

NASD

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

notice to members 85-51

August 2, 1985

TO: All NASD Members

RE: Donald E. Sheldon & Co., Inc.
One Wall Street
New York, New York 10005

ATTN: Operations Officer, Cashier, Fail-Control Department

On July 30, 1985, the United States District Court for the Southern District of New York appointed a Temporary Receiver for the above-captioned firm.

Members may use the "immediate close-out" procedures as provided in Section 59(i)(2) of the NASD's Uniform Practice Code to close out open OTC contracts. Also, MSRB Rule G-12(h)(iii) provides that members may use the above procedures to close out transactions in municipal securities.

Questions regarding the firm should be directed to:

Temporary Receiver

Stanley T. Lesser, Esquire
Kaye, Scholer, Fierman,
Hays & Handler
425 Park Avenue
New York, New York 10022
Telephone: (212) 407-8000

NASD

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

notice to members 85-52

August 5, 1985

IMPORTANT

TO: All NASD Members and Other Interested Persons

RE: SEC Request for Comment on Issues Relating to the Designation of NASDAQ/NMS Securities

In November 1984, the SEC approved, by a split vote, the NASD's long-standing petition that the Commission amend its rule governing the qualifications for companies seeking inclusion in the NASDAQ National Market System.

This landmark decision which, in essence, substitutes qualitative standards for market activity criteria, made an additional 1,500 National Newspaper List companies eligible for admission to the NASDAQ National Market System. In the opinion of the NASD Board, it has been one of the most important developments to have occurred in the continuing development of our nation's securities markets, and a decision that has resulted in substantial benefits for investors, NASDAQ companies and the securities industry. NASDAQ/NMS combines up-to-the-minute last-sale reporting characteristics of the major stock exchanges with the unique strength of the NASDAQ market -- its highly competitive network of competing dealers.

Notwithstanding the benefits that are directly attributable to this decision, the SEC has determined to revisit this very issue less than eight months later. It is doing so mainly in response to complaints from competing markets during the rulemaking proceeding, particularly the American Stock Exchange, which claimed that the NASD was using "NMS designation" as a marketing device in competing with the exchanges for "listings."

Among the questions being raised by the SEC at this time are:

- Is the NMS Securities Rule still necessary in its present form to maintain last-sale reporting in the NASDAQ market?

- If the NMS Securities Rule is no longer essential for that purpose, should the entire group of NASDAQ stocks that have last-sale reporting continue to be designated as NASDAQ/NMS securities?
- Is last-sale reporting sufficiently developed in the NASDAQ market that issuer choice should be removed from the Tier 2 designation criteria? In other words, should some or all of the securities that satisfy the Tier 2 criteria now be designated automatically in the same manner as securities qualified for Tier 1?
- If the NMS Securities Rule retains its current focus, is there a danger of misperception of the significance of NMS designation with respect to the investment quality of a stock? Would such possible misperceptions be ameliorated if NMS designation were not limited to NASDAQ stocks?
- To the extent the rule is deemed either to be no longer necessary to encourage NASDAQ last-sale reporting or to confer an unfair advantage on NASDAQ stocks designated as NMS securities, should the rule be refocused to designate other types of securities as NMS securities, i.e., securities listed on national securities exchanges, securities that essentially meet New York or American Stock Exchange listing criteria, securities traded in two or more markets, and securities traded through the Intermarket Trading System of the exchanges and the NASD?

NASDAQ companies have found that inclusion in NASDAQ/NMS has substantially improved the visibility of their stocks and the amount of market data that is available regarding their trading. Many have found, too, that they have attracted additional institutional investors, overseas interest and other investors who use market data and technical analyses. NASD members have confirmed the companies' findings.

As the foregoing list of questions suggests, the SEC is still responding to complaints from competing markets about issues that were thought to be settled less than one year ago. It is essential, therefore, that NASD members make their views known. At stake is the future visibility and credibility of the NASDAQ National Market System which paradoxically is an innovation of the SEC and one of its most successful efforts.

In commenting to the SEC, it is suggested that you convey your enthusiastic support for NASDAQ/NMS to the SEC by addressing the following:

- What designation as a NASDAQ/NMS security has meant to your customers.
- Why the NMS Securities Rule should be continued.
- Why the SEC should ignore the complaints of competing markets.

The NASD Board strongly believes that there is considerable danger in changing the NMS designation rule after it has been approved. It is baffling to think that something so successful, something that has produced substantial benefits for so many -- investors, NASDAQ companies, the securities industry -- and something that was decided only recently with extensive input from many NASD member firms, NASDAQ company CEO's and others could now be questioned by the same entity that created it, the SEC.

It is important to note that the NASD has never claimed an exclusive right to the term "National Market System." The NASD has repeatedly stated that NASDAQ/NMS is but a subsystem or component of a broader national market system. The NASD has never said that NASDAQ constitutes the national market system. There is no restriction on the use of the term National Market System by the exchanges for securities that were, in fact, NMS designated. The Amex's claim that the NASD has attempted to mislead investors and issuers through use of the "NMS" term is without foundation in fact. To the degree NASDAQ/NMS is successful in retaining companies, it is doing so on merit and not on unfair competition.

Further, the NASD, like the SEC, has not represented, nor would it, that designation as a "National Market System" security warrants the quality of the issuer of any security so designated. It does represent that at the time of inclusion in NASDAQ/NMS, certain threshold standards were met. NMS designation does not substitute, nor has it ever been intended to substitute, for the quality judgments of investors.

The SEC's release also raises the question of issuer choice in electing NMS designation. The thinking of the NASD Board has been that as issuers are free to select the market in which their shares are traded, so too they should be free to elect the segment of NASDAQ in which their shares are to be traded. As a practical matter, the overwhelming majority of eligible companies have sought inclusion in NASDAQ/NMS.

In its release, the SEC is also asking a number of collateral questions:

- If the SEC were to grant unlisted trading privileges to the exchanges, whether trading in NASDAQ/NMS securities should be integrated with exchange trading via existing or other possible linkages.
- Whether the NASD's best-execution rule provides displayed NASDAQ/NMS quotations with sufficient price protection.
- Whether short-sale rules should be applied to NASDAQ/NMS securities.

These questions are presently under discussion and study by several NASD committees, including the Market Surveillance Committee and the National Business Conduct Committee, prior to their formal consideration by the NASD Board of Governors. The NASD Board believes that this deliberative process should run its course. It would be much appreciated if NASD members would send their comments and suggestions on these issues to the Board.

* * *

All NASD members are urged to express their views on this release to the SEC on or before the comment period ending date of September 30, 1985. Your ideas and opinions are extremely important and the nature of your comments will substantially affect the final SEC decision on this matter.

Your comments to the SEC should reference File No. S7-737 and be directed to:

Mr. John Wheeler, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

If you have questions concerning the release that you would like answered before writing to the SEC, please feel free to call either John H. Hodges, Jr., Senior Vice President, Market Services, at (212) 839-6326, or S. William Broka, Vice President, NASDAQ Operations—Companies, at (202) 728-8050.

Finally, it would be very helpful to the NASD if you would send us a copy of your comment letter to the SEC. It may be sent to:

Mr. S. William Broka, Vice President
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Once again, it is important for your voice to be heard on these issues. The SEC's November 1984 decision on NMS was the right decision and under no circumstances should it now be dismantled.

Sincerely,



Gordon S. Macklin
President

Attachment

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-22127; File No. S7-737]

National Market System Securities

AGENCY: Securities and Exchange Commission.

ACTION: Solicitation of public comments.

SUMMARY: The Commission solicits comments on issues relating to the designation of securities as National Market System Securities. In connection with the recent expansion of the criteria for designation as a National Market System Security, the Commission believes that it would be useful to obtain comments on a broader range of issues regarding National Market System designation.

DATES: Comments to be received by September 30, 1985.

ADDRESSES: All comments should be submitted in triplicate to John Wheeler, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549. All comments should refer to File No. S7-737, and will be available for inspection at the Commission's Public Reference Room 450 Fifth Street NW., Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Andrew E. Feldman, Esq., (202) 272-2414, Room 5205, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Summary

Rule 11Aa2-1 ("NMS Securities Rule" or "Rule")¹ under the Securities Exchange Act of 1934 ("Act")² establishes procedures by which certain securities traded in the over-the-counter ("OTC") market are designated as qualified for trading in a national market system ("OTC/NMS Securities"). On December 18, 1984, the Commission adopted amendments to the Rule that increased the number of OTC securities eligible for designation as NMS Securities from approximately 1350 to approximately 2500.³ The Commission

believes it is appropriate to solicit comment on the direction which the designation process for National Market System ("NMS") Securities should take and the manner in which these securities should participate in the NMS. Accordingly, the Commission requests comment on the manner in which current OTC/NMS Securities should be integrated into additional NMS facilities and initiatives, and whether the Rule should be amended to focus on other groups of securities or to achieve different purposes.

II. Background

In the 1975 Amendments, Congress directed the Commission "to facilitate the establishment of a national market system for securities."⁴ In giving the Commission this broad mandate, Congress neither defined the term "national market system" nor specified the minimum components of such a system. Instead, Congress vested in the Commission "broad discretionary powers to oversee the development of a national market system" and "maximum flexibility" in working out its specific details in a manner consistent with the findings and goals of the 1975 Amendments.⁵

As part of the general mandate to facilitate the establishment of an NMS, Congress specifically directed the Commission, by rule, to "designate the securities or classes of securities qualified for trading in the national market system."⁶ The 1975 Amendments, however, were silent as to the particular standards the Commission should employ in designating NMS Securities. Similarly, the legislative history did not mandate the use of any particular standard in the designation process. Instead, Congress provided the Commission with the flexibility and discretion to base NMS designation

standards upon the Commission's experience in facilitating the development of a national market system. Given the Congressional desire that the system develop primarily through the interplay of market forces, such flexibility appears essential.⁷

On February 17, 1981, the Commission adopted the NMS Securities Rule. The Rule provides criteria and procedures by which certain securities traded exclusively OTC are designated as NMS Securities.

The primary effect of designating OTC stocks as NMS Securities at the present time is that transactions in such securities must be reported in a real-time system in accordance with the Commission's last sale reporting rule,⁸ and quotations for such securities must be firm as to the quoted price and size in accordance with the Commission's firm quotation rule.⁹ In adopting the Rule, the Commission determined, among other things, that real-time transaction reporting and firm quotations would increase market efficiency and enhance opportunities for public investors to obtain execution of their orders in the best possible market.¹⁰

The Rule employs a two-tiered approach for designation.¹¹ Tier 1, which became effective April 1, 1982, requires that the most actively traded OTC securities be designated as NMS Securities.¹² Tier 2, which became effective on February 1, 1983, permits certain additional OTC securities to become NMS designated at the election of the issuer.¹³

Based on the early trading experience of OTC/NMS Securities, the Commission and most industry participants concluded that last sale

¹ Amendments Release, *supra* note 3, at 737.

² 17 CFR 240.11Aa3-1.

³ 17 CFR 204.11Ac1-1.

⁴ See Adoption Release, *supra* note 1, at 13906.

⁵ OTC securities for which quotation information is disseminated in the National Association of Securities Dealers, Inc.'s ("NASD") electronic interdealer quotation system ("NASDAQ") are eligible for designation. The Rule provides for the removal of the NMS designation "[i]f such security becomes listed and registered, or admitted to unlisted trading privileges, on an exchange." 17 CFR 240.11Aa2-1(a), (b). In this regard, the Commission recently published for public comment a rule proposal that would allow certain NMS Securities also to be listed on a regional securities exchange. See Securities Exchange Act Release No. 21703 (February 1, 1985), 50 FR 7065.

In adopting the NMS Securities Rule, the Commission concluded that imposing NMS qualification criteria upon listed securities was unnecessary at that time because most listed securities already were included in NMS last sale and quotation disclosure facilities, and selection of less than all reported securities as NMS Securities could create unwarranted distinctions among these securities. Nonetheless, the Commission specifically left open whether exchange traded securities should be designated as NMS Securities in the future. See Adoption Release, *supra* note 1, at 13905.

¹² 17 CFR 240.11Aa2-1(b) (4)(i).

¹³ 17 CFR 240.11Aa2-1(b) (4)(ii).

⁴ Section 11A(a)(2) of the Act.

⁵ Senate Comm. on Banking, Housing, and Urban Affairs, *Report to Accompany S. 249: Securities Acts Amendments of 1975*, S. Rep. No. 94-75, 94th Cong., 1st Sess. 7-9 [Comm. Print 1975], *reprint in* [1975] U.S. Code Cong. & Ad News 179, 185-87 ["Senate Report"]. See also Securities Exchange Act Release No. 14416 (January 28, 1978), 43 FR 4354 ("January Statement"); Securities Exchange Act Release No. 15671 (March 22, 1979), 44 FR 20360 ("Status Report").

The 1975 Amendments establish that "[t]he securities markets are an important national asset which must be preserved and strengthened" through the application of "new data processing techniques." Section 11A(a)(1) of the Act. Congress found that these techniques should be used to foster intermarket linkages, enhance investor protection, and maintain fair and orderly markets. Congress stated as goals of an NMS the availability of quotation and transaction information, the efficient execution of transactions, fair competition between the markets, the execution of customer orders in the best possible market, and, where consistent with other goals, the execution of orders without the participation of a dealer. Section 11A(a)(2) of the Act.

⁶ Section 11A(a)(2) of the Act.

¹ 17 CFR 240.11Aa2-1. See Securities Exchange Act No. 17549 (February 17, 1981), 46 FR 13992 ("Adoption Release").

² 15 U.S.C. 78a *et seq.*, as amended by the Securities Acts Amendments of 1975 ("1975 Amendments"), Pub. L. 94-29 (June 4, 1975), 89 Stat. 97, [1975] U.S. Code Cong. & Ad. News 97.

³ Securities Exchange Act Release No. 21583 (December 18, 1984), 50 FR 730 ("Amendments Release"). At that time 1104 OTC securities had actually been designated as NMS Securities.

reporting and firm quotations have improved the markets for OTC/NMS Securities and benefited investors without imposing undue burdens on market makers.¹⁴ In February 1984, the NASD petitioned the Commission to expand the Tier 2 designation criteria to allow more issuers of OTC securities to elect NMS status.¹⁵ On December 18, 1984, the Commission amended the Tier 2 designation criteria to incorporate the standards used by the NASD in determining its National List (*i.e.*, the list of NASDAQ securities that the NASD supplies to the national news media), thereby increasing the number of OTC securities eligible for NMS designation from 1350 to approximately 2500.¹⁶

III. Discussion and Request for Comment

In adopting the Rule, the Commission stated that designating "OTC securities as NMS Securities and thereby including these Securities for the first time in a real-time transaction reporting system, is only one in a series of steps . . . toward the development of an NMS."¹⁷ In the nearly three years since the first OTC securities were designated as NMS Securities, the Commission believes that last sale reporting has become an established part of the OTC market. Accordingly, the Commission finds that the designation of OTC/NMS Securities has progressed sufficiently that it is now appropriate to consider the relative costs and benefits of taking additional steps in the development of an NMS.¹⁸

The Commission today solicits comment on several issues regarding NMS Securities. These issues include whether and how OTC/NMS Securities should be integrated into other NMS facilities and initiatives,¹⁹ and in particular the extent to which these securities should be made subject to trade-through and short sale rules.²⁰ A

further issue is whether the Rule should be amended to include exchange-traded securities or be revised to eliminate any unnecessary competitive burden on competing exchange markets.

A. Inclusion of OTC/NMS Securities in Additional Facilities and Initiatives

1. Linkages

The Commission has requested comment on whether exchanges should be granted unlisted trading privileges ("UTP") in OTC/NMS Securities.²¹ If the Commission determines to grant such requests,²² an important issue that must be addressed is the integration of OTC and exchange trading in these securities. In this regard, a fundamental finding of the 1975 Amendments was that "[t]he linking of all markets for [NMS] securities through communications and data processing facilities" would benefit investors and the securities markets.²³

Accordingly, the Commission solicits comment on whether OTC/NMS Securities should be integrated into existing or other possible linkages, and the manner in which this could be accomplished. In this regard, the Commission notes that the NASD has developed a Computer Assisted Execution System ("CAES") to link OTC market makers and to provide, among other things, an automated order routing and execution system. CAES also is linked to the Intermarket Trading System ("ITS").²⁴ The Commission requests comment on whether OTC/NMS Securities should be included in

CAES²⁵ and the ITS/CAES linkages.²⁶ In this connection, commentators should address whether inclusion should be accompanied with any changes in the present operation of these linkages.²⁷ The Commission requests commentators to consider whether any other linkage facilities would be appropriate for OTC/NMS Securities.

2. Price Protection

As early as 1973, the Commission indicated that the facilities of an NMS should provide a broker-dealer with the ability to insure that "his customer's order is executed in the best market available."²⁸ Similarly, the 1975 Amendments declared that "[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the practicability of brokers executing investor's orders in the best market. . . ."²⁹ In accord with these principles, the Commission has stated that "'trade-throughs' are inconsistent with the goals of a national market system."³⁰ In response to these concerns, the ITS Plan participants submitted, and the Commission approved, amendments to the ITS Plan that provide "trade-through" protection for displayed bids and offers for securities traded through ITS.³¹

In adopting the NMS Securities Rule, the Commission stated that it "may be appropriate to reexamine a broker-dealer's responsibilities with respect to the execution of a customer's order in an NMS Security" once OTC securities are

Act Release No. 21496 (November 16, 1984), 49 FR 46156 ("UTP Release"), and proposing amendments to its confirmation rule, Rule 10b-10 under the Act, requiring broker-dealers executing trades in reported securities as principal with customers to disclose the trade price and mark-up in the trade (Securities Exchange Act Release No. 21708 (February 4, 1985), 50 FR 5786.

²¹The Commission emphasizes that the question whether exchanges should be granted UTP in OTC securities is under consideration and no determination has been made.

²²UTP Release, *supra* note 20, at 46160.

²³Section 11A(a)(1)(D) of the Act.

²⁴The ITS is an intermarket linkage and order routing facility operated jointly pursuant to an NMS Plan by certain national securities exchanges and the NASD. The current ITS Plan participants are the New York ("NYSE"), American ("Amex"), Boston ("BSE"), Cincinnati ("CSE"), Midwest ("MSE"), Pacific ("PSE"), and Philadelphia ("Phlx") Stock Exchanges, and the NASD.

At present, the ITS/CAES interface links exchange and OTC markets in Rule 19c-3 securities. See Securities Exchange Act Release Nos. 17744 (April 21, 1981), 46 FR 23856; 18713 (May 9, 1982), 47 FR 20413; and 19372 (December 23, 1982), 47 FR 58287.

Rule 19c-3 under the Act eliminates exchange off-board trading restrictions for reported securities which were listed after April 26, 1979, or were listed on April 26, 1979 but ceased to be traded on an exchange for any period of time thereafter. Securities Exchange Act Release Nos. 16888 (June 11, 1980), 45 FR 41125; 17744 (April 21, 1981), 46 FR 23856; and 20074 (August 12, 1983), 48 FR 38250.

²⁵NMS Securities can now be traded in CAES at the election of one market maker; however, there is no requirement that all market makers in securities traded in CAES be participants in CAES. The Commission understands that trading activity in CAES continues to be very light. The Commission requests comments regarding whether all market makers trading in a CAES linked stock should be required to participate in CAES.

²⁶If OTC/NMS Securities were traded on an exchange pursuant to UTP, they would become Rule 19c-3 securities and thus eligible for inclusion in the ITS/CAES interface.

²⁷The Commission notes that orders entered into the ITS/CAES interface by exchange specialists are executed automatically, but that orders entered into ITS by CAES market makers are not. CAES market makers have complained that this disparity puts them at a competitive disadvantage in making markets in Rule 19c-3 securities. The exchange in return, have argued that this disparity was introduced by the NASD in designing CAES.

²⁸SEC, *Policy Statement on the Structure of a Central Market System*, at 17 (March 29, 1973) ("Policy Statement"), reprinted in [1973] Sec. Reg. & L. Rep. (BNA) No. 196 at D-1, D-4.

²⁹See Section 11A(a)(1)(C)(iv) of the Act.

³⁰Securities Exchange Act Release No. 17314 (November 20, 1980), 45 FR 79018, 79020 n.22. The term 'trade-through' generally refers to the execution of an order in one market center at a price inferior to that being displayed in another market center. *Id.* at 79019 n.12.

³¹Securities Exchange Act Release No. 17703 (April 9, 1981); Securities Exchange Act Release No. 19249 (November 17, 1982), 47 FR 53552.

¹⁴See Amendments Release, *supra* note 3, at 735.

¹⁵For a discussion of the NASD's petition, see Securities Exchange Act Release No. 20902 (April 30, 1984), 49 FR 19314. For a discussion of the views of OTC market makers and issuers, see Amendments Release, *supra* note 3, at 733.

¹⁶Amendments Release, *supra* note 3. As of June 4, 1985, there were 1,997 OTC/NMS Securities.

¹⁷Adoption Release, *supra* note 1, at 14000.

¹⁸The Commission believes that the concerns expressed by certain commentators in 1979 regarding the "premature incorporation" of NMS Securities into additional NMS facilities and initiatives may not be applicable today. For those concerns, see Status Report, *supra* note 5, at 20367.

¹⁹The Commission's directive to facilitate the development of a national market system includes specific recognition that there could be subsystems of an NMS. Section 11A(a)(2) of the Act. The Commission requests commentators to address the possible inclusion of some NMS Securities in one or more other subsystems of an NMS.

²⁰In addition to these NMS initiatives, the Commission has issued releases requesting comment on granting exchanges unlisted trading privileges in OTC securities (Securities Exchange

designated as NMS Securities.³² Noting that OTC/NMS Securities would be traded "in an environment characterized by real-time transaction reporting and firm quotations," the Commission further stated "that it may be appropriate to expect that . . . a broker-dealer either will route his customer's order to the best displayed bid or offer (in size) or will provide his customer with a price equal to the best displayed bid or offer (in size)."³³

Because last sale reporting and firm quotations are now present for OTC/NMS Securities, the Commission solicits comments on whether price protection should be provided for displayed bids or offers for these securities.³⁴ Specifically, the Commission requests comment on whether an OTC "trade-through" rule should apply to OTC/NMS Securities, and whether some or all OTC/NMS Securities should be subject to these requirements.³⁵ The Commission also requests comment on how an OTC "trade-through" rule should be structured. The Commission urges commentators to focus on the degree to which the present regulation of "trade-throughs" for ITS (including ITS/CAES) securities can, or should, be applied to the OTC markets.³⁶

In discussing this questions, commentators should address the practical effect of such a rule on the OTC market. The Commission recognizes that virtually all OTC market makers currently display quotes with a size of 100 shares (the minimum that can be displayed in NASDAQ),³⁷ even though they generally are willing to effect larger trades at their quoted

price.³⁸ The Commission requests comment on how a trade-through rule would affect the display of quote-size by OTC market makers and by exchanges receiving UTP in OTC/NMS Securities.³⁹

3. Short Sales

The Commission's short sale rule, Rule 10a-1 under the Act,⁴⁰ generally does not apply to the OTC market.⁴¹ However, with the implementation in 1975 of a consolidated reporting system⁴² for transactions in listed securities both on the exchanges and in the "third market,"⁴³ the Commission extended Rule 10a-1 to OTC transactions in reported securities.⁴⁴

In adopting the NMS Securities Rule, and thereby extending last sale reporting to OTC/NMS securities, the Commission specifically sought comment on whether short sale limitations should be extended to OTC/NMS Securities.⁴⁵ Now that over 1900

³²In particular, market maker participants in the NASD's Small Order Execution System ("SOES") stand willing to accept trades of 500 Shares or less in SOES stocks at the best NASDAQ quote. Therefore, these market makers could be considered to be quoting 500 share markets at the best NASDAQ price in these stocks. In addition, some market makers are willing to accept orders of up to 1000 shares at the best NASDAQ bid or offer in other OTC automatic execution systems.

³³In this regard, it is noted that, unlike OTC market-makers, exchanges typically compete both on the basis of price and by displaying quote size in stocks in which they make an active market.

³⁴17 CFR 240.10a-1.

³⁵Rule 10a-1 currently applies to securities as to which last sale information is disseminated in the consolidated transaction reporting system. It relies on a tick test which is not easily workable without current last sale reporting. Securities Exchange Act Release No. 11468 (June 12, 1975), 40 FR 25442, 25443 ("1975 Rule 10a-1 Adoption Release"). The "tick" test compares the price of a proposed short sale to immediately preceding transactions to determine its permissibility. Under this rule, short sales may be effected only on a plus tick (i.e., at a price above the price at which the immediately preceding last sale was effected) or a zero-plus tick (i.e., at a price equal to the last sale if the last preceding transaction at a different price was at a lower price), established by reference to the last sale either in the consolidated transaction report system or in a particular marketplace. Securities Exchange Act Release No. 17347 (November 28, 1980), 45 FR 80834, 80834 n.2.

³⁶The Consolidated Tape Association ("CTA") collects and disseminates transaction reports for listed securities from all markets. The CTA members are the NYSE, Amex, BSE, CSE, MSE, PSE, Phlx, and NASD. See Securities Exchange Act Release Nos. 10787 (May 10, 1974), 39 FR 17799; and 11255 (February 18, 1975), 40 FR 9397.

³⁷The third market is a term used to describe OTC transactions in listed securities.

³⁸1975 Rule 10a-1 Adoption Release, *supra* note 41. The Commission stated that its "original short sale rules did not apply to [OTC] transactions since, in the absence of publicity concerning [OTC] short sales [such as that afforded by the CTA], there appeared to be little reason to fear that such sales would have a manipulative or destabilizing impact on the market." *Id.* at 25443.

³⁹Adoption Release, *supra* note 1, at 14001-02. In response to that solicitation, the NASD stated that "short selling regulations prior to and during a distribution of NMS securities would be appropriate but that it is not necessary, at this time, to impose across-the-board short sale regulations on

OTC securities have been designated as NMS Securities, with prospects that additional securities will soon be designated, the Commission again solicits comment on whether and how short sales in OTC securities designated as NMS Securities should be regulated. In particular, The Commission asks that commentators discuss whether Rule 10a-1 should be amended to cover all, or a portion of, OTC/NMS Securities.⁴⁶

In assessing the feasibility of existing short-sale regulations to OTC/NMS Securities, it would be beneficial if commentators discuss the operation of Rule 10a-1 in the listed market.⁴⁷

transactions in NMS Securities." Letter from S. William Broka, Secretary, NASD, to George A. Fitzsimmons, Secretary, SEC (July 31, 1981) ("1981 NASD Short Sale Comment"), at 1. The NASD asserted that short sale limitations comparable to those imposed on the market for listed securities were unnecessary for the market for OTC/NMS securities because NMS issues will have volume and market maker requirements which will ensure an active competitive market." *Id.* at 1-2.

The Commission notes that under the amended NMS Securities Rule, a minimum trading volume standard is retained only in the Tier 1 designation criteria. See Amendments Release, *supra* note 3, at 737. The Commission also notes that the revised maintenance criteria for NMS Securities, which it has approved on a temporary basis, do not contain a trading volume requirement. See Securities Exchange Act Release No. 21670 (January 17, 1985), 50 FR 3610. Accordingly, the Commission solicits comment on the question whether the elimination of trading volume requirements from the Tier 2 designation criteria and the NMS maintenance criteria affects the need to extend Rule 10a-1 to OTC/NMS Securities.

⁴⁶If the short sale rule were to be extended to cover all, or a portion of, OTC/NMS securities, should it operate in the same manner as Rule 10a-1 currently operates with respect to listed securities (i.e., relying on the tick test)? The Commission also solicits comments on the question of whether there are unique issues associated with OTC/NMS Securities generally that would make another approach preferable.

In considering this question, commentators may wish to consider the two alternative versions of proposed Rule 10b-21 under the Exchange Act, which would restrict short sales of securities, including OTC securities, prior to and during underwritten offerings of securities of the same class as outstanding securities. The first version of proposed Rule 10b-21 would deter manipulative short selling prior to underwritten offerings by limiting the ability of short sellers to make covering purchases from certain persons within certain periods during an underwriting. Securities Exchange Act Release No. 11328 (April 12, 1975), 40 FR 16090. The second version, which focused on short selling itself rather than on covering purchases, would regulate short sales from the preoffering period until the end of post-offering stabilization arrangements through the use of a "tick test." Securities Exchange Act Release No. 13092 (December 21, 1976), FR 56542. Neither version of proposed Rule 10b-21 has been adopted.

⁴⁷In 1976, the Commission instituted a public rulemaking proceeding to determine whether Rule 10a-1's regulation of short sales of securities registered, or admitted to unlisted trading privileges, on national securities exchanges was still necessary. See Securities Exchange Act Release No. 13091 (December 21, 1976), 41 FR 56530. Stating that commentators generally indicated that the operative provisions of Rule 10a-1 worked well and should not be modified, the Commission withdrew proposed rules which would have suspended in part the operation of the "tick test". See Securities Exchange Act Release No. 17347 (November 28, 1980), 45 FR 80834.

³² Adoption Release, *supra* note 1, at 14003.

³³ *Id.*

³⁴ The Commission also notes that, under the NASD's rules, a broker has an obligation to use reasonable diligence to both "ascertain the best interdealer market" for a security and execute his customer's order "so that the resultant price to the customer is as favorable as possible under prevailing market conditions." NASD, Interpretation of the Board of Governors—Review of Corporate Financing, Rules of Fair Practice, Art. III, section 1, NASD Manual (CCH) ¶ 2151.03(A), at 2035. The Commission requests comment on whether this NASD rule interpretation provides displayed OTC/NMS quotations with sufficient price protection.

³⁵ If OTC/UTP is not requested by an exchange or granted by the Commission, these requirements would apply only to the OTC market. If such UTP were to be requested and granted, these requirements would apply to all markets.

³⁶ The current ITS "trade-through" rule includes an exception for quotes of 100 shares, reflecting the use of automatic quotation-generation devices by regional exchanges to generate 100 share quotes in certain stocks. Because automatic quotation generating devices are not used in the OTC market, this exception need not necessarily be carried over to the OTC market if a trade-through rule were applied to that market.

³⁷ The Commission continues to believe that the display of quotes with size would be of benefit to the OTC market, and encourages OTC market makers to reflect accurately the size at which they are willing to trade in their quotations.

Accordingly, the Commission solicits comment on the costs and benefits of Rule 10a-1 to the listed markets, *e.g.*, to what extent has the Rule been successful in preventing manipulative short sales and to what extent has the Rule inhibited legitimate short-selling activities? Additionally, the Commission requests comment on the harms, if any, attributable to the absence of short sale rules for OTC/NMS Securities. In this connection, the Commission requests commentators to discuss whether the absence of short sale rules for OTC/NMS securities has contributed to manipulative or fraudulent activity.⁴⁸ Alternatively, has the absence of such rules benefited investors, issuers, or the markets in these stocks?

B. NMS Securities

Commentators in the rulemaking proceeding that adopted the NASD's proposals raised certain fundamental concerns about NMS Securities. These commentators questioned whether the Rule continued to be necessary to bring last sale reporting to the OTC market, and whether the Rule should be redirected to encompass listed securities that have been included in other NMS facilities.⁴⁹ Accordingly, the Commission believes that it is appropriate to consider whether the Rule should be refocused.

At present, the only practical effect of designation as an NMS Security is to require last sale trade reporting in that security. When the NMS Securities Rule was adopted in 1981, this narrow focus was considered appropriate because the Rule was seen initially as a mechanism for gradually introducing last sale reporting to the OTC market. The Commission intended the mandatory Tier 1 standards to automatically include those OTC securities which clearly belonged in NMS disclosure facilities. The lower Tier 2 designation criteria, which rely on issuer choice, were intended to insure that, in the early stages of last sale reporting in the OTC market, only those other securities whose markets would benefit from NMS designation would be designated.⁵⁰ As a practical matter, including exchange-listed securities within the scope of the NMS Securities Rule would have had no effect at that time because most exchange-listed securities already were included in NMS last sale and quotation disclosure facilities.⁵¹

The Commission believes that last sale reporting has become an established part of the OTC market.

There are over 1900 OTC/NMS Securities today. In addition, the NASD and many OTC issuers and market makers strongly endorsed the recent amendments to the Rule that increased the number of qualified securities from approximately 1350 to around 2500.⁵² On the other hand, opponents of the NASD's petition to expand the number of securities eligible for NMS designation argued that the NASD was using the fact of NMS designation as a marketing device in competing with exchanges for "listings."⁵³

In view of the foregoing, the Commission requests public comment on the following questions:

(i) Is the NMS Securities Rule still necessary in its present form to maintain last sale reporting in the OTC market?

(ii) If the NMS Securities Rule is no longer essential for that purpose, should the entire group of OTC stocks that have last sale reporting continue to be designated OTC/NMS Securities?

(iii) Is last sale reporting sufficiently developed in the OTC market that issuer choice should be removed from the Tier 2 designation criteria? In other words, should some or all of the securities that satisfy the Tier 2 criteria now be designated automatically in the same manner as securities qualified for Tier 1?

(iv) If the NMS Securities Rule retains its current focus, is there a danger of misperception of the significance of NMS designation with respect to the investment quality of a stock? Would such possible misperceptions be ameliorated if NMS designation were not limited to OTC stocks?

(v) To the extent the Rule is deemed either to be no longer necessary to encourage OTC last sale reporting or to confer an unfair advantage on OTC stocks designated as NMS Securities, should the Rule be refocused to designate other types of securities as NMS Securities? These types could include:

(a) securities with last sale reporting. The main consequence of OTC/NMS security designation, last sale reporting, also is present for securities listed on national securities exchanges. In discussing whether all securities with last sale reporting should be designated as NMS Securities, commentators should consider the costs and benefits of NMS designation for these securities.

(b) "reported securities". Listed securities substantially meeting NYSE or Amex listing criteria are eligible to be

reported through the consolidated transaction reporting system and as such are deemed "reported securities" under Rule 11Aa3-1 and other rules.

(c) multiply traded securities. This group of securities could include securities traded through the ITS or ITS/CAES linkages, and current OTC/NMS Securities if, for example, the Commission were to grant exchanges UTP in these securities and such securities were included in an intermarket linkage.

(d) securities subject to trade—through rules. At present ITS and ITS/CAES securities are subject to such a rule. In the future, other securities such as OTC/NMS Securities also could be provided with trade-through protection.

IV. Conclusion

By publishing this release soliciting public comment, the Commission seeks to elicit suggestions on possible directions in which the NMS Securities Rule should evolve. Comments should be addressed to John Wheeler, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549. Comments should be received by September 30, 1985.

By the Commission.

Shirley E. Hollis,
Assistant Secretary.
June 21, 1985.

[FR Doc. 85-15401 Filed 6-26-85; 8:45 am]

BILLING CODE 8010-01-M

⁴⁸ See, *e.g.*, *Serving Readers—our Sources?* OTC Review, January, 1985 at 16.

⁴⁹ See Amendments Release, *supra* note 3, at 734-35.

⁵⁰ Adoption Release, *supra* note 1, at 13996-99.

⁵¹ Adoption Release, *supra* note 1, at 13994-95.

⁵² Amendments Release, *supra* note 3, at 732.

⁵³ *Id.* at 734. In approving the proposed amendments to the Rule, the Commission stated that it "has never suggested that NMS designation warrants the quality of these securities," and that "there was no intent on the Commission's part to use this initiative as a vehicle to contrast the relative merits of OTC and listed securities". *Id.* at 737 n.88.

NASD

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

notice to members 85-53

August 12, 1985

TO: All NASD Members and Level 2 and Level 3 Subscribers

RE: NASDAQ National Market System Grows to 2,091 Securities With 22 Voluntary Additions on August 20, 1985

On Tuesday, August 20, 1985, 22 issues are scheduled to join the NASDAQ National Market System bringing the total number of issues in NASDAQ/NMS to 2,091. These 22 issues, which will begin trading under real-time trade reporting, are entering the NASDAQ/NMS pursuant to the Securities and Exchange Commission's criteria for voluntary designation.

The 22 issues scheduled to join NASDAQ/NMS on Tuesday, August 20, 1985, are:

Symbol	Company	Location
CFSC	CFS Financial Corporation, Inc.	Fairfax, VA
CARG	Carriage Industries, Inc.	Calhoun, GA
CEDC	Catalyst Energy Development Corporation	New York, NY
CARX	Certified Collateral Corporation	Chicago, IL
CNHC	Commonwealth National Financial Corporation	Harrisburg, PA
CELC	Corporation for Entertainment and Learning, Inc. (The)	New York, NY
EMET	Eastmet Corporation	Baltimore, MD
EVAN	Evans, Inc.	Chicago, IL
FABKO	First of America Bank Corporation (Ser. D) (Pfd.)	Kalamazoo, MI
KEII	Keithley Instruments, Inc.	Solon, OH

Symbol	Company	Location
LCNAF	Lacana Mining Corporation	Ontario, Canada
MKTAY	Makita Electric Works, Ltd.	Aichi, Japan
NCIS	National Controls, Inc.	Santa Rosa, CA
PWNE	Pawnee Industries, Inc.	Wichita, KS
PHCC	Preferred Health Care Corp.	Katonah, NY
PBNK	Progress Federal Savings Bank	Norristown, PA
SCFC	Scientific Communications, Inc.	Garland, TX
SOMB	Somerset Bancorp, Inc.	Somerville, NJ
SWWC	Southwest Water Company	La Puente, CA
TRRO	Triton Group Ltd.	Los Angeles, CA
TRROO	Triton Group Ltd. (Ser. C) (Pfd.)	Los Angeles, CA
VLAB	Vipont Laboratories, Inc.	Fort Collins, CO

The following changes to the list of NASDAQ/NMS securities occurred since July 26, 1985:

NASDAQ/NMS Symbol and/or Name Changes

New/Old Symbol	New/Old Security Name	Date of Change
TCBY/TCBY	TCBY Enterprises, Inc./This Can't Be Yogurt	7/31/85
BDEP/BDEP	BanPonce Corporation/Banco de Ponce	8/01/85
FAMS/GMEX	Famous Restaurants, Inc./Garcia's of Scottsdale, Inc.	8/01/85
FIBK/FIBK	First Interstate Corporation of Alaska/First Interstate Bank of Alaska	8/01/85
DAHL/DESI	Dahlberg, Inc./Dahlberg, Inc.	8/06/85
SCORZ/ SCORZ	Nuclear Pharmacy, Inc. (Wts)/ Syncor International Corp. (Wts)	8/06/85

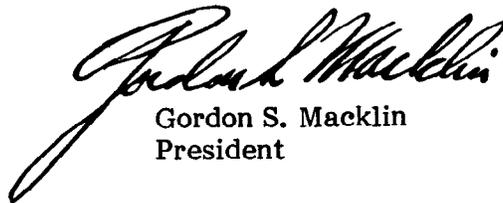
NASDAQ/NMS Deletions

Symbol	Security	Date
ONIX	ONYX & IMI, Inc.	7/31/85
VGCIE	Veta Grande Companies, Inc.	7/31/85

Symbol	Security	Date
GTCM	Guaranty Commerce Corporation	8/01/85
GULL	Gull, Inc.	8/01/85
FFIC	Fairmont Financial, Inc.	8/05/85
SPDC	S-P Drug Company, Inc.	8/05/85
SCOR	Syncor International Corporation	8/06/85
FTEC	FilmTec Corporation	8/08/85

Any questions regarding this notice should be directed to Donald Bosc, Assistant Director, NASDAQ Operations, at (202) 728-8043. Questions pertaining to trade reporting rules should be directed to Steve Hickman, Market Surveillance, at (202) 728-8202.

Sincerely,



Gordon S. Macklin
President

NASD

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

notice to members 85-54

August 13, 1985

IMPORTANT MAIL VOTE

OFFICERS, PARTNERS AND PROPRIETORS

TO: All NASD Members

RE: Proposed New Rule of Fair Practice Relating to Private Securities Transactions

LAST VOTING DATE IS SEPTEMBER 13, 1985

Enclosed is a proposed addition to Article III of the NASD's Rules of Fair Practice. The proposed new rule has been approved by the Board of Governors and now requires the membership's approval.

The rule would establish new requirements for the private securities transactions of persons associated with members, and would entirely replace the Private Securities Transactions Interpretation under Article III, Section 27 of the Rules of Fair Practice.

If approved, the rule must then be filed with and approved by the Securities and Exchange Commission. As discussed below, the proposed rule was published for membership comment on March 29, 1985 (Notice to Members 85-21).

The text of the new rule is attached as Exhibit 1. The text of the Private Securities Transactions Interpretation is attached as Exhibit 2.

BACKGROUND

The NASD has long been concerned about the private securities transactions of persons associated with broker-dealers. These transactions can generally be grouped into two categories.

1. Transactions in which an associated person sells securities to public investors on behalf of another party, e.g., as part of a private offering of limited partnership interests, without the participation of the individual's employer firm.
2. Transactions in securities owned by an associated person.

The first category of transactions presents serious regulatory concerns because securities may be sold to public investors without the benefit of supervision or oversight by a member firm and perhaps without adequate attention to such regulatory protections as due diligence investigations and suitability determinations. In some cases, investors may be misled into believing that the associated person's firm has analyzed the security being offered and "stands behind" the product and transaction. The firm in fact may be unaware of the associated person's participation in the transaction. Under some circumstances, the firm may be liable for the actions of the associated person even though the firm was not aware of his or her participation in the transaction. ^{1/}

In view of these concerns, the NASD promulgated the Private Securities Transactions Interpretation several years ago. The Interpretation requires associated persons to notify their employer firms prior to participating in private securities transactions. A significant number of associated persons have been disciplined by the NASD for violation of this Interpretation in recent years. It is believed that the existence of the Interpretation has allowed firms to exercise better supervision over their associated persons.

The Interpretation has been a source of substantial confusion, however, because it addresses only the responsibility of associated persons to notify their member firms of such transactions. It does not specifically address the supervisory and oversight responsibilities of the firms. The Board of Governors' Advisory Council and several District Business Conduct Committees have requested that the Interpretation be amended to clarify firms' responsibilities in this area. After careful study, the Board has decided to adopt a new rule of fair practice to replace the Interpretation.

The rule is designed to set forth specific responsibilities for associated persons and member firms regarding the handling of associated persons' private securities transactions. Based on an analysis of regulatory problems regarding private securities transactions, the rule would treat transactions differently depending upon whether the associated person receives selling compensation. In either case, the rule specifies the responsibilities of member firms.

COMMENTS RECEIVED

As previously noted, the NASD published the proposed rule on private securities transactions for comment in Notice to Members 85-21 (March 29, 1985). Twenty-five comments were received. Two writers opposed the proposed rule as an abridgment of the rights of registered representatives to engage in legitimate private transactions. Seven encouraged the adoption of the rule as drafted. Five

^{1/} This concern has been addressed in earlier NASD notices. See Notices to Members 82-39 (June 15, 1982) and 80-62 (December 1, 1980).

urged that the rule be strengthened by, for example, requiring the member firm to confirm private securities transactions similar to the way it confirms its own transactions, or by expanding the rule's application beyond securities transactions to all private transactions for compensation. Eleven commentators concurred generally with the proposal but suggested some change.

In response to the comments received, and following further consideration of the proposed rule, the Board of Governors made two amendments to the rule. These changes are noted in the following analysis.

ANALYSIS OF THE PROPOSED RULE

Applicability — The new rule, the text of which is attached as Exhibit 1, would apply to any situation in which an associated person of a member proposes to participate in any manner in a private securities transaction.

"Private securities transaction" is defined broadly, and generally parallels the concept in the present Interpretation. (See Exhibit 2.) Transactions subject to Article III, Section 28 of the NASD Rules of Fair Practice ^{2/} and personal transactions in investment company and variable annuity securities are excluded. Upon further consideration, the Board amended the rule as originally proposed to exclude also those transactions among immediate family members (as defined in the Interpretation of the Board of Governors on Free-Riding and Withholding ^{3/}) for which no associated person receives any selling compensation. Because regulatory problems most frequently occur in connection with private placements of new offerings, those transactions are specifically included within the definition of "private securities transaction."

Written Notice — The present Interpretation requires associated persons to provide written notice of such transactions to their employers. The new rule also would require written notice to the employer member by the associated person prior to participating in any private securities transaction; however, under the new rule, the notice would be required to include a detailed description of the proposed transaction and the individual's proposed role therein. Because the rule would treat compensatory and noncompensatory transactions differently, it would also be necessary for the associated person to state whether he or she will receive selling compensation in connection with the transaction.

Transactions for Compensation — As noted above, the Board of Governors has concluded that it is important to draw a distinction between transactions in which persons receive selling compensation and those handled as an accommodation or under another noncompensatory arrangement. The most serious regulatory concerns relate to situations in which associated persons receive selling compen-

^{2/} Section 28 requires associated persons who handle personal securities transactions through a member other than their employer (the "executing member") to notify the executing member of their employment with another member of the NASD. The executing member is then required to notify the employer member of all of the associated person's activity. See NASD Manual (CCH) ¶2178.

^{3/} NASD Manual (CCH) p. 2045.

sation and therefore have an incentive to execute sales, perhaps without adequate supervision or adequate attention to suitability and due diligence responsibilities.

For transactions in which an associated person has or may receive selling compensation, the rule would require that a member receiving written notice from its associated person respond to him or her in writing, indicating whether the firm approves or disapproves of his or her participation in the proposed transaction. If the firm approves of the associated person's participation, the firm would then be required to treat the transaction as its own, to record the transaction on the firm's books and records, and to supervise the associated person's participation in the transaction to the same extent as if the transaction were executed on behalf of the firm.

If the firm disapproves of the associated person's participation, he or she would be prohibited from participating in the transaction in any manner.

Transactions Not For Compensation — The Board of Governors believes that there may be some transactions in which associated persons participate without compensation that should not be subjected to the same level of scrutiny as other transactions. For example, a salesperson may own stock in a closely held family corporation and wish to transfer that stock to another family member. While the firm should be made aware of such a transaction, it appears unnecessary to treat that type of transaction as a transaction of the employer firm.

Accordingly, the new rule would require a member receiving notice that an associated person proposes to participate in a transaction or a series of related transactions ^{4/} without compensation to provide the associated person with written acknowledgment of the submitted notice.

The NASD has consistently taken the position that firms must be able to supervise and regulate effectively each associated person's securities activities. The rule would therefore give the employer firm the right to impose conditions upon each associated person's participation in noncompensatory transactions and would require that he or she adhere to such conditions. It is intended that a firm would have full discretion to utilize this authority to restrict its associated persons' private securities activities, including activities performed on a non-compensatory basis.

Definition of Selling Compensation — The definition of "selling compensation" plays a key role in the proposed rule. Because the treatment of transactions varies significantly depending upon whether selling compensation is to be received, the definition of "selling compensation" is deliberately broad in its scope.

The definition includes "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security." Certain examples are provided, including commissions, finder's fees, securities, and rights of participation in profits, tax benefits, or dissolution proceeds as a general partner or otherwise. While these examples are intended to

^{4/} The Board of Governors added the phrase "or a series of related transactions" to the rule as originally proposed to allow associated persons to report a series of related transactions without compensation in a single notice.

include some of the most common forms of compensation, the definition is not intended to be restricted to those examples but rather to include any item of value received or to be received directly or indirectly.

It is important to note that the definition of "selling compensation" includes compensation received or to be received by anyone acting in the capacity of either a salesperson or in some other capacity, specifically including the capacity of a general partner. The definition is intended to address a practice in which associated persons function as general partners in forming limited partnerships and then sell limited partnership interests in private securities transactions. Any involvement in a securities transaction by an associated person of an NASD member firm may be subject to the panoply of regulatory requirements applicable to persons associated with a broker-dealer. Participation in transactions as a general partner, therefore, carries with it significant regulatory responsibilities.

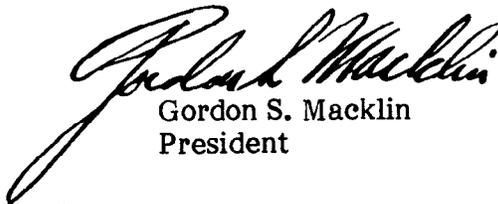
* * * *

The Board of Governors believes this proposed new rule of fair practice is necessary and appropriate. It recommends that members vote their approval.

Please mark the attached ballot according to your convictions and return it in the enclosed, stamped envelope to "The Corporation Trust Company." Ballots must be postmarked no later than September 13, 1985.

Questions concerning this notice may be directed to Dennis C. Hensley or Phillip A. Rosen, NASD Office of the General Counsel, at (202) 728-8446.

Sincerely,



Gordon S. Macklin
President

Attachments

PROPOSED NEW RULE OF FAIR PRACTICE *

Section _: Private Securities Transactions

(a) Applicability — No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.

(b) Written Notice — Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

(c) Transactions for Compensation —

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member that has received notice pursuant to Subsection (b) shall advise the associated person in writing stating whether the member:

(A) approves the person's participation in the proposed transaction; or

(B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to Subsection (c)(1), the transaction shall be recorded on the books and records of the member, and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to Subsection (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

(d) Transactions Not For Compensation — In the case of a transaction or a series of related transactions in which an associated person has not and will not

* All language is new. This rule would replace the Private Securities Transactions Interpretation under Article III, Section 27 of the NASD Rules of Fair Practice. See Exhibit 2.

receive any selling compensation, a member that has received notice pursuant to Subsection (b) shall provide the associated person prompt written acknowledgment of said notice and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction.

(e) Definitions — For purposes of this section, the following terms shall have the stated meanings:

- (1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including though not limited to new offerings of securities that are not registered with the Commission; provided however that transactions subject to the notification requirements of Article III, Section 28 of the Rules of Fair Practice, transactions among immediate family members (as defined in the Interpretation of the Board of Governors on Free-Riding and Withholding) for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities shall be excluded.
- (2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including though not limited to commissions; finder's fees; securities or rights to acquire securities; expense reimbursements; and rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise.

**INTERPRETATION OF THE NASD BOARD OF GOVERNORS
ON PRIVATE SECURITIES TRANSACTIONS ***

Introduction

The Board of Governors, under its obligation to "prevent fraudulent and manipulative acts [and] practices and to promote just and equitable principles of trade," believes it should again emphasize to members their continuing responsibility to exercise appropriate supervision over associated personnel and, in particular, to emphasize to such personnel their responsibilities of good faith to the member and its customers. For purposes of this Interpretation, private securities transactions shall include securities transactions which involve a limited number of purchases or sales (as contrasted, for example, with transactions involving public offerings registered with the SEC) and other investment transactions involving associated personnel which may mislead customers or participants into believing the transactions are sponsored by the member.

Depending upon all the facts and circumstances, private securities transactions effected outside the usual or normal course or scope of employment and nowhere reflected on broker-dealer books and records may expose the participants to charges of serious violations of federal securities laws, as well as industry rules and regulations, and to civil liability. In some instances, severe sanctions have been imposed on registered and associated personnel for engaging in private securities transactions effected outside the scope of their association and nowhere reflected on broker-dealer books and records.

Persons associated with a member should also be aware that their involvement in private securities transactions outside the scope of their association with a member may raise serious questions regarding their need to register as broker-dealers and/or investment advisers under state and federal securities laws. In addition, effecting private securities transactions without disclosure to the member deprives the member of an ability to supervise the securities transactions of persons associated with it thereby making it difficult for the member to exercise its obligation of good faith in its dealings with its customers.

Accordingly, the Board of Governors has determined that no person may be involved in any way with a private securities transaction outside the regular course or scope of his association or employment without prior notice to the member with whom he is associated. To insure compliance with this determination, the member may, at its option, request duplicate copies of all documents and statements related to such transactions. It shall be the duty of any person associated with a member to promptly comply with such a request.

Personal securities transactions with another member of the Association, which transactions are properly recorded on the books of the executing member and which are subject to the notification requirements of Article III, Section 28 of the Rules of Fair Practice, are not considered to be private securities transactions for the purposes of this Interpretation. Purchases or redemptions of variable contracts

* This Interpretation is proposed to be deleted in its entirety.

or redeemable securities of companies registered under the Investment Company Act of 1940, for the personal account of the person associated with a member, are also not considered to be private securities transactions for purposes of this Interpretation.

* * * *

The following Interpretation of Article III, Sections 1, 27, and 28 of the Association's Rules of Fair Practice is adopted by the Board of Governors of the Association pursuant to the provisions of Article VII, Section 3(a) of the Association's By-Laws and Article I, Section 3 of the Rules of Fair Practice.

Interpretation

It shall be deemed conduct inconsistent with just and equitable principles of trade for any person associated with a member to engage in a private securities transaction outside the regular course or scope of his association or employment with a member, for himself, or with or for any other person without prior written notification to the member. In order for that member to exercise supervision over such transactions, it may request duplicate copies of all confirmations and other documents or other information related to such transactions from the person notifying the member, and it shall be deemed conduct inconsistent with just and equitable principles of trade for this person to fail to promptly comply with such request.

NASD

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

notice to members 85-55

August 16, 1985

TO: All NASD Members and Municipal Securities Bank Dealers

ATTN: All Operations Personnel

RE: Labor Day: Trade Date-Settlement Date Schedule

Securities markets and the NASDAQ System will be closed on Monday, September 2, 1985, in observance of Labor Day. "Regular-Way" transactions made on the business days immediately preceding that day will be subject to the following schedule.

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

<u>Trade Date</u>		<u>Settlement Date</u>		<u>*Regulation T Date</u>	
August	23	August	30	September	4
	26	September	3		5
	27		4		6
	28		5		9
	29		6		10
	30		9		11
September	2	Markets Closed			—
	3		10		12

The foregoing settlement dates should be used by brokers, dealers and municipal securities dealers for purpose of clearing and settling transactions pursuant to the Association's Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice. Questions regarding the application of these settlement dates to a particular situation may be directed to the Uniform Practice Department of the NASD at (212) 839-6256.

* Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date members must take such action is shown in the column entitled "Regulation T Date."

NASD

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

notice to members 85-56

August 19, 1985

TO: All NASD Members and Other Interested Persons

RE: Donald E. Sheldon & Co., Inc.
One Wall Street
New York, New York 10005

ATTN: Operations Officer, Cashier, Fail-Control Department

On August 13, 1985, the United States District Court for the Southern District of New York appointed a SIPC Trustee for the above-captioned firm.

Please refer to Notice to Members 85-51 regarding the previous appointment of a Temporary Receiver.

Questions regarding the firm should be directed to:

SIPC Trustee

Stanley T. Lesser, Esquire
Kaye, Scholer, Fierman,
Hays & Handler
425 Park Avenue
New York, New York 10022
Telephone: (212) 407-8000

NASD

National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 726-8000

notice to members 85-57

August 28, 1985

TO: All NASD Members and Level 2 and Level 3 Subscribers

RE: NASDAQ National Market System Grows to 2,111 Securities With 24 Voluntary Additions on September 3, 1985

On Tuesday, September 3, 1985, 24 issues are scheduled to join the NASDAQ National Market System, bringing the total number of issues in NASDAQ/NMS to 2,111. These 24 issues, which will begin trading under real-time trade reporting, are entering the NASDAQ/NMS pursuant to the Securities and Exchange Commission's criteria for voluntary designation.

The 24 issues scheduled to join NASDAQ/NMS on Tuesday, September 3, 1985, are:

Symbol	Company Name	Location
AEAGF	Agnico-Eagle Mines Limited	Ontario, Canada
AAHS	Alco Health Services Corporation	Valley Forge, PA
AMERZ	America First Federally Guaranteed Mortgage Fund Limited Partnership	Omaha, NE
ATLFP	Atlantic Financial Federal (Pfd)	Bala Cynwyd, PA
CFNVF	Centrafarm Group, N.V.	The Netherlands
DTSI	Datron Systems, Inc.	Simi Valley, CA
ESNE	Edgecomb Steel of New England, Inc.	Nashua, NH
EMCC	Emett & Chandler Companies, Inc.	Los Angeles, CA
FCOLA	First Colonial Bankshares Corporation (Cl A)	Chicago, IL
FEXCO	First Executive Corporation (Ser F) (Depositary Preferred)	Los Angeles, CA
FNET	FundsNet, Inc.	Englewood, NJ
GALCF	Galactic Resources Ltd.	Vancouver, Canada
HERE	Heritage Entertainment, Inc.	Los Angeles, CA
INMT	Intermet Corporation	Atlanta, GA

Symbol	Company	Location
MODX	Modulaire Industries, Inc.	San Francisco, CA
NANO	Nanometrics Incorporated	Sunnyvale, CA
GOSHA	Oshkosh B'Gosh, Inc. (Cl A)	Oshkosh, WI
GOSHB	Oshkosh B'Gosh, Inc. (Cl B)	Oshkosh, WI
PASBP	Perpetual American Bank, F.S.B. (Ser A) (Pfd)	Alexandria, VA
RESC	Roanoke Electric Steel Corporation	Roanoke, VA
SCNC	South Carolina National Corporation	Columbia, SC
USMA	Union Special Corporation	Chicago, IL
UNIH	United HealthCare Corporation	Minnetonka, MN
VMLPZ	VMS Mortgage Investors Limited Partnership	Chicago, IL

The following changes to the list of NASDAQ/NMS securities occurred since August 12, 1985:

NASDAQ/NMS Symbol and/or Name Changes

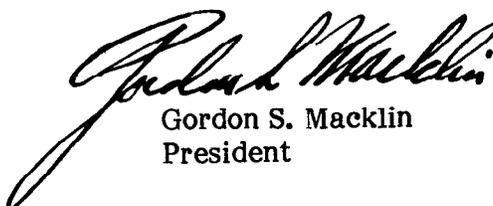
New/Old Symbol	New/Old Security Name	Date of Change
LORI/APEC	The Lori Corporation/Apeco Corporation	8/12/85

NASDAQ/NMS Deletions

Symbol	Security Name	Date
ERESE	Energy Reserve, Inc.	8/12/85
HFAX	Halifax Engineering, Inc.	8/16/85
TTSC	TSC, Inc.	8/19/85
TCTYC	Twin City Barge, Inc.	8/19/85
DCTL	Docutel/Olivetti Corporation	8/21/85

Any questions regarding this notice should be directed to Donald Bosis, Assistant Director, NASDAQ Operations, at (202) 728-8043. Questions pertaining to trade reporting rules should be directed to Steve Hickman, Market Surveillance, at (202) 728-8202.

Sincerely,


Gordon S. Macklin
President

NASD

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

notice to members 85-58

August 30, 1985

TO: All NASD Members and Other Interested Persons

RE: Request for comments on a proposed new rule governing the prompt payment for investment company shares sold to customers by NASD members

LAST DATE FOR COMMENT: SEPTEMBER 30, 1985

The National Association of Securities Dealers, Inc. (NASD), is soliciting comments from members and other interested persons on a proposed new rule (new paragraph (m), Article III, Section 26, NASD Rules of Fair Practice) that would govern the prompt payment by NASD members for investment company shares.

The new rule would require NASD members to transmit payments for investment company shares, which such members have sold to customers, to underwriters by the end of the fifth business day after receiving a purchase order from a customer (trade date + 5). The rule would also require members who are underwriters to transmit payment for investment company shares, which they have received from customers or other members, to investment company issuers within one business day after receiving such payments (day of receipt + 1).

The new rule would replace the NASD Board of Governors' interpretation governing the prompt payment by members for shares of investment companies, which appears at ¶5265 of the NASD Manual and is attached as Exhibit 2.

The text of the proposed rule is attached to this notice as Exhibit 1.

PROPOSED PROMPT PAYMENT RULE: BACKGROUND AND EXPLANATION

During the past several years, the investment company industry has experienced unprecedented growth. For the first five months of 1985, sales of mutual funds (excluding short-term funds) totaled \$37.1 billion. Total annual sales were \$45.9 billion in 1984 and \$40.4 billion in 1983. Both totals set new records at the time.

As of December 31, 1983, total net assets of all mutual funds were \$293 billion, compared with the end of May 1985 when they were \$424 billion.

In 1984, 57 percent (\$38 billion) of investors' purchases and redemptions of mutual funds (excluding short-term funds) were processed by NASD member firms using multifarious procedures that included the telephone, mail deliveries, express mail, messengers and some automation facilities. These procedures are often inefficient, costly and non-uniform. The ever-increasing number of transactions magnified the adverse effect of these inefficiencies and led to the formation of a joint NASD/Investment Company Institute Task Force, which was charged with the responsibility of finding a solution to the problem.

After lengthy discussions of a variety of options, the Task Force reached an agreement with the National Securities Clearing Corporation (NSCC) in January 1985. The NSCC began developing a system that will automate, standardize and centralize the processing of transactions in mutual funds. It is anticipated that a substantial volume of members' transactions in mutual fund shares will be processed through the system when it begins operating in 1986.

The new system will provide for automatic net settlement in a participating member's account with the NSCC on the fifth business day following the trade date. It will also provide for net settlement with mutual fund issuers on the same day.

For the past 28 years, prompt payment by members for mutual fund shares, which they have sold to customers, has been governed by the NASD Board of Governors' Prompt Payment Interpretation. This interpretation was adopted when the mutual fund industry was in its infancy in terms of the volume of transactions. (In 1957, there were 143 mutual funds with \$8.7 billion in net assets and annual sales of \$1.4 billion.)

The interpretation does not include a definition of the term "prompt payment." Under its provisions, if an underwriter does not receive payment from a member within 10 business days of the trade date, it is required to notify the local NASD District Office where the originating dealer's office is located. Currently, this results in a blizzard of paper flowing into NASD District Offices. Upon investigation of the reason for such late payments, the NASD staff invariably finds that the cause is the inefficiencies of the various settlement systems currently used which have often been overwhelmed by the sheer volume of transactions.

The NASD believes that the adoption of a centralized settlement system will solve most of the settlement problems that participants in the proposed system are experiencing, and it will do so at a lower unit cost.

The NASD also believes that the trade date + 5 settlement requirement that is to be incorporated into the new system should become the universal standard for all mutual fund sales processed by NASD members. It considers that all members who are underwriters should be governed by a similar standard for settlement with mutual fund issuers. That is, payments for mutual fund shares received directly from customers or from other members should be transmitted within one business day of the receipt of such payments.

RESCISSION OF THE PROMPT PAYMENT INTERPRETATION

Several of the provisions that are included in the current Prompt Payment Interpretation, the rescission of which is being proposed, are not included in the proposed new rule for the following reasons:

Recordkeeping

Since the provisions of Rule 17(a)(3) under the Securities Exchange Act of 1934 and Article III, Section 21 of the NASD Rules of Fair Practice, govern the recordkeeping requirements to which all members are subject, there is no reason to repeat such requirements in the proposed rule.

Ten-Day Notification Requirement

For the reasons discussed above, the NASD does not believe it is necessary to retain this requirement. Although there may have been rationale for such a requirement in the absence of a definition of the term "prompt payment," such will no longer be valid when a rule is in place that defines prompt payment in specific terms and which will subject members to disciplinary action for violation of its provisions.

Reference to Regulation T

The NASD considers that the negative reference to Regulation T in the interpretation serves no useful purpose, and is therefore superfluous.

* * * * *

All members and other interested persons are invited to submit written comments on the proposed new rule and the proposed rescission of the Prompt Payment Interpretation. Comments must be received no later than September 30, 1985, and should be directed to:

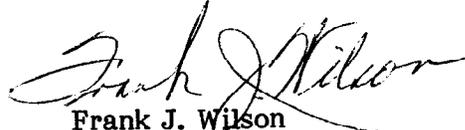
Mr. James M. Cangiano
Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Comments received by the indicated date will be considered by the Investment Companies Committee and the NASD Board of Governors. If the pro-

posals are approved by the Board, they must then be submitted to the membership for a vote. Any rule approved by the Board and the membership must be filed with and approved by the Securities and Exchange Commission before becoming effective.

Questions regarding this notice should be directed to A. John Taylor, Vice President, Investment Companies/Variable Contracts, at (202) 728-8328.

Sincerely,

A handwritten signature in cursive script, appearing to read "Frank J. Wilson".

Frank J. Wilson
Executive Vice President
and General Counsel
Legal and Compliance

Attachment

**Proposed Amendment to Article III, Section 26
of the NASD Rules of Fair Practice***

Prompt Payment for Investment Company Shares

- (m) (1) Members shall transmit payments for investment company shares, which such members have sold to customers, to underwriters or their designated agents by the end of the fifth business day following receipt of a customer order to purchase such shares.
- (2) Members who are underwriters shall transmit payments for investment company shares, which such members have received from other members or customers, to investment company issuers by the end of one business day following receipt of such payments.

* New language is underlined.

15265

**Prompt Payment by Members for Shares
of Investment Companies***

Failure by members to pay underwriters (who are also members) promptly, and failure by underwriters to insist upon such prompt payment by members, for investment company shares which members have sold to customers is contrary to the accepted standards of the business.

Members are required to transmit payment to underwriters (or custodians) promptly after the date of the transaction. Underwriters must pay issuers for shares acquired to fill dealers' orders promptly after the date of the transaction.

Members must maintain records, showing date of transaction, date upon which payment is received from customer, and date of payment to underwriter, as to all transactions in investment company shares.

In the event an underwriter does not receive payment from a member within ten (10) business days following the date of any transaction involving more than \$100, or if any check received from a dealer for payment of an open transaction is returned by a bank as uncollectable, regardless of when the check was originally received, the underwriter must immediately notify the district office of the Association in the district where the dealer's office is located. The notice to the Association shall state that the underwriter has communicated with the member and shall contain any explanation furnished by the member for the failure to make prompt payment. A copy of this notice must be furnished to the member involved.

Failure to comply with the procedures set forth herein may be considered a violation of Section 1 of Article III of the Rules of Fair Practice.

Transactions in investment company shares between customers and members are subject to Regulation T of the Federal Reserve Board. However, the Interpretation above is in no way related to Regulation T.

[As amended effective August 3, 1978.]

* This interpretation is proposed to be deleted in its entirety.