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

notice to members 83-67

December 9, 1983

IMPORTANT

MAIL VOTE

Officers * Partners * Proprietors

TO: All NASD Members

RE: Proposed Amendments to the Corporate Financing Rule

Proposed Amendments to Section 26 of the Rules of Fair Practice

Last Voting Date is January 9, 1984

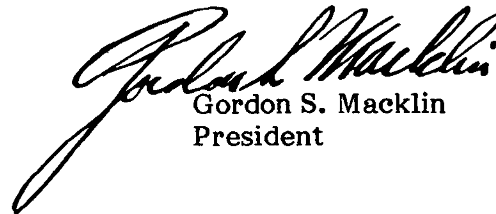
Attached are amendments regarding two separate issues which are being submitted to the membership for a vote. The first issue is that of amendments to the proposed Corporate Financing Rule filing requirements which would exempt from those requirements all debt and equity securities registered with the Securities and Exchange Commission on Registration Statement Form S-3. The proposed exemption would replace the present NASD exemptions for debt rated "B" or better by a recognized rating service and for debt and equity offerings registered on a Form S-3 and distributed pursuant to Rule 415.

On May 27, 1983, the Association requested comments on the amendments to the proposed Corporate Financing Rule filing requirements. (Notice to Members 83-25). The proposed amendment was approved by the Association's Board of Governors on July 15, 1983, and now requires approval by the membership. If approved, it must be filed with and approved by the Securities and Exchange Commission pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended. The background and details of the amendment are discussed below (Exhibit A). The text of the proposed amendments is attached to this notice (Exhibit B).

The second issue requiring a membership vote is that of proposed amendments to Article III, Section 26 of the Rules of Fair Practice. The proposed amendments to subsection (k) of Section 26 are purely technical in nature and have no material effect on the standards contained in the rule. They represent language clarifications requested by the staff of the Securities and Exchange Commission in connection with the Commission's approval of prior amendments. The text of the proposed amendments is also attached to this notice (Exhibit C).

Should the proposed amendments be approved by membership vote, they must be filed with and approved by the Securities and Exchange Commission pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended.

Sincerely,



Gordon S. Macklin
President

Enclosures

CORPORATE FINANCING RULE

BACKGROUND

The Interpretation of the Board of Governors — Review of Corporate Financing ("Corporate Financing Interpretation") under Article III, Section 1 of the Rules of Fair Practice (NASD Manual (CCH) Para. 2151) requires that most public offerings of debt and equity securities which involve member participation be filed with the Association for a review of the underwriting terms and arrangements. Historically, the Association, through its filing requirements, has tried to identify offerings in which review of the underwriting terms and arrangements would be most meaningful. In the past, certain types of offerings have been exempted from the filing requirements where market forces or other constraints were present to assure the fairness and reasonableness of underwriting terms and arrangements, including specifically the amount of underwriting compensation.

In Notice-to-Members 83-24 (May 19, 1983), the Association submitted to the membership for vote a new Corporate Financing Rule which, when approved by the SEC, will replace the Corporate Financing Interpretation. Sections (c)(3)(D) and (F) of the Corporate Financing Rule exempt from the filing requirements debt rated "B" or better by a recognized rating service and securities registered as part of a "shelf" registration on Form S-3 issued by a registrant which meets the requirements of Form S-3 as those requirements were in effect on March 1, 1983.

The exemption for offerings of debt securities rated "B" or better by a recognized rating service reflects the nature of the debt market during the late 1960's when the filing requirements were developed. At that time, most outstanding debt was rated "B" or better. There was a small amount of debt rated below "B" which was of significantly lesser quality.

The exemption for securities registered on a Form S-3 and distributed pursuant to Rule 415*/ is an extension of prior policy which provided an exemption for "shelf" offerings registered on a Form S-16 which do not involve an underwriting agreement. The current exemption reflects a determination that, irrespective of whether the securities are sold in normal brokerage transactions or pursuant to an underwriting agreement, market pressures in connection with "shelf" offerings result in the amount of underwriting compensation being determined through a virtual competitive bidding process which helps to achieve its reasonableness. Even in "shelf" offerings which eventually include a traditional underwriting agreement, the Association believes that the competitive pressures which come into play in the negotiations preceding the execution of that agreement can usually be relied upon to achieve the overall fairness of the arrangement.

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*/ The Association recently clarified the filing requirements with respect to "shelf" offerings registered on a Form S-3 in Notice-to-Members 83-12 (March 8, 1983).

Recently, the Association reexamined its filing requirements in light of the adoption by the SEC of the Form S-3 eligibility criteria. Form S-3 is the most streamlined of SEC registration statement forms and permits issuers to incorporate by reference substantial amounts of information from annual reports and other periodic filings. The Commission devoted substantial resources to identifying those securities and issuers which were widely followed and subject to sufficiently meaningful market forces as to assure that adequate information was readily available in the marketplace.

To use Form S-3, both the registrant and the transaction must meet specified qualifications. Form S-3 may be used by a U.S. registrant which has been a reporting company for 36 months prior to the filing, and has made timely filings for 12 months preceding the filing date. In addition, neither the registrant nor its subsidiaries may have defaulted in the payment of required dividends or any material obligations since the end of its last audited year.

Form S-3 may be used for primary offerings of such registrants which have outstanding voting stock held by non-affiliates with an aggregate market value of $150 million, or alternatively, $100 million aggregate market value and annual trading volume of three million shares. Primary offerings by qualified registrants of "investment grade" non-convertible debt and preferred securities may also be registered on Form S-3. Investment grade debt is defined as those securities rated by a nationally recognized statistical organization in the four highest categories (e. g. "AAA" through "BBB" by Standard & Poor's and "Aaa" through "Baa" by Moody's). Secondary offerings of outstanding securities by any person other than the issuer may be registered on Form S-3 if the securities are quoted on NASDAQ or listed on a national securities exchange. Finally, rights offerings, dividend and interest reinvestment plans, and offerings of securities upon conversion and the exercise of warrants may be registered on Form S-3.

Having observed the operation of the integrated disclosure system for over a year, the Corporate Financing Committee and Board of Governors have concluded that it is appropriate to amend the NASD filing requirements to reflect the new structure of SEC registration requirements.

EXPLANATION OF PROPOSED AMENDMENTS

The proposed amendments significantly alter present NASD filing requirements for both debt and equity securities. With respect to equity offerings, i.e. offerings which have any attribute of equity ownership, the number of offerings which would be required to be filed would be substantially reduced. Currently, most equity offerings are required to be filed with the Association, except where the offering is being made pursuant to Rule 415. Under the proposed amendment, the current exemption for equity offerings registered on a Form S-3 and distributed pursuant to Rule 415 would be eliminated. In its place, the Association is proposing that an exemption for all equity offerings registered with the SEC on Form S-3 (or an equivalent successor form) be adopted. As explained above, primary offerings of equity securities can generally be registered on Form S-3 when the issuer has outstanding voting stock held by non-affiliates with an aggregate market value of

$150 million or such stock has an aggregate market value of $100 million and a trading volume of three million shares. The market value and trading volume requirements are inapplicable to preferred offerings, rights offerings, dividend and interest reinvestment plans and offerings upon conversion and the exercise of warrants.

With respect to debt offerings, i.e. offerings with no equity characteristics, the proposed amendments would require a greater number of such offerings to be filed than at present. Pursuant to the proposed amendment, the present exemptions for debt rated "B" or better and "shelf" offerings of debt registered on a Form S-3 would be eliminated. In its place, an exemption for all debt registered on Form S-3 (or an equivalent successor form) would be adopted. Generally speaking, therefore, debt instruments rated "B", or "BB" by Standard and Poor's and "B" or "Ba" by Moody's would become subject to NASD filing requirements. In today's market, the nature of debt instruments is significantly different than that which existed when the filing requirements were developed in the late 1960's. There has been a proliferation of types and levels of quality debt. The Corporate Financing Committee concluded, therefore, that it is appropriate to subject these instruments to review by the Association to assure the fairness and reasonableness of their overall underwriting terms and arrangements.

In recommending the proposed amendments, the Corporate Financing Committee concluded that competitive market forces which ordinarily affect a public offering by an issuer qualified to use Form S-3 are effective in assuring that the underwriting terms and arrangements generally are fair and reasonable. In addition, the Committee noted that rapid access to the marketplace has become increasingly critical for certain issuers and that such access has been facilitated by SEC policies which permit offerings to become effective without detailed review. The Association has long been committed to expediting its review of offerings where rapid market access was critical. It is therefore appropriate that the Association take steps to assure ready access to the marketplace so long as investor protection is assured.

It is important to note that the proposed amendments relate only to filing requirements and do not constitute exemptions from the substantive requirements of the Corporate Financing Interpretation or the proposed Rule. Members will still be expected to assure compliance with those requirements in any offerings in which they participate. Additionally, the proposed exemptions relate only to filing requirements under the proposed Corporate Financing Rule; these exemptions do not extend to offerings which are subject to Schedule E to Article IV, Section 2 of the NASD By-Laws concerning offerings by members of their own securities or those of affiliates.

The text of the proposed amendments is attached.

PROCEDURES FOR ADOPTION OF RULE

The authority for this proposal is contained in Section 15A of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78o-3), and Article VII of the Association's By-Laws.

Text of Proposed Amendment */

Subsection (c): Filing Requirements

(1) General

No member or person associated with a member shall participate in any manner in any public offering of securities unless documents and information as specified herein relating to such offering have been filed with and reviewed by the Association for compliance with this section. For purposes of this section, participation in a public offering shall include participation in the preparation of offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten or any other basis, or participation in any advisory capacity related to the offering.

* * *

(3) Excepted Offerings

The provisions of paragraph (1) notwithstanding, documents and information shall not be required to be filed with respect to offerings of the following types of securities:

(A) securities which are defined as "exempt securities" in Section 3(a)(12) of the Securities Exchange Act of 1934, as amended;

(B) securities of investment companies registered under the Investment Company Act of 1940, as amended, except securities of a management company defined as a "closed-end company" in Section 5(a)(2) of that Act;

(C) variable contracts as defined in Article III, Section 29(b)(1) of the Rules of Fair Practice;

~~(D) nonconvertible debt securities or preferred stock which is rated "B" or better by a national rating agency recognized by the Association;~~

~~(E)~~(D) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act of 1935, as amended;

~~(F)~~(E) securities registered ~~as part of a "shelf" registration, provided that said securities are registered~~ with the Securities and Exchange Commission on registration statement Form S-3 or a similar form promulgated in lieu of Form S-3 ~~and are~~ issued by an issuer which

presently meets the ~~issuer~~ requirements of Form S-3 as those requirements were in effect on March 1, 1983; ~~and provided further, that said securities are reasonably expected to be offered pursuant to Rule 415 adopted under the Securities Act of 1933, as amended, as that rule was in effect on March 1, 1983;~~

(~~G~~)(F) private offerings which are exempt from registration under Section 4(1), 4(2) or 4(6) of the Securities Act of 1933, as amended; and

(~~H~~)(G) tender offers made pursuant to Regulation 14D adopted under the Securities Exchange Act of 1934, as amended, as that regulation was in effect on March 1, 1983.

Below are technical amendments which will have no substantive effect on Article III, Section 26. The proposed changes are merely in conformance with the Commission's request for language changes.

Proposed Amendments to
Article III, Section 26(k)
of the Rules of Fair Practice

(additions underlined; deleted material in brackets)

Execution of Investment Company Portfolio Transactions

(k) (1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular investment company or group of investment companies on the basis of brokerage commissions received or expected by such member from any source, including such investment company, or any covered account.

(2) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of shares of an investment company.

(3) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.

(4) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any investment company or covered account to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

(5) No member shall, with respect to such member's activities as an underwriter of investment company shares, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the shares of any investment company which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

(6) No member shall, with respect to such member's retail sales or distribution of investment company shares:

(A) provide to salesmen, branch managers or other sales personnel any incentive or additional compensation for

the sale of shares of specific investment companies based on the amount of brokerage commissions received or expected from any source, including such investment companies or any covered account. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaigns or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any investment company or group of investment companies based on brokerage commissions;

(B) recommend specific investment companies to sales personnel, or establish "recommended," "selected," or "preferred" lists of investment companies, regardless of the existence of any special compensation or incentives to favor or disfavor the shares of such company or companies in sales efforts, if such companies are recommended or selected on the basis of brokerage commissions received or expected from any source;

(C) grant to salesmen, branch managers or other sales personnel any participation in brokerage commissions received by such member from portfolio transactions of an investment company whose shares are sold by such member, or from any covered account, if such commissions are directed by, or identified with, such investment company or any covered account; or

(D) use sales of shares of any investment company as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an investment company or of any covered account, whether such transaction is executed in the over-the-counter market or elsewhere.

(7) <u>Provided that the member does not violate any of the specific provisions of this subsection (k)</u>, [N]<u>n</u>othing [in this subsection (k)] <u>herein</u> shall be deemed to prohibit:

(A) the execution of portfolio transactions of any investment company or covered account by members who also sell shares of the investment company;

(B) a member from selling shares of, or acting as underwriter for, an investment company which follows a policy, disclosed in its prospectus, of considering sales of shares of the investment company as a factor in the selection of broker-dealers to execute portfolio transactions, subject to the requirements of best execution;

(C) a member from compensating its salesmen and managers based on total sales of investment company shares attributable to such salesmen or managers, whether by use or

overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular investment companies on a basis prohibited by this subsection (k).

NASD notice to members 83-68

NOT AVAILABLE AT THIS TIME

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

notice to members 83-69

December 16, 1983

TO: All NASD Members

ATTN: Operations Principals, Cashiers and Buy-in Personnel

RE: Amendments to the Uniform Practice Code to Extend Applicability of the Code to Secondary Market Transactions in Unit Investment Trust Securities

The Association's Board of Governors has adopted various amendments to the Uniform Practice Code which prescribes the manner in which over-the-counter securities transactions are compared, cleared and settled between NASD member firms. These amendments to the Code apply to all NASD members participating in secondary transactions in unit investment trust securities.

BACKGROUND AND EXPLANATION OF AMENDMENTS

The amendments to the Uniform Practice Code are designed to extend the applicability of the Code to secondary market transactions in unit investment trust securities. The amendments also specifically exempt from such coverage, transactions in other redeemable securities registered under the Investment Company Act of 1940 and direct participation program securities, both of which have in the past been treated as being exempt from coverage of the Code.

The original proposal to extend the scope of the Code was urged by member firms because of the increased popularity and trading activity in this investment product. In particular, it was perceived that a substantial "fail-to-deliver" problem existed in the secondary market for UITs. Historically, the Code has been applied only to corporate equity and debt securities and not to securities registered under the Investment Company Act of 1940. In this regard a special subcommittee of the Association's Uniform Practice Committee was formed to study the feasibility of adapting the Code to UITs and to develop the necessary amendments.

The subcommittee concluded that UPC coverage of UITs was feasible and desireable. The subcommittee then undertook a section-by-section analysis of the Code to determine what, if any, changes were appropriate to extend the coverage of the Code to UITs. The resulting amendments to the Code will provide industry-wide uniformity in trading and trade processing for unit investment trust securities.

The amendments to Section 1 of the Code, relating to the scope of coverage of the Code provide for the inclusion of UITs, the exclusion of DPP securities and a clarification of existing practice that the Code applies only to secondary market trades. The purpose of the amendments, with the exception of Section 59, is simply to extend application of the affected Sections to UITs. The amendments to Section 59 of the Code relating to buy-in procedures provide a number of options available to a purchaser wishing to "buy-in" contracts in unit investment trust securities. These options allow the purchaser either to buy-in identical securities, to accept UIT units comparable to those originally purchased, or if neither of the first two options are available, to require the seller to repurchase the unit investment trust securities. Such a repurchase is to be completed on terms which require the seller to bear the burden of any change in market price in the securities along with accrued interest. This option, which is similar to that provided by MSRB Rule G-12, is made available because, as with municipal securities, only a limited number of identical or comparable trust units may be available thereby precluding a true buy-in on the part of the aggrieved purchaser.

The following is a brief description of the adopted amendments to the Code. The full text of the amendments is attached.

- In Section I(a) of the Code, the term "secondary market" has been added to express more clearly the fact that only aftermarket transactions are covered by the Code and that its provisions are not applicable to the original distribution of a new issue.

- A new Section 1(a)(iv) has been added which generally excludes redeemable securities from coverage under the Code. The exception is made, however, for all secondary market transactions in UITs except redemptions.

- Old Section 6(b) defining "record date" has been redesignated Section 3(d) and amended to specifically include unit investment trust securities and principal payments on these securities.

- Non-substantive language has been added in Section 5(b)(3) to clarify the process for declaration of ex-dividend dates on securities of open-end management investment companies.

- Language has been added to Section 10 relating to descriptions of securities in confirmations and comparisons to include the payment option on unit investment trust securities.

(b)(1) and (2) - Unchanged

(b)(3) - Ex-dividend dates for investment company shares

Notwithstanding the above, the ex-dividend date on [stock] securities of an open-end management investment company shall be the date designated by the issuer or its principal underwriter.

(c) - Unchanged

Sec. 6 TRANSACTIONS "EX-INTEREST" IN BONDS WHICH ARE DEALT IN "FLAT"

[(a)] - Text of subsection unchanged

["Record Date"

(b) As used in this Section, the term "record date" means the date fixed by the trustee, registrar, paying agent or issuer for the purpose of determining the holders of bonds, or similar evidences of indebtedness entitled to receive interest payments.]

Sec. 7-9 Unchanged

Sec. 10 DESCRIPTION OF SECURITIES

Confirmations or comparisons shall include, in addition to an adequate description of the security [and] (which shall include payment options on a unit investment trust series), the price at which the transaction was made[,] and any other information deemed necessary to insure that the buyer and seller agree as to details of the transaction. Such "other information" should include, if applicable, but need not be limited to, such phrases as "ex-warrants," "ex-stock," "registered," "flat," "part-redeemed," "Canadian funds," "with proxy," etc.

Sec. 11-17 - Unchanged

Sec. 17A - Units of Delivery - Unit Investment Trust Securities

The minimum unit of delivery for Unit Investment Trust Securities shall be a single unit of the trust.

Sec. 18-45 - Unchanged

Sec. 46 COMPUTATION OF INTEREST

- A new Section 17(A) is being added to define the unit of delivery for unit investment trust securities as a single unit of the trust.

- In Sections 46(a), (c) and (d), the term "bond" has been deleted and replaced with the word "security" in order to expand the application of those sections dealing with the computation of accrued interest for unit investment trust securities.

- Sections 48(b) and (d) have been amended to specifically refer to unit investment trust securities in the definition of "due-bill checks."

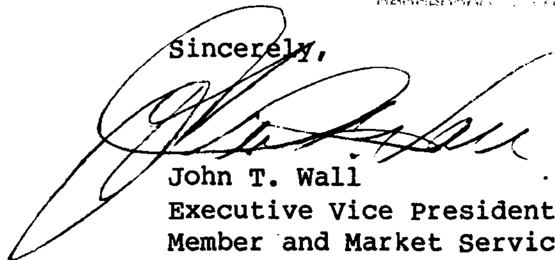
- In Section 49(c), language has been added to specifically refer to unit investment trust securities in the procedure for claiming interest payments.

- Language has been added in Section 56(a) to specifically refer to unit investment trust securities in the procedure for reclamations.

- Old Section 59(c) has been redesignated Section 59(c)(i) and a new Section 59(c)(ii) has been added to provide a buy-in procedure for unit investment trust securities. In essence, these provisions allow a purchaser of securities which have not been delivered either to buy the securities in, to agree upon a substitution of securities or, if both of these options are unavailable, to effect a repurchase of the securities. These procedures are comparable to the buy-in provisions of Rule G-12 of the Municipal Securities Rulemaking Board.

The text of these amendments to the Association's Uniform Practice Code is attached. Questions regarding these amendments may be directed to Donald J. Catapano, Uniform Practice Department at (212) 839-6255.

Sincerely,



John T. Wall
Executive Vice President
Member and Market Services

Enclosures

(a) Interest to be added to the dollar price

In the settlement of contracts in interest - paying securities other than for "cash," there shall be added to the dollar price interest at the rate specified in the [bond] security, which shall be computed up to but not including the fifth business day following the date of the transaction. In transactions for "cash," interest shall be added to the dollar price at the rate specified in the [bond] security up to but not including the date of transaction.

(b) Unchanged

(c) [Registered bonds] Securities traded "and interest"

When a delivery of a [registered bond] security traded "and interest" is made between the record date fixed for the purpose of determining the holder entitled to receive interest and the interest payment date, a deduction equivalent to the full amount of the interest to be paid [by the obligor] shall be made on settlement.

(d) [Registered bonds] Securities traded "flat"

When delivery of a [registered bond] security traded "flat" is made after the record date fixed for the purpose of determining the holder entitled to receive interest, in the settlement of a contract made prior to the date on which the [issue of bonds] security was traded "ex-interest," a due-bill check for the full amount of the interest to be paid [by the obligor] shall accompany the delivery.

(e) and (f) - Unchanged

Sec. 47 Unchanged

Sec. 48 DUE-BILLS AND DUE-BILL CHECKS

(a) Unchanged

(b) Definition of due-bill checks

The term "due-bill checks" as used in this Section means a due-bill in the form of a check payable on the date of payment of a cash dividend [or], interest on registered bonds or interest on unit investment trust securities, which prior to such date shall be considered as a due-bill, as defined in paragraph (a) above, for the amount of such dividend or interest [on registered bonds].

(c) Unchanged

TEXT OF AMENDMENTS TO UNIFORM PRACTICE CODE
TO INCLUDE UNIT INVESTMENT TRUST SECURITIES

(New language is underlined, deleted language is bracketed)

UNIFORM PRACTICE CODE

Sec. 1 SCOPE OF UNIFORM PRACTICE CODE

(a) All over-the-counter secondary market transactions in securities between members shall be subject to the provisions of this Code except:

(i), (ii), (iii) - Unchanged

(iv) transactions in redeemable securities issued by companies registered under the Investment Company Act of 1940; provided however the the Code shall apply to secondary market transactions between members in any security issued by a registered investment company classified as a "unit investment trust" under Section 4 of the Investment Company Act. Redemption of securities directly by the trustee of the unit investment trust are not transactions between members for purposes of this subsection.

(v) transactions in Direct Participation Program securities as defined in Article III, Section 34 of the Association's Rules of Fair Practice.

(b) and (c) - Unchanged

Sec. 2 Unchanged

Sec. 3 DEFINITIONS

(a), (b), (c) - Unchanged

Record Date

(d) As used in this Code the term "record date" means the date fixed by the trustee, registrar, paying agent or issuer for the purpose of determining the holders of bonds, similar evidences of indebtedness or unit investment trust securities entitled to receive interest or principal payments.

Sec. 4 Unchanged

Sec. 5 TRANSACTIONS IN SECURITIES "EX-DIVIDEND," "EX-RIGHTS" OR "EX-WARRANTS"

(a) - Unchanged

(d) Due-bill checks for cash distribution and interest

Due bill checks for a cash distribution, [or] interest on registered bonds or interest on unit investment trust securities shall accompany securities delivered too late for transfer on or before the record date.

(e) and (f) - Unchanged

Sec. 49 CLAIMS FOR DIVIDENDS, RIGHTS, INTEREST, ETC.

(a) and (b) - Unchanged

(c) Interest or rights [on registered bonds]

The provisions of subsections (a) and (b) of this section shall be equally applicable to interest or rights pertaining to registered bonds and unit investment trust securities.

Sec. 50-55 - Unchanged

Sec. 56 IRREGULAR DELIVERY - TRANSFER REFUSED - LOST OR STOLEN SECURITIES

(a) Irregular delivery

Reclamation, by reasons of the fact of an irregularity in the delivery of a security, shall be within 30 months after the settlement date of the contract. For purposes of this section, the term "irregular delivery" shall include, among other things, wrong, duplicate, misdirected [and] or over-[delivery] deliveries and delivery of unit investment trust securities having the incorrect payment option.

(b), (c), (d) - Unchanged

Sec. 57-58 - Unchanged

Sec. 59 "BUYING-IN"

(a) and (b) - Unchanged

(c)(i) Seller's failure to deliver after receipt of notice

On failure of the seller to effect delivery in accordance with the "buy-in" notice, or to obtain a stay as hereinafter provided, the buyer may close the contract by purchasing all or any part of the securities necessary to complete the contract. Such execution will

also operate to close-out all contracts covered under retransmitted notices of buy-in issued pursuant to the original notice of buy-in, A "buy-in" may be executed by a member from its long position and/or from customer's accounts maintained with such member. In all cases, members must be prepared to defend the price at which the "buy-in" is executed relative to the current market at the time of the "buy-in."

(c)(ii) Buy-in for unit investment trust securities

Buy-in execution options, in addition to those contained in (c)(i), may be available when the purchaser wishes to buy-in contracts made for unit investment trust securities.

The purchaser may,

(a) by mutual agreement, accept from the seller in lieu of the seller's obligation under the original contract (which shall be concurrently cancelled) the delivery of unit investment trust securities which are comparable to those originally bought in quantity, quality, yield or price and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller.

(b) if the purchaser's option in (c)(i) is not available and the purchaser and seller cannot agree upon option (a), above, require the seller, for the account and liability of the seller, to repurchase the unit investment trust securities on terms which provide that the seller pay an amount which requires the seller to bear the burden of any change in the market price from the original contract price, with accrued interest.

Bearing the burden of any change in the market price from the original contract price means that if the current market price is higher than the original contract price, the purchaser may require the seller to repurchase the unit investment trust securities at the current market price and conversely means that if the current market price is lower than the original contract price, the purchaser may require the seller to repurchase the unit investment trust securities at the original contract price, with accrued interest.

(d) - (n) - Unchanged

Sec. 60-64 Unchanged

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

notice to members 83-70

December 16, 1983

TO: All NASD Members

RE: Automatic Money Market Fund Redemptions

There appears to be a growing practice among member firms to offer their retail customers a service whereby debit balances created by the purchase of securities in the customer's cash account with the member will be automatically satisfied by the redemption of shares of a money market fund. This practice is distinguishable from what have been called "account management plans" under which a customer, upon application, by maintaining a specified account balance and paying certain fees, is entitled to a defined "package" of services including both credit and debit "sweeps" of the customer's securities and money fund accounts. The practice which is the subject of this Notice involves debit "sweeps" only and applies to any customer having both a securities and money fund account.

The structure of the automatic redemption plans generally involves automatic sale or redemption of the money market fund shares unless the customer specifically notifies the member of his intention to make payment by another method. Even though this service tends to be viewed as an optional method of payment for securities purchased, it does involve the processing of an order to sell securities, i.e. money market fund shares, for which a member should have proper authorization. Such authorization is necessary in light of the Policy of the Board of Governors relating to Fair Dealing with Customers, which is found under Article III, Section 2 of the Rules of Fair Practice. This policy prohibits the execution of transactions by member firms which are unauthorized by the customer.

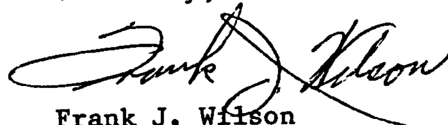
The Association recognizes the fact that when a member wishes to make an automatic money market fund liquidation service available to large numbers of existing clients, it may become extremely difficult and impractical to obtain specific written agreement from each client prior

to initiating the procedure. The Association's Board of Governors has reviewed this question in light of existing practices of members and has concluded that, in situations where a member institutes an automatic redemption program of which adequate notice is given to account holders, no disciplinary action against the firm for executing unauthorized transactions by virtue of redemption of money market fund shares would be warranted. To be considered adequate notice in the context of potential review by a District Business Conduct Committee, the notification process should include a letter or other written notice specifically calling the program to the attention of the customer and outlining the procedures to be followed by the customer to utilize the automatic redemption or to elect not to do so. The notice should also outline the specific procedures followed by the member in effecting the automatic redemption policy, including the steps the client must take to override the automatic procedure as to a specific purchase transaction. Of course, where written discretionary authority over the account has been obtained, pursuant to Article III, Section 15 of the Association's Rules of Fair Practice, no separate notice of the automatic money market fund redemption procedure would be required.

Members should recognize that this notice relates solely to the application and administration of NASD Rules and policies and does not purport to define the contractual obligation of the member and customer under the laws of any state. Neither should the policy outlined herein be deemed to permit members to execute transactions in securities of other than money market funds without specific authorization. The policy reflects the unique use of money market fund shares as a cash management vehicle. In addition, members undertaking and administering any automatic redemption program must, as in all dealings with customers, act in a manner consistent with Article III, Section 1 of the Rules of Fair Practice and the Association's requirements for fair dealing with customers.

Questions regarding this Notice to Members should be addressed to T. Grant Callery at (202) 728-8285.

Sincerely,



Frank J. Wilson
Executive Vice President
and General Counsel

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

notice to members 83-71

December 20, 1983

TO: ALL NASD MEMBERS

RE: Hanover Square Securities Group Inc.
5 Hanover Square
New York, New York 10004

ATTN: Operations Officer, Cashier, Fail-Control Department

On December 15, 1983, the United States District Court for the Southern District of New York appointed a SIPC trustee for the above captioned firm. Previously, a temporary receiver had been appointed for the firm on December 8, 1983.

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

Questions regarding the firm should be directed to:

<u>SIPC Trustee</u>

James W. Giddens, Esquire
Hughes Hubbard & Reed
One Wall Street
New York, New York 10005
Telephone: (212) 943-6500

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

notice to members 83-72

December 20, 1983

IMPORTANT

Officers * Partners * Proprietors

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

RE: Request for Comments on Proposed Amendment to Schedule C to the By-Laws

COMMENT PERIOD CLOSES ON: January 20, 1984

The National Association of Securities Dealers, Inc. ("Association") is publishing for comment a proposed amendment to Schedule C to the By-Laws. The amendment was approved by the Board of Governors at its November 1983 meeting. After the comment period has expired, the Board of Governors will review the proposal taking into consideration the comments received. If adopted by the Board of Governors the proposal will thereafter be filed with the Securities and Exchange Commission for approval.

A discussion of the background and purpose of the amendment, an explanation of the changes and the text of the amendment appear below.

BACKGROUND AND PURPOSE

The proposal would amend the definition of "representative" in Schedule C to the By-Laws to cover a class of persons including persons who are employed by certain non-broker/dealer organizations and who perform activities on behalf of members similar to those performed by registered representatives. The effect of the amendment will be to require members to register such persons as representatives and bring them under regulation comparable to the regulation to which registered representatives of members presently are subject.

In the mid-1940s the Association instituted its existing program for regulation of personnel of members by adopting amendments to its By-Laws and Rules of Fair Practice requiring members to register certain persons associated with members as registered representatives. The amendments also made registered representatives subject to the same obligations as members under the Association's rules and allowed disciplinary action to be brought against registered representatives for violations of Association rules. The regulation of registered representatives was extended in 1956 by the introduction of a requirement that persons becoming registered as representatives take and pass a written qualification examination before they could function as registered representatives of members.

At the present time the registration and qualification requirements are contained in Schedule C to the By-Laws adopted by the Board of Governors pursuant to the authority granted by Article I, Section 2(d) of the By-Laws. The provisions of Schedule C have been refined in the intervening years so that today there are separate registration categories for principals and representatives and separate examinations for principals and representatives. In addition, there are specialized qualification exminations within the two broad categories for principals and representatives who engage in specialized areas such as the sale of investment company securities and variable annuities, direct participation program securities, options and municipal securities.

Under existing Schedule C all persons who are compensated by members for solicitation, accepting orders, or recommending securities to customers or providing investment advice resulting in securities transactions must be registered before being permitted by a member to engage in such activities. The definition of "representative" in Schedule C covers persons who are engaged in the investment banking and securities business "for the member" including the functions of "solicitation or conduct of business in securities". The definition, however, has been traditionally applied only to employees, independent contractors and other natural persons who are directly compensated by the member for such activities.

The Board is proposing to extend the coverage of Schedule C to apply to certain persons who, if they were employees of a member, would clearly fall within the definition of representative. The securities activities of banks, savings and loan associations and certain other organizations such as real estate brokers have expanded over the past few years. In addition, the relationship between members and these institutions has assumed a different direction. There have traditionally been personnel within these institutions engaged in securities activities such as trust officers, traders, portfolio managers and investment consultants and financial consultants and investment officers. In the past, however, these institutions simply referred securities business to members which charged the institutions a commission or fee. The commissions or fees earned by members from this referred business was not shared by the members with the institutions. A number of banks and savings and loan associations and other business organizations have recently

entered into contractual or other arrangements with members to refer the institution's customers to members for execution of transactions and in return for such business the members have agreed to compensate the institutions by sharing commisions or in other ways. 1/ This appears to be an increasing trend in the securities industry. In many cases the ability of institutions to provide brokerage services to its customers through these arrangements with members is actively promoted through advertising and publications. Although some personnel at the institutions appear to perform only clerical and ministerial functions, there do not appear to be any requirements to limit the ability of personnel to make recommendations or engage in other functions specified in the definition of representative in Schedule C to the By-Laws. If such persons do make recommendations to customers, however, it does not appear that the registration requirements of Schedule C would apply since they often receive no direct compensation from members even though the employer institution does.

The Board believes the public interest is not served by exempting from the registration requirements employees of organizations who are dealing with public customers in the same way in which registered representatives of members deal with the public. At the present time these persons are not required to take qualification examinations and function outside the supervisory responsibilities which members are required to exercise over their other representatives. It is also not entirely clear, absent registration, whether the Association could hold them individually accountable for misconduct by imposing disciplinary sanctions against them. The Association is concerned that the lack of any formal qualification standards, supervision and individual accountability for misconduct may create conditions which unnecessarily may expose public customers to the risk of harm. The Board believes that unless registration is a requirement it cannot fully carry out its statutory responsibility to prevent fraudulent acts and practices, to promote just and equitble principles of trade and to protect investors and the public interest.

The proposal is intended to cover non-broker/dealer personnel who perform securities activities on behalf of members. It is thus limited to employees of organizations which have entered into arrangements with members by which the activities of the employees actively further the securities business of the members. Further, the only non-broker/dealer employees who would come under the new definition of "representative" in proposed section (b)(ii) would be employees who receive compensation from members or whose employers receive compensation from members. The Board believes that its statutory duty to regulate its members is not fully implemented by allowing a situation where persons soliciting or receiving business for members are not required to take and pass qualification examinations and to be subject to disciplinary action for violations of applicable requirements. The Board believes that if a person is soliciting or receiving business for a member and the member compensates the employer the impact on the public interest is no less great than if the person is compensated directly by the member. The need for protection against unqualified persons achieved by examinations and

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1/ Banks are exempt from the broker/dealers definitions in the 1934 Act and a number of savings and loans have received "no-action" letters to permit such arrangements without broker/dealer registration.

accountability through disciplinary proceedings and member supervisory responsibility is no less important. Accordingly, the effect of the proposal is to require members to register such persons so that investors will receive equal protection under the Association's rules and the federal securities laws.

SCOPE OF PROPOSAL

The following is a brief discussion of the intended scope of the proposal.

1. It does not appear that the public interest requires registration of all persons employed by banks or other organizations which assist the organization and the member in furthering the member's securities business. Those employees who perform clerical and ministerial functions such as distributing literature describing the securities service being offered through a member or handing out necessary forms and providing routine procedural directions and instructions are not intended to be covered by the proposal. Such clerical activities do not require registration under present Schedule C for persons directly compensated by members where their employment is solely and exclusively limited to such activities.

The only persons who would be deemed representatives under the proposed amendment are those employees of non-broker/dealer organizations whose activities fall into two categories: (1) solicit or receive orders from public customers for the purchase or sale of securities, or (2) give investment advice or make recommendations to public customers with respect to securities transactions. The language used is intended to limit the definition to employees of non-broker/dealers who receive orders directly from members of the public, whether or not solicited, or who make recommendations or give advice directly to public customers with respect to securities even though any resulting order may be directly transmitted by the customer to the member for execution.

2. It is not intended that the proposal would apply to employees of banks or other organizations who engage in securities activities in areas of an organization where dealings with members do not result in payment of compensation by the member to the organization. The Board believes that its statutory responsibility to regulate its members makes it necessary and appropriate to assure the qualfications and integrity of employees of organizations who are employed in an area of the organization's operations where customers are introduced or referred to a member and compensation is paid to the employee or organization. Thus, the language of proposed Subsection (1)(b)(ii) of Part II of Schedule C would require registration only with respect to employees of organizations where the organization has entered into an arrangement with a member to receive compensation from transactions executed by the member. It also makes clear that only certain employees whose activities with the organization are in furtherance of the arrangement with the member are covered.

The proposal is not intended to interfere with conventional securities activities of banks or other organizations. Where no compensation is received from members, the personnel in bank trust departments, traders, money managers, portfolio managers could continue to engage in such securities activities as making recommendations covering securities and executing or transmitting orders to

broker/dealers for execution without any requirement to register.

3. The proposal does not cover arrangements between members and organizations which are registered broker/dealers because under such arrangements the organization's personnel have satisfied applicable qualification requirements and are already subject to regulatory jurisdiction by one or more regulatory organizations. For the same reason employees of non-broker/dealer organizations who are themselves registered broker/dealers are excluded from coverage. The proposal is also intended to cover natural persons who, although not employees, are affiliated with the organization such as consultants or other independent contractors. The definition of "compensation paid by the member" to include commission sharing is intended to prevent circumvention through arrangements structured to make it appear that the compensation is being paid by the organization to the member. If the nature of the arrangement contemplates referral of customer business to the member with an agreement to share resulting commissions, the mechanics of sharing the commissions would be irrelevant for purposes of the new definition.

4. The changes proposed in Subsections (1)(a), (2)(a)(i), (2)(b)(i), (2)(c)(i) and (2)(d) of Part II of Schedule C are technical amendments to avoid misunderstanding concerning the intended scope of new Subsection (1)(b)(ii). The Association believes that in the vast majority of cases such individuals would clearly come within the definition of associated persons under the By-Laws. The Association recognizes, however, that there may be some situations where the definition of associated persons would apply but in an indirect way. The approach the Association has taken therefore is to make the registration requirements clear by defining the term registered representative to specifically include such persons as registered representatives.

All comments pertaining to this proposal should be in writing and sent to S. William Broka, Secretary, National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006, and be received on or before January 13, 1984, in order to receive consideration. Questions concerning the proposal may be directed to John F. Mylod, Jr., Assistant General Counsel, at (202) 728-8288.

Sincerely,

Frank J. Wilson
Executive Vice President
Legal and Compliance

TEXT OF PROPOSED AMENDMENTS

Schedule C to the By-Laws

II.

REGISTRATION OF REPRESENTATIVES

(1) Registration Requirements

(a) All Representatives Must be Registered — All persons included within the definition of Representative ~~associated with a member who are to function as representatives~~ shall be registered as such with the Corporation in the category of registration appropriate to the function to be performed as specifed in Part II, Section (2) hereof. Before their registrations can become effective, they shall pass a Qualification Examination for Representatives appropriate to the category of registration as specified by the Board of Governors.

(b) Definition of Representative:

(i) Persons associated with a member, including assistant officers other than principals, who are engaged in the investment banking or securities business for the member including the functions of supervision, solicitation or conduct of business in securities or who are engaged in the training of persons associated with a member for any of these functions ~~are designated as representatives~~; and

(ii) Any other natural person, other than a registered broker or dealer, who solicits or receives orders from customers for the purchase or sale of securities for execution by a member, or gives investment advice or makes recommendations to customers with respect to securities transactions for execution by a member in furtherance of any arrangement by which compensation is paid by the member for such activities to such person or to an entity, other than a registered broker or dealer, with which such person is employed or otherwise affiliated. For purposes of this subsection, "compensation paid by the member" shall include any sharing of compensation paid by customers.

[In addition, Subsections (2)(a)(i), (2)(b)(i), (2)(c)(i) and (2)(d) of Part II of Schedule C would be amended to eliminate the phrase "associated with a member".]

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

notice to members 83-73

December 28, 1983

IMPORTANT

Officers * Partners * Proprietors

TO: All NASD Members

RE: SEC Adopts Rule 15c2-2 Governing Binding Arbitration Clauses in Customer Agreements

BACKGROUND

On November 18, 1983, the Securities and Exchange Commission issued Release No. 34-20397 announcing the adoption of Rule 15c2-2 (the "Rule") under the Securities Exchange Act of 1934 (the "Act") (17 CFR Part 240). Rule 15c2-2 prohibits broker-dealers from using mandatory arbitration clauses in customer agreements that purport to bind public customers to the arbitration of claims arising under the federal securities laws. Those clauses, in the view of the Commission, are inconsistent with the deceptive practice prohibitions of Section 10(b) and Section 15(c) of the Act.

In adopting the Rule, the Commission reaffirmed its support for the use of arbitration as an important and effective means for resolving certain broker-customer disputes and as an economical alternative to litigation. The Commission explained, however, that public customers were intended by Congress to have the "special protection" of the federal courts for securities acts claims and that this protection may not be waived in advance by agreement of the parties. According to the SEC, the purpose of this Rule is to ensure that public customers are not misled concerning their right to such recourse. The Rule also requires broker-dealers to disclose to existing public customers that they are not precluded by such clauses from judicial recourse with respect to those claims. The Rule requires members to undertake certain compliance measures within the timeframes specified in the Rule. These measures are described in detail below.

COMPLIANCE WITH RULE 15c2-2

All agreements entered into by a broker-dealer and a public customer after the effective date of the Rule, December 28, 1983, are prohibited from containing clauses that purport to bind public customers to the arbitration of future

disputes arising under federal securities laws. However, broker-dealers may use existing supplies of preprinted forms which may contain the prohibited language for new accounts provided that a separate written disclosure is provided to these customers using the language described in paragraph (b) of the Rule.

This separate written disclosure may be utilized until December 31, 1984, and must read as follows:

> Although you have signed a customer agreement form with (FIRM NAME) that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

The Commission also believes that it is important for existing customers to be made aware that they are not required by prior agreement to resolve federal securities law disputes by arbitration. Therefore, paragraph (c) of the rule requires that existing customers be so notified. The separate written disclosure noted above must also be used in providing the notification to existing public customers.

All outstanding agreements need not be amended immediately. Those customers for whom a broker-dealer, after July 1, 1983, has carried a free credit balance, or held securities in safekeeping or as collateral, or has effected a securities transaction must be sent the required disclosure prior to January 1, 1985. Any other customers would have to be provided with the required notification only upon completion of their next transaction.

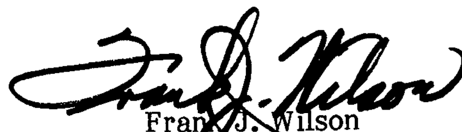
By January 1, 1985, all broker-dealer customer agreement forms must be revised and may not contain the mandatory arbitration clause.

On January 1, 1985, and thereafter, it shall be considered a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

Please refer to the attached chart for Rule 15c2-2 compliance action and deadlines. The text of the rule follows.

Please direct any questions concerning SEC Rule 15c2-2 to Jean McNeill, at (202) 728-8286.

Sincerely,



Frank J. Wilson
Executive Vice President
and General Counsel

Attachments

SEC RULE 15c2-2

DEADLINE	REQUIRED ACTION
After December 28, 1983	• Effective date for SEC Rule 15c2-2 which prohibits broker-dealers from using predispute arbitration clauses in customer agreements that purport to bind public customers to the arbitration of claims arising under the federal securities laws.
Between December 28, 1983 and December 31, 1984	• Broker-dealers are required to attach a separate written disclosure statement if the agreement forms which contain mandatory arbitration clauses are used. • Broker-dealers must notify all active (see note below) existing customers by means of a separate written disclosure.
After January 1, 1985	• All customer agreement forms must be free of the binding predispute arbitration clause prohibited by the Rule.

NOTE: Active existing customers are defined as those for whom: a free credit balance was carried, securities were held as collateral or in safekeeping, or a securities transaction was effected after July 1, 1983.

federal register

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-20397; File No. S7-976]

Recourse to the Courts Notwithstanding Arbitration Clauses in Broker-Dealer Customer Agreements

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting a rule that prohibits broker-dealers from using predispute arbitration clauses in customer agreements that purport to bind public customers to the arbitration of claims arising under the federal securities laws. The rule also requires broker-dealers to disclose to existing public customers that they are not precluded by such clauses from judicial recourse with respect to those claims. The purpose of this rule is to ensure that public customers are not misled concerning such recourse.

EFFECTIVE DATE: December 28, 1983.

FOR FURTHER INFORMATION CONTACT: Robert A. Love, Esq., Division of Market Regulation (202-272-2792).

SUPPLEMENTARY INFORMATION: The Commission today announced the adoption of a rule that prohibits the use in broker-dealer customer agreements of provisions purporting to bind public customers to the arbitration of future disputes arising under the federal securities laws. The Commission's rule codifies its longstanding view that such clauses are inconsistent with the deceptive practice prohibitions of section 10(b) [15 U.S.C. 78j(b)] and section 15(c) [15 U.S.C. 78*o*(c)] of the Securities Exchange Act of 1934 ("Act") [15 U.S.C. 78a *et seq.*]

Discussion

The Commission proposed rule 15c2-2 for comment in Securities Exchange Act of 1934 Release No. 19813 (May 23, 1983) 48 FR 24728 (June 2, 1983). The Commission reaffirmed in that release its support for the use of arbitration as an important means for the resolution of certain disputes between broker-dealers and their customers. For example, the Commission recognizes that the Uniform Code of Arbitration (the "Code"), drafted by the Securities Industry Conference on Arbitration (SICA) and adopted by the securities industry's self-regulatory organizations ("SROs"), provides an efficient procedure for the resolution of disputes and is often an economical alternative to litigation.[1]

The federal securities laws, however, provide that broker-dealer agreements purporting to bind public customers to the arbitration of disputes arising in the future are void and unenforceable as applied to claims arising under those laws.[2] *Wilko v. Swan,* 346 U.S. 427 (1953), and subsequent cases have held that Congress had determined that public customers should have available the special protection of the federal courts for the resolution of disputes arising under the federal securities laws, and that under the anti-waiver provisions of those laws, that protection may not be waived in advance by contract of the parties. For example, in *First Heritage Corp. v. Prescott, Ball & Turben,* [3] the court noted that "[c]ourts have consistently held that *Wilko's* holding and rationale [under the Securities Act of 1933] are equally applicable to cases arising under the 1934 Act."[4]

In *First Heritage Corp.* the litigants were broker-dealers and members of the National Association of Securities Dealers, Inc. ("NASD"), which has rules providing for the arbitration of disputes between NASD members firms.[5] The court held, however, that section 29(a), the Act's anti-waiver provision, precluded enforcement of the predispute arbitration provision because the plaintiff broker-dealer also represented numerous public customers.

The Commission has received seventeen letters of comment regarding proposed rule 15c2-2. Those comments, which can be reviewed in file no. S7-976 in the Commission's Public Reference Room, and amendments to the proposed rule are address below.

Virtually all of the commentors on the proposed rule agreed that the statutory and case law clearly render unenforceable agreements to arbitrate future disputes between broker-dealers

[1] The Commission notes that SICA has recently reconvened in an effort to improve the Code with the benefit of the industry's first few years of experience with it. The Commission notes further that its approval of the adoption of the Code by the SROs specifically took into account that with respect to claims arising under the federal securities laws, arbitations conducted under the Code were to be an alternative to litigation, which could be agreed to by public customers only after a dispute had arisen. *See, e.g.,* Securities Exchange Act Release No. 16390 (November 30, 1979).

[2] The basis for this view was discussed at length by the Commission in Securities Exchange Act Release No. 15984 (July 2, 1979).

[3] Fed. Sec. L. Rep. (CCH) ¶99,404 (6th Cir. 1983).

[4] *Id.* at pp. 96,328 and 96,329 (citation omitted).

[5] Courts have recognized an exception to the *Wilko* doctrine for suites between members of the securities industry's self-regulatory organizations. The Commission need to consider those decisions here as they are outside the scope of rule 15c2-2.

and their public customers arising under the federal securities laws. [6] Nethertheless as we have stated in earlier releases, many broker-dealer continue to include in standard customer agreements language substantially as follows:

Any controversy between us arising out of or relating to this agreement or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either * * *.

In light of the clearly contrary law in this area, such language is a misleading statement of customers' rights under the federal securities laws. Because years of informal discussions have failed to correct this practice, the Commission has decided that it is appropriate to adopt this rule.

Paragraph (a) of the rule embodies the general prohibition that broker-dealers' customer agreements may not contain clauses that purport to bind public customers to the arbitration of future disputes arising under the federal securities laws. A violation of the rule requires both the existence of a deficient clause and a purchase or sale of securities. In response to those comments noting that courts often enforce predispute arbitration clauses for disputes under the federal securities laws involving such nonpublic customers as parties to international commercial disputes and members of the securities industry's SROs, the word "public" has been added to the paragraph before "customer" to clarify the intended scope of this rule. The term "public customer" has long been used in the Code and SRO arbitration pamphlets.

Paragraph (b) of rule 15c2-2 as proposed required that predispute arbitration clauses that do purport to bind public customers to the arbitration of future federal securities law disputes include the disclosure "Arbitration cannot be compelled with respect to disputes arising under the federal securities laws." The disclosure was designed to ensure the public customers are not misled by predispute arbitration clauses.

Proposed paragraph (b) has been deleted from the rule. Beginning January 1, 1985, it will no longer be sufficient for arbitration clauses, such as the one described above, to be supplemented with disclosure language. All new customer agreement forms must reflect as of that date the prohibition expressed by the rule and this release. The use of alternate disclosure language prescribed in new paragraph (b), however, is permitted in order to amend the agreements of existing customers and to allow broker-dealers to use existing supplies of preprinted forms that otherwise violate paragraph (a). In those instances the rule requires the following disclosure:

Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

With respect to the disclosure language contained in proposed paragraph (b), various commentators have pointed out that for certain unrelated situations, the disclosure was too broad. A discussion of those comments will be helpful in understanding the amended rule. For example, although the proposing release noted that the rule is not intended to affect existing law with respect to contractual agreements for the resolution by arbitration of international commercial disputes, the proposed disclosure in paragraph (b) did not specifically make that distinction.[7] Also, commentators noted that certain other agreements to arbitrate federal securities laws claims have in some instances been enforced by the courts. The validity of any such agreements, between members of the securities industry's SROs or between a broker-dealer and its public customers, agreed to *after* a dispute has arisen,[8] is outside the scope of rule 15c2-2. The arbitration agreements that are the subject of this rule are those entered into by a public customer with his broker-dealer prior to the existence of any dispute and before an investor normally would be concerned with the matter of choosing a forum for dispute resolution. Since the rule applies only to those standard agreements between broker-dealers and their public customers that purport to govern the parties' alternatives in future disputes under the federal securities laws, these other categories of disputes are unaffected by the rule.

Several commentators expressed the view that the Commission should not require specific disclosure language for the arbitration clauses in customer agreements.[9] On a related point, another commentator, Wall Street Clearing Co., while "agree[ing] completely with this concept [of disclosure] and find[ing] it a proper position for the Commission to take in furthering the protection of customers," commented that it believes the Commission has "sufficient authority to ensure compliance with the principles of Release No. 15984 without recourse to formal rulemaking."[10]

The Commission is sensitive to each of these concerns. In adopting the rule the Commission has determined that prescribing specific language for the disclosure to existing public customers would simplify broker-dealer compliance in this area. The language is intended to remove any remaining uncertainty by broker-dealers as to what language is adequate to counter language currently employed in certain of their agreements.

The use of the prescribed disclosure, however, is available only for the notification of existing public customers and the amendment of existing supplies of customer agreements. Subsequent to the transition period provided for in the rule, broker-dealers' customer agreements may not contain the representation that all future disputes between a broker-dealer and its public customers are required to be settled by arbitration.

The Commission agrees with those commentators that stated that it should not prescribe specific language for such agreements and that the broker-dealer community and the SROs are capable of drafting agreements that will be in compliance with this rule. However, as stated in the proposing release, the Commission believes that language currently appearing in some broker-dealers' customer agreement forms, such as "unless unenforceable due to state or federal law," or "to the extent consistent with state or federal law" or which is otherwise ambiguous concerning the investors' rights is inadequate with

[6] One commentator, the Securities Industry Association ("SIA"), maintained, without citing a specific basis, that the case law "rests on questionable legal ground." Several commentators noted that to date predispute arbitration clauses have been held unenforceable only with respect to causes of action arising under the Securities Act of 1933 and the Securities Exchange Act of 1934. American Bar Association ("ABA"); Shearson/American Express, Inc. ("Shearson"); Goldman Sachs & Co. ("Goldman"); American Stock Exchange, Inc. ("ASE"). These commentators have cited no basis upon which the Commission can determine that the Wilko analysis does not hold equally true for other federal securities acts, which contain substantially identical anti-waiver provisions.

[7] *See* comments of Thurston R. Moore, Esq.; ABA; American Arbitration Association ("AAA"); Shearson; Smith Barney, Harris Upham & Co. ("Smith Barney").

[8] *See* comments of Thurston R. Moore, Esq.; Professor Egon Guttman; SIA; Smith Barney.

[9] Wall Street Clearing Co., Seligman Securities Inc.; SIA; ASE.

[10] Hanifen, Imhoff Inc. commented that use of arbitration clauses that "state the customer has no other remedy for violations of the federal securities laws" is deceptive, but believed that such "deceptive practices . . . can be dealt with on a case-by-case basis."

respect to the concerns addressed by the Commission in this rule.

Although the Commission agrees with the comment that it has authority under the general anti-fraud provisions to enforce compliance by broker-dealers with the principles in the 1979 release without recourse to rulemaking, we have determined to adopt this rule in order to provide guidance to the industry and promote compliance with the federal securities laws.

One commentator offered its support for an alternative "proposal which codified [attempts to compel arbitration of federal securities law disputes] as a violation of the Act, with appropriate sanctions." [11] Although such an approach might address "the aggressive conduct of certain broker-dealers",[12] it would miss certain of the intended beneficiaries of this rule. For example, some public customers may decide not to pursue their claims in any forum rather than submit a claim to an industry-administered arbitration forum as dictated in their customer agreement. Whether a given public customer's reservations or suspicion of arbitration have merit, the fact remains that the federal securities laws provide him with the right to seek the resolution of his disputes under those laws in forums other than arbitration. Therefore, those cases where public customers abandon a federal securities law claim based upon the dictates of an arbitration clause would most likely not be flagged for enforcement action.[13]

Another commentator expressed the view that no cause of action exists under the federal securities laws unless properly pleaded under the federal rules of civil procedures and that, consequently, it is appropriate for it to pursue arbitration pursuant to predispute arbitration clauses, subject to challenge by customers.[14] The comment, however, does not focus on the narrow issue addressed by the rule. The determination of claims "under the federal securities laws" is a separate question.

Other commentators stated that the approach of employing predispute arbitration clauses as a basis for submitting all claims to arbitration has resulted in wasteful and costly litigation.

[11] Tucker, Anthony & R.L. Day, Inc.

[12] *Id.*

[13] The same commentator also suggested the Commission might "require any firm which proposes arbitration to a customer as a forum for resolving a dispute be required to make the disclosure." The Commission believes that compliance with any such rule would be very difficult to monitor and thus less effective than this rule.

[14] Shearson.

Egon Guttman, Professor of Law at the American University commented that:

> This * * * has led to the numerous cases following *Wilko v. Swan* in which the broker-dealers have attempted to enforce arbitration clauses in customer contracts even though the attorneys representing the broker-dealers must have been aware that securities laws violations were in issue [citations omitted].[15] The effect of such attitude is to violate the primary duty of a broker-dealer as a fiduciary to his customer as was stated by Mr. Chief Justice Cardozo in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928).
>
> * * * * *
>
> Insistence on arbitration would thus be a clear overreaching and * * * a misrepresentation of legal rights of the customer. To deliberately obfuscate the existence of a right which has been repeatedly recognized by the courts and which would be material in determining the overall decision whether to deal through a particular broker [citations omitted] in connection with the purchase and sale of securities would lead to the conclusion that such obfuscation could amount to a violation of Securities Exchange Act 10(b) and Commission Rule 10b–5 promulgated thereunder. [citations omitted]

One commentator [16] suggested that the proposal be adopted as a rule of the National Association of Securities Dealers, Inc. ("NASD"), presumably to promote just and equitable principles of trade, rather than as a Commission rule under the anti-fraud provisions.[17] Inasmuch as the Commission has determined that the clauses discussed in this release are misleading statements when employed in connection with the purchase or sale of securities,[18] adoption of this rule under the deceptive practice prohibitions of sections 10(b) and 15(c) of the Act is appropriate in the public interest.

The commentator also suggested that the rule apply prospectively and not require notification of existing clients. The Commission believes, however, that it is important for existing customers to be made aware that they are not required by agreements they have signed in order to open an account with a broker-dealer to resolve federal securities law disputes by arbitration. The notification of existing customers anticipated by paragraph (c) of the rule is designed to correspond as closely as possible to the periodic mailings of broker-dealers and consequently should entail only minimal expense. Paragraph (c) provides that broker-dealers may amend outstanding customer agreements which do not comply with paragraph (a). Not all outstanding agreements must be amended. Those customers for whom a broker-dealer, after July 1, 1983, has carried a free credit balance, or held securities in safekeeping or as collateral, or has effected a securities transaction must be sent the required disclosure prior to January 1, 1985. These persons have had sufficiently recent dealings with their broker-dealers for it to be appropriate to ensure that they are supplied with the required disclosure. Furthermore, these persons should be readily identifiable by broker-dealers for inclusion into the mailing list for their next regularly scheduled mailing.

[15] Similarly, Richard F. Hill, Esq. commented that "[i]n each case [in which he has represented public customers in disputes with broker-dealers], counsel to the broker-dealer has demanded that the entire action, including the securities claims, be submitted to arbitration [based upon arbitration clauses described by this release]. Consequently, [his] clients have had to incur legal fees to oppose Motions to Compel Arbitration."

[16] Bear, Stearns & Co.

[17] The NASD has not indicated an intention to propose such a rule during discussions on this subject over the past several years.

[18] Several other commentators also questioned the connection between an agreement for the purchase or sale of securities and a purchase or sale of securities. ABA; SIA; Smith Barney; Shearson.

Any other customer agreements would have to be amended only upon the completion of the next transaction pursuant to that agreement. Thus, a customer who has not had any activity in his account since July 1, 1983 would not have to be sent the disclosure unless and until he again does business with the firm under the agreement.

Paragraph (b) permits broker-dealers to enter into new agreements with customers using existing supplies of preprinted forms that otherwise would violate paragraph (a) of the rule, until December 31, 1984, provided that adequate written disclosure accompany such agreements.[19]

Another point mentioned by a number of the commentators concerns disclosure of the *Wilko* doctrine contained in the arbitration pamphlets of the SROs that administer arbitrations under the Code.[20] These commentators believed that since all investors who are likely to submit a claim to arbitration receive the pamphlet, there is no need for additional disclosure or other changes to current customer agreement forms. The Commission does not agree with this view. First, as noted above, some investors may never receive the pamphlet because of their reluctance to submit a dispute to arbitration. Second, the disclosure in that pamphlet does not

[19] Thurston R. Moore, Esq. suggested that an interlineation on existing supplies of customer agreements would be as effective as a separate paper containing the written disclosure. Such a practice would be consistent with paragraph (b).

[20] Bear Stearns, ASE; SIA, Smith Barney; ABA.

appear to have discouraged a number of broker-dealers from attempting to compel the arbitration of federal securities law claims.[21]

Two of the commentators suggested that legislation be recommended that would permit the use of binding predispute arbitration clauses for future federal securities law disputes.[22] Such a change in the law would require additional study and is beyond the scope of this rulemaking proceeding.[23] Today's action should not be interpreted as inconsistent with the Commission's traditional strong support for the use of arbitration for the resolution of disputes that may arise between broker-dealers and their customers.

Regulatory Flexibility Act Certification

Pursuant to 5 U.S.C. 605(b), the Chairman certified at the time this rule was proposed that it would not, if promulgated, have a significant economic impact on a substantial number of small entities. The Commission has received one comment on the certification.[24]

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

Text of Rule

In accordance with the foregoing, Chapter II of Title 17 of the Code of Federal Regulations is amended by adding § 240.15c2-2 to read as follows:

[21] *See* comment letter of Professor Guttman for a partial list of cases litigated on this question.

[22] Goldman; SIA.

[23] For a concise statement of views in this regard *see* Poser, Norman "Litigate? or Arbitrate? A proposed SEC rule ensuring investors know they can sue in disputes with brokers raises a minor storm of protest" Investment Dealers Digest (September 13, 1983).

[24] Smith Barney commented that compliance with the rule would be "an unreasonable financial burden in light of the proposed rule's questionable benefit." The comment does not offer support that there would be any significant impact on a substantial number of small entities, the inquiry anticipated by the Regulatory Flexibility Act. The Commission finds that there would be no such impact.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

§ 240.15c2-2 Disclosure regarding recourse to the courts notwithstanding arbitration clauses in broker-dealer customer agreements.

(a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

(b) Notwithstanding paragraph (a) of this section, until December 31, 1984 a broker or dealer may use existing supplies of customer agreement forms if all such agreements entered into with public customers after December 28, 1983 are accompanied by the separate written disclosure:

Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

(c) A broker or dealer shall not be in violation of paragraph (a) of this section with respect to any agreement entered into with a public customer prior to December 28, 1983 if:

(1) Any such public customer for whom the broker or dealer has after July 1, 1983 (i) carried a free credit balance, or (ii) held securities for safekeeping or as collateral, or (iii) effected a securities transaction is sent, no later than December 31, 1984, the disclosure prescribed in paragraph (b) of this section; or

(2) Any other public customer is sent upon the completion of his next transaction pursuant to such agreement, the disclosure prescribed in paragraph (b) of this section.

Statutory Authority and Competitive Considerations

The Securities and Exchange Commission, acting pursuant to the Act, and particularly sections 2, 10, 15, 23 and 29 thereof (15 U.S.C. 78b, 78j, 78*o*, 78w and 78cc), hereby adopts the amendment to § 240.15c2-2. The Commission finds that there will be no burden upon competition imposed by the amendments. This action becomes effective thirty days after publication in the Federal Register.

By the Commission.

Dated: November 18, 1983.

Shirley E. Hollis,

Assistant Secretary.

[FR Doc. 83-31095 Filed 11-25-83; 8:45 am]

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

notice to members 83-74

December 30, 1983

IMPORTANT

MAIL VOTE

Officers * Partners * Proprietors

TO: All NASD Members

RE: Proposed Amendments to Article III, Section 19 of the Rules of Fair Practice, "Customers' Securities or Funds"

Last Voting Date Is January 30, 1984

Enclosed herewith are proposed amendments to Article III, Section 19 of the Rules of Fair Practice and the Explanation thereto. These amendments have been approved by the Association's Board of Governors for submission to the membership for a vote. If approved, they must then be filed with, and approved by, the Securities and Exchange Commission.

BACKGROUND OF THE PROPOSED AMENDMENTS

As an ongoing responsibility, the standing committees of the Board of Governors review and, if necessary, recommend revisions to the Association's rules and regulations. In this regard, the Capital and Margin Committee has proposed certain revisions to Article III, Section 19 of the Rules of Fair Practice, "Customers' Securities or Funds." The changes proposed by the Committee are more technical rather than substantive in nature and reflect similar actions by other self-regulatory organizations.

The revisions are intended to eliminate regulation which has been rendered obsolete by a member's obligation to comply with certain requirements of SEC Rule 15c3-3, the "Customer Protection Rule," which governs the protection of customers' funds and securities. The current provisions contained in Section 19 with respect to the lending of customers' securities under a "fair and reasonable" standard are now either addressed or superseded through the possession and control requirements of Rule 15c3-3.

The proposed revisions will also eliminate the necessity for receiving, processing and retaining certain duplicative paperwork. Specifically, the amendments will eliminate the requirement of obtaining written lending authorizations separate and apart from the standard margin agreements. This will permit members to use only one margin/loan consent agreement requiring only one signature from a customer rather than two as is currently required. As previously noted, these changes eliminating the "two signature" requirement have already been adopted by recent amendments to New York Stock Exchange Rule 402 and AMEX Rule 449.

In light of the foregoing considerations, the Board determined that this proposal should be circulated to the membership for approval.

DISCUSSION OF THE PROPOSED RULE AMENDMENTS

One of the proposed amendments to Section 19 includes the addition of a new section, entitled "General Provisions." This section places an affirmative obligation on a member to adhere to the provisions of SEC Rule 15c3-3 with respect to possession and control requirements and the maintenance of cash reserves.

A second proposed change concerns the section regarding a member's authorization to lend customers' securities. In this paragraph, the rule currently requires a member to obtain a lending authorization separate from, and in addition to, a margin account agreement before it may lend customers' securities. Federal securities laws relating to the lending of securities do not require such separate authorizations. In light of this, and in consideration of the other regulatory safeguards that have evolved over the years, the requirement for separate authorizations appears unnecessary. Therefore, the proposed revisions eliminate the two-agreement requirement entirely.

In a third proposed change, paragraph (c) of the current rule would be deleted. This paragraph requires that a member obtain from a customer a specific authorization designating the particular securities to be loaned should they be fully paid or excess margin securities. The proposal eliminates this requirement in favor of relying on the safeguards embodied in Rule 15c3-3(b)(3) with respect to the lending of fully paid and excess margin securities.

Finally, the Explanation of the Board of Governors, which follows the rule, has been revised in accordance with the provisions discussed above.

* * *

The text of the proposed rule is attached and merits your immediate attention. Please mark the 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 January 30, 1984.

The Board of Governors believes the proposed amendments are necessary and appropriate and recommends that members vote their approval.

Questions concerning this notice may be directed to James M. Cangiano, Associate Director, Department of Policy Research, at (202) 728-8273, or to your District Director.

Sincerely,

Gordon S. Macklin
President

Attachments

TEXT OF PROPOSED REVISIONS

Customers' Securities or Funds

Sec. 19.
Improper Use

(a) No member or person associated with a member shall make improper use of a customers' securities or funds.

General Provisions

(b) Every member in the conduct of its business shall adhere to the provisions of Rule 15c3-3 promulgated under the Securities Exchange Act of 1934 with respect to obtaining possession and control of securities, and the maintenance of appropriate cash reserves. For the purposes of this Section, the definitions contained in Rule 15c3-3 shall apply.

Authorization to lend – ~~Pledging or lending related to indebtedness~~

~~(b)~~ (c) No member shall lend, either to himself or to others, securities carried for the account of any customer, which are eligible to be pledged or loaned unless such member shall first have obtained from the customer a ~~separate~~ written authorization permitting the lending of securities thus carried by such member. ~~And, regardless of any agreement between a member and a customer authorizing the member to lend or pledge such securities, no member shall lend or pledge more of such securities than is fair and reasonable in view of the indebtedness of the customer, except such lending as may be specifically authorized under subsection (c).~~

~~**Separate lending authorization designating securities**~~

~~(c) No member shall lend securities carried for the account of any customer which have been fully paid for or which are in excess of the amount which may be loaned in view of the indebtedness of the customer, unless such member shall first have obtained from such customer a separate written authorization designating the particular securities to be loaned.~~

Segregation and identification of securities

(d) No member shall hold securities carried for the account of any customer which have been fully paid for or which are ~~in excess of the amount which may be pledge in view of the indebtedness of the customer,~~ excess margin securities unless such securities are segregated and identified by a method which clearly indicates the interest of such customer in those securities.

Prohibition against guarantees

(e) No member or person associated with a member shall guarantee a customer against loss in any securities account of such customer carried by the member or in any securities transaction effected by the member with or for such customer.

Sharing in accounts; extent permissible

(f) No member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member, unless such member or person associated with a member obtains prior written authorization from the member carrying the account; and, a member or person associated with a member shall share in the profits or losses in any account of such customer only in direct proportion to the financial contributions made to such account by either the member or person associated with a member. Exempt from the direct proportionate share limitation are accounts of the immediate family of such member or person associated with a member. For purposes of this section, the term "immediate family" shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the member or person associated with a member otherwise contributes directly or indirectly.

o o o **Explanation of the Board of Governors**

Explanation of ~~Certain Paragraphs~~ Paragraph (d)
Section 19 of Article III of the
Rules of Fair Practice

~~Paragraph (b)~~

~~The first part of this paragraph requires a member to obtain a lending authorization in addition to a margin account agreement before lending a customer's securities. The particular securities to be lent need not be designated so long as the member does not lend more securities than are "fair and reasonable."~~

~~The second part of this paragraph limits the amount of a customer's securities which may be lent or pledged under a general agreement with the customer. With respect to lending, the "fair and reasonable" standard means that a member may lend a customer's securities only in an amount which is reasonably related to the customer's debit balance, unless the additional written authorization required under paragraph (c) is obtained from the customer.~~

~~With respect to pledging a customer's securities, the "fair and reasonable" standard refers to the amount of the customer's securities which a member would be required to deposit as collateral in order to borrow an amount approximating the customer's debit balance; the amount of collateral so required usually depends on the type and quality of securities in question, as well as the policies of the lending institution.~~

~~Paragraph (c)~~

~~This paragraph requires a member to obtain a specific authorization designating the particular securities in order to lend a customer's fully paid securities or those in excess of an amount which is reasonably related to the customer's debit balance.~~

Paragraph (d)

This paragraph requires members to segregate and identify by customers both fully paid and ~~securities held in margin accounts which are in excess of the amount which may be pledged under the "fair and reasonable" standards in paragraph (b). These are commonly referred to~~ as excess margin securities. ~~although not mentioned as such in the section.~~

With regard to a customer's account which contains only stocks, it is general practice for firms to segregate that portion of the stocks having a market value in excess of 140% of the debit balance therein. When a customer's account contains bonds, the basis upon which the member is borrowing or can borrow on such bonds should be taken into consideration in determining the amount of securities to be segregated.

Following are three general types of segregation of customer's securities currently in use by many firms:

1. Physical segregation of securities by issue, with a separate list showing ownership of the securities by each customer. The listing, on cards or other records, should reflect all changes in ownership interest. This method is for securities in street name (not in individual customers' names), but the proportionate interests of the individual customers are indicated by the records.

2. Physical segregation of securities by issue, affixing to each certificate a tab or other identification showing the name of the beneficial owner of the certificate. This may be used for shares in street name or in the customer's name.

3. Specific segregation of all certificates of each customer in separate envelopes or folders, identified by customer, or by clipping the certificates together and identifying the customer by tab or other notation affixed to the segregated certificates.

In all the above methods, the records should note the dates when the securities are segregated. When such securities are not in the actual custody of the member, for instance, when they are in the physical possession of a correspondent firm, their location and the means by which they may be identified as belonging to each customer should be indicated on the books of the member carrying the customers' accounts.

~~For purposes of Section 19, a customer's securities subordinated under a "satisfactory subordination," as defined in Rule 15c3-1 of the Securities and Exchange Commission, are not deemed to be securities carried for the account of a customer.~~