

Notice To Members

National Association of Securities Dealers, Inc.

November 1991

Number 91-68

Suggested Routing:*

- Senior Management
- Corporate Finance
- Government Securities
- Institutional

- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund

- Operations
- Options
- Registration
- Research
- Syndicate
- Systems
- Trading
- Training

*These are suggested departments only. Others may be appropriate for your firm.

MAIL VOTE

Subject: Proposed Amendment to Article III, Sections 26 and 29 of the NASD Rules of Fair Practice Re: Cash and Noncash Compensation Received by Members in Connection With the Sale of Investment Company Securities and Variable Contracts; Last Voting Date: December 20, 1991

EXECUTIVE SUMMARY

The NASD invites members to vote on a proposed amendment to Article III, Sections 26 and 29 of the NASD Rules of Fair Practice. The amendment would revise, simplify, and add a recordkeeping requirement to subsection (l) of Section 26, the Investment Company rule, and create subsection (h) of Section 29 to add a similar provision to the Variable Contracts rule.

BACKGROUND

In *Notice to Members 91-25* (May 1991), the Board of Governors requested comment on a proposed amendment to Article III, Section 26(l) (the Investment Company rule) and on a proposed new Section 29(h) (the Variable Contracts rule) of the NASD Rules of Fair Practice that would (1) require that members maintain records of all cash and noncash compensation received from offerors and the distribution of the compensation to its associated persons; (2) prohibit associated persons from receiving any such compensation from any-

one other than the member with which the person is associated; (3) prohibit a member from receiving securities from an offeror; and (4) prohibit receipt by a member of any type of compensation from the offeror unless such is described in the current prospectus of the investment company or variable contract. Notwithstanding the foregoing, the proposal would permit associated persons to receive gifts with a value not exceeding \$100 per annum and permit offerors to pay or reimburse members for training and educational meetings at a business location where the offeror or member has its office or in the vicinity of such an office. Exceptions are also provided for, among others, compensation arrangements between a member and its associated persons.*

Twenty-one letters were received in response to the *Notice to Members*. Four commenters were opposed to members receiving noncash concessions from offerors for the sale of investment company shares. One commenter did not agree that compensation paid by a member to its own associ-

*Or a nonmember company and its sales personnel who are registered with an NASD member that controls, is controlled, or is under common control with the nonmember.

ated persons should be exempt from prospectus disclosure.

Most of the remaining commenters were generally in favor of the proposed amendment if certain changes are made to it. To respond to these commenters, the proposal published in *Notice to Members 91-25* is modified as follows:

The \$100 Gift Ceiling

The commenters suggested that gifts of not more than \$100 per annum by an offeror to a registered representative should not be subject to the recordkeeping requirements in paragraphs (l)(1) and (h)(1) of the respective rules. The Board of Governors agrees, and subsections (l)(1) and (h)(1) have been amended to reflect this exemption.

One member suggested that the \$100 maximum limit on gifts should be more flexible and related to any future increases in the Consumer Price Index. The proposal (subsections 5(a) in each rule) has been amended to give the authority to the Board of Governors to change the maximum amount in future years. This will be accomplished by use of a footnote to display the maximum gift allowance, which currently is \$100.

Exception for Training and Educational Meetings

The current rule and the proposed amendment prohibit cash and noncash compensation from being received by members from offerors unless such is disclosed in the current prospectus of an investment company. Such disclosure would not be required when an offeror pays for a training or educational meeting attended by a member's associated persons where attendance is not conditioned on sales. In the amendment as proposed in *Notice to Members 91-25*, the location of such meetings would have been confined to places "where the offeror or the member has an office." Several members requested that the amendment be revised to eliminate this restriction. The Board of Governors does not agree that the restriction should be eliminated entirely, but it has broadened the language to include locations for such meetings that are in the vicinity of offices of a member or an offeror. Subsection (5)(b) in each rule has been amended.

Exception for a Member's Associated Persons

The current rule contains an exemption from the rules' provisions for compensation arrange-

ments between a member and its own associated persons. Several commenters suggested that a non-member whose salespersons are registered representatives of a member that controls, is controlled by, or is under common control with that nonmember, should be afforded a similar exemption. The Board of Governors agrees, and a new paragraph (6)(d) has been added to each rule.

SUMMARY

The fundamental purpose of Article III, Sections 26(l) and 29(h) of the NASD Rules of Fair Practice is to require disclosure in prospectuses of cash and noncash compensation paid to members by offerors for the sale of investment company shares and variable contracts. The proposed amendment introduces a recordkeeping requirement that is designed to assist members in controlling the receipt of compensation, particularly noncash compensation, from offerors. The prohibition against associated persons receiving compensation directly from offerors without the knowledge and agreement of their member firms is retained.

REQUEST FOR VOTE

The NASD Board of Governors believes that this amendment to the two Rules of Fair Practice is necessary and appropriate and recommends that members vote their approval. Please mark the enclosed ballot according to your convictions and return it in the enclosed, stamped envelope to the Corporation Trust Company. Ballots must be post-marked **no later than December 20, 1991**.

Questions concerning this notice may be directed to A. John Taylor, Vice President, Investment Companies Department, at (202) 728-8328.

PROPOSED AMENDMENT TO ARTICLE III, SECTION 26 OF THE NASD RULES OF FAIR PRACTICE

(Note: New text is underlined; deleted text is in brackets.)

(a) Unchanged.

Definitions

(b)(1) - (6) Unchanged.

[(7) "Associated person of an underwriter," as used in subsection (1) of this section, shall include an issuer for which an underwriter is the sponsor or a principal underwriter, any investment adviser

to such issuer, or any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such underwriter, issuer, or investment adviser.]

(7) The terms "offeror," "cash compensation," and "non-cash compensation" as used in subsection (1) of this section shall have the following meanings:

"Offeror" shall mean an investment company, an adviser to an investment company, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities.

"Cash compensation" shall mean compensation received by a member in cash, by check and by electronic means, and shall include loans and overrides.

"Non-cash compensation" shall mean any form of compensation received by members that is not cash compensation, including but not limited to merchandise, gifts and prizes, and payment of travel expenses, meals and lodging.

* * * * *

(c) - (k) Unchanged.

[Dealer concessions] Member Compensation

[(1)(1) No underwriter or associated person of an underwriter shall offer, pay or arrange for the offer or payment to any other member in connection with retail sales or distribution of investment company securities, any discount, concession, fee or commission (hereinafter referred to as "concession") which:]

[(A) is in the form of securities of any kind, including stock, warrants or options;]

[(B) is in a form other than cash (e.g., merchandise or trips), unless the member earning the concession may elect to receive cash at the equivalent of no less than the underwriter's cost of providing the non-cash concession, or]

[(C) is not disclosed in the prospectus of the investment company. If the concessions are not uniformly paid to all dealers purchasing the same dollar amounts of securities from the underwriter, the disclosure shall include a description of the circumstances of any general variations from the standard schedule of concessions. If special compensation arrangements have been made with individual dealers, which arrangements are not generally available to all dealers, the details of the arrangements, and

the identities of the dealers, shall also be disclosed.]

[(2) No underwriter or associated person of an underwriter shall offer or pay any concession to an associated person of another member, but shall make such payment only to the member.]

[(3)(A) In connection with retail sales or distribution of investment company shares, no underwriter or associated person of an underwriter: shall offer or pay to any member or associated person, anything of material value, and no member or associated person shall solicit or accept anything of material value, in addition to the concessions disclosed in the prospectus.]

[(B) For purposes of this paragraph (1)(3), items of material value shall include but not be limited to:]

[(i) gifts amounting in value to more than \$50 per person per year.]

[(ii) gifts or payments of any kind which are conditioned on the sale of investment company securities.]

[(iii) loans made or guaranteed to a non-controlled member or person associated with a member.]

[(iv) wholesale overrides (commissions) granted to a member on its own retail sales unless the arrangement, as well as the identity of the member, is set forth in the prospectus of the investment company.]

[(v) payment or reimbursement of travel expenses, including overnight lodging, in excess of \$50 per person per year unless such payment or reimbursement is in connection with a business meeting, conference or seminar held by an underwriter for informational purposes relative to the fund or funds of its sponsorship and is not conditioned on sales of shares of an investment company. A meeting, conference or seminar shall not be deemed to be of a business nature unless: the person to whom payment or reimbursement is made is personally present at, or is en route to or from, such meeting in each of the days for which payment or reimbursement is made; the person on whose behalf payment or reimbursement is made is engaged in the securities business; and the location and facilities provided are appro-

priate to the purpose, which would ordinarily mean the sponsor's office.]

[(C) For purposes of this paragraph (1)(3), items of material value shall not include:]

[(i) an occasional dinner, a ticket to a sporting event or the theater, or comparable entertainment of one or more registered representatives which is not conditioned on sales of shares of an investment company and is neither so frequent nor so extensive as to raise any question of propriety.]

[(ii) a breakfast, luncheon, dinner, reception or cocktail party given for a group of registered representatives in conjunction with a bona fide business or sales meeting, whether at the headquarters of a fund or its underwriter or in some other city.]

[(iii) an unconditional gift of a typical item of reminder advertising such as a ballpoint pen with the name of the advertiser inscribed, a calendar pad, or other gifts amounting in value to not more than \$50 per person per year.]

[(4) The provisions of this subsection (1) shall not apply to:]

[(A) Contracts between principal underwriters of the same security.]

[(B) Contracts between the principal underwriter of a security and the sponsor of a unit investment trust which utilizes such security as its underlying investment.]

[(C) Compensation arrangements of an underwriter or sponsor with its own sales personnel.]

(1) In connection with the sale and distribution of investment company securities:

(1) Except for gifts as described in paragraph (1)(5)(a), a member shall maintain records of all compensation, cash and non-cash, received from offerors and the distribution by the member of any such compensation to its associated persons. The records shall include the names of the offerors, the names of the associated persons and the amount and nature of the compensation received and distributed.

(2) Except as described in paragraph (5), no associated person of a member shall accept any compensation, cash or non-cash, from anyone other than the member with which the person is associated.

(3) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(4) Except as described in paragraph (5), no member shall accept any compensation, cash or non-cash, from an offeror unless such is described in the current prospectus of the investment company. When special compensation arrangements are offered by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus.

(5) Notwithstanding the provisions of subsections (2) and (4) of this section, the following items of compensation may be accepted and are not required to be disclosed in a prospectus provided that they are not conditioned on sales or the promise of sales:

(a) Gifts by an offeror to associated persons of members, with the approval of the member, that do not exceed an annual amount per person fixed periodically by the Board of Governors.¹

(b) Payment or reimbursement by offerors to members in connection with training or educational meetings where the location is appropriate to the purpose of the meeting. A location appropriate to the purpose of a meeting shall mean an office of the offeror or the member or a facility located in the vicinity of such an office.

(6) The provisions of this Section (1) shall not apply to:

(a) Compensation arrangements between principal underwriters of the same security.

(b) Compensation arrangements between the principal underwriter of a security and the sponsor of a unit investment trust which utilizes such security as its underlying investment.

(c) Compensation arrangements between a member and its own associated persons.

(d) Compensation arrangements between a non-member company and its sales per-

¹The current annual amount fixed by the Board of Governors is \$100.

sonnel who are registered representatives of an NASD member which, directly or indirectly controls, is controlled by, or is under common control with that non-member company.

* * * * *

**PROPOSED AMENDMENT TO ARTICLE III,
SECTION 29 OF THE NASD
RULES OF FAIR PRACTICE**

(Note: New text is underlined.)

(a) Unchanged.

Definitions

(b)(1) - (2) Unchanged.

(3) The terms "offeror," "cash compensation" and "non-cash compensation" as used in subsection (h) of this Section shall have the following meanings:

"Offeror" shall mean a separate account of an insurance company, an adviser to a separate account of an insurance company, an underwriter and any affiliated person (as defined in Section 2(a)(3) of the Investment Company Act of 1940) of such entities.

"Cash compensation" shall mean compensation received by members in cash, by check and by electronic means and shall include loans and overrides.

"Non-cash compensation" shall mean any form of compensation received by members that is not cash compensation, including but not limited to merchandise, gifts and prizes, and payment of travel expenses, meals and lodging.

* * * * *

(c) - (g) Unchanged.

Member Compensation

(h) In connection with the sale and distribution of variable contracts:

(1) Except for gifts as described in paragraph (h)(5)(a), a member shall maintain records of all compensation, cash and non-cash, received from offerors and the distribution by the member of any such compensation to its associated persons. The records shall include the names of the offerors, the

names of the associated persons and the amount and nature of the compensation received and distributed.

(2) Except as described in paragraph (5), no associated person of a member shall accept any compensation, cash or non-cash, from anyone other than the member with which the person is associated. This requirement will not prohibit arrangements, agreed to by a member, where an insurance company maintains a commission account as a ministerial service for a member and, on behalf of the member, pays commission checks from such an account directly to associated persons of the member.

(3) No member or person associated with a member shall accept any compensation from an offeror which is in the form of securities of any kind.

(4) Except as described in paragraph (5), no member shall accept any compensation, cash or non-cash, from an offeror unless such is described in the current prospectus of the variable contract. When special compensation arrangements are offered by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the variable contracts of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus.

(5) Notwithstanding the provisions of subsections (2) and (4) of this section, the following items of compensation may be accepted and are not required to be disclosed in a prospectus provided that they are not conditioned on sales or the promise of sales:

(a) Gifts by an offeror to associated persons of members, with the approval of the member, that do not exceed an annual amount per person fixed periodically by the Board of Governors.¹

(b) Payment or reimbursement by offerors to members in connection with training or educational meetings where the location is appropriate to the purpose of the meeting. A location appropriate to the purpose of a meeting shall mean an office of the offeror or the member or a facility located in the vicinity of such an office.

¹The current annual amount fixed by the Board of Governors is \$100.

(6) The provisions of this Section (h) shall not apply to:

(a) Compensation arrangements between principal underwriters of the same security.

(b) Compensation arrangements between the principal underwriter of a security and the sponsor of a unit investment trust which utilizes such security as its underlying investment.

(c) Compensation arrangements between

a member and its own associated persons.

(d) Compensation arrangements between a non-member company and its sales personnel who are registered representatives of an NASD member which, directly or indirectly, controls, is controlled by, or is under common control with that non-member company.

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Notice To Members

National Association of Securities Dealers, Inc.

November 1991

Number 91-69**Suggested Routing:***

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| <input checked="" type="checkbox"/> Senior Management | <input checked="" type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Application of NASD Rules, Interpretations, By-Laws, and Federal Securities Laws to the Secondary Market in Direct Participation Program Interests**EXECUTIVE SUMMARY**

The NASD recently completed a study of secondary market trading in direct participation program (DPP) securities. As a result, this notice is being issued to emphasize the applicability and relevance of certain NASD rules, Interpretations, By-laws, and federal securities laws for those members and associated persons participating in the growing secondary market for DPP securities.

The study uncovered many cases of unawareness of pertinent rules or inappropriate application of the rules. Therefore, members are reminded of their responsibilities to ensure compliance with relevant regulatory requirements when engaging in this secondary market. Furthermore, members must take

steps to modify existing practices where necessary in a manner consistent with this *Notice to Members* and the applicable laws and rules. Among others, existing NASD rules involving markups, suitability of recommendations, and best execution are and have long been applicable to secondary market transactions with customers in DPP securities.

The NASD is committed to ensuring a fair and credible secondary market for all participants, including broker/dealers and investors. To achieve this result, strict adherence to all rules and regulations is necessary and expected. The NASD intends to closely surveil this market with that goal in mind.

BACKGROUND

In October 1990, the NASD through its Direct Participation Programs/Real Estate Committee (the "DPP Committee") initiated a study of the nature and functioning of the secondary market for public partnership securities. There were several factors that led the DPP Committee to conclude such a study was necessary. Concern was ex-

pressed about the growth in secondary markets for DPP securities, a relatively recent phenomenon brought about in large part by the Tax Reform Act of 1986, the inability of partnerships to liquidate their portfolios and distribute the proceeds, and the subsequent decline in oil and gas and real estate prices.

Also, during examinations of various mem-

bers, examiners had found questionable practices involving DPP securities that raised concerns as to possible violations of NASD rules. In some cases, the violations appeared serious enough to warrant disciplinary action. Given the seriousness of these matters, the NASD continued to pursue its regulatory investigations of apparent abusive practices, while the DPP Committee conducted a parallel but distinctly separate review of industry practices in this evolving and growing market.

Data gathered during the study indicated that approximately \$90 billion was invested in public DPP securities in the 1970s and 1980s by more than 10 million investors. The programs were organized to invest in a variety of industries including, but not limited to, real estate, oil and gas, cable television, commodities, and equipment leasing. Although these securities were generally not intended to be liquid and tradable, a secondary market in DPP securities nevertheless has developed.

The study also found that approximately two dozen participants (both NASD members and non-members) act as principal or agent for customers in a fragmented secondary market that, in the aggregate, transfers ownership of an estimated \$250 to \$300 million worth of public partnership securities annually. The primary concern of the study was to determine how the market currently operates, whether it functions efficiently, and whether members are in compliance with applicable securities laws and rules, including NASD rules.

The DPP Committee, through a subcommittee appointed specifically for this study, met with representatives from 10 NASD members and nonmembers that are engaged in secondary market transactions in DPP securities. In addition, the subcommittee solicited and received written submissions from other market participants. Each was asked to provide information as to how it conducted its business and for any insights or recommendations that it believed would be helpful to the Committee.

The NASD study, as well as the routine examinations conducted by NASD examiners, noted widespread differences in the manner in which DPP secondary trading is conducted by members and found that certain practices were at variance with applicable guidelines and regulations. The DPP Committee study was intentionally separated from the investigations and routine examinations being conducted by NASD examiners. Thus, the NASD Board of Governors has decided to issue

this *Notice to Members* to: emphasize to members the applicability of existing rules to this business, apprise the membership of the general conclusions of its study, inform members of the apparent violative practices noted by examinations, and discuss various issues that may require further study and possible rulemaking.

Specifically, applicability of rules relating to markups, filing of advertising and sales literature, determinations of suitability prior to a transaction, solicitation and tender offers, disclosure, Schedule H reporting requirements, transactions with non-members, quotation dissemination, and best execution as to price are emphasized. This notice also addresses problems relating to settlement and transfer, net capital, and escrow procedures.

NASD RULES AND BY-LAWS

Markups and Markdowns

NASD disciplinary cases and the DPP secondary market study have shown that many members engaged in secondary market activities may not be complying with the NASD Mark-Up Policy ("Policy") as set forth in an Interpretation of the Board of Governors under Article III, Section 4 of the NASD Rules of Fair Practice. The "Mark-Up Policy" specifies that for a markup or markdown in a principal transaction with a customer in equity transactions to be fair, it should generally not exceed 5 percent of the prevailing market price. This longstanding "5% Policy" is based on the obligations of a broker/dealer to deal fairly with its customers, particularly the obligation to charge customers only prices that are reasonably and fairly related to the prevailing market price at the time of the transaction.

The 5% Policy applies to customer purchases and sales of all securities traded in the Nasdaq and over-the-counter markets, including DPP securities. Since the Policy acts as a general guide, not a rule, a markup or markdown of more than the 5 percent guideline could be considered fair or reasonable where the specific facts and circumstances of the transaction clearly justify that price. On the other hand, a markup of less than 5 percent could be considered unfair under the circumstances of a specific transaction.

According to the 5% Policy, pricing considerations should take into account all relevant factors, including the type of security involved, the availability of the security, the price of the security, the

services rendered, the amount of money involved in the transaction, and disclosure. If a dealer seeks to charge its customers more than a 5 percent markup or markdown, it should be fully prepared to justify its reasons for the higher markup or markdown with adequate documentation.

Markups or markdowns that exceed the prevailing market price by 10 percent or more may not only be deemed unfair under the Mark-Up Policy and a violation of Article III, Sections 1 and 4 of the NASD Rules of Fair Practice, but also could be viewed as fraudulent and a violation of Article III, Section 18 of the Rules. While a member firm may attempt to justify a markup or markdown greater than 10 percent, the current state of the law creates a presumption of a fraudulently excessive markup or markdown that will be very difficult to overcome or rebut.

A markup or markdown compensates a dealer for its ordinary costs and risks associated with its handling of a transaction with a customer. The 5% Policy was designed to cover ordinary selling expenses, such as a normal commission to salespersons and the normal cost of processing a trade. Thus, such ordinary expenses cannot be charged again to customers in the form of increased markups or markdowns. In addition, excessive expenses cannot be used to justify a higher markup or markdown. The NASD has consistently held that its markup policy does not guarantee a dealer a net profit regardless of unreasonable expenses, such as excessive commissions to salespersons, excessive salaries to officers, and excessive telephone costs.

The NASD study found that DPP secondary market transactions with customers often involved fixed expenses such as general partner fees, settlement charges, and state transfer charges. Where such expenses are required by the general partner or state law, they may be directly passed on to customers as a separate charge or expense provided they are fully documented, not shared in by the member, and are fully disclosed prior to the transaction. However, charges to a customer that seek to defray overhead or internal administrative charges of the member are clearly inappropriate and may not be passed on to the customer directly or indirectly, or used as a basis for justifying a markup or markdown in excess of 5 percent.

The NASD study also indicates that, generally speaking, dealers in the DPP secondary market

do not act as "market makers" as that term is defined in the Securities Exchange Act of 1934¹ and interpreted by case law. Also, the overwhelming number of transactions reviewed by the NASD through its field examinations and in conjunction with this study indicate that a dealer purchasing or selling for its own proprietary account is usually doing so to fill a customer order and, as a result, does not generally incur market risk.

If a dealer is engaged in such a riskless transaction or is determined not to be a market maker with respect to a particular transaction, then the markup must be calculated by using the dealer's contemporaneous cost as the best evidence of the prevailing market price. Similarly, for markdowns, the dealer's most contemporaneous sales price to another dealer must be used. However, to the extent that a dealer actually functions as a market maker in an active, competitive market by placing its own capital at risk through buying and selling for its own account in the interdealer market, while providing and standing by its quotes in transactions with other dealers on a regular and continuous basis, the member may be able to use its actual contemporaneous sales prices (for markups) and contemporaneous purchase prices (for markdowns) with other broker/dealers as the best evidence of the prevailing market price at the time of its transactions with customers.

Thus, the current NASD Mark-Up Policy is fully applicable and must be complied with by members when determining the markup or markdown of DPP securities. The Policy provides comfort to members that a markup or markdown of 5 percent or less will be acceptable for the vast majority of DPP trades. If a member incurs reasonable additional time or costs in effecting a trade because of the limited availability of the DPP securities, the flexibility of the Policy may permit a markup or markdown of greater than 5 percent. In fact, the Policy acknowledges that markups in DPP securities may be higher than for sales of common stock. But, the member should be fully prepared to support the reasons for the higher markup or markdown with adequate documentation of each transaction.

Advertising and Sales Literature

Communications with the public, such as ad-

¹See Section 3(a)(38) of the Securities Exchange Act of 1934, as amended.

vertisements and sales literature concerning direct participation programs, are regulated under Article III, Section 35 of the Rules of Fair Practice. Secondary market advertising and sales literature, including research reports on public partnerships, must be filed within 10 days of first use with the NASD's Advertising Department for review, as required by Section 35(c).

The filing requirement, in effect since 1986, applies to all public programs but does not distinguish between material used in an offering and that used in the secondary market. The rule language requires members to file both types of material. This determination was made by the DPP Committee in 1989.

"Advertisement" and "sales literature" are specifically defined in Article III, Section 35(a). These definitions should be carefully reviewed to be certain that all pertinent material has been properly filed.

Suitability of Recommendations

NASD members and associated persons are required pursuant to Article III, Section 2 and Appendix F to Article III, Section 34 of the Rules of Fair Practice, when recommending to an investor the purchase, sale, or exchange of a DPP security, to have reasonable grounds to believe the recommendation is suitable for the customer based on the customer's investment objectives, other investments, financial situation and needs, tax status, and any other information known by the member or associated person. Additionally, the member and associated person must determine that the investor has the appropriate investment objectives, is in a position to fully understand the risks and benefits of the transaction, and has a net worth sufficient to sustain the risks involved in an investment in a DPP security.

The requirement to make a suitability determination not only applies to any initial distribution of partnership securities but to secondary market transactions as well. This requirement also includes the obligation to make reasonable efforts to obtain the customer information necessary to make the suitability determination. In addition, members must consider the suitability standards that may be imposed by state law when making a finding of customer suitability.

In making recommendations, members also must be aware of their fundamental responsibility

of fair dealing with customers including determining whether a reasonable basis exists for engaging in the DPP transaction, considering any tax implications to the customer, and the fairness of the recommended price for the purchase or sale.

Schedule H Reporting and Filing Requirements

Schedule H of the NASD's By-Laws requires daily electronic price and volume reporting of all non-Nasdaq securities, which encompass any equity security not included in Nasdaq or traded on any national securities exchange. Secondary market transactions in DPP securities are therefore reportable securities under Schedule H. As a result, members must report requisite price and volume information through the non-Nasdaq Reporting System for all secondary market trades in DPP securities that are executed on a principal basis.

Additionally, members are required to make Schedule H filings with the NASD of other required information prior to disseminating quotations in non-Nasdaq securities to comply with SEC Rule 15c2-11. (See section on SEC Rule 15c2-11, *infra.*) This filing requirement aspect of Schedule H is also applicable to DPP securities.

Although Schedule H reporting and filing requirements clearly apply to DPP securities, the NASD recognizes that, since these obligations may not have been specifically delineated in the past, many members may need additional time and guidance in order to implement the necessary procedures that will facilitate compliance with the rule. Therefore, in an upcoming *Notice to Members*, the NASD will provide additional information and directives regarding members' Schedule H compliance for DPP secondary market transactions.

Best Execution of Customer Orders

In any transaction for or with a customer, an NASD member is required to provide that customer with best execution as to price. To ensure fair dealing with customers, the Interpretation of the Board of Governors — Execution of Retail Transactions in the Over-the-Counter Market — under Article III, Section 1 of Rules of Fair Practice requires a member to obtain quotations from at least three dealers (or all dealers if three or less) to determine the best interdealer market price for a non-Nasdaq security. Article III, Section 21 of the Rules of Fair Practice requires that the quotes and

dealers contacted be recorded on the member's books and records.

Contrary to these requirements, some members have not obtained or recorded the required three quotes on order tickets nor obtained the best execution for their customers in the DPP secondary market. In addition, members holding themselves out as market makers have refused to quote prices when contacted by other members seeking quotes. NASD members are reminded that such conduct is inappropriate and may result in disciplinary action against the member. Thus, if a member holds itself out as a market maker, it is required to disseminate quote information to other members on request and stand by those quotes for execution purposes.

Uniform Clearance and Settlement

The NASD has found that one of the major problems in the secondary market for direct participation program securities is the inefficient and untimely transfer of limited partnership interests on the books of partnerships. Transfer problems can also lead to delays or mistakes in the allocation of cash distributions between buyers and sellers.

Since transfer difficulties have caused unacceptable delays in settlement and proved to be costly for all participants in the secondary market, the NASD intends to study the feasibility of developing a uniform system of transfers and settlements. The Board of Governors has authorized the appointment of a special committee for this purpose.

FEDERAL AND STATE SECURITIES LAW ISSUES

Numerous federal and state securities laws apply to the distribution of and secondary market transactions in DPP securities. Certain of these laws and regulations are outlined below. Members are urged to consult with counsel to ensure that they are in compliance with these and other pertinent laws.

Broker/Dealer Registration and Transactions With Nonmembers

The NASD is concerned that certain firms and individuals are buying and selling securities on behalf of public customers without being registered as broker/dealers or becoming members of the NASD. Such firms and individuals may be in

violation of federal securities laws requiring brokers and dealers to register with the Securities and Exchange Commission (SEC) and to become a member of a self-regulatory organization. The NASD urges its members to take great care in selecting the firms with which they do business and to report the actions of any market participants that they believe are nonregistered broker/dealers to the SEC or state securities regulators who have the authority to enforce requirements of registration, licensing, and other securities laws. Information concerning the activities of nonregistered broker/dealers supplied to the NASD will be referred to these agencies.

Members are also reminded that Section 25 of the NASD Rules of Fair Practice regulates transactions with nonmember broker/dealers. It generally requires members to deal with any nonmember broker/dealer at the same prices, commissions, fees and terms as they accord the general public. Thus, NASD members that transact business with nonmembers in the same manner they would another NASD member are in violation of Section 25.

Tender Offers Rules

To the extent that members engage in blanket solicitations of all limited partners of a particular partnership, members should be certain that such solicitation activity is either not subject to the tender offer rules of the Securities Exchange Act of 1934, or is in full compliance if they are applicable. Under certain circumstances, offers to purchase partnership interests made to all limited partners may constitute an unconventional tender offer.

Prospectus Disclosure Requirement

NASD members affiliated with a sponsor or general partner that also operate an internal bulletin board (e.g., a matching service) to match persons who wish to buy and sell interests in affiliated programs may be in violation of the registration provisions of the Securities Act of 1933. The SEC has recently stated that attempts by the general partner or its broker/dealer affiliates to facilitate or create an alternative secondary market may require that an "evergreen prospectus" be maintained. An evergreen prospectus is a part of an SEC registration statement that is continuously amended and updated so that the registration statement is always current and effective. General partners or their af-

filiates involved in such matching services or crossing arrangements may cause the offer to be deemed a sale of securities by the partnership-issuer that requires registration.²

Solicitation Under State Law

The NASD also believes that members should be aware that the resale of limited partnership interests by DPP secondary market participants following the widespread solicitation of the limited partners of a partnership may also be inconsistent with the registration provisions of various state laws. Under the Uniform Securities Act of 1956,³ a registration statement for a class of outstanding securities is effective for only one year.⁴ If resales occur after one year, an exemption from the registration provisions of state law may not be available. If no exemption is available, then it may be necessary to file a special registration statement to permit a new distribution by the issuer.⁵

Compliance With SEC Rule 15c2-11

SEC Rule 15c2-11 governs the initiation and resumption of quotations in a non-Nasdaq "interdealer quotation medium" by a broker or dealer for over-the-counter securities, including DPP securities. An interdealer quotation medium is defined as a quotation system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers. The rule was designed to help prevent manipulative and fraudulent trading schemes by prohibiting brokers and dealers from furnishing such quotations in the absence of sufficient information about an issuer.

A violation of Rule 15c2-11 may occur regardless of whether the broker/dealer is engaged in retail activity in the security, whether interdealer transactions have occurred, or whether the subject security is thinly traded. Indeed, the NASD has initiated disciplinary actions against members that have failed to comply with Rule 15c2-11.

Unless a broker/dealer qualifies for an exemption from Rule 15c2-11, the rule's information maintenance requirements can be satisfied in one of only five ways. Should a member seek to quote a DPP security in any interdealer quotation system, excluding the Nasdaq system, one of the most common methods of complying with the rule would be to obtain a prospectus filed with the SEC that is less than 90 days old since the majority of DPP securities that trade in the secondary market were

subject to a full registration statement.

Once the funding operation is completed for a DPP, a substantial portion of these issuers have the minimum number of holders and total assets necessary to trigger periodic reporting requirements with the SEC. As a result, another manner of complying with Rule 15c2-11 would be for the broker/dealer to obtain the issuer's latest 10-K report, and all subsequent 10-Qs and 8-Ks. Other methods of complying with the Rule include obtaining and reviewing any recent Regulation A filing or certain other specified information about the issuer, such as recent financial statements.⁶

Importantly, members that may decide to initiate or resume a quotation of a DPP security in an interdealer quotation medium must recognize duties that go beyond simply securing the referenced materials. The member must, for example, carefully review the Rule 15c2-11 information and documents and have a reasonable basis for believing that the information is accurate in all material respects. Additionally, an affirmative standard is imposed by the SEC that requires the broker/dealer to have a reasonable basis for concluding that the documents and information about the issuer are derived from a reliable source.

Although the rule is applicable, to date the NASD has not found members disseminating quotations in DPP securities in a non-Nasdaq interdealer quotation medium that would subject them to Rule 15c2-11. Nevertheless, members are advised that the NASD found that some broker/dealers active in the DPP secondary market are doing little, if any, due diligence or research to support prices they charge or quotations they disseminate to the public and other broker/dealers on request. Since Rule 15c2-11 applies to DPP securities traded in the non-Nasdaq market, members are urged to consult the full text of the rule and relevant SEC releases re-

²See Securities Act Release 33-6900, pages 36-38, June 17, 1991.

³The Uniform Securities Act of 1956 is a model act approved by the National Conference of Commissions on Uniform State Laws on August 25, 1956. It has been enacted into law by a majority of the states. Counsel should be consulted as to the provisions that may be applicable in the state or states involved.

⁴See Section 302(a)(2) Uniform Securities Act of 1956.

⁵See Section 305(i); and Note 9, NCCUSL Comment to Uniform Securities Act of 1956.

⁶See 17 CFR 240.15c2-11(a)(1) through (a)(5).

garding any intended quotations activities in order to be certain they are in full compliance.

Although members should have been complying with Rule 15c2-11, the NASD recognizes that members engaged in secondary market DPP activities may not have clearly understood the applicability of the rule. Therefore, the follow-up *Notice to Members* referred to above in the discussion of Schedule H will provide further guidance and direction to members regarding compliance with this rule.

Confirmation Disclosure Requirements

SEC Rule 10b-10, the so-called "customer confirmation rule," is fully applicable to members' transactions with their customers in DPP securities. The Rule requires, before the completion of any transaction with a customer, that the member send written notification to the customer disclosing specific information about the transaction. Included in the required disclosure are: (1) the capacity in which the member is acting in the transaction (i.e., as agent for the customer or principal or otherwise); (2) the date of the transaction and the identity, price, and amount of the security purchased or sold by such customer; and (3) the amount of the markup or markdown charged the customer where the dealer has acted in a riskless principal or agent capacity.

The study generally found that members active in the DPP secondary market generally do not meet the definition of a market maker and therefore are required to comply with the provisions of Rule 10b-10 as it applies to each transaction they engage in with customers.

Net Capital

The NASD reminds members that broker/dealers that engage in principal transactions in the DPP secondary market must adhere to a minimum net capital requirement of \$25,000. Under SEC Rule 15c3-1 (the "Net Capital Rule"), only \$25,000 net capital broker/dealers may handle customer funds or make markets in equity securities. However, a \$5,000 broker/dealer may act as agent in the secondary market provided it either introduces all customer accounts on a fully disclosed basis through another broker/dealer or utilizes a bank escrow account (similar to that required by SEC Rule 15c2-4) to process and hold all customers' funds and/or securities.

Members should also be aware that given the current lack of readily available price information and liquidity, the Net Capital Rule may require a 100 percent charge for such securities when held in inventory, as they will not generally meet the "ready market" test of the Net Capital Rule.

CONCLUSION

Market participants are urged to refocus their attention on the proper calculation of markups, markdowns, spreads, and expenses in the DPP securities market. Some firms make little effort to determine the investor's suitability to purchase DPP securities, have no knowledge as to the applicability of transaction reporting requirements, and violate NASD rules with predatory pricing practices, lack of best execution, and absence of due diligence on behalf of customers. In addition, some members are not making required filings of advertising and sales literature with the NASD and are improperly doing business with nonmember broker/dealers. Others are not properly disclosing expenses being charged in connection with a purchase or sale, conflicts of interest the broker/dealer may have with the customer, and the basis on which they are recommending the price at which the securities are being bought or sold.

The NASD understands that some of the shortfalls and deficiencies noted by NASD examiners and identified in the DPP Committee's study may be caused by a lack of knowledge on the part of members as to the applicability and relevance of existing NASD rules and federal securities laws. Nevertheless, the regulations applicable to this market are quite explicit as to the obligations of members. Members, in turn, have a responsibility to be aware of those regulations and to adhere to them. Thus, the purpose of this notice is to alert members to the relevance of these regulations and to assist in complying with the various requirements applicable to the DPP secondary market.

The NASD staff will continue to focus its regulatory efforts on DPP secondary market practices, and strict adherence to existing rules is expected. Members transacting business in the secondary market found to be in apparent violation of such rules may be subject to disciplinary action if such a determination is made by a District Business Conduct Committee. If members have questions as to the applicability of a given rule or law, or the bona

fides of a course of conduct they are planning, they should not hesitate to contact their local NASD district office and seek clarification.

Questions concerning this notice may be directed to Charles L. Bennett, Director; Richard J.

Fortwengler, Associate Director; or Carl R. Sperapani, Assistant Director, Corporate Financing Department at (202) 728-8258 or Daniel M. Sibears, Director, Compliance Division at (202) 728-8959.

Notice To Members

National Association of Securities Dealers, Inc.

November 1991

Number 91-70

Suggested Routing:*

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|---|--|---------------------------------------|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Trading |
| <input checked="" type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: SEC Approval and Startup of Nasdaq InternationalSM Service

EXECUTIVE SUMMARY

The Securities and Exchange Commission approved on October 10 the establishment of Nasdaq InternationalSM service for a two-year pilot period. All Nasdaq National Market issues, American Depositary Receipts on regular Nasdaq, and equity securities listed on U.S. exchanges qualify for inclusion in Nasdaq International. The startup of Nasdaq International is scheduled for early January 1992. The service will support a European trading session from 3:30 a.m. to 9 a.m., Eastern Time, tracking the initial business hours of the London financial markets, to accommodate international trading of U.S. securities by investors in the U.S., United Kingdom (U.K.), and other parts of Europe. Nasdaq Workstation devices will support maker-maker participation from the U.S. or U.K.

BACKGROUND

In June 1990, the NASD filed a proposed rule change with the Securities and Exchange Commission (SEC) to extend electronic market facilities to a cross-border session that would run from 3:30 a.m. to 9 a.m., Eastern Time (ET) on each U.S. business day. This period overlaps the busi-

ness hours of the London securities markets. The service is designed primarily to accommodate international trading by investors in the U.S., United Kingdom (U.K.), and other parts of Europe.

This service will mark the first instance that a U.S. securities market has operated across continents in a time period that had been used exclusively by foreign exchanges. Nasdaq International will offer the potential for European trading to many U.S. securities firms that don't operate there now. The service will enable domestic firms to participate in order flow in U.S. stocks that now is directed to foreign markets.

Market makers in the U.K. will be linked to London-based Nasdaq computers already in place that provide the same functions as do Nasdaq computers in the United States. A transatlantic cable connects the London facility to the NASD central computer complex in the U.S.

On October 10, 1991, the SEC approved the service and specialized NASD rules (International Rules) that will govern broker/dealer participation. The NASD expects to launch the service in early January 1992.

In approving the two-year service pilot, the SEC noted that this development advances the statutory goals of improving the efficiency of market operations, broadening the distribution of market information, enhancing opportunities to achieve best execution and promote competition among

market participants, and linking all clearance and settlement facilities in a way that reduces costs.

FEATURES OF NASDAQ INTERNATIONAL

The Nasdaq International service will offer the basic Nasdaq automated services, except for the Small Order Execution System (SOES), now provided during the domestic session to support market making by NASD members. These include the SelectNet service, which allows trades to be negotiated entirely via computer, as well as the Automated Confirmation Transaction (ACT) service, which facilitates efficient clearance and settlement. Access to market-making services during the cross-border session will be provided exclusively through Nasdaq Workstation devices.

Bid and ask quotations from each market maker will be available on Nasdaq terminals throughout the European session. These quotations also will be disseminated to domestic and international vendors of market information.

To be eligible, market makers must be NASD members or approved U.K. affiliates of NASD members. A U.S. firm with no U.K. branch may participate by staffing its U.S. trading desk during the European session. Market makers must disseminate quotations throughout the European session.

Broker/dealers that are not NASD members but that are authorized to carry on an investment business in the U.K. and have a "control relationship" with an NASD member may participate in the service as the member's agent.¹ All transactions effected by the affiliate will be captured on the books and records of the sponsoring NASD member. To participate in this fashion, the sponsor and its affiliate must enter into a specialized compliance agreement with the NASD.

The agreement also would provide that (1) only registered representatives of the sponsoring member may enter quotations into the service from the affiliate's premises in the U.K., (2) a registered principal of the sponsoring member must be designated to supervise those registered personnel, and (3) the sponsoring member must develop and have approved by the NASD adequate supervisory procedures covering the affiliate's participation before the affiliate begins to quote markets in the service. The registered principal responsible for supervising the affiliate's personnel must be assigned to the foreign affiliate's office within nine months of the affiliate's initial approval.

In addition, the sponsoring member must agree to assume full responsibility for the affiliate's compliance with all provisions of the service rules as well as other applicable NASD rules. The sponsor also must commit to ensure that all NASD regulatory data requests are satisfied and that the NASD can obtain access to original books and records located in the U.S. or U.K. that relate to the affiliate's participation in the service.

These procedures, the SEC noted in its approval order, are intended to place the same requirements on the sponsoring member that would pertain if it were to participate directly in the service.

Two classifications of market makers are authorized for the service — European only and International. European-only market makers must quote firm, two-sided markets in the qualified securities in which they have registered to trade during the cross-border session. International market makers will have identical obligations during the cross-border session and also will have to function as market makers in their respective registered securities during the domestic session. During the latter period, International market makers will assume the full range of obligations that now apply to member firms registered as Nasdaq or Consolidated Quotation Service (CQS) market makers. Approved U.K. affiliates will be limited to participating as European-only market makers.

To provide maximum flexibility, market-maker classifications will be assigned on an individual security and terminal basis, not on a firm-wide basis. Thus, a participating firm could use a Nasdaq Workstation terminal located in the U.S. to enter quotations as a European-only market maker in 10 qualified issues, an International market maker in 20 additional issues, and a U.S.-only market maker in another 15 issues.

A market maker's classification is set at the time of initial registration (or reregistration). Excused withdrawals and voluntary terminations of market-maker registration will be handled in essentially the same manner as they are today for Nasdaq's domestic session. Nasdaq personnel will be on duty throughout the cross-border session to handle operational matters.

One major difference between the domestic

¹For this purpose, "control relationship" means that the member controls, is controlled by, or is under common control with an NASD member.

and cross-border sessions is in the application of the 20-day waiting period for reregistration in a Nasdaq security. Since SOES will not be available in the cross-border session, the 20-day waiting period will not apply, thereby adding greater flexibility for market-maker participants.

During the initial phase of Nasdaq International, all qualified issues will be quoted and traded exclusively in U.S. dollars. The ranking of market-maker quotes in an eligible security will continue to be based on price and by time within price. In addition, closed quotes will appear below all open positions.

REQUIREMENTS FOR MARKET MAKERS

Market makers participating in the cross-border session will be subject to most of the operational requirements that currently apply to broker/dealers registered in Nasdaq or CQS issues. These requirements are summarized as follows:

1. Registration on a security-by-security basis by individual member firms is a prerequisite for market-maker participation.
2. Registered market makers must either be self-clearing or have a clearing arrangement with a firm that is a member of a registered clearing agency.
3. Participation in the Automated Confirmation Transaction (ACT) service and the Trade Acceptance and Reconciliation Service (TARS) will be mandatory for all participating firms, thereby providing immediate comparison as well as trade reporting for regulatory purposes.
4. All trades classified as international transactions must be cleared and settled through a registered clearing agency using a continuous net settlement system. A settlement cycle of five business days will apply to all "regular way" transactions.
5. Market-maker participants in the service must maintain firm, two-sided quotes throughout the European session in each qualified security in which they have registered as a European-only or International market maker.

QUALIFIED SECURITIES

Securities that qualify for quotation in the Nasdaq International service are:

- Nasdaq National Market (Nasdaq/NMS) securities.

- Foreign equities (excluding Canadian issues) and American Depositary Receipts (ADRs) in regular Nasdaq.

- Equity securities listed on U.S. exchanges. These securities will be included in Nasdaq International at the request of any Nasdaq International or European market maker.

TRADE AND VOLUME REPORTING AND DISSEMINATION

A significant distinction between the domestic and European session concerns entry of trade reports. During the domestic session, transactions in Nasdaq/NMS or listed securities must be reported to the NASD within 90 seconds of execution through the ACT facility. For the cross-border session, the requirement will be three minutes, the prevailing standard for market makers in the U.K. The data elements to be reported, however, will be identical to those now required during the NASD's domestic market session.

While domestic transactions in reportable securities are disseminated instantly, individual transaction reports on Nasdaq/NMS and exchange-listed securities in the European session will not be disseminated to vendors, except for those securities that have such trade-by-trade information disseminated by the London Stock Exchange. With that exception, all other trade data will be gathered by the NASD for regulatory purposes only.

At the close of the European session, the NASD will furnish information on the high, low, and closing transaction prices and aggregate volume for securities with at least two market makers in the service. Data from the European session will not be consolidated with trade information from the domestic session. While this information is less than that provided for domestic Nasdaq/NMS transactions, it will mark the first time that any aggregate volume or trading-range information for U.S. securities has been publicly disseminated during U.K. trading hours.

The NASD expects that securities information vendors will disseminate the closing price and volume information.

For additional information about the service described in this notice, contact Gary Guinn, Director of Nasdaq International, at (202) 728-8087. For compliance-related questions, call Michael Kulczak, Associate General Counsel, at (202) 728-8811.

Notice To Members

National Association of Securities Dealers, Inc.

November 1991

Number 91-71

Suggested Routing:*

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|---|--|--|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input checked="" type="checkbox"/> Registration | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Broker/Dealer and Agent Renewals for 1991-92

EXECUTIVE SUMMARY

The 1991-92 NASD broker/dealer and agent registration renewal cycle begins in early November. This program simplifies the renewal process through the payment of one invoice amount that will include fees for NASD personnel assessments, NASD branch-office fees, New York Stock Exchange, American Stock Exchange, and Chicago Board Options Exchange maintenance fees, state agent renewal fees, and state broker/dealer renewal fees. Members should read this notice and the instruction materials included in the invoice package to ensure continued eligibility to do business in the states effective January 1, 1992.

INITIAL RENEWAL INVOICES

On or around November 12, 1991, initial renewal invoices were mailed to all member firms. The invoices included fees for NASD personnel assessments, NASD branch-office fees, New York Stock Exchange (NYSE), American Stock Exchange (Amex), and Chicago Board Options Exchange (CBOE) maintenance fees, state agent renewal fees, and state broker/dealer renewal fees. The NASD must receive full payment of

the November invoice **no later than December 18, 1991.**

NASD personnel assessments for 1992 will be based on the number of registered persons with an approved NASD license as of December 31, 1991. That personnel assessment is \$10 per person. NASD branch-office assessments will be based on the number of active branches as of December 31, 1991. This branch-office assessment is \$50 per branch.

Agent renewal fees for NYSE, Amex, CBOE, and state affiliations are listed in a table enclosed with each invoice. The table includes a list of broker/dealer renewal fees for states that are participating in this year's broker/dealer renewal program. NYSE, Amex, and CBOE maintenance fees — collected by the NASD for firms that are registered with NYSE/Amex/CBOE as well as the NASD — are based on the number of NYSE-, Amex-, and/or CBOE-registered personnel employed by the member.

If a state is not participating in this year's broker/dealer renewal program, members registered in that state must contact the state directly to assure compliance with renewal requirements. In addition, some participating states may require steps beyond the payment of renewal fees to complete the broker/dealer renewal process. Members should contact states directly for further information on state renewal requirements.

Payment of the initial invoice should be in the form of a check made payable to the National Association of Securities Dealers, Inc. The check should be drawn on the member firm's account, with the firm Central Registration Depository (CRD) number included on the check. Submit the check along with the top portion of the invoice and mail them in the return envelope provided with the invoice. To ensure prompt processing, the renewal invoice payment should not be included with other forms or fee submissions. Members should be aware that failure to return payment to the NASD by the December 18, 1991 deadline will mean a loss of eligibility to do business in the states effective January 1, 1992.

FILING FORM U-5

Members may wish to avoid unwanted renewals by filing Form U-5 for agent terminations in one or more jurisdiction affiliations. Because of the increased convenience and flexibility reported by members that used predated Form U-5 for renewals in previous years, the NASD will again process predated agent terminations this year. From November 1 to December 18, the NASD will accept and process Forms U-5 (both partial and full terminations) with **predated dates of termination**. Under this procedure, if the U-5 indicates a termination date of December 31, 1991, an agent may continue doing business in a jurisdiction until the end of the calendar year without being assessed renewal fees for that jurisdiction. Please ensure that Forms U-5 are filed by the renewal deadline date of December 18, 1991. Also, **predated U-5s cannot be processed if the date of termination indicated is January 1, 1992 or thereafter.**

Members should exercise care when submitting predated Forms U-5. The NASD will process these forms as they are received but cannot withdraw a predated termination once processed. To withdraw a predated termination, a member would have to file a new Form U-4 **after** the termination date.

The NASD encourages members having access to the Firm Access Query System (FAQS) to utilize electronic filings for the submission of all Forms U-5 and page 1s of Form U-4. FAQS offers several advantages to firms in this regard, including the ability to **immediately** process terminations, ensure in-house control over agent registrations, and reduce normal and express mail-

ing costs as well as long-distance telephone calls. It also allows members to quickly and efficiently handle the large filing volumes that typically occur at this time every year. Because of that, the NASD will provide an additional service to FAQS users by expanding the on-line user hours for November and December 1991. The system will be operational from 7 a.m. to 11 p.m., Eastern Time (ET) Mondays through Fridays and also will be available on Saturdays from 8 a.m. to 6 p.m., ET during those months.

FILING FORMS BDW

The CRD Phase II program, now in its third year, allows firms requesting terminations (either full or state only) to file their Forms BDW with the CRD to avoid the assessment of renewal fees in those jurisdictions that are designated on the Form BDW, **provided that the jurisdiction is a CRD Phase II participant**. Currently, there are six jurisdictions that are **not** participating in Phase II. They are:

- Michigan
- New Jersey
- Puerto Rico
- American Stock Exchange
- Chicago Board Options Exchange
- New York Stock Exchange

Firms requesting termination in any of the above-listed jurisdictions must submit a Form BDW directly to the jurisdiction.

The deadline for receipt of Forms BDW by the CRD for firms desiring to terminate an affiliation before year-end 1991 is December 18, 1991. This same date applies to the filing of Forms BDW with the jurisdictions that are not participating in Phase II. Predated Forms BDW filed with the CRD **will be** accepted and processed in the same manner as predated Forms U-5.

REMOVING OPEN REGISTRATIONS

For the fifth year, the NASD will include in the initial invoice package a roster of firm agents whose NASD registration is either terminated or purged because of the existence of a deficient condition for more than 180 days but who have approved registrations with states. This roster should aid in the reconciliation of personnel registrations prior to year's end. Firms may terminate obsolete state registrations through the submission of a

Form U-5 or reinstate NASD licenses through the filing of a page 1 of Form U-4. No roster will be included if a firm does not have agents within this category.

BILLING CODE BREAKDOWN

This year's final invoice package will again include a breakdown of fees assessed by billing code for firms that use billing codes in the registration process. This breakdown will aid firms in their internal research and allocation of fees.

FINAL ADJUSTED INVOICES

On or about January 13, 1992, the NASD will mail final adjusted invoices to members. These invoices will reflect the final status of firm and agent registrations as of December 31, 1991. Any adjustments in fees owed as a result of registration terminations or approvals subsequent to the initial invoice mailing will be made in this final reconciled invoice. If a member has more agents registered at year's end than it did on the November invoice date, additional fees will be assessed. If a member has fewer registered personnel at year's

end than it did in November, a credit will be issued.

Included with this adjusted invoice will be the member renewal rosters, which will list all renewed personnel registered with the NASD, NYSE, Amex, and each state. Persons whose registration is approved in any of these jurisdictions during November and December will automatically be included in this roster, while registrations that are pending approval or are deficient at year's end **will not** be included in the renewal process. Firms also will receive an NASD branch-office roster that lists all branches for which they have been assessed.

Firms then will have a two-month period in which to reconcile any discrepancies on the rosters. All jurisdictions should be contacted directly in writing. Specific information and instructions concerning the final adjusted invoice package will appear in the January 1992 issue of the *Notices to Members*, as well as on the inside cover of the renewal roster.

Questions concerning this notice may be directed to NASD Information Services at (301) 590-6500.

Notice To Members

National Association of Securities Dealers, Inc.

November 1991

Number 91-72

Suggested Routing:*

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| <input type="checkbox"/> Senior Management | <input checked="" type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options | <input type="checkbox"/> Systems |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal | <input checked="" type="checkbox"/> Registration | <input type="checkbox"/> Trading |
| <input type="checkbox"/> Institutional | <input type="checkbox"/> Mutual Fund | <input type="checkbox"/> Research | <input checked="" type="checkbox"/> Training |

*These are suggested departments only. Others may be appropriate for your firm.

Subject: Enhancements to the Firm Access Query System (FAQS)

EXECUTIVE SUMMARY

On November 12, 1991, the NASD activated enhancements to the Firm Access Query System (FAQS) that will enable subscribers to more efficiently process Forms U-5 and access certain registration information about their active and pending representatives. For those subscribers that electronically file Form U-5, the ability to recall, display, and print the filing through the Central Registration Depository system will be available. Firms no longer will have to retain a hard copy of the

electronically filed U-5. Through the enhanced query prompt, specific information about an agent's status and exam records can be viewed without the user having to review the individual's entire record.

These enhancements represent the first phase of system revisions designed to make the electronic processing of forms more cost effective and to improve the efficiency of the registration process.

BACKGROUND

The Firm Access Query System (FAQS) enables subscriber NASD member firms to review the registration and examination data, maintained on the Central Registration Depository (CRD), relating to their pending and registered individuals. Through FAQS, subscribers also may elect to schedule exams, review accounting transactions and balances, and file select Form U-4 amendments and U-5s electronically.

During the past year, the NASD set out to develop system enhancements that will promote increased utilization of the electronic filing process, streamline the access to certain key registration

data elements, and provide a means for subscribers to efficiently reconcile filing deficiencies.

SYSTEM ENHANCEMENTS

With the support of present subscribers and the North American Securities Administrators Association (NASAA), the NASD has designed system enhancements to FAQS. The most significant of these will result in a streamlined electronic form filing program no longer requiring retention of the hard copy filing. Using the new program, an electronically submitted U-5 form can be displayed and printed on demand. The firm, as well as all regulators, will have the ability to view and screen-

print the filing summary. NASAA has agreed to accept this system-generated form display in lieu of the hard-copy form.

Firms that file electronically will benefit further as similar enhancements are scheduled in the near future. The updated version for page 1 and page 2 amendments to Form U-4 is slated to be activated by the end of 1991.

This most recent software revision will also provide more focused prompts within the Query

command of CRD that will enable display of records by a specific affiliation/position and exam type. This new process will result in more efficient identification of relevant data without costly and time-consuming review of an agent's entire CRD display.

Questions about this notice, subscriber inquiries, and requests for access to FAQs should be directed to Ilene Taylor or Shirley Suggs in Member Services at (301) 590-6862.