NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-11

Suggested Routing:*

__Senior Management	__Internal Audit	__Operations	__Syndicate
__Corporate Finance	✓Legal & Compliance	__Options	__Systems
__Government Securities	__Municipal	__Registration	__Trading
__Institutional	✓Mutual Fund	__Research	__Training

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

Subject: SEC Approval of Rule Amendment Requiring Filing of Advertising and Sales Literature for Investment Company Securities — Effective March 1, 1989

EXECUTIVE SUMMARY

The Securities and Exchange Commission recently approved an amendment to Article III, Section 35 of the NASD Rules of Fair Practice. The amendment requires that advertising and sales literature for registered investment company securities be filed by members with the NASD Advertising Department within 10 days of first use or publication. The requirement will be effective March 1, 1989.

BACKGROUND

Article III, Section 35 of the NASD Rules of Fair Practice regulates members' communications with the public. It requires that all such communications be based on principles of fair dealing and good faith and that they provide a sound basis for evaluating the facts regarding any securities offered by members.

Material facts or qualifications may not be omitted if, in the context of the material presented, the omission would make the communication misleading. Exaggerated or misleading statements are prohibited, and members may not publish or distribute any public communication that the member knows, or has reason to know, contains any untrue statement of a material fact or is otherwise false or misleading.

Article III, Section 35 currently requires a member, for one year, to file all advertisements with the NASD Advertising Department for review 10 days prior to use, commencing with the member's initial advertisement. Under certain circumstances, an NASD District Business Conduct Committee (DBCC) also may require a member to file advertising and/or sales literature with the Advertising Department at least 10 days prior to first use. All members are subject to routine spot checks of their advertising and sales literature.

Members also must file advertising and sales literature pertaining to direct participation programs and government securities within 10 days of first use, and certain options-related materials must be filed 10 days prior to first use. Also, advertising and sales literature concerning registered investment company securities must be filed within 10 days of first use by members **that are principal underwriters of such companies.**

During the past three years, attention has been focused on problems with mutual fund advertising, particularly income fund advertising. The Securities and Exchange Commission (SEC) recently adopted extensive rule amendments governing the presentation of investment company performance (see SEC Release Nos. 33-6753;

IC-16245). One purpose of such rules and amendments is to enhance investors' ability to compare and evaluate investment company performance claims. The rules and amendments (1) standardize the computation of mutual fund performance data in advertising and sales literature; (2) require certain risk and other disclosures in sales material; and (3) eliminate the requirement to file sales material with the SEC if it is filed with the NASD.

The NASD Board of Governors also addressed these concerns in *Notice to Members* 86-41 regarding the presentation of investment companies' yield quotations. One of the Board's concerns was that the problems were not limited to material prepared by investment company underwriters but also were common in material prepared by dealers. The Board noted that the majority of complaints received by the NASD about investment company communications related to material prepared by dealers. Much of the material was written and published by individual representatives or branch managers and reflected a lack of knowledge or observance of SEC and NASD rules.

In addition, numerous violations resulted from dealers inappropriately revising advertisements prepared by underwriters or using material that contained information that was no longer current. The NASD has referred such practices to the appropriate DBCC.

The Board of Governors notes that the underwriter or distributor of a fund bears the responsibility for disseminating to dealers literature that has been filed with the NASD and that complies with applicable regulations. It is also the responsibility of the underwriter or distributor, when disseminating the material, to inform the dealer when information contained in such material is outdated and thus no longer should be used.

The Board believes that underwriters supplying noncomplying material should be referred to the appropriate DBCC for possible disciplinary action. Nevertheless, the Board recognizes that a large number of problems are created after the material is distributed to dealers, or when dealers prepare the material themselves. Therefore, the Board believes that the filing requirement for all investment company advertising and sales literature is necessary.

SUMMARY

The amendment, which was approved by the SEC November 28, 1988, becomes effective March 1, 1989. It requires that advertising and sales literature used in conjunction with registered investment companies be filed with the NASD Advertising Department within 10 days of first use or publication by a member. Filing prior to use is recommended. The NASD will review the material for conformance with the standards contained in Article III, Section 35 of the NASD Rules of Fair Practice as well as with applicable SEC regulations.

The responsibility of members to comply with the filing requirement applies regardless of whether advertising and/or sales literature is prepared by the member, the underwriter, the distributor, or another entity. However, the member need not file material that has been filed previously and that is used without change.

ADVERTISING SERVICE CHARGE

Members also are reminded that, in January 1988, the Board of Governors amended Schedule A of the NASD By-Laws to establish a service charge of $15 for each item of advertising and/or sales literature filed with or submitted to the NASD, except for items submitted in response to a written request from the NASD Advertising Department issued pursuant to Article III, Section 35(C)(6) of the NASD Rules of Fair Practice (see *Notice to Members* 88-14, dated February 10, 1988). Members may pay by check or money order made payable to the NASD, Inc. In addition, members anticipating regular filing activity may elect to establish an advertising account from which deductions for each filing will be made.

Any material submitted without a fee will be returned to the member, and any applicable filing requirement will not be considered fulfilled. If multiple copies of identical material are submitted as one package, one filing has been made and one $15 fee should be paid. If several distinct items are submitted in one package, a separate $15 fee should be included for each individual piece in the package.

Questions concerning this notice can be directed to R. Clark Hooper, Director, NASD Advertising Department, at (202) 728-8330.

AMENDMENT TO ARTICLE III, SECTION 35 OF THE NASD RULES OF FAIR PRACTICE

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

Communications with the Public
Sec. 35

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(c) Filing Requirements and Review Procedures

(1) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) shall be filed with the Association's Advertising Department within 10 days of first use or publication by any member. [who has utilized or distributed such material in connection with the offer or sale of such securities issued by companies for which such member is a principal underwriter.] Filing in advance of use is recommended [optional]. Members are not required to file advertising and sales literature which have previously been filed and which are used without change.

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NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-12

Suggested Routing:*

__Senior Management	✓Internal Audit	__Operations	__Syndicate
__Corporate Finance	✓Legal & Compliance	__Options	__Systems
__Government Securities	__Municipal	__Registration	✓Trading
__Institutional	__Mutual Fund	__Research	__Training

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

Subject: Reporting Suspicious Currency and Other Questionable Transactions To the IRS/Customs Hotline

EXECUTIVE SUMMARY

The Department of the Treasury recently established a toll-free number, **800-BSA-CTRS**, as a hotline for reporting suspicious currency transactions. Broker-dealers can use the hotline to refer information on transactions that appear to be arranged in such a way as to evade the requirements of the Bank Secrecy Act (the Act) to report cash transactions of $10,000 or more. Members are strongly advised also to be alert to suspicious noncash transactions (i.e., multiple cashier's checks, money orders, traveller's checks, and bank checks in amounts below $10,000) and wire transfers that may involve illegal activities, such as money laundering. Such transactions could be violations of the Money Laundering Control Act of 1986 (MLCA) and should be reported to the Customs hotline, **800-BE-ALERT.**

BACKGROUND

SEC Rule 17a-8 requires broker-dealers that are subject to the requirements of the Act to file reports and make and preserve records in accordance with the regulations promulgated pursuant to the Act, Part 103, Title 31 of the Code of Federal Regulations. These regulations implement the provisions of the Act and require certain financial institutions, including broker-dealers, to keep records and file reports regarding various financial matters that would be useful in criminal, tax, or other regulatory investigations. Under the regulations, members must report all cash transactions of $10,000 or more. However, to avoid this reporting, some individuals break down their transactions involving $10,000 or more in currency into smaller transactions so that none exceeds the $10,000 threshold. Such arrangements can constitute a criminal violation for evasion of the regulations' currency-reporting requirements.

EXPLANATION

In 1986, Congress incorporated into the Act an anti-structuring provision, 31 U.S.C. 5324, to combat the problem of drug traffickers and other money launderers who routinely engage in transactions under the $10,000 reporting threshold to conceal their activities from law enforcement authorities. This provision and the regulations thereunder, which were issued in 1987, prohibit an individual from conducting transactions in a manner designed to evade the currency-reporting requirements.

With regard to securities transactions, broker-dealers should be aware that multiple transactions by or for any person, which in any one day total more than $10,000, must be treated as a single transaction. If a transaction in currency of more than $10,000 has occurred, it does not matter if the transaction was conducted by one person with one account, several persons with the same account, or one person with several accounts. It is a reportable transaction, and a broker-dealer is required to file a currency transaction report. Structuring, however, is not limited to multiple transactions conducted on the same day at a single financial institution.

Although the enactment of Section 5324 was meant to clarify that all currency transaction structuring schemes, regardless of whether the $10,000 threshold is met at a single financial institution on a single day, are unlawful, some concern has arisen because neither the statute itself nor the regulation defines the terms "structure" or "structuring." As a result, the Treasury has proposed an amendment to the regulations that would add a formal definition of "structure" and "structuring" (see Department of the Treasury, Notice of Proposed Rulemaking, *Federal Register*, June 21, 1988).

This definition states clearly that a person structures a transaction when that person, acting alone, or in conjunction with, or on behalf of, other persons, conducts or attempts to conduct one or more transactions in currency, in any amount, at one or more financial institutions, on one or more days, in any manner, to evade the currency-reporting requirements. Therefore, it is important for all members to be alert for individuals who may be attempting to launder money by intentionally structuring transactions to evade the currency-reporting requirements and to elude law enforcement authorities.

If a member becomes aware of suspicious activity, the member should report it to the Internal Revenue Service. Members now can use a recently installed IRS hotline to report suspicious currency transactions. The toll-free number, **800-BSA-CTRS**, will put the caller in touch with an appropriate IRS office. Members still can report suspicious activity directly to their local office of the IRS Criminal Investigation Division.

Members who report suspicious transactions through the toll-free number or directly to the IRS are urged to maintain a written record providing evidence that the referrals were made to the IRS. The record, which may be kept in any manner a member chooses, should contain at a minimum the following information:

- names and account numbers of any persons involved in the suspicious transactions;
- home and business addresses;
- Social Security or taxpayer identification numbers;
- types of accounts;
- description of the financial instruments involved;
- location of the office where the suspicious transactions occurred;
- a notation of the offense that the member believes was violated; and
- a description of the activities giving rise to the member's suspicions.[1]

Members also should know that money launderers and others may seek to hide their profits by engaging in transactions that do not involve currency. MLCA makes it a federal criminal offense to engage in financial or monetary transactions involving the profits from illegal activities that are aimed at, among other things, concealing or disguising the source, ownership, location, or nature of profits from unlawful activity or aimed at avoiding state and federal reporting statutes (see 18 U.S.C. 1956 and 1957). It was the specific intent of Congress in enacting this legislation to address the laundering of illegal proceeds through wire transfers and other noncash transactions.

Some examples of possible suspicious transactions that could violate MLCA are:

- Large international funds transferred to or from the accounts of domestic customers in amounts and of a frequency that are not consistent with the nature of the customer's known business activities.
- Receipt of funds in the form of multiple cashier's checks, money orders, traveller's checks, bank checks, or personal checks that are drawn on or issued by U.S. financial institutions and made payable to the same individual or business, in U.S. dollar amounts that are below the $10,000 Bank Secrecy Act reporting threshold and that then are wire-transferred to a financial institution outside the U.S.

Members that notice such transactions should report them to the Customs Department via the hotline, **800-BE-ALERT**, or by contacting their local Customs office. As with reports of suspicious currency transactions, members are encouraged to keep a written record of any reports to Customs concerning questionable noncash transactions.

Since the scope of these regulations encompasses noncash transactions, as well as currency transactions, all members are urged to have their legal counsel review these matters to determine their obligations under the law and advise them regarding any necessary changes to their operating procedures. A member that, as a matter of policy, does not accept cash still has an obligation to report suspicious transactions. Failure to report such transactions could be construed as aiding and abetting, for which the member may face civil and criminal charges.

Questions concerning this Notice can be directed to Susan Lang, Senior Research Analyst, NASD Surveillance Department, at (202) 728-6969.

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[1] Members should note that Congress enacted amendments to the Right to Financial Privacy Act of 1978, Section 1103(c), to permit financial institutions to disclose this information.

NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-13

Suggested Routing:*

✓Senior Management	__Internal Audit	✓Operations	__Syndicate
__Corporate Finance	✓Legal & Compliance	__Options	__Systems
__Government Securities	__Municipal	✓Registration	✓Trading
__Institutional	__Mutual Fund	__Research	__Training

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

Subject: Access to Disciplinary Information on Prospective Employees

EXECUTIVE SUMMARY

Effective February 6, 1989, members may obtain disciplinary information on prospective employees either through the Firm Access Query System (FAQS) or by submitting a written request to the NASD. Before accessing this information, a member must obtain written consent from the individual permitting access to this information.

BACKGROUND

The NASD Board of Governors, in implementing the recommendations of the Regulatory Review Task Force, re-emphasized the NASD's policy that a member adequately research the background of its potential employees. To assist member firms in fulfilling this requirement, the NASD's Registration Committee concluded that members should be permitted to access the disciplinary information of prospective employees maintained by the Central Registration Depository (CRD). The Registration Committee also said firms that subscribe to the Firm Access Query System (FAQS) may use that service to access this information. Access to the disciplinary records of prospective employees will be made available to members beginning February 6, 1989.

ACCESS TO DISCIPLINARY INFORMATION

Prior to receiving disciplinary information on a prospective employee, members must obtain written consent from the individual. This consent, which may take any written form, should contain language that specifies the individual has given his or her consent for the member to review the person's background, including disciplinary matters, through CRD. The consent must be signed by the prospective employee. Page 4 of Form U-4, the Uniform Application for Securities Industry Registration or Transfer, contains appropriate language and, if signed by the prospective employee prior to the member's inquiry, would meet the prior consent standard.

Members that subscribe to FAQS will be allowed access to the disciplinary history of a prospective employee after certifying, through the electronic system, that the individual is being considered for employment and that the member has written consent from the individual on file. FAQS subscribers are required to maintain a copy of the individual's consent in their files.

Member firms that do not subscribe to FAQS may call NASD Information Services at (301) 590-6500 to request information on a prospective employee's disciplinary history. The member will be asked for its firm CRD number and the CRD or Social Security number of the individual under consideration for employment. Members will be informed if there is or isn't any disciplinary information on the individual's record. If the member wants a copy of the prospective employee's disciplinary history, a written request and a copy of the individual's signed consent should be forwarded to:

NASD
Attn: SRR Special Services
9513 Key West Avenue
Rockville, MD 20850

Instructions for accessing the CRD records of prospective employees are being sent to all FAQS subscribers. Firms interested in subscribing to FAQS are urged to contact Melissa Wimberly at (301) 590-6862 for details. Questions regarding this notice may be directed to Ellen J. Badler at (301) 590-6743.

NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-14

Suggested Routing:*

__Senior Management	__Internal Audit	✓Operations	__Syndicate
__Corporate Finance	✓Legal & Compliance	__Options	__Systems
✓Government Securities	__Municipal	✓Registration	__Trading
__Institutional	__Mutual Fund	__Research	__Training

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

Subject: SEC Approves Amendments to Rule 17f-1, Lost and Stolen Securities Program

EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) has adopted amendments to Rule 17f-1, also known as the Lost and Stolen Securities Program. Among other things, the amendments: 1) expand the definition of reporting institution to include government securities broker-dealers; 2) amend the exemptions from registration to include a reporting institution that limits its activities exclusively to uncertificated securities or whose business activities do not involve the handling of certificates; 3) identify the Federal Bureau of Investigation as the "appropriate law enforcement agency" to receive reports in instances of suspected criminal activity; 4) define the terms "customer" and "securities-related transaction" for purposes of the customer inquiry exemption; and 5) revise the reporting and inquiry provisions to exempt uncertificated securities and to eliminate the exemption for registered-form government and agency securities. The amendments became effective December 27, 1988.

BACKGROUND

SEC Rule 17f-1 governs the Lost and Stolen Securities Program, which was established in 1977 as a means of tracking and deterring trafficking in missing, lost, stolen, or counterfeit securities. The rule requires certain financial institutions to register as participants in the program. These participants, which are referred to as reporting institutions, are required to file reports and make inquiries about missing, lost, stolen, or counterfeit securities. The SEC's designee to receive all such reports and inquiries is the Securities Information Center (SIC), located in Wellesley Hills, Massachusetts. SIC serves as the central facilities manager responsible for maintaining this data base.

EXPLANATION

The amendments, which originally were published for comment three years ago, are designed to codify long-standing interpretations of the rule, focus the rule on negotiable certificated securities and clarify common questions about the program. The changes that may be applicable to NASD members are discussed below.

Definition of Reporting Institution

The amendments expand the definition of the term "reporting institution" to specifically include government securities broker-dealers. This clarification, which is compatible with the requirements of Section 102 of the Government Securities Act of 1986, should eliminate any confusion about the applicability of Rule 17f-1 to these firms, i.e., government securities broker-dealers are required to register with the SIC and must comply with the reporting and inquiry provisions of the rule.

Exemptions from Registration

One revision to the rule's registration exemptions provides for a more functional exemption that takes into account the increasing immobilization of securities. The revision replaces the previous exemption for broker-dealers that engage solely in the sale of variable contracts or limited partnership interests and that do not take or hold securities subject to the reporting or inquiry provisions of the rule.

Specifically, the amendments exempt any reporting institution that limits its securities activities **exclusively** to uncertificated securities, global securities issues, or any securities issue for which neither record nor beneficial owners can obtain a negotiable securities certificate. These terms are defined later in this *Notice*. Although the SEC expects that, at present, this exemption will apply infrequently because few institutions deal exclusively in uncertificated issues, the SEC anticipates that, as an increasing number of issues become available in book-entry-only form, a larger number of institutions will be able to take advantage of this exemption.

The amendments also add another exemption from registration. Any reporting institution whose business activities do not involve the handling of securities certificates is not required to register with the SIC. However, the SEC advises that the phrase "the handling of securities certificates" includes, among other things, any involvement in the sale, purchase, pledge, transfer, or safekeeping of securities. This is a rather limited exemption that is available to certain securities firms, such as mergers and acquisitions specialists, that because of the nature of their business would never have occasion to make inquiries or reports to the SIC. The exemption would not be available to firms that introduce business on a fully disclosed basis.

In connection with these amendments, the SEC issued a warning statement to any firm claiming an exemption from registration under these provisions. The SEC has advised that if a member accepts **even one securities certificate for processing**, even on an accommodation basis, it will be required to register with the SIC and otherwise participate in the program for at least six months.

Reporting Requirements

The amendments make several changes to the rule's reporting requirements. The first change concerns instances involving the discovery of a theft or loss of any securities certificates where there is a substantial basis for believing that criminal activity was involved. Previously, in these cases, reporting institutions were required to file their reports (Form X-17F-1A) with the "appropriate law enforcement agency," as well as with the SIC and the registered transfer agent. The term "appropriate law enforcement agency" has been deleted, and the amended rule now specifically requires that the reports involving suspected criminal activity be filed with the Federal Bureau of Investigation. The SEC cautions, however, that this change does not in any way affect members' obligations under other statutes, rules, or regulations. Furthermore, the SEC advises that, as a matter of good business practice, members should routinely continue to report all losses where potential criminal activity may be indicated to the police and all federal law-enforcement agencies with jurisdiction, as well as to their designated examining authority.

Secondly, the changes to the reporting requirements include a technical conforming amendment that clarifies how reports must be completed when a mail loss has occurred. Members now are specifically required to use the check-off box on Form X-17F-1A to indicate, when appropriate, that certificates were lost in the U.S. mails. This will enable the SIC to promptly notify the Postal Service of losses that are under its investigative jurisdiction.

The amendments also make a clarification concerning recovery reports. The obligation to report recoveries of securities previously reported missing, lost, or stolen is limited to the institution that originally reported the security as missing, lost, or stolen. Since, in the past, some reporting institutions interpreted this obligation differently, the rule has been amended to state this limitation clearly.

Inquiry Requirements

The only amendment to the inquiry requirements pertains to the customer exemption and only to the extent that the rule now includes a definition of "customer." The language of the customer exemption remains unchanged, but the terms "customer" and "securities-related transaction" are defined in the first section of the rule.

The term "customer" means any person with whom the reporting institution has entered into at least one prior securities-related transaction. The term "securities-related transaction" is defined as a purchase, sale, or pledge of investment securities, or a custodial arrangement for investment securities. According to the SEC, requiring some prior securities-related transaction should ensure that members have previously investigated the customer's identity and thus should inhibit instances of stolen or forged securities certificates. Members should be aware, however, that the SEC intends to construe this exemption strictly. For example, if a customer presents securities registered in his or her name, as well as someone else's (e.g., a spouse's), the exemption is available only if both owners are "customers" under the definition.

Securities Subject to Inquiry And Reporting Requirements

The amendments to the inquiry and reporting provisions of the rule eliminate the exemption for registered U.S. government and U.S. government agency securities. Registered-form government securities now are subject to these requirements, as are bearer-form government securities, which have been covered by the program since 1979.

Since the program in its current form has no applicability to functionally uncertificated issues, the amendments add these types of securities to the list of securities that are not subject to inquiry and reporting. Uncertificated securities, global securities issues, and any securities issues for which neither record nor beneficial owners can obtain a negotiable securities certificate, therefore, now are exempt from the reporting and inquiry provisions of the rule.

The amendments also have added to the rule definitions of the terms "uncertificated security" and "global certificate securities issue." The term "uncertificated security" means a security not represented by an instrument and the transfer of which is registered on books maintained for that purpose by or on behalf of the issuer. The term "global certificate securities issue" means a securities issue for which a single master certificate representing the entire issue is registered in the nominee name of a registered clearing agency and for which beneficial owners cannot receive negotiable securities certificates.

The revised text of Rule 17f-1, as well as additional background and commentary, is contained in SEC Release No. 34-26096, which was published in the *Federal Register,* September 26, 1988. Questions concerning this notice may be directed to Roberta Donohue, Development Specialist, NASD Surveillance Department, at (202) 728-8203.

NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-15

Suggested Routing:*

✓Senior Management	_Internal Audit	✓Operations	_Syndicate
_Corporate Finance	✓Legal & Compliance	_Options	_Systems
_Government Securities	_Municipal	_Registration	✓Trading
_Institutional	_Mutual Fund	_Research	_Training

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

Subject: Adoption of Rule Amendment to Permit Withdrawal of Quotations from NASDAQ for Market-Maker Vacations — Effective December 20, 1988

EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved an amendment to Paragraph (b), Part VI, Section 7, Schedule D to the NASD By-Laws. The amendment permits market makers with three or fewer NASDAQ Level 3 terminals to receive excused withdrawals from NASDAQ for vacations, provided the request is submitted to the NASD in writing 20 business days prior to the effective date of withdrawal from the NASDAQ system and the request includes a list of securities for which withdrawal is requested.

BACKGROUND AND SUMMARY

The SEC approved on June 9, 1988 amendments to Part VI, Schedule D to the NASD By-Laws setting forth requirements applicable to NASDAQ market makers.[1] In part, the rule amendments deleted vacations from the list of reasons for which NASDAQ market makers would be permitted to withdraw their quotations from the NASDAQ system. Since the rule amendments became effective, a number of market makers have written to the NASD to request that Schedule D be amended to permit excused withdrawals for vacations. The market makers requesting the rule amendment were from smaller firms that believe the Schedule D provisions on excused withdrawals place them at a competitive disadvantage to larger firms that are able to provide adequate coverage for traders who are on vacation. After considering the market makers' request, the NASD concluded that firms with a limited number of personnel are most affected by the excused withdrawal provisions under Schedule D because these firms are unable to assign stocks to other experienced personnel during a trader's absence. The NASD thus filed a proposed rule amendment with the SEC October 31, 1988. The rule amendment was approved by the SEC December 20, 1988.

The new rule change permits market makers with three or fewer NASDAQ Level 3 terminals to receive excused withdrawals from NASDAQ for vacation, provided that the request for withdrawal is submitted to the NASD in writing 20 business days prior to the effective date of withdrawal from the NASDAQ system and the request includes a list of the securities for which withdrawal is requested.

Any questions regarding this notice may be directed to Eneida Rosa, NASD Assistant General Counsel, at (202) 728-8284.

SCHEDULE D TO THE NASD BY-LAWS

(Note: New language is underlined.)

Part VI

Requirements Applicable to
NASDAQ Market Makers

Sec. 7 Withdrawal of Quotations

(b) Excused withdrawal status based on physical circumstances beyond a market maker's control may be granted for up to five (5) business days, unless extended by NASDAQ Operations. Excused withdrawal status based on demonstrated legal or regulatory requirements, supported by appropriate documentation and accompanied by a representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon written request, be granted for not more than sixty (60) days. Excused withdrawal status based on religious holidays may be granted only if notice is received by the Association five (5) business days in advance and is approved by the Association. Excused withdrawal status based on vacation may be granted only if: (1) the request for withdrawal is received by the NASD twenty (20) business days in advance, and is approved by the NASD; (2) the request includes a list of the securities for which withdrawal is requested; and (3) the request is made by a market maker with three (3) or fewer NASDAQ Level 3 terminals. The withdrawal of quotations because of pending news, a sudden influx of orders or price changes, or to effect transactions with competitors shall not constitute acceptable reasons for granting excused withdrawal status.

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[1] File No. SR-NASD-88-1, Securities Exchange Act Release No. 34-25791.

NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-16

Suggested Routing:*

✓Senior Management	__Internal Audit	__Operations	__Syndicate
✓Corporate Finance	✓Legal & Compliance	__Options	__Systems
__Government Securities	__Municipal	__Registration	__Trading
__Institutional	__Mutual Fund	__Research	__Training

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

Subject: Amendment to Appendix F Permitting Indeterminate Compensation in Public Direct Participation Programs — Effective February 1, 1989

EXECUTIVE SUMMARY

NASD members are advised that on January 13, 1989, the Securities and Exchange Commission (SEC) approved an amendment to Appendix F under Article III, Section 34 of the NASD Rules of Fair Practice (Securities Exchange Act Release No. 34-26458). The amendment, which permits the receipt of indeterminate compensation as underwriting compensation in connection with the sale of public direct participation programs, becomes effective February 1, 1989. The text of the amendment follows this notice.

BACKGROUND

NASD policies with respect to the regulation of underwriting compensation received by members in connection with the distribution of public direct participation programs are contained in Appendix F to Article III, Section 34 of the NASD Rules of Fair Practice (Appendix F). Appendix F provides that "all items of compensation paid by the program directly or indirectly from whatever source to underwriters, broker-dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration . . . " in determining the fairness and reasonableness of underwriting compensation. *Notice to Members* 82-51 (dated October 19, 1982) contains the NASD's currently effective compensation guidelines for public direct participation programs of 10 percent plus .5 percent reimbursement for *bona fide* due diligence expenses.

Section 5(b)(5) of Appendix F effectively precludes members from receiving underwriting compensation of an indeterminate value in connection with the public offering of a direct participation program. Compensation is deemed to be indeterminate if the total value that eventually will accrue to the member as a result of a compensation arrangement cannot be determined definitively. Types of compensation prohibited as indeterminate include, but are not limited to: a percentage of the management fee, a profit-sharing arrangement, an overriding royalty interest, a net-profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, and other similar items.

Since Appendix F applies only to public offerings of direct participation programs, private program offerings frequently are sold with an underwriting compensation arrangement that includes a percentage interest in program distributions. The NASD has developed the amendment to Appendix F to permit members distributing an offering to forgo front-end compensation in a program in exchange for a possible participation in distributions from the program.

Permitting members to receive back-end compensation in lieu of front-end compensation allows a greater percentage of offering proceeds to be directed to the business of the partnership, thereby benefitting investors. The trade-off of front-end compensation for an interest in program distributions also helps to focus the selling efforts of members on quality public programs, since members take on the risk that the program will be successful enough to generate sufficient distributions to provide returns to investors as well as an amount of compensation to the member.

EXPLANATION OF AMENDMENT

The amendment to Appendix F permits indeterminate compensation to be paid to a member or person associated with a member in connection with a public offering of a direct participation program if four conditions are satisfied. The first condition, Item (i) of Subsection 5(b)(5), is that the member's continuing compensation may be received only after all investors have received cash distributions from the program equal to 100 percent of their cash investment plus a 6 percent cumulative annual return on their adjusted investment. The "cash investment" includes the amount paid by the investor for the security in cash, payments of assessments, and reinvestment of a limited partner's income in the same program. The cash investment does not include any amounts represented by an outstanding promissory note on unpaid installments. The "adjusted investment" is the investor's cash investment less cash distributions from the program. The 6 percent cumulative annual return, chosen as a prerequisite to the receipt by members of continuing compensation, coincides with a similar provision in the North American Securities Administrators Association (NASAA) guidelines.

Item (ii) of the amendment requires that the member's continuing compensation be calculated as a percentage of cash distributions from the program. There is no restriction on the source of such cash distributions, so members may receive continuing compensation from operations, the sale of program assets, program investments and financing, dissolution of the program, etc.

Item (iii) restricts the amount of back-end compensation that a member may receive to 3 percent of the partnership's cash distributions for each one percentage point that the total of all underwriting compensation received at the time of the offering falls below 9 percent. Therefore, continuing compensation is permitted only when the aggregate of all categories of front-end compensation is below 9 percent. Front-end compensation includes retail and wholesale commissions, expense reimbursements, and other items of compensation that are enumerated in Section 5(c) of Appendix F. The trade-off ratio of 3-for-1 was based on an analysis indicating that members will realize a meaningful benefit by deferring compensation only if the program provides an attractive return to investors. Further, it was determined that such a ratio assures that members have sufficient incentive to give up front-end compensation in return for continuing compensation of an indeterminate value.

Item (iii) also restricts the total amount of continuing compensation that a member may receive to 12 percent of the cash distributions from the program. The limit on continuing compensation is intended to assure some consistency in the compensation structure of public programs. It is also intended to prevent undue discrimination against smaller member firms that might not be able to absorb all the costs of the distribution of a program in exchange for deferred compensation.

Item (iv) provides that the percentage of a member's continuing compensation from the limited partner's interest in program distributions cannot exceed the percentage that limited partners are entitled to receive. The purpose of this provision is to ensure that if any of the distributions of a program payable to limited partners is to be used to pay the member's continuing compensation, the percentage of that compensation paid from the limited partner's distributions cannot exceed the percentage of program distributions payable to the limited partners.

It should be noted that the amendment is permissive only; that is, it does not require members to exchange front-end compensation for deferred indeterminate compensation. It only permits members and issuers to negotiate previously prohibited indeterminate compensation arrangements as an alternative to the current practice of paying all underwriting compensation at the time of the offering.

EFFECTIVENESS OF AMENDMENT

The amendment to Appendix F is effective February 1, 1989. Public direct participation programs on file for review with the NASD Corporate Financing Department as of February 1, 1989, which have not received an opinion of "no objections" to the underwriting terms and arrangements, and direct participation programs subsequently filed with the department on or after February 1, 1989, may include an underwriting arrangement that complies with the new indeterminate compensation provision of Appendix F. In addition, any direct participation program offering that previously has received an opinion of "no objections" from the department may be resubmitted on or after February 1, 1989, for review of revised underwriting terms that include an indeterminate compensation arrangement, so long as the SEC or state regulatory authority (if an intrastate offering) has not declared the offering effective.

Questions concerning this notice can be directed to Richard J. Fortwengler, Assistant Director, NASD Corporate Financing Department, at (202) 728-8258.

APPENDIX F TO ARTICLE III, SECTION 34 OF THE NASD RULES OF FAIR PRACTICE

(**Note**: New language is underlined.)

Section 5. Organization and Offering Expenses

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(b) In determining the fairness and reasonableness of organization and offering expenses for purposes of subsection (a) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

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(5) the program provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of program units, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an overriding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items; provided, however, that an arrangement which provides for continuing compensation to a member or person associated with a member in connection with a public offering shall not be presumed to be unfair and unreasonable if all of the following conditions are satisfied:

(i) the continuing compensation is to be received only after each investor in the program has received cash distributions from the program aggregating an amount equal to his cash investment plus a six percent cumulative annual return on his adjusted investment;

(ii) the continuing compensation is to be calculated as a percentage of program cash distributions;

(iii) the amount of continuing compensation does not exceed three percent for each one percentage point that the total of all compensation pursuant to subsection (b)(1) of this section received at the time of the offering and at the time any installment payment is made fall below nine percent; provided, however, that in no event shall the amount of continuing compensation exceed 12 percent of program cash distributions; and

(iv) if any portion of the continuing compensation is to be derived from the limited partners' interest in the program cash distributions, the percentage of the continuing compensation shall be no greater than the percentage of program cash distributions to which limited partners are entitled at the time of the payment.

NASD

Notice To Members

National Association of Securities Dealers, Inc. February 1989

Number 89-17

Suggested Routing:*

✓ Senior Management	__Internal Audit	✓ Operations	__Syndicate
__Corporate Finance	✓ Legal & Compliance	__Options	✓ Systems
__Government Securities	__Municipal	__Registration	✓ Trading
__Institutional	__Mutual Fund	__Research	__Training

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

Subject: Adoption of Rule Amendments Mandating the Automated Submission Of Trading Data Technical Specifications

EXECUTIVE SUMMARY

As previously reported in *Notice To Members* 88-104, the NASD, beginning February 12, 1989, will require its members to respond to requests for trading data using an automated format. The format is consistent with that required by other self-regulatory organizations, including the New York Stock Exchange (NYSE) and American Stock Exchange (Amex). This Notice briefly discusses a member's technical options regarding compliance with these requirements.

BACKGROUND AND EXPLANATION

In *Notice to Members* 88-104, the NASD announced that it would be filing with the SEC, in conjunction with other self-regulatory organizations, a rule that requires members to submit trading data in a standarized automated format in response to a self-regulatory organization request. The NASD will be employing the same automated format that was developed jointly by the NYSE, the Securities Industry Association (SIA) and the Securities and Exchange Commission (SEC).

All members must submit this data in an automated format starting **February 12, 1989.**

To assist member firms in their compliance with these requirements, the following reporting options are available now or will be available in the near future.

New York Stock Exchange —Joint Members Of the NASD and Self-Clearing

The NASD is working with the Securities Industry Automation Corporation (SIAC) to develop a communications line directly to the NASD Operations Center in Rockville, Maryland. This would permit NASD/NYSE member firms to submit automated trading information relating to NASDAQ securities to SIAC using the same systems and procedures as they would in submitting NYSE information. The data link is expected to be operational shortly after the effective date of the rule. In the interim, NASD/NYSE members are required to submit this information via computer tape or diskette according to the specifications noted below.

Sole NASD Member Firms — Self-Clearing

NASD member firms that self-clear and that perform internal recordkeeping by an in-house automated system also are required to submit automated trading information via computer tape or diskette.

The specifications for responding by **tape** are:

- ASCII format.
- External label to identify the submitting firm.
- No internal label.
- Block size of 4096.
- BPI of 6250.

The specifications for responding by **diskette** are:

- 5.25-inch floppy disk formatted in MS-DOS or (PC-DOS) version 2.x or 3.x.
- 360K or 1.2MEG format.
- ASCII characters in blocks of 80 characters. The blocks may be separated by new lines or carriage returns.
- Naming the file(s) blue.1, blue.2, etc.

Exhibit 1 contains the file format for the trading information. This format is applicable for both tape and diskette submissions. Members using service bureaus should advise them of this requirement to provide the NASD with trading information in an automated format and should determine what arrangements the service bureaus have made to provide the self-regulatory organizations with the required data.

NASD and Exchange Members That Clear on a Fully Disclosed Basis

NASD and exchange member firms that introduce their business on a fully disclosed basis should check with their clearing broker-dealers to ensure that they are able to provide automated NASDAQ trading information submissions to the NASD on behalf of the introducing firm. The NASD considers it the responsibility of the introducing firm to ensure that the requests for information and the 10-day time limitation are met. In this regard, an introducing firm must make other arrangements to provide the data electronically should its clearing firm, for whatever reason, not be prepared to act on its behalf.

As noted in *Notice to Members* 88-104, the NASD will consider granting limited exemptions on an "as requested" basis. In considering such exemptions, the NASD will review the nature of the firm requesting the exemption including but not limited to its back-office capabilities, the scope and nature of the information requested, and the number of Market Surveillance questionnaires that the firm is sent routinely.

In a related matter, the NASD is in the process of developing the capability of accepting requested information through a personal computer by means of dial-up communication. The NASD will keep the membership apprised on the progress being made in this regard, and will inform the membership promptly when this capability is in place. This personal computer capability will provide all members with a cost-effective way of complying with the new automated reporting requirements.

Questions concerning the technical aspects of this Notice should be directed to John DeSaix, Director, Information Systems Development, at (301) 590-6628. Questions concerning the requirements in general should be directed to James M. Cangiano, Vice President, Market Surveillance, at (202) 728-8186.

RECORD LAYOUT FOR SUBMISSION OF TRADING INFORMATION

This Record Must Be the First Record of the File

Field Position From	To	Field Length	Field Name/Description/Remarks	Field Format	Justify	Picture Clause	Default Value
1	3	3	FILLER	A	LJ	X (3)	HDR
4	5	2	FILLER	A	LJ	X (2)	.S
6	10	5	DTRK-SYSID	N	LJ	9 (5)	12343
11	12	2	FILLER	A	LJ	X (2)	.E
13	14	2	FILLER	N	LJ	9 (2)	00
15	16	2	FILLER	A	LJ	X (2)	.C
17	20	4	FILLER	A	LJ	X (4)	B
21	22	2	FILLER	A	LJ	X (2)	.S
23	26	4	FILLER	A	LJ	X (4)	B
27	27	1	FILLER	A	LJ	X (1)	B
28	33	6	DTRK-DATE Contains submission date.	N	LJ	9 (6)	MMDDYY
34	34	1	FILLER	A	LJ	X (1)	B
35	59	25	DTRL-DESCRIPTION Required to identify this file.	A	LJ	X (25)	FIRM TRADING INFOR-MATION
60	80	21	FILLER	A	LJ	X (21)	B
1	1	1	HEADER RECORD CODE Value: Low Values	A	—	X	—
2	5	4	SUBMITTING BROKER NUMBER If NSCC member, use NSCC clearing number. If *not* a NSCC member, use clearing number assigned to you by your clearing agency.	A	LJ	X (4)	B
6	40	35	FIRM'S REQUEST NUMBER Tracking number used by the firm to record requests from an organization.	A	—	X (35)	B

Field Format — Code

alphanumeric = A
numeric = N
packed = P
binary = B

Default Values — Code

Blanks = B
Zero = Z

Justify

RJ = Right Justification of Data
LJ = Left Justification of Data

Field Position From—To		Field Length	Field Name/Description/Remarks	Field Format	Justify	Picture Clause	Default Value
41	46	6	FILE CREATION DATE Format is YYMMDD.	A	—	X (6)	—
47	54	8	FILE CREATION TIME Format is HH:MM:SS.	A	—	X (8)	—
55	55	1	REQUESTOR CODE Requesting Organization Identification. Value = R	A	—	X	—
56	70	15	REQUESTING ORGANIZATION NUMBER Number assigned by requesting organization.	A	LJ	X (15)	B
71	80	10	FILLER	A	—	X (10)	B
1	1	1	RECORD SEQUENCE NUMBER ONE The first record of the transaction. Value: 1	A	—	X	—
2	5	4	SUBMITTING BROKER NUMBER Identical to submitting broker number in Header Record.	A	LJ	X (4)	—
6	9	4	OPPOSING BROKER NUMBER The NSCC clearinghouse number of the broker on the other side of the trade.	A	LJ	X (4)	B
10	21	12	CUSIP NUMBER The cusip number assigned to the security. Left justified since the number is nine characters at present (8 + check digit) but will expand in the future.	A	LJ	X (12)	B
22	29	8	TICKER SYMBOL The symbol assigned to this security.	A	LJ	X (8)	B
30	35	6	TRADE DATE The date this trade was executed. Format is YYMMDD.	A	—	X (6)	B
36	41	6	SETTLEMENT DATE The date this trade will settle. Format is YYMMDD.	A	—	X (6)	B
42	53	12	QUANTITY The number of shares or quantity of bonds or option contracts.	N	RJ	9 (12)	Z

Field Format — Code

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numeric = N
packed = P
binary = B

Default Values — Code

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Zero = Z

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Field Position From—To		Field Length	Field Name/Description/Remarks	Field Format	Justify	Picture Clause	Default Value
54	67	14	NET AMOUNT The proceeds of sales or cost of purchases after commissions and other charges.	N	RJ	S9(12)V99	Z
68	68	1	BUY/SELL CODE Values: 0 = Buy, 1 = Sale, 2 = Short Sale, 3 = Open Long, 4 = Open Short, 5 = Close Long, 6 = Close Short. A = Buy Cancel, B = Sell Cancel, C = Short Sale Cancel, D = Open Long Cancel, E = Open Short Cancel, F = Close Long Cancel, G = Close Short Cancel. Values 3 to 6 and D to G are for options only.	A	—	X	B
69	78	10	PRICE The transaction price. Format: $$$$ CCCCCC.	N	RJ	9(4)V(6)	Z
79	79	1	EXCHANGE CODE Exchange where trade was executed. Values: A = New York Stock Exchange B = American Stock Exchange C = Midwest Stock Exchange D = Philadelphia Stock Exchange E = Pacific Stock Exchange F = Boston Stock Exchange G = Cincinnati Stock Exchange K = CBOE L = London Stock Exchange M = Toronto Stock Exchange N = Montreal Stock Exchange O = Vancouver Stock Exchange R = NASDAQ S = Over-the-Counter T = Tokyo Stock Exchange X = Securities Exchange Commission Z = Other	A	—	X	B
80	80	1	BROKER/DEALER CODE Indicates if trade was done for another Broker/ Dealer. Values: 0 = No; 1 = Yes	A	—	X	B
1	1	1	RECORD SEQUENCE NUMBER TWO Value: 2	A	—	X	—
2	2	1	SOLICITED CODE Value: 0 = No; 1 = Yes	A	—	X	B

Field Format — Code

alphanumeric = A
numeric = N
packed = P
binary = B

Default Values — Code

Blanks = B
Zero = Z

Justify

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Field Position From	—To	Field Length	Field Name/Description/Remarks	Field Format	Justify	Picture Clause	Default Value
3	4	2	STATE CODE Standard postal two-character identification.	A	—	X (2)	B
5	14	10	ZIP CODE/COUNTRY CODE Zip code — five or nine character (zip plus four) Country code — for future use.	A	LJ	X (10)	B
15	22	8	BRANCH OFFICE/REGISTERED REPRESENTATIVE NUMBER Each treated as a four-character field. Both are left justified.	A	LJ	X (8)	B
23	28	6	DATE ACCOUNT OPENED Format is YYMMDD.	A	—	X (6)	B
29	48	20	SHORT NAME FIELD Contains last name followed by comma (or space) then as much of first name as will fit.	A	LJ	X (20)	B
49	78	30	EMPLOYER NAME	A	LJ	X (30)	B
79	79	1	TIN 1 INDICATOR Values: 1 = SS#; 2 = TIN	A	—	X	B
80	80	1	TIN 2 INDICATOR Values: 1 = SS#; 2 = TIN — for future use.	A	—	X	B
1	1	1	RECORD SEQUENCE NUMBER THREE Value: 3	A	—	X	—
2	10	9	TIN ONE Taxpayer Identification Number; Social Security or Tax ID Number.	A	LJ	X (9)	B
11	19	9	TIN TWO Taxpayer Identification Number #2, reserved for future use.	A	LJ	X (9)	B
20	20	1	NUMBER OF N&A LINES	A	—	X	B
21	50	30	NAME AND ADDRESS LINE ONE	A	LJ	X (30)	B
51	80	30	NAME AND ADDRESS LINE TWO	A	LJ	X (30)	B
1	1	1	RECORD SEQUENCE NUMBER FOUR Value: 4	A	—	X	—

Field Format — Code	
alphanumeric	= A
numeric	= N
packed	= P
binary	= B

Default Values — Code	
Blanks	= B
Zero	= Z

Justify
RJ = Right Justification of Data
LJ = Left Justification of Data

Field Position From—To		Field Length	Field Name/Description/Remarks	Field Format	Justify	Picture Clause	Default Value
2	31	30	NAME AND ADDRESS LINE THREE	A	LJ	X (30)	B
32	61	30	NAME AND ADDRESS LINE FOUR	A	LJ	X (30)	B
62	62	1	PROPRIETARY-CUSTOMER INDICATOR 1 = Trade was for a proprietary account of submitting broker/dealer or another broker/dealer. 2 = Trade was for customer of submitting broker/dealer or another broker/dealer.	A	—	X	B
63	80	18	ACCOUNT NUMBER Account number.	A	LJ	X (18)	B
1	1	1	RECORD SEQUENCE NUMBER FIVE Value: 5	A	—	X	—
2	31	30	NAME AND ADDRESS LINE FIVE	A	LJ	X (30)	B
32	61	30	NAME AND ADDRESS LINE SIX	A	LJ	X (30)	B
62	80	19	FILLER	A	—	X (19)	B
1	1	1	TRAILER RECORD CODE One record per submission. Must be the last record on the file. Value: High Values	A	—	X	—
2	17	16	TOTAL TRANSACTIONS The total number of transactions. This total excludes Header and Trailer Records.	N	RJ	9 (16)	B
18	33	16	TOTAL RECORDS ON FILE The total number of 80-byte records. This total includes Header and Trailer Records, but not the Datatrak Header Record (i.e., does not include the first record on the file).	N	RJ	9 (16)	Z
34	80	47	FILLER	A	—	X (47)	B

Field Format — Code

alphanumeric = A
numeric = N
packed = P
binary = B

Default Values — Code

Blanks = B
Zero = Z

Justify

RJ = Right Justification of Data
LJ = Left Justification of Data