry, and not the government, was best equipped to handle this task.

Shortly thereafter, the Association and the NYSE extended invitations to the various self-regulatory organizations asking them to join a conference to develop a uniform and streamlined arbitration system that would be responsive to the needs of investors. The Securities Industry Conference on Arbitration was subsequently formed and is composed of representatives from the Association, the New York, American, Cincinnati, Midwest, Pacific and Philadelphia Stock Exchanges, the Chicago Board Options Exchange, the Municipal Securities Rulemaking Board, the Securities Industry Association and three representatives of the public.

In response to the aforementioned industry initiatives and pending the outcome of these efforts, the Securities and Exchange Commission announced that it had decided to defer action on its proposed nationwide system for handling customer disputes. However, the Commission conditioned its action on the industry developing definite recommendations on this subject by November 15, 1977. In its announcement, the Commission expressed the belief that uniform arbitration procedures were tied to a national market system and that self-regulatory efforts in this area were a proper exercise of the self-regulatory agencies' authority as embodied in the Securities Exchange Act of 1934.

As its first priority, the Conference focused its attention on the development of a simplified uniform system for the resolution of customer claims involving small amounts. On the basis of its deliberations, a draft set of proposals was developed and on November 15, 1977, they were presented to the SEC. The Conference also met with the SEC on December 8, 1977, for the purpose of discussing its proposals and obtaining informal Commission comment thereon. As a result of that meeting, the Conference made some modifications in its small claims proposal. Each of the self-regulatory organizations participating in the Conference then brought these modified proposals before their respective Boards for approval.

The Association's Board adopted the Conference's small claims proposals as an amendment to Section 4 of the NASD's Code of Arbitration Procedure at its March meeting and it thereafter filed such with the SEC on March 28, 1978. Also, each self-regulatory organization participating

in the Conference has filed or will file shortly with the Commission comparable amendments to its rules pertaining to arbitration.

Explanation of the Small Claims Rules

Under the new rule provisions, disputes involving claims of $2,500 or less are to be decided by a single arbitrator solely on the basis of documents submitted by the parties to the proceeding. A claimant may, however, request a hearing or an arbitrator may, after consideration of the evidence presented, decide on his own motion that a hearing is necessary. Should a hearing be convened, its location would be determined by the NASD's Director of Arbitration, giving due consideration to the residence of the claimant.

In order to begin a small claims arbitration, a customer must prepare a letter describing his claim and send it along with a $15 deposit to the Association's Director of Arbitration. This $15 is simply a deposit. It will be refunded to the claimant if the matter is resolved without the need of an arbitrator. If the services of an arbitrator are required, the arbitrator will decide if the deposit should be refunded. The claimant must also sign a submission agreement. By signing the submission agreement, the claimant agrees to submit the dispute to arbitration and to abide by the decision of the arbitrator. The claimant also agrees to be bound by the decision of the arbitrator as to any counterclaim permitted by the small claims procedures which may be asserted against him. In that connection, the rules permit a claimant to withdraw from arbitration if an opposing party files a counterclaim exceeding the amount of his original claim. The claimant can do this by notifying the Director of Arbitration of a desire to withdraw the claim. If a counterclaim exceeded $2,500, and the customer did not withdraw from the proceeding, an arbitrator may refer the claim, counterclaim and all related claims to a larger panel of arbitrators. However, the claimant's $15 fee would not be increased as a result of any counterclaim of an opposing party or the decision of an arbitrator to refer the dispute to a larger panel.

The single arbitrator would be appointed by the Director of Arbitration who would make a reasonable effort to select an arbitrator from the public who is "knowledgeable in securities matters," but who is not associated with or employed by a member of a securities industry organization. In cases in which a public arbitrator is not available, a securities industry person would be chosen.

Amendments to Section 4 (Simplified Arbitration) of the Association's Code of Arbitration Procedure

Sec. 4 (a) Any dispute, claim or controversy, arising between a public customer(s) and an associated person or a member subject to

arbitration under this Code involving a dollar amount not exceeding $2500.00, exclusive of attendant costs and interest, shall upon demand of the customer(s) or by written consent of the parties be arbitrated as hereinafter provided.

(1) The Claimant shall file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Statement of Claim of the controversy in dispute, together with documents in support of the claim. The Statement of Claim shall specify the relevant facts, the remedies sought and whether or not a hearing is demanded.

(2) The Claimant shall pay the sum of $15.00 upon filing of the Submission Agreement. The final disposition of this sum shall be determined by the arbitrator.

(3) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Respondent(s) one (1) copy of the Submission Agreement and one (1) copy of the Statement of Claim. The Respondent(s) shall within twenty (20) calendar days from receipt of service file with the Director of Arbitration one (1) executed Submission Agreement and one (1) copy of the Respondent's Answer, together with supporting documents. The Answer shall designate all available defenses to the Claim and may set forth any related Counterclaim and/or related Third Party Claim the Respondent(s) may have against the Claimant or any other person. If the Respondent(s) has interposed a Third Party Claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of same together with a copy of the Submission Agreement on such Third Party who shall respond in the manner herein provided for response to the Claim. If the Respondent(s) files a related Counterclaim exceeding $2500.00, the arbitrator may refer the Claim, Counterclaim and/or Third Party Claim, if any, to a panel of three (3) or five (5) arbitrators in accordance with Section 15 of this Code, or he may dismiss the Counterclaim and/or Third Party Claim without prejudice to the Counterclaimant(s) and/or Third Party Claimant(s) pursuing the Counterclaim and/or Third Party Claim in a separate proceeding. The costs to the Claimant under either proceeding shall in no event exceed $15.00.

(4) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the Claimant a copy of the Answer, Counterclaim, Third Party Claim or other responsive pleading, if any. The Claimant, if a Counterclaim is asserted against him, shall within ten (10) calendar days either (i) file a Reply to any Counterclaim with the Director of Arbitration who will serve a copy of the Reply on the Respondent(s) or, (ii) if the amount of the Counterclaim exceeds the Claim, shall have the right to file a statement withdrawing the Claim. If the Claimant withdraws the Claim, the proceedings will be discontinued without prejudice to the rights of the parties.

(5) The dispute, claim or controversy shall be submitted to a single arbitrator knowledgeable in the securities industry selected by the Director of Arbitration. Unless the public customer demands or consents to a hearing, or the arbitrator(s) calls a hearing, the arbitrator shall decide the dispute, claim or controversy solely upon the pleadings and evidence filed by the parties. If a hearing is necessary, such hearing shall be held as soon as practicable at a locale selected by the Director of Arbitration.

(6) The Director of Arbitration may grant extensions of time to file any pleading upon a showing of good cause.

(7) The arbitrator shall be authorized to require the submission of further documentary evidence as he, in his sole discretion deems advisable.

(8) Upon the request of the arbitrator, the Director of Arbitration shall appoint two (2) additional arbitrators to the panel which shall decide the matter in controversy.

(9) In any case where there is more than one (1) arbitrator, the majority will be public arbitrators.

(10) In his discretion, the arbitrator may, at the request of any party, permit such party to submit additional documentation relating to the pleadings.

(11) Except as otherwise provided herein, the general arbitration rules of the Association shall be applicable to proceedings instituted under this Code.

Member/Associated Person Controversies

(b) Any dispute, claim or controversy arising between or among members or associated persons 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 ten (10) business days following the filing of the last pleading a request for a hearing of the matter.

(1) In any proceeding pursuant to this subsection, an arbitration panel shall consist of no less than one but no more than three arbitrators, all of whom shall be from within the securities industry.

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

Chairmen of Panels

(c) The Director of Arbitration shall name the Chairman of all panels.

Awards

(d) All awards rendered in proceedings pursuant to subsections (a) or (b) hereof shall be made within thirty (30) business 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.

* * *

The Conference is presently developing a uniform code of arbitration of which the small claims procedures will be but a part. When finalized, the new code will serve as the basis for a uniform system of arbitration for the entire securities industry. Before that code can be implemented, it will have to be approved by the self-regulatory organizations having arbitration facilities and filed with and approved by the SEC. Members will be kept apprised of the progress of the Conference in this area.

* * *

Should you have any questions concerning this notice, please contact the Association's Arbitration Department by calling (212) 943-8400, or by writing the NASD, Arbitration Department, 17 Battery Place, New York, New York 10005.

Sincerely,

Gordon S. Macklin
President

NOTICE TO MEMBERS: 78-28
Notices to Members should be retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 7, 1978

TO: All NASD Members

RE: Notice Regarding Foreign Options

On May 11, 1978, the Securities and Exchange Commission issued Securities Exchange Act Release No. 14745 concerning trading in certain foreign options listed on the European Options Exchange (EOE). The full text of the release is reprinted at the end of this notice.

In its release, the SEC notes that options traded on the EOE are not registered with the Commission and, therefore, cannot be publicly offered, sold, or distributed in the United States. Further, broker-dealers who purchase EOE options for their own accounts will receive no value for net capital purposes with respect to such securities.

While the Commission states that it is presently unaware that any EOE options are being publicly marketed in this country, it has requested persons having information with regard to the public offer, sale, or distribution of such securities to notify the Director of its Division of Enforcement. In this connection, members are asked to carefully review the release and to determine the implications which it may have on their transactions in EOE listed options.

Should you have any questions concerning this matter, please contact S. William Broka, Assistant Director, Department of Regulatory Policy and Procedures at (202) 833-7247.

Sincerely,

Gordon S. Macklin
President

Attachment

SECURITIES ACT OF 1933
Release No. 5930/May 11, 1978

SECURITIES EXCHANGE ACT OF 1934
Release No. 14745/May 11, 1978

NOTICE REGARDING FOREIGN OPTIONS

The Securities and Exchange Commission today issued this notice to investors and broker-dealers in connection with the opening of the European Options Exchange, which is located in Amsterdam, Holland. On April 4, 1978, trading began on that Exchange in nine classes of options, three of which are options on the securities of United States corporations. The European Options Clearing Corporation in Amsterdam is the issuer and guarantor of those options. Some of these options are on the same stocks and have the same expiration dates and exercise prices as options which are traded on American exchanges. In addition, several U. S. broker-dealer firms, or their affiliates, are members of that Exchange.

The stock options which are traded on the European Options Exchange, and which have been issued and guaranteed by the European Options Clearing Corporation, are not included in an effective registration statement filed with the Commission pursuant to the provisions of the Securities Act of 1933. In the absence of such a registration statement or an appropriate exemption, the public offer, distribution or sale of such options in the United States is unlawful. Such a violation would exist regardless of whether or not the options involved constitute interests on the stock of American issuers, foreign issuers, or foreign issuers whose stock is traded in the United States. All of the stock options traded on national securities exchanges in the United States are issued by the Options Clearing Corporation of Chicago, Illinois, and are the subject of an effective registration statement with the Commission.

The Commission warned that if options, which are not the subject of an effective registration statement or which do not qualify for an exemption from the registration requirements of the Securities Act, are publicly offered, distributed or sold within the United States, such options will be added by the Commission to its Foreign Restricted List of securities which may not be sold to the public or traded by broker-dealers in the United States. The primary purpose of the issuance of the restricted list is to alert not only public investors but also broker-dealer firms that the Commission has received information that particular foreign securities are being offered for public sale in this country in violation of the Securities Act registration requirements.

Broker-dealers who purchase for their own account options which are not the subject of an effective registration statement, nor exempted from the registration requirements of the Securities Act, are reminded that because such options are not readily marketable in the United States, broker-dealers will receive no value on such options for net capital purposes.

Appropriate enforcement action may be taken against those involved in any illegal offer, distribution or sale of stock options which are not the subject of an effective registration or which do not qualify for an exemption from the registration requirements of the Securities Act. Any person having information concerning the offer, distribution or sale of such options is requested to inform the Director of the Commission's Division of Enforcement at 500 North Capitol Street, Washington, D. C. 20549.

By the Commission.

George A. Fitzsimmons
Secretary

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NOTICE TO MEMBERS: 78-29
Notices to Members should be retained for future reference

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

July 26, 1978

I M P O R T A N T

OFFICERS: PARTNERS: PROPRIETORS

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

RE: SEC RULE CONCERNING QUOTATIONS IN LISTED SECURITIES TO BECOME EFFECTIVE

On August 1, 1978 the provisions of SEC Rule 11Ac1-1 become effective. This Rule governs the collection and dissemination of quotations in certain listed securities.

Commencing August 1, 1978, every member who meets the definition of a Third Market Maker contained in Rule 11Ac1-1 is required by that Rule to transmit to the Association its bid and ask quotations in reported securities. A Third Market Maker is defined as any broker or dealer who holds himself out as being willing to buy and sell a reported security for his own account on a regular and continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such broker or dealer who also represents, as agent, orders to buy or sell reported securities on behalf of any other person and communicates bids and offers to a national securities association on behalf of such other persons as well as for his own account). A reported security is defined as any equity security as to which last sale information is reported on the Consolidated Tape. These include all securities listed on the American and New York stock exchanges and certain securities listed on regional stock exchanges. Rule 11Ac1-1 also provides that quotations in reported securities may be accompanied by a quotation size, and, if no size is specified, the quotations shall be firm for a normal unit of trading.

The Board of Governors of the Association has adopted amendments to Part III of Schedule D under Article XVI of the By-Laws which reflect the adoption of Rule 11Acl-1 and require Third Market Makers to utilize the NASDAQ System to transmit their quotations to the Association. The amended Part III of Schedule D as well as the text of Rule 11Acl-1 is attached. Subject to SEC approval, these amendments will become effective August 1, 1978. Market Makers who make markets in any reported securities and who are required by the Rule to transmit their quotations to the Association are required to register with the Association as CQS Third Market Makers and to enter their quotations and sizes into the NASDAQ Consolidated Quotations Service. Their quotations and sizes will be displayed on the CQS along with the quotations and sizes of the exchanges. CQS currently displays quotations on all reported securities from Third Market Makers and the American, Boston, Midwest, New York, Pacific and Philadelphia stock exchanges.

Rule 11Acl-1 also provides that every Third Market Maker is obligated to execute an order to buy or sell, other than an odd-lot, presented to him by another broker or dealer or any other person with whom such Third Market Maker customarily deals. The execution must be at or better than the Third Market Maker's quotations as displayed at the time of receipt of the order exclusive of any commission, commission equivalent or differential customarily charged in connection with such order. In addition, the execution must be in an amount up to the displayed quotation size. A Third Market Maker is not obligated, however, to execute a transaction at his quotation if (1) before he is presented with an order he has communicated to CQS a revised quotation; or (2) at the time an order is presented, he is in the process of executing a transaction in that security and immediately after execution he revises his quotation.

Members who are subject to the requirements of Rule 11Acl-1 must register with the Association as CQS Third Market Makers and should contact the NASDAQ Department, 17 Battery Place, New York City - telephone (212) 344-5520, for instructions and practice in test securities prior to the August 1 operational date. The operating procedures for CQS subscribers are attached.

Sincerely,

Gordon S. Macklin
President

OPERATING PROCEDURES FOR CQS SECURITIES

MARKET MAKER AND EXCHANGE IDENTIFIERS

Third Market Maker identifiers (MMID's) are the same as in NASDAQ. Exchange specialists are identified by a four-letter symbol with the first letter always being "X". The identifiers for exchange quotations displayed in CQS as of August 1, 1978 are as follows:

EXCHANGE	IDENTIFIER
American Stock Exchange	XASE
Boston Stock Exchange	XBSE
Midwest Stock Exchange	XMSE
New York Stock Exchange	XNYE
Pacific Stock Exchange	XPSE
Philadelphia Stock Exchange	XPHL

SECURITY SYMBOLS

Where possible, ticker symbols are used in CQS. In those instances where the ticker symbol exceeds five (5) characters or contains unique characters not available on the NASDAQ keyboard, a different security identifier has been assigned. CQS securities with their symbols appear in the NASDAQ Symbol Directory.

EXCHANGE QUOTATIONS

(1) If an exchange is registered in a CQS security but has no quotation available, the exchange market identifier will be displayed on the screen without a quotation.

(2) If an exchange halts or suspends trading in a CQS security, the exchange market identifier and the most recent quotation followed by "HALT" will be displayed on the screen.

(3) Exchange quotations may be bid only or ask only, and "0" will be displayed in the appropriate bid or ask field. Third Market Makers are required to enter two-sided quotations at all times, as in NASDAQ.

(4) The one-character field currently used to display the "closed" indicator (C) shall be used to display the following notations for exchange quotations:

(a) U - Unusual Market Conditions. This informs subscribers that a quotation is not firm due to some unusual activity on the exchange floor.

(b) H - Indication of Interest. This informs subscribers that the quotation is only an indication of interest; e.g., a quotation released by an exchange market maker during a trading halt, indicating a price range within which the security is expected to open when trading is resumed.

NOTE: If a "closed" condition (C) exists and the quote also has a U or H condition applicable, then only the C will be displayed.

QUOTATION RANKING

"Ranking" by best bid or best ask will continue to be determined on the basis of price and time of entry of a quotation in CQS, and size or change of size will have no bearing on the ranking procedure. Exchange quotations with an appended U or H shall be considered closed quotations for ranking purposes and will appear in a quote response following all other open quotations.

OPERATING PROCEDURES

CQS operates on the same hours as NASDAQ Service, i.e., between 9:00 a.m. and 6:30 p.m. Eastern Time, and subscribers follow the same procedures for obtaining quotations that are used for NASDAQ-OTC securities. NEWS codes and billable calls apply to CQS as well as NASDAQ.

Third Market Makers' quotations must be submitted through a NASDAQ terminal. Present quotations updating methods will continue to be utilized, but the System has been modified to allow the entry and updating of size.

Market Maker registration in CQS securities is the same as in NASDAQ, i.e., by using the "XR" call through the Level 3 terminal or by telephoning the NASDAQ Department, New York City (212) 344-5520.

SIZE ENTRIES

Size is entered and displayed in units of trading and, when updating, size can only be changed by replacement entries, i.e., the ↑ and ↓ keys do not function for entries of size.

Most commonly, the standard unit of trading will be 100 shares. In cases where the unit of trading is other than 100 shares, the name field will be displayed and the unit of trading will be shown in the right-most field position. For example, the "Xylo Company of America A Preferred" (ten share unit of trading) would appear as follows:

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B XYZ$
XYLO CO AMER A PFD 10
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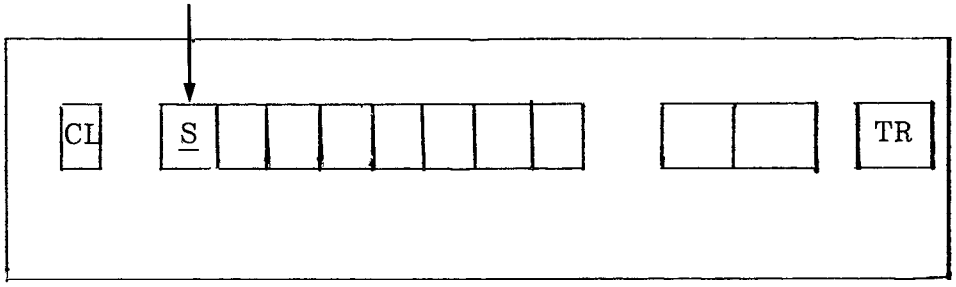
The entry of size must be preceded by the appropriate bid or ask function code to denote which size field is being updated. Unit size entries from 1 through 200 will be accepted. When no size entry is made, the System accepts the entry as one (1) unit of trading.

The size entry key is the special "S" key located in the upper left corner of the NASDAQ terminal keyboard. (See below)



In cases where the size entry is one (1) unit, or a size entry has not been made, the screen display for that field will be blank. When market makers enter size information, the responses to a bid or ask request will only show the numbers when the units entered are from 2 through 99. When the units entered are from 100 - 199, the letter "M" ("medium") will show on the screen. When a 200-unit entry is made, the letter "L" ("large") will appear.

EXAMPLES OF PRICE AND SIZE ENTRIES

The following chart shows a variety of entries and displays. The entries are not complete (e.g., the update function key and security identification have been eliminated), but have been simplified for clarity. All examples assume a 100-share trading unit.

MARKET MAKER SIZE	ENTRY		DISPLAY ON SCREEN
100 by 900	B S 1	A S 9	- 9
100 by 100	B S 1	A S 1	(blank)
10,000 by 1,000	B S 100	A S 10	M - 10
12,800 by 20,000	B S 128	A S 200	M - L
300 by 100	B S 3	A S 1	3 -
200 by 21,000	B S 2	A S 210	Reject - will not accept entry greater than 200

The following are examples of market maker entries changing various combinations of bid/ask price and sizes. The spaces are for clarity only, and market makers are not required, in making actual entries, to space between key entries.

KEYBOARD ENTRY		SCREEN DISPLAY OF QUOTATION		
1.	Complete entry of bid/ask with size:			
	U XYZ B10 S3 A10 1/2 S5	10	10 1/2	3-5
2.	Change bid size to 1 unit:			
	U XYZ B S 1	10	10 1/2	-5
3.	Change both bid and ask sizes:			
	U XYZ B S 102 A S 88	10	10 1/2	M -88
4.	Increase ask by 1/8; change ask size:			
	U XYZ ↑A S 200	10	10 5/8	M - L
5.	Increase bid by 1/4; change bid size to 5 units			
	U XYZ ↑B 1/4 S 5	10 1/4	10 5/8	5- L
6.	Increase ask price by 1/8; change ask size to 2 units:			
	U XYZ ↑A S 2	10 1/4	10 3/4	5-2
7.	Change bid size to 1 unit; increase ask price by 1/8:			
	U XYZ B S 1 ↑A	10 1/4	10 7/8	-2
8.	Increase bid and ask by 1/8; change bid size to 12 units:			
	U XYZ ↑B S 12 ↑A	10 3/8	11	12-2

ADDENDUM

POSTPONEMENT OF EFFECTIVE DATE

The Commission has amended its rule governing dissemination of quotation information with respect to reported securities to postpone the effective date of that rule from May 1 to August 1, 1978. The Commission has taken this action to permit the self-regulatory organizations to plan for the joint implementation of the rule in a manner which is designed to facilitate the development of a composite quotation system -- an important element of a national market system. (Rel. 34-14711)

SECURITIES EXCHANGE ACT OF 1934
Release No. 14415/January 26, 1978

Dissemination of Quotations for Reported Securities

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The rule requires all national securities exchanges and associations to establish procedures for collecting from their members bids, offers and quotation sizes with respect to reported securities, and for making such bids, offers, and sizes available to quotation vendors. It also requires that quotation information made available to vendors be "firm", subject to certain exceptions. The rule is intended to facilitate the prompt development of a composite quotation system, an integral component of a national market system.

EFFECTIVE DATE: May 1, 1978.

FOR FURTHER INFORMATION CONTACT: John W. Osborn, Division of Market Regulation, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549 (202-755-8961).

SUPPLEMENTARY INFORMATION:

The Securities and Exchange Commission has announced the adoption of Rule 11Ac1-1 [17 CFR §240.11Ac1-1] under the Securities Exchange Act of 1934 (the "Act") [15 U.S.C. 78a et seq., as amended by Pub. L. No. 94-29 (June 4, 1975)], governing dissemination of quotation information with respect to equity securities as to which last sale information is reported in the consolidated transaction reporting system (the "consolidated system") contemplated by Rule 17a-15 under the Act [17 CFR §240.71a-15] ("reported securities"). The Rule is designed to

facilitate the prompt development of a composite quotation system by improving the quality and reliability of quotation information made available by national securities exchanges ("exchanges") and third market makers.

The Rule, which will become effective on May 1, 1978, will require each exchange and third market maker (a "market center") to make available quotations (including size) in all reported securities in which that market center is making a market. In addition, quotations made available pursuant to the Rule will be required to be "firm", subject to certain exceptions.

I. Background

In February 1972, in its **Statement on the Future Structure of the Securities Markets**, the Commission first identified a composite quotation system as an integral component of a national market system when it stated that:

> an essential step toward formation of a central market system is to make information on prices, volume and quotes for securities in all markets available to all investors, so that buyers and sellers of securities, wherever located, can make informed investment decisions and not pay more than the lowest price at which someone is willing to sell nor sell for less than the highest price at which a buyer is prepared to offer. Such a communications system would thus serve to link the now scattered markets for listed securities.[1]

Following the publication of the Future Structure Statement, the Commission proposed Rule 17a-14 under the Act, which would have required each exchange and national securities association ("association") to make quotations of their members available to vendors.[2] Since that time, the Commission has pursued several alternative courses of action designed to establish a composite quotation system, including a proposal to require plans to be filed under Section 17(a) of the Act and an attempt to free competitive forces to bring about the development of such a system by removing barriers to the voluntary dissemination of quotation information.[3]

As noted by the Commission when it first proposed Rule 11Ac1-1 in 1976,[4] private efforts at developing a composite quotation system have proven largely unsucessful. Exchange markets continue to disseminate bid and asked price data which do not represent "firm" quotations and no self-regulatory organization makes available data as to quotation sizes. These and other deficiencies, which are more fully discussed in the 1976 Release, have convinced the Commission that it should take affirmative steps to improve the quality of quotation information disseminated by the various market centers by adopting Rule 11Ac1-1 which will require exchanges and third market makers to make available "firm" quotations while allowing the private sector, without regulatory compulsion, to develop the means of consolidating those quotations.

The initial version of Rule 11Ac1-1, proposed in July 1976 (the "1976 Proposal"),[5] would have required every exchange and association to establish and maintain procedures and mechanisms for collecting quotations in eligible securities[6] from its specialists and

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[1] Securities and Exchange Commission, **Statement on the Future Structure of the Securities Markets** (February 2, 1972) at 9, 37 FR 5286, 5287 ("Future Structure Statement").

[2] Securities Exchange Act Release No. 9529 (March 8, 1972, 37 FR 5760.

[3] In 1974, the Commission republished Rule 17a-14 in a substantially revised form, which would have permitted exchanges and associations to file plans (similar to the type of plan called for by Rule 17a-15 under the Act with respect to last sale reports), to govern the development and implementation of a composite quotation system. Securities Exchange Act Release No. 10969 (August 14, 1974), 39 FR 31920. However, in 1975, the Commission decided to defer consideration of that proposal and determined, as an alternative course of action, to take steps to remove restrictions imposed by exchanges on the dissemination of quotation information, while leaving the development of a system consolidating quotation information from the various market centers to private enterprise. **See** Securities Exchange Act Release Nos. 11288 (March 11, 1975), 40 FR 15015, and 11406 (May 7, 1975), 40 FR 25645.

[4] Securities Exchange Act Release No. 12670 (July 29, 1976), 41 FR 32856 ("1976 Release").

[5] **See id.**

[6] The 1976 Proposal used the term "eligible security," which was defined as any security as to which last sale information is reported in the consolidated system. In the subsequent proposal and the Rule as adopted, the term "reported security" has been utilized and defined to limit the application of the Rule to equity securities reported in the consolidated system.

third market makers and for making such quotations (and, if the specialist or third market maker desired, his quotation sizes) available to quotation vendors.[7] Each specialist and third market maker would have been required to communicate his quotations promptly to his exchange or association in accordance with the exchange's or association's procedures.[8]

The 1976 Proposal would also have required that, subject to certain exceptions, all quotations made available pursuant to the Rule be "firm". In particular, the Rule would have provided that any specialist or third market maker presented with an order for the purchase or sale of an eligible security (other than the purchase and sale of an odd-lot) stand ready to execute a transaction in that security in any amount up to such specialist's or third market maker's published quotation size (**i.e.**, his most recently communicated quotation size displayed by vendors or, in the event he had disseminated no quotation size, a normal unit of trading)[9] at a price at least as favorable to the buyer or seller as the bid price or asked price comprising part of that specialist's or market maker's published quotation (**i.e.**, his most recently communicated quotation displayed by vendors at the time the order is presented).[10]

Two exceptions to "firmness" were provided in the 1976 Proposal. First, a specialist or third market maker would have been relieved of his obligation to effect transactions at his published quotation if, after dissemination of a published quotation and before presentation of an order, that specialist or third market maker had communicated a quotation to his exchange or association superseding his published quotation.[11] Second, quotations of specialists and third market makers would not have been required to be "firm" for a period of three minutes following the execution of a transaction in the particular security involved on the floor of the specialist's exchange or by the third market maker (as the case may be) or following the report of a transaction in the security in the consolidated system (the "Three Minute Exception").[12]

Commentators responding to the 1976 Proposal felt that the Rule as then proposed would cause certain operational difficulties with respect to the collection and dissemination of exchange quotations. These commentators argued that, under the collection procedures then proposed, exchange quotations either would not accurately reflect all buying and selling interest on an exchange floor (by only disseminating the specialists' quotation) or would subject the specialist to firmness obligations for bids or offers which were not made by him. Additionally, some commentators suggested that, during periods of unusual or active trading, an exchange's procedures for quotation collection might be inadequate. In response to these comments, the Commission republished the Rule, in June 1977, in substantially revised form (the "1977 Proposal").[13]

The 1977 Proposal, rather than limiting the collection of exchange quotations to specialists' bids and offers, would have required each exchange to collect, process and make available to quotation vendors the highest bid and lowest offer[14] communicated at the location (or locations) designated for trading on the floor of that exchange by any "responsible broker or dealer" with respect to each reported security[15] listed or admitted to unlisted trading privileges on that exchange. The term "responsible broker or dealer" was defined to include any member of an exchange who communicated to another member on the floor of that exchange a bid or offer for a reported security at the location (or locations) designated by the exchange for trading in that security. In the event two or more members had communicated a bid or offer at the same price, both such members would be deemed responsible brokers or dealers, subject to the rules of priority and precedence then in

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[7]1976 Proposal, paragraph (b)(1).

[8]1976 Proposal, paragraph (c)(1).

[9]**See** 1976 Proposal, paragraph (a)(8).

[10]1976 Proposal, paragraph (c)(2). **See Id.**, paragraph (a)(10).

[11]1976 Proposal, paragraph (c)(3)(ii).

[12]1976 Proposal, paragraphs (c)(3)(i) and (c)(5).

[13]Securities Exchange Act Release No. 13626 (June 14, 1977), 42 FR 32418 ("1977 Release"). In addition, the 1977 Proposal contained a number of technical changes in response to comments by interested parties. **See** 1977 Release 19-21, 42 FR 32418, 32420.

[14]This requirement was limited to permit an exchange to exclude any bid or offer which was executed immediately after communication and any such bid or offer communicated by a responsible broker or dealer other than an exchange market maker which was cancelled or withdrawn if not executed immediately after communication. 1977 Proposal, paragraph (b)(2).

[15]**See** note 6 **supra**.

effect on that exchange.[16] Thus, an exchange would have been responsible for making available a single quotation, not necessarily of any individual market participant such as a specialist, but rather reflecting the highest bid and lowest offer of any broker or dealer at the post.[17]

Under the 1977 Proposal, each bid or offer made available by an exchange to quotation vendors would have been accompanied by a quotation size, which would be either (i) the number of shares or units of trading which the broker or dealer responsible for that bid or offer had specified for purposes of communication to quotation vendors that he would be willing to buy at the bid price or sell at the offer price comprising his bid or offer, or (ii) in the event no such number had been specified, a normal unit of trading.[18] If the bid or offer made available by an exchange represented the bids or offers of more than one responsible broker or dealer, the exchange would have been required to make available an aggregate quotation size with respect to such bid or offer (**i.e.**, the sum of the quotation sizes of all responsible brokers or dealers with respect to such bid or offer).[19]

The firmness requirements and exceptions thereto for revised quotations and for intervening transactions and trade reports contained in the 1976 Proposal were retained in the 1977 Proposal. However, the exceptions to firmness were modified to allow an exchange member, seeking to execute a transaction in a security when the published bid or published offer for that security represented the bids or offers of two or more members, to effect transactions with all of such responsible brokers or dealers up to the published aggregate quotation size. Specifically, if an order to purchase or sell a reported security was presented for execution to a responsible broker or dealer on the floor of an exchange at a time when the published bid or published offer of such exchange represented bids or offers (as the case may be) of more than one responsible broker or dealer on that exchange, no such responsible broker or dealer would have been relieved of his execution responsibility under the Rule until the member seeking to execute the order had either completed his order (if the order was in size equal to or less than the published aggregate quotations size) or (if the order was in size greater than the published aggregate quotation size) the member had purchased or sold an amount of the security equal to such published quotation size regardless of any revised quotation or any intervening transaction or trade report.[20]

In addition, the 1977 Proposal would have provided a further exception to firmness during periods of unusual or active trading when an exchange's quotation collection procedures would not be adequate to monitor the flow of quotation information or a specialist would not be able to update his quotations on a timely basis (the "Unusual Market Exception"). Under this exception, if an exchange, pursuant to rules and regulations approved by the Commission under Section 19(b)(2) of the Act, determined that the level of trading activity or the existence of unusual market conditions was such that the exchange was incapable of accurately collecting, processing and making available to vendors

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[16]1977 Proposal, paragraph (a)(3)(i). The 1977 Proposal would also have provided that, with respect to a bid or offer representing an order which had been transmitted from one member of that exchange to another member who undertook to act as agent with respect to the order, only the last member undertaking to act as agent with respect to the order would have been considered as the "responsible broker or dealer" for the bid or offer. Thus, for example, if an order had been given to a $2 broker for execution or left with a specialist, only the $2 broker or the specialist (and not the originating broker) would have been subject to the Rule's firmness obligations.

[17]Under the 1977 Proposal, each exchange would also have been responsible for establishing and maintaining procedures and mechanisms for ascertaining the identity of responsible brokers and dealers with respect to each bid and offer and would have been required, upon request of any member seeking to execute a transaction in reliance on the firmness requirements of the Rule, to disclose the identity of such responsible brokers and dealers to that member. 1977 Proposal, paragraph (b)(2).

[18]1977 proposal, paragraph (a)(10).

[19]1977 Proposal, paragraph (a)(12). The exchange would also have been responsible for keeping track of the quotation sizes of each broker or dealer and making that information available to a member seeking to effect a transaction in reliance on the firmness requirements of the Rule. 1977 Proposal, paragraph (b)(2).

[20]1977 Proposal, paragraph (c)(4).

the data required by the Rule, upon such exchange's notification to certain specified persons (including the Commission and each quotation vendor),[21] the firmness obligations of responsible brokers and dealers on such exchange, as well as the obligation of the exchange to ascertain the identity and quotation size of each responsible broker and dealer and to make such information available to members, would be suspended. The suspension would continue until the exchange had determined that the unusual market activity or conditions had terminated and renotified those specified persons. Durng the pendency of the suspension, the exchange involved would still be required to continue, to the maximum extent practicable under the circumstances, to collect, process and make available to vendors bids, offers and quotation sizes of its members.[22]

The 1977 Proposal did not significantly change the collection procedures and firmness requirements of the Rule for third market makers. Under the 1977 Proposal, each third market maker[23] would have been defined as a "responsible broker or dealer"[24] and would have been obligated to communicate his bids, offers and quotation sizes to the association of which he was a member pursuant to collection procedures established by that association.[25] Such bids, offers and quotations sizes would have been firm, subject to the same exceptions for revised quotations and intervening trade reports as contained in the 1976 Proposal.[26] Each association, in turn, would have been required, at all times last sale information with respect to reported securities was reported in the consolidated system, to collect, process and make available to vendors the highest bid and lowest offer and quotation size of each responsible broker or dealer who was a member of that association and who was acting in the capacity of a third market maker.[27]

In response to the publication of the 1977 Proposal, the Commission received comment letters from three vendors of market information, six exchanges, the National Association of Securities Dealers, Inc. ("NASD"), the Securities Industry Association, two broker-dealer firms and the Council on Wage and Price Stability. The Commission has also considered comments and statements concerning quotation systems generally and Rule 11Ac1-1 specifically which were received in connection with the Commission's current proceeding under Section 19(c) of the Act, considering amendment of exchange rules which limit or condition the ability of their members to effect transactions over-the-counter in listed securities and to consider the adoption of certain Commission rules to accompany any such action (the "Off-Board Proceeding").[28] Finally, the Commission has considered the views of the National Market Advisory Board ("NMAB") regarding a composite quotation system.[29] All of the comments and views received in response to the 1977 Proposal indicate that most of the mechanical and operational difficulties of the Rule had been resolved but that there was still some disagreement as to the basic regulatory approach of the Rule. After carefully considering these views and comments, the Commission has determined to retain the basic approach of the proposal and has adopted Rule 11Ac1-1 in substantially the same form as the 1977 Proposal, with the elimination, however, of the Three Minute Exception.

II. The Revised Proposal

A. Three Minute Exception

A number of commentators responding to both the 1977 and 1976 Proposals argued that the Three Minute

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[21] 1977 Proposal, paragraph (a)(15).

[22] 1977 Proposal, paragraph (b)(3).

[23] The 1977 Proposal changed the definition of "third market maker" to make clear that (i) a market maker may also represent a customer's order as agent as part of a bid or offer disseminated pursuant to the Rule, and (ii) a market maker would not include any person acting solely in the capacity of a block positioner. **See** Id., paragraph (a)(1).

[24] 1977 Proposal, paragraph (a)(3)(ii).

[25] 1977 Proposal, paragraph (c)(I).

[26] 1977 Proposal, paragraphs (c)(2),(3) and (5).

[27] 1977 Proposal, paragraph (b)(1)(ii). However, this requirement was limited to permit an association to exclude any bid or offer which was executed immediately after communication or cancelled or withdrawn if not executed immediately after communication.

[28] **See** Securities Exchange Act Release No. 13662 (June 23, 1977), 42 FR 33510.

[29] NMAB, "Next Steps to be Taken to Facilitate the Establishment of a National Market System," December 6, 1977, ("NMAB Report") 15-18.

Exception was both unnecessary, in light of actual trading conditions and recent technological developments premitting computer-generated quotations, and counterproductive because it would emasculate the firmness provisions of the Rule. Therefore, these commentators suggested that the quotation information disseminated pursuant to the Rule would be less useful for order routing decisions. One commentator also asserted that the Three Minute Exception would permit exchanges or third market makers to suspend making quotations available for lengthy periods of time during active markets.

The Three Minute Exception was originally included in the 1976 Proposal as a mechanism to assure that market makers were given sufficient time to update their quotations following completion of a transaction or after receiving a trade report from another market center. The Commission recognized that the Exception would result in the dissemination of quotations which were less useful for order routing decisions than quotations which were firm unless altered prior to the receipt of an order; however, because the Commission was concerned that the Rule might cause operational difficulties, especially in active markets, the Three Minute Exception was included to ensure the efficient operation of the Rule, As a further mechanism for accommodating active exchange markets, the Commission also added the Unusual Market Exception in the 1977 Proposal. However, because the Commission believed that quotation information would be more useful if these exceptions were not provided, it specifically requested comment in the 1977 Release on the "feasibility of requiring bids and offers made available pursuant to the Rule to be firm under all circumstances (unless a revised bid or offer had been communicated to the relevant exchange or association prior to the receipt of an order)."[30]

The Commission has concluded that the Three Minute Exception is not necessary to assure effective operation of the Rule because the exceptions for revised quotations and unusual market conditions should be adequate to accommodate even very active exchange markets.[31] Accordingly, since quotation information not subject to such an exception will, in our view, be more reliable and may therefore be of greater benefit to brokers and dealers in their order routing decisions, the Commission has adopted Rule 11Ac1-1 without the Three Minute Exception.[32]

Under the Rule as adopted, bids, offers and quotation sizes are required to be firm subject only to exceptions for revised quotations and unusual or active market conditions. The exception for revised quotations has been altered slightly to prevent a responsible broker or dealer from being required to execute more than one order on the basis of his published bid or published offer, a possibility which would have been precluded by the Three Minute Exception. Thus, under the Rule as adopted, a responsible broker or dealer would be relieved of his obligation to effect transactions at his published bid or published offer if, (i) before an order is presented for execution, he has communicated to his exchange or association a revised bid or offer superseding his published bid or offer (a "revised bid or offer") or, (ii) at the time an order is presented, he is in the process of effecting a transaction in that security,[33] and, immediately after the completion of such transaction, he communicates a revised bid or offer to his exchange or association.[34] In these circumstances, the responsible broker or dealer will be obliged to effect a transaction at his revised bid or offer if the broker or dealer presenting the order so requests.

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[30]1977 Release, **supra** note 13, at 25, 42 FR 32418, 32421.

[31]The comment letters of the Boston and Philadelphia Stock Exchanges and the NASD favored elimination of the Three Minute Exception. Additionally, two New York Stock Exchange, Inc. ("NYSE") specialists stated at the public hearings held in connection with the Off-Board Proceeding that the Three Minute Exception was not necessary to permit them to comply with the Rule. **See** Official Transcript of Proceedings Before the Securities and Exchange Commission, File No. 4-180, In the Matter of Off-Board Trading Rules at 397-398 and 599. Furthermore, officials of the NYSE and Pacific Stock Exchange, Incorporated ("PSE"), which had initially advocated the Exception, have informally confirmed that those exchanges no longer felt the Exception was necessary. **See** Memorandum of Telephone Conversations in File S7-648.

[32]The Rule has also been revised to delete those provisions limiting the Three Minute Exception when two or more responsible brokers or dealers on an exchange had published bids or published offers at the same price. **See** 1977 Proposal, paragraph (c)(4).

[33]A responsible broker or dealer should be deemed to be in the process of effecting a transaction from the moment an order is presented to him for execution until the completion of communication of all information necessary to complete the transaction.

[34]Rule 11Ac1-1(c)(3)(ii).

A responsible broker or dealer will also be permitted to revise his published quotation size at any time prior to the presentation of an order or, if he is in the process of effecting a transaction in that reported security at the time an order is presented, immediately after completion of the transaction.[35] In that event, the responsible broker or dealer will be obliged to execute a transaction in any amount requested by the broker or dealer presenting the order up to the responsible broker or dealer's revised quotation size.

B. Technical Changes

In addition to the changes discussed above, the Commission has made several drafting and technical changes in the Rule:

1. The 1977 Proposal provided an exception from the collection and dissemination requirements imposed on exchanges and associations for any bid or offer which was executed immediately after communication and any bid or offer communicated by a responsible broker or dealer (other than an exchange specialist) which was cancelled or withdrawn if not executed immediately after communication.[36] Commentators argued that the 1977 Proposal treated exchange market makers differently from third market makers (by requiring an exchange to collect an exchange market maker's bid or offer which was cancelled or withdrawn if not executed immediately after communication) and urged that the Commission extend this exception to exchange market makers. Because the bids and offers of any market maker may be characterized as cancelled or withdrawn if not accepted immediately after communication, the Commission has concluded that, to avoid possible circumvention of the Rule and to provide uniformity of treatment between exchange specialists and third market makers, the part of the exception which would have permitted an exchange or association to exclude from collection bids or offers which were cancelled or withdrawn if not executed immediately after communication should not be available either to third market makers or exchange specialists.[37] This determination is consistent with the Commission's intent in providing this exception for "ephemeral" quotation in the 1977 Proposal; that is, that the Rule as adopted reflects the fact that certain non-specialist participants in exchange "crowds" make bids and offers which, while narrowing the exchange quotation for an instant in time, never in fact become part of the quoted market on the exchange because they are withdrawn immediately if not accepted.

2. The Rule has been revised to explicitly state that an association is required to make available to vendors the identity of each responsible broker or dealer whose quotations are being made available by that association.[38] This change in the Rule is necessary to assure that vendors receive sufficient information to enable their subscribers to respond to third market quotations in appropriate circumstances.

3. Under the 1977 Proposal, the Unusual Market Exception would have provided an exception to the firmness provisions of the Rule upon notification of certain "specified persons," including the Commission. In order to expedite notification procedures, the Rule has been revised to omit notification to the Commission although notice must still be provided to each quotation vendor, the processor of the consolidated system and, in the case of a security underlying exchange traded options, the processor for the Options Price Reporting Authority.[39]

4. The Rule will become effective on May 1, 1978.[40] This effective date should provide sufficient time for exchanges and associations to file the necessary rule proposals with the Commission and to modify their quotation collection and dissemination procedures in accordance with the Rule. Furthermore, it will provide additional time to vendors to modify their information systems to accommodate the display of quotation information (including sizes) from the various market centers.

III. Additional Issues

The Commission has also considered a number of other issues raised by commentators.

A. Mandatory Participation

Both the 1976 and 1977 Proposals contemplated that each exchange would be required to collect and

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[35] Rule 11Ac1-1(c)(3)(i).

[36] 1977 Proposal, paragraph (b)(2).

[37] **See** Rule 11Ac1-1(b)(2).

[38] Rule 11Ac1-1(b)(1)(ii).

[39] Rule 11Ac1-1(a)(15).

[40] Rule 11Ac1-1(e).

disseminate quotations in every reported security listed or admitted to unlisted trading privileges on the exchange and that each association would be required to collect and disseminate quotations in every reported security in which one of its members was acting as a third market maker. In turn, each exchange specialist and third market maker would have been required to promptly communicate to his exchange or association quotations representing a continuous two-sided market. In response to both Proposals, the Commission received comments which questioned whether the Rule should mandate participation by each exchange and third market maker (as opposed to permitting such participation on a voluntary basis), particularly in an environment in which (i) brokers could not automatically execute against published bids or offers, (ii) there was no Commission rule requiring brokers to route orders to the market displaying the best published bid or offer, and (iii) there was no requirement that vendors display quotations from every market center.

Some commentators argued that competitive forces should be the same factor motivating brokers or dealers to make available firm quotations to vendors. These commentators cited the NASD's experience with NASDAQ, which provides for voluntary participation by over-the-counter market makers, as an example of a successful quotation system deriving exclusively from competitive forces. Other commentators asserted that, in the current market environment, there would be no economic benefit to be derived from communication of quotations in accordance with the Rule because orders would not be routed on the basis of displayed quotations. Therefore, according to one commentator, the adoption of a rule which required participation by all third market makers would be "anti-competitive" because it would impose greater burdens on smaller market centers which cannot spread the costs of providing quotations over a large order flow and cannot charge vendors or subscribers for quotation information as is done by certain larger self-regulatory organizations.[42] Thus, it was argued, particularly in the absence of increased order flow which might be derived from communication of quotations, a mandatory rule would act as a "barrier to new market makers" and would be a disincentive to existing third market makers. Finally, it was suggested that, if the Commission adopted a rule mandating the dissemination of quotations, the information made available pursuant to the Rule would not be as accurate (and hence as useful) as the information which would be disseminated pursuant to a voluntary rule.

The NMAB supported the view that the Rule should not require participation by all market centers:

> Contrary to the requirement contained in proposed Rule 11Ac1-1, the Board is of the view that requiring market makers to include their quotations in the [composite quotation system] might impose equipment and personnel costs that would discourage many broker-dealers from making markets. The Board believes it likely that broker-dealers which make markets in a significant number of securities would enter quotations into the system for at least some of the securities in which they make markets, and that the degree to which market makers entered quotations into the system would depend on the degree to which the system was used in directing order flow. If the system did not influence the direction of order flow, it would seem unfair to require market makers to make expenditures that were unlikely to have any business purpose.[43]

In reaching its decision to adopt Rule 11Ac1-1 in a form requiring dissemination of quotations for reported securities from all market centers, the Commission has carefully reviewed both the views of commentators who favor modification of the Rule to permit voluntary dissemination of quotations and the legislative history of Section 11A of the Act (particularly with respect to, among other things, Congressional expectations concerning a composite quotation system).[44]

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[41]Additionally, the 1977 Proposal would have required an exchange under certain circumstances to collect bids and offers of other brokers and dealers in the "crowd"

[42]For example, both the NYSE and American Stock Exchange currently impose direct charges on vendor subscribers for receipt of quotation information from their exchanges.

[43]NMAB Report, **supra** note 29, at 17.

[44]Section 11(A)(a) of the Act [15 U.S.C. 78k-1(a)] derives from S. 249, the Senate version of the bill which was ultimately enacted as the Securities Acts Amendments of 1975 (the "1975 Amendments"). **See** Comm. of Conference, Report to Accompany S.249, H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 92 (1975). The Senate report accompanying S. 249 indicates that the bill consolidates five prior bills (including S. 2519, a bill

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The Commission recognizes the legitimate concerns of some commentators concerning the costs of compliance with Rule 11Ac1-1 and the possibility that a composite quotation system may not exert a controlling influence on brokers' order routing decisions under current circumstances. Although the Commission cannot predict with certainty the effect quotation information disseminated pursuant to the Rule will have on brokers' decisions as to which of the several markets should be selected for execution of their customers' orders, the Commission's expectations are that implementation of Rule 11Ac1-1, and the resultant general availability of relatively "firm" quotations and quotation sizes for reported securities, will have a favorable impact on brokers' order routing decisions and upon the changing nature or brokers' agency obligations to their customers. These expectations, however, do not constitute the sole basis for the Commission's decision to adopt Rule 11Ac1-1 in a form requiring participation by all market centers. Rather, the Commission considers the adoption of Rule 11Ac1-1 in this form as an appropriate step in facilitating the integration of all markets into a national market system, including assuring "the availability to brokers, dealers and investors of information with respect to quotations for . . . securities" and "the practicability of brokers executing investors' orders in the best market."[45]

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containing provisions relating to the development of a national market system which was approved by the Senate in the 93rd Congress) and that the genesis of the legislation was the Securities Industry Study Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs. Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, Report to Accompany S. 249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 1 (1975) (the "Senate Report"). **See** Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, Securities Industry Study, S. Doc. No. 93-13, 93rd Cong., 1st Sess. (1973) (the "Senate Securities Industry Study"). The Senate report accompanying S. 2519 and the Senate Securities Industry Study indicate a clear Congressional understanding that the Commission would use its powers to establish a comprehensive composite quotation system, including quotations from all market centers. The report accompanying S. 2519 indicates that one of the communications facilities which was not then in existence and which the bill was designed to give the Commission authority to mandate was a "system through which **all** current quotes for listed securities can be seen on any single unit on a comparable basis." Senate Comm. on Banking, Housing and Urban Affairs, Report to Accompany S. 2519, S. Rep. No. 93-865, 93rd Cong., 2d Sess., 5-6 (1974) (emphasis added). The Senate Securities Industry Study also indicates that there was "no system through which **all** current quotes can be seen on a comparable basis. . . . " Senate Securities Industry Study at 97 (emphasis added).

In addition, the Senate Subcommittee was aware and noted in the Senate Securities Industry Study that the Commission had recently proposed Rule 17a-14 under the Act which would have required all exchanges and the NASD to make available quotations to vendors on a current and continuing basis. **Id.** at 101; **see** note 2 **supra.** In addition to its recognition of proposed Rule 17a-14, the Senate also cited in its Securities Industry Study the Commission's **Policy Statement on the Structure of a Central Market System,** Securities Exchange Act Release No. 10076 (March 29, 1973) (the "Policy Statement"). In the Policy Statement and earlier in the Future Structure Statement, the Commission specifically described the emerging "central market system" as envisioning the "disclosure of quotations from **all** markets." Future Structure Statement, **supra** note 1, at 8-9, 37 FR 5286, 5287 (emphasis added). **See** Policy Statement at 11, 15, 26 and 48.

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[45]**See** Section 11A((a)(1)(C)(iii) and (iv) of the Act [15 U.S.C. 78k-1(a)(1)(C)(iii) and (iv)]. The language and legislative history of the 1975 Amendments indicate a clear Congressional determination that a comprehensive composite quotation system is an essential element of the emerging national market system and that Congress contemplated an active Commission role in its development. For example, the Senate Subcommittee on Securities stated in the Senate Report as follows:

> In the securities markets, as in most other active markets, it is critical for those who trade to have access to accurate, up-to-the-second information as to the prices at which transactions in particular securities are taking place (**i.e.**, last sale reports) and the prices at which other traders have expressed their willingness to buy and sell (**i.e.**, quotations). For this reason, communications systems designed to provide automated dissemination of last sale and quotation information will form the heart of the national market system.

Senate Report, **supra** note 44, at 9. **See** Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, Securities Industry Study, H.R. Rep. No. 92-1519, 92nd Cong., 2d Sess. 123-25 (1972); Senate Securities Industry Study, **supra** note 44, at 101-104.

Thus, the Commission is convinced that the availability of "firm" quotations for reported securities, with size, from all market centers, is of considerable value to the markets generally and to participants in those markets, especially in the context of an evolving national market system.[46] Moreover, quite apart from the general importance of quotation information to be disseminated pursuant to the Rule, the Commission believes that the adoption of the Rule in a form requiring participation by all market centers should spur brokers to make greater efforts to achieve best execution of their customers' orders and should foster increased competition in market making. Finally, the Commission is concerned that the failure to ensure the availability of quotation information from all market centers could jeopardize efforts to perfect the functioning of a composite quotation system. Such a failure also could distort the Commission's and the securities industry's perception of that system's impact on the behavior of market professionals and of the precise nature of those additional steps which must be taken, building upon experience with use of a composite quotation system, to perfect the mechanisms of a national market system.

Although the Commission is aware that the cost burdens associated with compliance with the Rule (particularly the expenses associated with providing quotation information on a continuous basis) may be greater for some persons subject to the Rule than for others, these differences are, in large part, a direct function of the differing ways in which persons subject to the Rule have elected to conduct their businesses. In any event, the Commission has determined that those costs must be borne in order to advance the important purposes of the Act to be served by collecting and disseminating "firm" quotation information from all market centers.

The Commission believes that, until there has been some experience with a comprehensive composite quotation system, it is not possible to determine the precise impact which that system will have on order flow or upon the competitive opportunities and burdens which will be encountered by various market centers. The Commission is satisfied that the important purposes of the Act will be served by collecting and disseminating "firm" quotation information from all market centers and, accordingly, it is reluctant to sacrifice that opportunity because of a concern that some market centers might suffer a cost or competitive disadvantage. The Commission recognizes, however, that this concern is a real one and that some markets and market makers, particularly third market makers, may be subjected to cost burdens which are substantially disproportionate to the competitive benefits which they will obtain. Therefore, upon an appropriate showing, the Commission will be prepared to consider granting an exemption from the provisions of the Rule requiring the dissemination of quotation information so as to relieve unjustified burdens in a manner consistent with the purposes of the Act.

The Commission is aware that some persons required to provide quotations for dissemination pursuant to the Rule may be tempted to avoid the Rule's requirements by disseminating bid and asked prices which are a minimal increment "away" from, for example, the best published bid or offer, or from the published bid or published offer of the "primary" market, while quoting a more competitive market orally in response to inquiry. In this regard, it should be understood that the definitions of the terms "bid" and "offer" in the Rule require that the actual bid and asked prices at which a responsible broker or dealer is willing to effect transactions in reported securities from time to time be communicated to its exchange or association. The Commission believes that if a market maker continuously communicates quotations which do not reflect its actual market, that activity would constitute a violation of Rule 11Ac1-1 and the issuance of fictitious quotations within the meaning of Scetion 15(c)(2) of the Act.[47]

B. Best Execution

A number of commentators stated that, in their opinion, the adoption of Rule 11Ac1-1 would not significantly change brokers' order routing decisions unless the Commission also adopted a "best execution" rule. One commentator felt that such a rule should be general in nature, merely clarifying a broker's responsibilities as they exist today, and would exist after the adoption of Rule 11Ac1-1, while others appeared to be advocating a more specific rule which would require brokers to route orders to the market center displaying the best quotation.

The Commission does not believe it is appropriate, at this time, to promulgate a "best execution" rule. It has reached this conclusion because it does not believe it is reasonable, given the present structure of the securities

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[46]Similarly, in adopting Rule 17a-15 under the Act, the Commission was convinced of the value of providing comprehensive last sale information from all market centers. The Commission believes that quotation information will prove to be of at least equal value.

[47]Rule 11Ac1-1(d). See discussion at 49-50, infra.

markets, and presently available trading mechanisms, to require brokers under all circumstances to route their customers' orders to the market displaying the best quotation. However, since the Commission believes that adoption of Rule 11Ac1-1 will significantly improve the quality of quotation information available from all markets and market makers, the Commission expects brokers to give careful consideraton to that information in making their order routing decisions. Because the Commission believes that a broker's existing fiduciary duty to his customer requires that he take cognizance of quotation information available through a composite quotation system in seeking best execution of his customer's order, it is not clear at this time that a more definitive Commission rule prescribing best execution standards is necessary to ensure adherence to appropriate principles of agency conduct by brokers.

C. **Vendor Requirements**

Several commentators suggested that the Commission impose specific obligations on quotation vendors to display quotations from all market centers. The Commission agrees with these commentators that the general availability of quotation information from all markets and market makers by such vendors is a necessary prerequisite to the use of that information and is essential to the successful operation of the Rule. However, the Commission believes that adequate dissemination of quotation information will be achieved without specific vendor requirements formulated by the Commission. For example, it appears that prior to the effective date of the Rule at least one securities information system will be providing a montage or quotations (including sizes) from all market centers in all multiply-traded reported securities. Additionally, the Commission believes that competitive pressures will assure that each of the other vendors will eventually implement similar services or, at least, a best bid and asked display. The Commission will continue to monitor vendor progress in providing quotation information in a comprehensive and non-discriminatory manner and will reconsider its decision not to impose specific obligations on vendors if competitive pressures do not assure adequate dissemination and display of this information.[48]

D. **Multiple Market Makers**

Although most commentators expressed agreement with the firmness provisions of the Rule, two commentators suggested that this aspect of the Rule had certain anticompetitive effects. These commentators argued that the competing market maker system, as employed on the Chicago Board Options Exchange, Inc. and the options trading floors of the Midwest Stock Exchange, Inc. and PSE, may be a prototype of the enhanced competitive environment envisioned by Congress in the passage of the 1975 Amendments[49] and that a firm quotation rule would be unworkable in such an environment. Therefore, they argued that the adoption of Rule 11Ac1-1 would become an obstacle to other exchanges adopting such a competitive market maker system, and, in any event, that the Commission would have to exempt exchanges using this system from the operation of the Rule.

The Commission recognizes that compliance with Rule 11Ac1-1 may be more difficult in a multiple market maker exchange environment; however, no exchange currently utilizes such a system generally for trading in reported securities. Accordingly, it is not necessary at this time to consider modifying Rule 11Ac1-1 or altering its basic approach to collection of quotation information to take into account multiple market making in reported securities. However, the Commission wishes to clearly state its intent that the adoption of Rule 11Ac1-1 should not discourage competition among market makers and its commitment to give further consideration to the kinds of theoretical problems mentioned above should circumstances require further action to accommodate a large number of market makers on a single exchange floor

E. **Suitability**

Several commentators responded to an express request for comment made in a footnote to the 1977 Release regarding the applicability of standards of suitability and diligence.[50] The Commission confirmed in the

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[48]In this regard, the Commission notes that it expects that quotations will be displayed on a non-discriminatory basis (**i.e.**, from all market centers) and that access to composite quotations will be provided in a manner which will allow recall of these quotations as readily as quotations from a single market. For example, if the consolidated system stock symbol and a single request key are utilized to obtain quotations from a particular market center, consolidated quotations must be available by use of the consolidated symbol and a single request key. In addition to the display of quotations and quotation sizes based upon information from all market centers, the Commission expects that vendors will also indicate to users when these quotations are not firm due to the Unusual Market Exception.

[49]Both commentators noted, however, that Rule 11Ac1-1 as proposed would not be applicable to options trading. Rule 11Ac1-1 as adopted is not applicable to quotations in exchange-traded options.

[50]1977 Release, **supra** note 13, at 14 n. 16, 42 FR 32418, 32419.

footnote that the firmness provisions of the Rule (which would require a responsible broker or dealer to deal directly with any person belonging to a category of persons with which such broker or dealer customarily deals) were not intended to supersede or contravene rules governing suitability and diligency as to customer accounts.[51] One commentator felt that this qualification of the firmness requirement would be more appropriately contained in the Rule, not in a footnote in a release. Another commentator questioned the applicability of suitability and customer diligence rules to several hypothetical situations and also expressed its view that the Rule should not require a responsible broker or dealer to transact business with another broker or dealer regardless of such responsible broker or dealer's judgment as to the financial integrity of the other broker or dealer and his ability to deal in the size of the transaction in question.

The Commission continues to believe that the asserted concern that Rule 11Ac1-1 will force responsible brokers and dealers to transact business with financially unsound brokers or dealers has not been demonstrated to be a sufficient reason to amend the Rule. If such loss occurs, it would generally be limited to a risk of market loss for a short period of time. The infrequency and limited nature of such losses does not warrant the inclusion of a general exception to the firmness requirement of the Rule.

With respect to other persons who belong to a category of persons with whom a responsible broker or dealer customarily deals (and, therefore, who are entitled to require a responsible broker or dealer to effect a transaction at his published bid or published offer), the Commission notes that the phrase "customarily deals" connotes, among other things, that a responsible broker or dealer should not engage in a transaction with a customer when the broker's fiduciary responsibility, including principles of suitability and other obligations imposed on such brokers by law, would otherwise prohibit such a transaction.

F. **Errors**

One commentator noted that the 1977 Proposal would relieve a responsible broker or dealer from his firmness obligations if his published bid or offer as displayed by vendors was not the same as the bid or offer communicated by the responsible broker or dealer to his exchange or association due to some error in collection, transmission or display. This commentator stated that a responsible broker or dealer should also be relieved of firmness obligations when he has communicated an erroneous quotation to his exchange or association.

The Commission believes that responsible brokers and dealers should be held accountable for their own errors in order (i) to create incentive on the part of responsible brokers and dealers to accurately communicate their quotations and (ii) to avoid "backing away" by responsible brokers and dealers under the guise of erroneous quotations. Accordingly, the Rule has not been altered to provide a firmness exception for responsible brokers or dealers communicating erroneous quotations.

G. **Fees**

The Commission has again[52] received comments concerning the rights of exchanges and associations to charge vendors directly for receipt of quotation information and to impose certain contractual obligations on vendors. Rule 11Ac1-1 is not intended to define or recognize the right of an exchange or association to charge vendors for the receipt of quotation information; the Commission has not to date addressed that issue. The Commission notes that, under Section 11A(c)(1)(C) of the Act [15 U.S.C. 78k-1(c)(1)(C)], it continues to have authority to adopt rules and regulations designed to assure that all securities information processors may obtain quotation information from any exchange or association (or any executive processor) on fair and reasonable terms. The Commission expects that the vendors and self-regulatory organizations will resolve these matters satisfactorily without Commission intervention prior to the effective date of the Rule. However, the Commission will monitor the progress of these discussions to assure that compliance with the Rule and the other provisions of the Act are achieved and will take appropriate action if necessary.

H. **Unusual Market Exception**

Only one commentator addressed the operation of the Unusual Market Exception and suggested that this exception commence upon a determination that unusual conditions exist, not at the time specified persons are notified. In addition, this commentator felt the Rule's requirement that such determination be

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[51] **See, e.g.**, Article III, Sec. 2 of the Rules of Fair Practice of the NASD and Rule 405 of the NYSE.

[52] The Commission received similar comments in response to the 1976 Proposal and deleted a paragraph in that Proposal which would have permitted the imposition of fair and reasonable fees for use of quotation information. 1976 Proposal, paragraph (b)(3). **See** 1977 Release, **supra** note 13, at 21, 42 FR 32418, 32420.

made pursuant to rules approved by the Commission would not allow exchange officials sufficient discretion in utilizing the exception. Although the circumstances which justify the determination that unusual conditions exist would appear to impose burdens on responsible brokers and dealers from the moment these circumstances arise and, therefore, responsible brokers and dealers would be required to satisfy orders based upon quotations which may not be accurate or up to date from that time until completion of the notification procedure, the Commission believes that such a limited burden is necessary to assure prompt notification to the specified persons. The Commission has also revised the Rule to omit notification to the Commission, thereby expediting the notification process.[53] Moreover, during the period prior to notification it is unlikely that responsible brokers or dealers will be required to satisfy orders on the basis of their published bids or offers because the exception for revised quotations should assure that a responsible broker or dealer is not obliged to effect a transaction at a price which does not reflect the current market. In addition, if the Unusual Market Exception were to become operative prior to notification to vendors, displayed quotations would be misleading during such interim period.[54]

The Commission believes it is necessary that exchange procedures utilized in making a determination that unusual market conditions exist be filed with the Commission under Section 19(b) of the Act to assure some uniformity between the various exchanges and to assure that the factors to be considered in reaching these determinations are consistent with the Commission's intent in providing the exception.

I. Cost/Benefit Analysis

In response to the 1976 Proposal, the Council on Wage and Price Stability (the "Council") submitted a lengthy comment questioning the cost/benefit of a rule such as Rule 11Ac1-1 and urging the Commission not to adopt such a rule in the absence of an analysis demonstrating that the benefits of the proposal would outweigh the costs associated with its implementation.[55] In the 1977 Release, the Commission stated its conslusion that the projected benefits of the Rule, although difficult to quantify, outweighed the anticipated costs to exchanges, associations and market professionals.[56] In addition, the Commission noted that affirmative Commission action in implementing a composite quotation system was justified by the overriding public interest in the widespread dissemination of quotation information and by the provisions of the Act directing the Commission to take action to facilitate the development of a national market system.[57]

In response to the 1977 Proposals, the Council has requested the Commission to consider its comments submitted in response to the 1976 Proposal as applicable to the 1977 Proposal. The Commission has again considered the comments of the Council and continues to believe that the benefits provided by the Rule, particularly its role in facilitating the establishment of a national market system, outweigh the costs associated with implementation of the Rule. As an integral step in accomplishing the statutory goal of the "linking of all markets . . . [to] foster efficiency, enhance competition, . . . and contribute to best execution" of customers' orders, the Rule is justified even in the absence of inherently speculative efforts to quantify the cost and value of certain improvements in the quality of information which will result.

J. Miscellaneous Technical Comments

1. One commentator felt that the Rule should contain further standards refining the definition of "third market maker." The definition in the 1977 Proposal would have applied to any person who held himself out as willing to deal on a regular and continuous basis in amounts of less than block size. This commentator requested that the Commission provide standards for identifying those persons who are willing to deal on a regular and continuous basis and for determining "block size." The definition of third market maker contained in the Rule is similar to the definition of "market maker" contained in Section 3(a)(38) of the

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[53] **See** Rule 11Ac1-1(a)(15) and discussion **supra** at p. 24.

[54] **See** note 49 **supra**, in which the Commission has indicated that it expects that information furnished by quotation vendors will indicate when this exception is in effect.

[55] 1977 Release, **supra** note 13, at 27, 42 FR 32418, 32421.

[56] **Id.** at 27-30, 42 FR 32418, 32421-22.

[57] Comments of the Council on Wage and Price Stability on Eligible Securities, Dissemination of Quotations, October 6, 1976, in File No. S7-648.

[58] Section 11A(a)(1)(D) of the Act [15 U.S.C. 78k-1(a)(1)(D)].

Act [15 U.S.C. 78c(a)(38)], and should be sufficiently clear to identify persons acting in that capacity. Since the amount of securities which constitutes a "block" will vary from issue to issue, depending in part upon the trading characteristics of the issue (e.g., price, volume and liquidity), a specific definition of that term would appear to be unduly rigid.

2. One commentator requested that the Commission further define the standards under which it would grant exemptions from the Rule. The exemptive provisions of the Rule are designed to exempt market centers which do not account for any significant trading in reported securities or which would suffer economic burdens which are not justified by the purpose of the Act,[59] and to deal with other market structure developments.[60]

The Commission believes that a broad exemptive provision is necessary to provide flexibility in those instances when application of the Rule would be inappropriate.

3. Another commentator has made a number of technical suggestions, most of which the Commission feels are beyond the intended scope of the Rule. In essence, this commentator suggested that the Commission mandate the specifications of communication linkages between self-regulatory organizations and vendors and that the Commission require exchanges and associations to name an exclusive processor of quotations and make available quotations in a manner which will reduce stress on vendor computer hardware.

When the Commission deferred further action on proposed Rule 17a-14 under the Act,[61] which would have permitted exchanges and associations to file plans for the collection and dissemination of quotations, similar to the plan required to be filed under Rule 17a-15 under the Act with respect to last sale reports, it determined that industry forces should be allowed to create the means of collection, dissemination and display of quotations without direct Commission action. The implication of this decision to defer action on Rule 17a-14 was that, if the industry, after sufficient time, had not taken reasonable steps in creating appropriate procedures and facilities, the Commission would once again consider direct intervention. However, steps taken to date indicate that the exchanges, associations and vendors are responding to this challenge. The Commission believes that any arrangement between all of the various exchanges and associations leading to centralized processing, sequencing and validation of quotation information would be beneficial and it encourages the exchanges and associations to pursue such arrangements. With respect to technical specifications governing the method of transmitting quotation information, the Commission believes that these matters should be addressed, at least initially, by the self-regulatory organizations and the vendors, in keeping with the Commission's prior determination to rely upon the private sector to implement mechanisms for collection, dissemination and display of quotation information. The Commission sees no apparent utility in mandating these specifications and is confident that the vendors and self-regulatory organizations will satisfactorily resolve any problems which might impede the successful development of a composite quotation system.

IV. Statutory Basis and Competitive Considerations

The Securities and Exchange Commission hereby adopts Rule 11Ac1-1 [17 CFR §240.11Ac1-1] pursuant to its authority under the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq., as amended by Pub. L. No. 94-29 (June 4, 1975)], and particularly Sections 2, 3, 6, 9, 10, 11A, 15, 15A, 17 and 23 thereof (15 U.S.C. 78b, 78c, 78f, 78i, 78j, 78k-l, 78o, 78o-3, 78q and 78w).

For the reasons expressed in this release, the Commission finds that the Rule does not impose any burden on competition which is neither necessary nor appropriate in furtherance of the purposes of the Act.

The text of Rule 11Ac1-1 is as follows:

§240.11Ac1-1 Dissemination of quotations for reported securities.

(a) **Definitions.** For purposes of this section,

(1) The term "third market maker" shall mean any broker or dealer who holds himself out as being willing to buy and sell a reported security for his own account on a regular and continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such broker or dealer who also represents, as agent, orders to buy or sell reported securities on behalf of any other person and com-

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[59] See note 47 supra.

[60] For example, it may be necessary to use the exemptive provisions of the Rule to accommodate the Regional Market System employed on a pilot basis by the Boston, Cincinnati, Midwest and Pacific Stock Exchanges in the event this system eventually reflects all buying and selling interest in those securities traded in the system at all participating exchanges.

[61] See Securities Exchange Act Release No. 11288 (March 11, 1975) at 2, 40 FR 15015, 15016.

municates bids and offers to a national securities association ("association") pursuant to this section on behalf of such other persons as well as for his own account).

(2) The term "exchange market maker" shall mean any member of a national securities exchange ("exchange") who is registered as a specialist or market maker pursuant to the rules and regulations of such exchange.

(3) The term "responsible broker or dealer" shall mean

(i) when used with respect to bids or offers communicated on the floor of an exchange, any member of such exchange who communicates to another member on the floor of such exchange, at the location (or locations) designated by such exchange for trading in a reported security, a bid or offer for such reported security, as either principal or agent; **provided, however**, That, in the event two or more members of an exchange have communicated on the floor of such exchange bids or offers for a reported security at the same price each such member shall be considered a "responsible broker or dealer" with respect to that bid or offer, subject to the rules of priority and precedence then in effect on that exchange; and **further provided** That, with respect to a bid or offer which is transmitted from one member of an exchange to another such member who undertakes to represent such bid or offer on the floor of such exchange as agent, only the last such member who undertakes to represent such bid or offer as agent shall be considered the "responsible broker or dealer" with respect to that bid or offer; and

(ii) when used with respect to bids and offers communicated by a third market maker to another broker or dealer or to a customer otherwise than on an exchange, the third market maker communicating the bid or offer (regardless of whether such bid or offer is for his own account or on behalf of another person).

(4) The term "quotation vendor" shall mean any securities information processor engaged in the business of disseminating to brokers and dealers, on a real-time or current and continuing basis, bids and offers made available pursuant to this section, whether distributed through an electronic communications network or displayed on a terminal or other display device.

(5) The term "consolidated system" shall mean the consolidated transaction reporting system contemplated by §240.17a-15 (Rule 17a-15 under the Act).

(6) The term "reported security" shall mean any equity security as to which last sale information is reported in the consolidated system.

(7) The term "make available," when used with respect to bids, offers, quotation sizes and aggregate quotation sizes supplied to quotation vendors by an exchange or association, shall mean to provide circuit connections at the premises of the exchange or association supplying such data, or at a common location determined by mutual agreement of the exchanges and associations, for the delivery of such data to quotation vendors.

(8) The terms "bid" and "offer" shall mean the bid price or the offer price most recently communicated by an exchange member or third market maker to any broker or dealer, or to any customer, at which he is willing to buy or sell a particular amount of a reported security, as either principal or agent, but shall not include indications of interest.

(9) The terms "published bid" and "published offer" shall mean the bid or offer (as the case may be) of a responsible broker or dealer for a reported security communicated by him to his exchange or association pursuant to this section and displayed by a quotation vendor on a terminal or other display device at the time an order is presented for execution to such responsible broker or dealer.

(10) The term "quotation size," when used with respect to a responsible broker's or dealer's bid or offer for a reported security, shall mean (i) the number of shares (or units of trading) of that reported security which such responsible broker or dealer has specified, for purposes of dissemination to quotation vendors, that he is willing to buy at the bid price or sell at the offer price comprising his bid or offer, as either principal or agent, or (ii) in the event such responsible broker or dealer has not so specified, a normal unit of trading for that reported security.

(11) The term "published quotation size" shall mean the quotation size of a responsible broker or dealer communicated by him to his exchange or association pursuant to this section and displayed by a quotation vendor on a terminal or other display device at the time an order is presented for execution to such responsible broker or dealer.

(12) The term "aggregate quotation size" shall mean the sum of the quotation sizes of all responsible brokers or dealers who have communicated on the floor of an

exchange bids or offers for a reported security at the same price.

(13) The term "published aggregate quotation size" shall mean the aggregate quotation size calculated by an exchange and displayed by a quotation vendor on a terminal or other display device at the time an order is presented for execution to a responsible broker or dealer.

(14) The term "odd-lot" shall mean an order for the purchase or sale of a reported security in an amount less than a normal unit of trading.

(15) The term "specified persons," when used in connection with any notification required to be provided pursuant to paragraphs (b)(3)(i) and (b)(3)(ii) of this section, shall mean

(i) each quotation vendor;

(ii) the processor for the consolidated system; and

(iii) the processor for the Options Price Reporting Authority (in the case of a notification with respect to a reported security which is a class of securities underlying options admitted to trading on any exchange).

[b] Dissemination requirements for exchanges and associations.

(1) Every exchange and association shall establish and maintain procedures and mechanisms for collecting bids, offers, quotation sizes and aggregate quotation sizes from responsible brokers or dealers who are members of such exchange or association (as the case may be), processing such bids, offers and sizes, and making such bids, offers and sizes available to quotation vendors, as follows:

(i) Every exchange shall, at all times such exchange is open for trading, collect, process and make available to quotation vendors the highest bid and the lowest offer communicated on the floor of that exchange (or, in the event such exchange maintains more than one trading floor, communicated on any of such floors) by any responsible broker or dealer (excluding any such bid or offer which is executed immediately after communication and any such bid or offer communicated by a responsible broker or dealer other than an exchange market maker which is cancelled or withdrawn if not executed immediately after communication) for each reported security listed or admitted to unlisted trading privileges on that exchange except during any period when trading in that security has been suspended or halted, or prior to the commencement of trading in that security on any trading day, on that exchange;

(ii) Every association shall, at all times last sale information with respect to reported securities is reported in the consolidated system, collect, process and make available to quotation vendors the highest bid and lowest offer communicated otherwise than on the floor of an exchange by each member of such association acting in the capacity of a third market maker for a reported security and the identify of that member (excluding any such bid or offer which is executed immediately after communication), except during any period when over-the-counter trading in that security has been suspended; and

(iii) Every bid and offer made available to quotation vendors by an exchange or association pursuant to this section shall be accompanied by the quotation size or the aggregate quotation size (as the case may be) associated with it.

(2) Each exchange shall, with respect to each published bid and published offer representing a bid or offer of a member, establish and maintain procedures for ascertaining and disclosing to other members of that exchange, upon presentation of orders sought to be executed by them in reliance upon paragraph (c)(2) of this section, the identity of each responsible broker or dealer who made such bid or offer and the quotation size associated with it.

(3)(i) If, at any time an exchange is open for trading, such exchange determines, pursuant to rules and regulations approved by the Securities and Exchange Commission pursuant to Section 19(b)(2) of the Act, that the level of trading activity or the existence of unusual market conditions is such that the exchange is incapable of collecting, processing and making available to quotation vendors the data with respect to a reported security required to be made available pursuant to paragraph (b)(1) of this section in a manner which accurately reflects the current state of the market on the floor of such exchange, such exchange shall immediately notify all specified persons of that determination. Upon such notification,

responsible brokers or dealers who are members of that exchange shall be relieved of their obligation under paragraph (c)(2) of this section and such exchange shall be relieved of its obligations under paragraphs (b)(1) and (2) of this section with respect to that security; **provided, however**, That such exchange shall continue, to the maximum extent practicable under the circumstances, to collect, process and make available to quotation vendors such data for that security in accordance with paragraph (b)(1) of this section.

(ii) During any period an exchange, or any responsible broker or dealer who is a member of that exchange, is relieved of any obligation imposed by this section with respect to any reported security by virtue of a notification made pursuant to paragraph (b)(3)(i) of this section, such exchange shall monitor the activity or conditions which formed the basis for such notification and shall immediately renotify all specified persons when that exchange is once again capable of collecting, processing and making available to quotation vendors the data with respect to that security required to be made available pursuant to paragraph (b)(1) of this section in a manner which accurately reflects the current state of the market on the floor of such exchange. Upon such renotification, any exchange or responsible broker or dealer which had been relieved of any obligation imposed by this section as a consequence of the prior notification shall again be subject to such obligation.

(4) Nothing in this section shall preclude any exchange or association from making available to quotation vendors indications of interest at any time or bids and offers with respect to a reported security at any time such exchange or association is not required to do so pursuant to paragraph (b)(1) of this section.

(c) **Obligations of responsible brokers and dealers.**

(1) Every responsible broker or dealer shall promptly communicate to his exchange or association (as the case may be), pursuant to procedures established by that exchange or association, his bids, offers and quotation sizes.

(2) Subject to the provisions of paragraph (c)(3) of this section, every responsible broker or dealer shall be obligated to execute any order to buy or sell a reported security, other than an odd-lot order, presented to him by another broker or dealer, or any other person belonging to a category of persons with whom such responsible broker or dealer customarily deals, at a price at least as favorable to such buyer or seller as the bid price or offer price comprising such responsible broker's or dealer's published bid or published offer (exclusive of any commission, commission equivalent or differential customarily charged by such responsible broker or dealer in connection with execution of any such order) in any amount up to his published quotation size.

(3)(i) If, (A) prior to the presentation of an order for the purchase or sale of a reported security, a responsible broker or dealer has communicated to his exchange or association (as the case may be), pursuant to paragraph (c)(1) of this section, a quotation size superseding his published quotation size (a "revised quotation size"), or, (B) at the time an order for the purchase or sale of a reported security is presented, a responsible broker or dealer is in the process of effecting a transaction in such reported security, and, immediately after the completion of such transaction, he communicates to his exchange or association (as the case may be) a revised quotation size, such responsible broker or dealer shall not be obligated by paragraph (c)(2) of this section to purchase or sell a reported security in an amount greater than such revised quotation size.

(ii) No responsible broker or dealer shall be obligated to execute a transaction for any reported security as provided in paragraph (c)(2) of this section if,

(A) before the order sought to be executed is presented, such responsible broker or dealer has communicated to his exchange or association (as the case may be) pursuant to paragraph (c)(1) of this section, a bid or offer superseding his published bid or published offer (a "revised bid or offer"); or

(B) at the time the order sought to be executed is presented, such responsible broker or dealer is in the process of effecting a transaction in such reported security, and, immediately after the completion of such transaction, such responsible broker or dealer communicates to his exchange or association (as the case may be) pursuant to paragraph (c)(1) of this section, a revised bid or offer;

provided, however, That such responsible broker or dealer shall nonetheless be

obligated to execute any such order in such reported security as provided in paragraph (c)(2) of this section at his revised bid or offer in any amount up to his published quotation size or revised quotation size (as the case may be).

(d) **Exemptions.**

The Commission may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any responsible broker or dealer, exchange, or association if the Commission determines that such exemption is consistent with the public interest, the protection of investors and the removal of impediments to and perfection of the mechanism of a national market system.

(e) **Effective Date.**

The effective date of this section shall be May 1, 1978.

(Secs., 2, 3, 6, 9, 10, 15, 17, 23, Pub. L. No. 78-291, 48 Stat. 881, 882, 885, 889, 891, 895, 897, 901, as amended by Secs. 2, 3, 4, 11, 14, 18, Pub. L. No. 94-29, 89 Stat. 97, 104, 121, 137, 155 (15 U.S.C. 78b, 78c, 78f, 78i, 78j, 78o, 78q, 78w, as amended by Pub. L. No. 94-29 (June 4, 1975)); Sec. 1, Pub. L. No. 75-719, 52 Stat. 1070, as amended by Sec. 12, Pub. L. No. 94-29, 89 Stat. 127-131 (15 U.S.C. 780-3, as amended by Pub. L. No. 94-29 (June 4, 1975)); Sec. 7, Pub. L. No. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1)).

By the Commission.

George A. Fitzsimmons
Secretary

January 26, 1978

The following is the full text of the proposed amendment to Part III of Schedule D of the Association's By-Laws relating to the Association's Consolidated Quotations Service. (New language indicated by underlining, deleted language indicated by brackets.)

III

CONSOLIDATED QUOTATIONS SERVICE

A. Description of Service

The Consolidated Quotations Service (CQS) [will] provides the subscriber with access to bid/ask quotations and quotation sizes for securities listed on national stock exchanges. [Initially,] The CQS [will] includes [approximately 2,000] all common stocks, preferred stocks, warrants and rights registered or admitted to unlisted trading privileges on the American Stock Exchange, and the New York Stock Exchange and certain securities listed on the regional stock exchanges. The Subscriber will have access to quotations and quotation sizes in such securities from all registered CQS Third Market Makers and the American, Boston, Midwest, New York, Pacific and Philadelphia Stock Exchanges. Quotations [entered and displayed by registered Third Market Makers] are required by SEC Rule 11Ac1-1 to be firm for the displayed size or if no size is displayed for [at least] a normal unit of trading.

The CQS will operate between 9:00 a.m. and 6:30 p.m. Eastern Time. All quotations for marketplaces that are open will be listed

according to the best bid quotation or the best ask quotation following the quotations of the open marketplaces. If a stock exchange suspends trading in a security, a "HALT" notation will be displayed along with the last quotation. During any such suspension, quotations from marketplaces remaining open will continue to be displayed.

B. Definitions

(1) Third Market Maker - Any broker or dealer who holds himself out as being willing to buy and sell a reported security for his own account on a regular and continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such broker or dealer who also represents, as agent, orders to buy or sell reported securities on behalf of any other person and communicates bids and offers to the Corporation on behalf of such other persons as well as for his own account).

(2) Reported Security - Any equity security as to which last sale information is reported in the consolidated transaction reporting system (Consolidated Tape).

[B.] C. Initiating Service

[Any member who desires to enter and display bid/ask quotations for CQS securities may apply for registration as a Third Market Maker.]

Every Third Market Maker shall communicate to the Corporation through the NASDAQ System his bids, offers and quotation sizes in reported securities by registering with the Corporation as a Third Market Maker. If accepted for registration and a terminal is in place, a Third Market Maker's registration shall be effective at the start of business on the second business day following receipt of its application by the Corporation. Otherwise registration shall be effective at the start of business on the second business day following installation of the terminal.

[C. Character of Quotations Entered into the CQS

A registered Third Market Maker which receives a buy or sell order must execute a trade for at least a normal unit of trading at its quotations as they appear on the CQS CRT screens at the time of receipt of any buy or sell order. Each quotation entered and displayed by a registered Third Market Maker must be reasonably related to the prevailing market.]

D. Obligations of Third Market Makers

The rules and regulations with respect to the obligations of Third Market Makers in reported securities are contained in SEC Rule 11Ac1-1 which is hereby incorporated as part of this Schedule D. Rule 11Ac1-1 is reprinted at paragraph

Paragraphs D., E., F., and G. are redesignated E., F., G. and H.