NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 83-62

November 18, 1983

TO: Selected NASD Members

RE: American Telephone and Telegraph Company (AT & T) Divestiture

Under the AT & T divestiture program, for every ten shares of existing ("old") AT & T owned, shareholders of record December 30, 1983 will receive one share in each of seven newly-formed regional holding companies, while continuing to own ten shares of divested ("new") AT & T as well.

Beginning Monday, November 21, 1983, "when-issued" trading will commence in the seven regional holding companies and new AT & T, and is expected to continue until mid-February, 1984. Old AT & T will trade with due bills from January 3, 1984 to mid-February, 1984 representing the spin-off ownership in the holding companies.

This pending AT & T divestiture and the anticipated heavy when-issued trading volume expected to occur during the relatively long when-issued trading period is a matter of concern especially in the areas of credit requirement and net capital. The Association in cooperation with the Securities and Exchange Commission (SEC) and New York Stock Exchange (NYSE) has been active in developing an approach to address these concerns.

Accordingly, subject to SEC approval, the NASD in conjunction with the NYSE is requiring accounts otherwise exempt from margin requirements for when-issued transactions to make and maintain specified margin deposits. In connection therewith, the Board of Governors has enacted a temporary amendment to Appendix A of Section 30 of the Rules of Fair Practice making the exception to the margin requirements of Appendix A inapplicable with respect to when-issued transactions in special cash accounts for accounts of broker-dealers, banks, trust companies, investment companies, investment trusts, insurance companies, charitable or non-profit educational institutions and similar fiduciary type accounts hereafter referred to as "exempt" accounts. This temporary amendment is solely for the purpose of when-issued trading in the securities of AT & T and its regional holding companies and will be in effect only until such when-issued trading has terminated.

Furthermore, the amendment will require that fiduciary accounts such as those described above deposit initial margin of 10% for each when-issued transaction and thereafter maintain a minimum maintenance of 7%. A more detailed discussion of these special margin requirements appears in Section II below.

With this as background, members should be aware of the following areas that may be affected by the AT & T divestiture stock distribution:

I. Options Available to Certain AT & T Stockholders of Record

AT & T stockholders of record December 30, 1983 who own from 10 to 499 shares are being given the following three options:

1. Receive whole shares in any or all of the regional companies, with cash payment for fractional shares;

2. Deposit shares in each regional company's dividend reinvestment plan;

3. Sell their holdings in one or more of the regional companies and buy stock in other regional companies.

In mid-January, 1984, AT & T plans to mail to these stockholders their option cards, but shareholders will have until April, 1984 to elect what distribution they desire. Because of the substantial time interval, the Association strongly recommends that members require their customers to immediately complete and return their option card to AT & T to insure that the new shares are promptly distributed to them. Before accepting a when-issued sell transaction in any regional company, members should determine which option their customer will elect because up to April, 1984, AT & T will not deliver any shares prior to their having received an executed option card signed by the stockholder. After April, 1984, only whole shares in the regional companies will be distributed, with cash payment made for any fractional shares. Thereafter, members have the responsibility for obtaining the necessary securities against sales to complete delivery on settlement date at the time the when-issued transactions go regular way.

II. Application of Regulation T to When-Issued Transactions

A. Cash Account

1. Regulation T, Section .8(b) requires full cash payment for customer purchases within 7 business days of the date any when-issued security is made available by the issuer for delivery to purchasers. Since the when-issued securities will not be available until the middle of February, 1984, payment under Regulation T for cash account purchases will not be required until late February, 1984. (See Ninety-Day Freeze Section below.)

Notwithstanding this, NASD Rule of Fair Practice 30, Appendix A, Section 6 (paragraph 2180A) requires that transactions in when-issued securities executed in cash accounts are subject to the same margin maintenance requirements and marks-to-market as they would have were they executed in a margin account. (See Section II B. for details.)

Although fiduciary-type accounts as identified in Section 6 are not subject to this margin requirement, the Board's action to adopt a temporary rule amendment as noted above renders this exception inapplicable and these types of accounts will now be required to deposit 10% of the contract price for each when-issued security transaction within seven business days from the date of the transaction and to maintain thereafter a minimum maintenance requirement of 7%.

Members must take prompt and appropriate action when accounts fail to provide initial deposits or meet subsequent maintenance requirements. Charges to capital for deficits in accounts are discussed in Section V below.

2. <u>90-Day Freeze in Cash Accounts</u>

Section .8(c) of Regulation T requires that a customer's cash account be frozen for a period of 90 calendar days if a non-exempt security in the account is sold or delivered to another broker-dealer without having been previously paid for in full by the customer. Subsequent purchases can be effected only if cash is deposited in the account prior to execution or if proper authorization is obtained from the NASD or a national securities exchange.

Section .8(c) of Regulation T is applicable to transactions in all AT & T when-issued securities. Therefore, if a customer sells an existing when-issued position, full cash payment for the purchase must be made during the period of time between the purchase and sale. If not, the account is subject to a 90-day freeze period which would begin on the date of the sale of an AT & T when-issued security, regardless of the date it was previously purchased.

B. <u>Margin Accounts</u>

NASD Rule of Fair Practice, Article III, Section 30 and Regulation T apply to when-issued transactions which take place in margin accounts. Specifically, Section .5(a) of Regulation T requires that a when-issued transaction in a margin account be treated for margin purposes as if the security were an issued margin security. Therefore, all margin requirements apply, i.e. 50 percent initial margin requirement on net long or net short when-issued commitments, plus any unrealized loss or less any unrealized profit on the commitment. Should an account with a net short when-issued commitment have a net long position in the related issued security, no margin is required.

Section 5 of Appendix A of the NASD's Rule of Fair Practice Article III, Section 30 requires that the minimum amount of margin maintained in any transaction or net position in each when-issued security be the same as if that security were issued. As such, when-issued positions are fully subject to the Association's minimum margin maintenance requirements as described in Appendix A, Section 4. Briefly, minimum margin maintenance is the greater of $2,000 or:

- 25% of the market value of all net long positions;
- $5 per share or 30% of market value (whichever is greater) of each stock short in the account with a market value of $5 per share or above;
- For purchases under $2,000, a deposit equal to the total cost must be made.

Section 5 of Appendix A also requires that <u>each</u> position in a when-issued security be marked to the market separately to determine margin maintenance requirements, and any unrealized profit applied only to the amount of margin required on the position in the particular security. A short position in a when-issued security in an account that is also long the securities upon which the when-issued security is to be issued should be marked to the market and the balance in the account adjusted for any unrealized loss.

The current market value of all fully-paid securities (including the underlying security) held in a cash account may be used as an offset to the mark-to-the-market capital charge after deducting from the total value NASD maintenance requirements for such securities, provided such securities are held in negotiable form.

III. Transaction Reporting

As NASD Notice to Members 83-59 advises, all seven regional holding companies, while to be listed on the New York Stock Exchange, are fully subject to SEC Rule 19c-3.

All requirements for reporting transactions to the Consolidated Tape as specified by the provisions of Article XVIII, Schedule G of the Association's By-Laws apply to member transactions in any of the AT & T when-issued securities which are executed in the over-the-counter market. Inasmuch as these securities are subject to Rule 19c-3, any market maker in CQS is a "Designated Reporting Member" for purposes of Schedule G. Members are referred to Schedule G (paragraph 1681) for details.

With regard to when-issued trading in AT & T divested securities only, orders received prior to the opening of the reporting member's market in each such security which are simultaneously executed at the opening at the same price may be aggregated (i.e. bunched) for transaction reporting purposes into a single transaction report. However, members should not use the modifier (.B) to identify a bunched trade report in AT & T when-issued securities. Bunching is only permitted for pre-opening orders.

Members reporting bunched trades are required to identify in their records all of the individual orders that were aggregated for each bunched trade reported.

IV. Clearing of AT & T When-Issued Transactions

Those NASD firms that are members of the National Securities Clearing Corporation (NSCC) have already received notifications from NSCC describing its plans for processing when-issued trades in divested AT & T and the seven regional holding companies. Briefly, NSCC will establish a special when-issued account that will produce when-issued contracts on machine-readable output, as well as on conventional hard-copy reports.

Members are reminded that NSCC will be computing daily cash marks-to-the-market which could potentially result in substantial daily cash demands. Members are encouraged to become familiar with NSCC's comparison and clearance systems for AT & T so that they can effectively meet their commitments during the when-issued trading period and on settlement date in February, 1984.

V. Special Net Capital Provisions

During the period of when-issued trading, the SEC is granting special temporary net capital treatment to (i) the securities haircut requirements applicable to proprietary positions under subparagraphs (c)(2)(vi) and (c)(2)(viii) of Rule 15c3-1 all securities involved in the AT & T divestiture which are cleared through the facilities of a registered clearing agency on a continuous net settlement (CNS) system; and (ii) deficits in special cash accounts of "exempt" accounts.

		Positions	Haircut
A.			
1.		Long AT & T (old shares)	
	a.	Long position only	15% of long market value
	b.	Long position and short equal when-issued positions of divested issues (flat after February, 1984 regular way settlement date)	5% of when-issued market value
	c.	Long position and short some when-issued positions of divested issues.	5% of when-issued market value plus 15% of unhedged net long market value
2.		Short AT & T (old) shares	
	a.	Short position only	15% of short market value
	b.	Short position and long position equal when-issued position in divested issues (flat after February, 1984 regular way settlement date)	5% of short market value
	c.	Short position and long some when-issued positions of divested issues	5% of long when-issued market value plus 15% of unhedged net short market value, plus mark-to-market loss if any. (Gains can be used to reduce haircuts.)
3.		When-Issued Positions	
	a.	Net long or short positions in any issue (each issue must be considered separately)	15% of market value plus mark-to-market loss if any. (Gains can be used to reduce haircut.)
	b.	Matching long and short positions in any issue	Deduct net loss if any for all matched positions taken together. Ignore net gain.

4. Undue Concentration

a.	Market value of net long or short positions in any issue exceeding 10% of tentative net capital. (Shares of divestiture issues to be received will be included.)	7 1/2%

5. Options

a. In the money options for pre-divestiture shares offset by when-issued positions will be given the same consideration as long or short positions in 1 and 2 above adjusted for strike price and mark-to-market consideration, (i.e. matched) - 5%; net short unmatched 15% of market value of underlying shares.

b. Out of the money options will be treated as in subparagraph (c)(2)(x) or Appendix A of Rule 15c3-1 as appropriate, subject to a 15% haircut where deductions are based on underlying securities values.

B. Customer Accounts

The net capital charge for deficits in customer accounts after application of margin calls outstanding five business days or less is 100% of the deficit amount as required by subparagraph (c)(2)(iv)(B) of Rule 15c3-1. However, in the case of those "exempt" accounts subject to the above-noted 10% and 7% requirements, the net capital charge after application of calls for margin outstanding less than five business days shall be based on the amount of the deficit in relation to the member's excess net capital as follows:

	Condition	Charge to Net Capital
1.	For "exempt" accounts where trades are affirmed through the Depository Trust Corporation's Institutional Delivery System (DTC-IDS):	
a.	Deficit up to 10% of excess net capital	10% of deficit
b.	Deficit over 10% but not over 20% of excess net capial	25% of deficit
c.	Deficit over 20% of excess net capital	100% of deficit

2.	For "exempt" accounts whose trades are not affirmed through DTC-IDS:	
a.	Deficit up to 10% of excess net capital	25% of deficit
b.	Deficit over 10% of excess net capital	100% of deficit
3.	Total deficits in all "exempt" accounts combined, less amount of deficits charged per 1 and 2 above:	
a.	Up to 100% of excess net capital	No charge
b.	Over 100% of excess net capital	100% of deficit which exceeds 100% of excess net capital
4.	Short due bill securities	
	If payment of proceeds is made to any customer against receipt of AT & T shares with due bills, the due bill positions will be treated as unsecured shorts.	100% of the market value of the due bill securities

C. Other

- "Exempt" accounts can meet margin requirements by depositing with the broker-dealer cash or readily marketable securities. If there are legal impediments to the depositing of cash or securities, then Letters of Credit or Guarantee can be accepted by the member. However, these letters will be given no value for purposes of Rule 15c3-1 when computing deficits in B above.

- Excess net capital may be based on the most recently required SEC Rule 15c3-1 capital computation.

- For valid reasons, members may request extensions of time for initial or maintenance deposits using existing NASD Regulation T processing procedures and forms.

- For when-issued positions, the amount of deficit may be calculated by netting gains or losses in matched when-issued long and short positions in one when-issued AT & T security with the others taken together.

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The Association cautions members who plan to actively engage in when-issued trading of the AT & T divested issues to be aware at all times of their cash and capital needs and to establish in-house procedures to assure that trading activity for both proprietary and customer accounts is being maintained within levels permitted by the firm's cash flow resources and excess net capital. The Association will be monitoring designated members' activities in this area and will be watching closely for any impact on a firm's financial and operational condition that might result from market movements in all AT & T issues. The Association's normal surveillance programs may be expanded to require the filing of special reports relative to AT & T trading activity if conditions warrant.

Members are encouraged to discuss with their local NASD District Office their plans for AT & T trading and to keep the District Office apprised of any significant changes.

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Any questions about this notice should be directed to Darrell Proctor, Associate Director - Financial Responsibility, at (202) 728-8236 or Thomas Cassella, Director - Financial Responsibility, at (202) 728-8237. Questions about trade reporting should be addressed to Stephen Hickman in Market Surveillance at (202) 728-8201.

Sincerely,

Frank J. Wilson
Executive Vice President
Legal and Compliance