CURRENT TEXT

Item 4 on ballot

NASD Manual, ¶ 2151.05, pp. 2037-5 — 2038

[. . . Interpretation of the Board of Governors]

[Forwarding of Proxy and Other Materials]

[Introduction]

[.05 A member has an inherent duty in carrying out high standards of commercial honor and just and equitable principles of trade to forward all proxy material, annual reports, information statements and other material required by law to be sent to stockholders periodically, which are properly furnished to it by the issuer of the securities, to each beneficial owner of shares of that issue which are held by the member for the beneficial owner thereof. For the assistance and guidance of members in meeting their responsibilities, therefore, the Board of Governors has promulgated this Interpretation. The provisions hereof shall be followed by all members and failure to do so shall constitute conduct inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of Article III, Section 1 of the Rules of Fair Practice of the Association.]

[Interpretation]

[Section 1. No member shall give a proxy to vote stock which is registered in its name, except as required or permitted under the provisions of Section 2 or 3 hereof, unless such member is the beneficial owner of such stock.]

[Section 2. Whenever a person soliciting proxies shall timely furnish to a member:]

[(1) sufficient copies of all soliciting material which such person is sending to registered holders, and]

[(2) satisfactory assurance that he will reimburse such member for all out-of-pocket expenses, including reasonable clerical expenses incurred by such member in connection with such solicitation, such member shall transmit promptly to each beneficial owner of stock of such issuer which is in its possession or control and registered in a name other than the name of the beneficial owner all such material furnished. Such material shall include a signed proxy indicating the number of shares held for such beneficial owner and bearing a symbol identifying the proxy with proxy records maintained by the member, and a letter informing the beneficial owner of the time limit and necessity for completing the proxy form and forwarding it to the person soliciting proxies prior to the expiration of the time limit in order for the shares to be represented at the meeting. A member shall furnish a copy of the symbols to the person soliciting the proxies and shall also retain a copy thereof pursuant to the provisions of Rule 17a-4 of the General Rules and Regulations under the Securities Exchange Act of 1934, 17 C. F. R. 240.17a-4. Notwithstanding the provisions of this section, a member may give a proxy to vote any stock pursuant to the rules of any national securities exchange to which the member is also responsible provided that the records of the member clearly indicate which procedure it is following.]

[This section shall not apply to beneficial owners residing outside of the United States of America though members may voluntarily comply with the provisions hereof in respect to such persons if they so desire.]

[Section 3. A member may give a proxy to vote any stock registered in its name if such member holds such stock as executor, administrator, guardian, trustee, or in a similar representative or fiduciary capacity with authority to vote.]

[A member which has in its possession or within its control stock registered in the name of another member and which desires to transmit signed proxies pursuant to the provisions of Section 2, shall obtain the requisite number of signed proxies from such holder of record.]

[Section 4. A member when so requested by an issuer and upon being furnished with:]

[(1) sufficient copies of annual reports, information statements or other material required by law to be sent to stockholders periodically, and]

[(2) satisfactory assurance that it will be reimbursed by such issuer for all out-of-pocket expenses, including reasonable clerical expenses, shall transmit promptly to each beneficial owner of stock of such issuer which is in its possession and control and registered in a name other than the name of the beneficial owner all such material furnished.]

[This section shall not apply to beneficial owners residing outside of the United States of America though members may voluntarily comply with provisions hereof in respect to such persons if they so desire.]

[Section 5. The Board of Governors for the guidance of members is authorized to establish a

suggested rate of reimbursement of members for expenses incurred in connection with transmitting the proxy solicitation to the beneficial owners of the securities pursuant to Section 2 hereof or in transmitting information statements or other material to the beneficial owners of securities pursuant to Section 4 hereof. Such shall be attached hereto by appendix.]

PROPOSED NEW SECTION [D] OF THE NASD RULES OF FAIR PRACTICE

Item 4 on ballot

Proxies

Sec. [D].

Restrictions on giving of proxies

(a) No member shall give or authorize the giving of a proxy to vote any security which is registered in its name, or in the name of its nominee, except as permitted under the provisions of subsection (d), unless the member is the beneficial owner of the security. These restrictions shall also apply to voting in person.

Forwarding of proxy material to customers

(b) Whenever a person soliciting proxies shall timely furnish to a member sufficient copies of all soliciting material which the person is sending to registered holders, and satisfactory assurance that he will reimburse the member for all out-of-pocket expenses, including reasonable clerical expenses, incurred by the member in connection with the solicitation, the member shall:

(1) transmit or cause to be transmitted to each beneficial owner of the security that is in its possession or control and registered in the name of the member, or the name of its nominee, all such material furnished no later than five (5) business days after receipt thereof; and,

(2) transmit with the material a signed proxy and cover letter indicating the number of shares held for the beneficial owner and bearing a symbol identifying the proxy with proxy records maintained by the member, and also a letter informing the beneficial owner of the time limit and necessity for completing the proxy form and forwarding it to the person soliciting proxies in order for the securities to be represented at the meeting. A member shall furnish a copy of the symbols to the person soliciting the proxies and shall also retain a copy as required by SEC Rule 17a-4 under the Securities Exchange Act of 1934.

Signed proxy and transmittal letter

(c) Notwithstanding the provisions of subsection (b), a member which is also a member of a national securities exchange may give a proxy to vote any security pursuant to the rules of any such exchange provided that the records of the member clearly indicate which rule it is following.

Member as executor or similar representative capacity

(d) A member may give a proxy to vote any security registered in its name if the member holds the security as executor, administrator, guardian, trustee, or in a similar representative or fiduciary capacity with authority to vote.

Signed proxies for security in names of other members

(e) A member which has in its possession or control any security registered in the name of another member and that desires to transmit signed proxies pursuant to the provisions of subsection (b) of this section shall request the requisite number of signed proxies from the other member, which shall have a duty to comply with the request.

Forwarding of annual reports and other material

(f) A member, when requested by an issuer, and upon being furnished with sufficient copies of annual reports, interim reports of earnings, information statements, or other material being sent to security holders and satisfactory assurance that it will be reimbursed by the issuer for all out-of-pocket expenses, including reasonable clerical expenses, shall transmit or cause to be transmitted promptly all the material received by the member to each beneficial owner of any security of the issuer that is registered in its name or the name of its nominee.

Suggested rates of reimbursement

(g) The Board of Governors, for the guidance of members, is authorized to establish a suggested rate of reimbursement of members for expenses incurred in connection with transmitting the proxy solicitation to the beneficial owners of the securities pursuant to subsection (b) hereof or in transmitting information statements or other material to the beneficial owners of securities pursuant to subsection (f) hereof. The suggested rates of reimbursement authorized hereby shall be incorporated into Appendix G to be attached to and made a part of this rule. The Board of Governors shall have the power to alter, amend, supplement, or modify the provisions of Appendix G from time

to time without recourse to the membership for approval, as would otherwise be required by Article VII of the By-Laws.

Beneficial owners residing outside the United States

(h) The requirements of this section shall not apply to beneficial owners residing outside of the United States.

EXPLANATION

This new section codifies the language that now appears in the NASD Manual as an Interpretation of the Board of Governors — "Forwarding of Proxy and Other Materials," under Article III, Section 1 of the NASD Rules of Fair Practice (Proxy Interpretation). The existing Proxy Interpretation was adopted in 1967 to establish requirements applicable to proxies covering "street name" stock. The new section appears as Item 4 on the ballot.

The introduction to the Proxy Interpretation is not included in new Section [D] since it merely restates some of the substantive provisions that are contained later in the Interpretation. Section [D] would contain new headings above each subsection for clarity. The heading "Restrictions on Giving of Proxies" above Subsection (a), for example, is intended to emphasize the fact that there are only very limited circumstances that allow a member to give a proxy to vote securities registered in its name. Subsection (a) also would make the restrictions applicable to securities registered in the name of a nominee of a member to prevent technical evasion of the restrictions. For the same reason, the restrictions would be made expressly applicable to voting in person since the current language appears limited to situations involving voting by proxy.

Subsection (b) provides that, upon being furnished with sufficient copies of proxy solicitation material and assurance of reimbursement of expenses, a member is required to forward the material to the beneficial owners. The requirement applies whether the proxies are being solicited by the issuer or someone else, provided assurance of expense reimbursement is received. The new language authorizing a member to cause the material to be transmitted is intended only to clarify that a member may contract with another person to forward the material. The new language also clarifies that a member is responsible only for forwarding materials if it or its nominee is the record holder. The deletion of the word "promptly" and substitution of "a five-day period" to furnish the material conforms to the requirement of SEC Rule 14b-1(b).

Subsection (c) requires a member to transmit with the solicitation material a signed proxy to be completed by the beneficial owner and mailed directly to the issuer or other person soliciting proxies. Exchange rules permit a member to request voting instructions from the beneficial owners and, if instructions are received, the member is required to vote the proxies in accordance with the instructions received. With the exception of certain corporate events, the failure to receive voting instructions allows a member to vote a proxy at its discretion. The Proxy Interpretation deliberately omits this alternative procedure, but it does allow a member that is also an exchange member to elect to follow the exchange's proxy rules.

The changes in the second paragraph of Subsection (c) are for clarification only. The redraft retains these provisions. The third paragraph has been moved to new Subsection (h). The language of proposed Subsection (d) is basically unchanged from the existing language.

The changes in Subsection (e) concerning securities in the possession of a member that are registered in the name of another member are designed to clarify that the member in whose name the securities are registered must comply with any request by the member in possession to be furnished with signed proxies.

The changes in new Subsection (f) that impose a duty under certain conditions to forward annual reports and other materials not part of the proxy material are designed to make the language similar to the exchange rules. Thus, as revised, the requirement would apply to any material being sent to security holders by an issuer. The current language is limited to material "required by law" to be sent by an issuer to its security holders.

Under Subsection (g), the NASD Board is granted authority to adopt an Appendix G to new Section [D] establishing suggested rates of reimbursement for the cost of forwarding materials. It is contemplated that this appendix will be the same as the existing appendix under the Proxy Interpretation. The current appendix is not included in this notice since a membership vote is not required. When new Section [D] becomes effective, the current appendix will be placed immediately

after the new section.

CURRENT TEXT

NASD Manual, ¶ 2151.06, pp. 2040 — 2407-3
Item 5 on ballot
[. . .Interpretation of the Board of Governors]
[**"Free Riding and Withholding"**]

[Introduction]

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

[This interpretation is based upon the premise that members have an obligation to make a bona fide public distribution at the public offering price of securities of a public offering which trade at a premium in the secondary market whenever such secondary market begins (a "hot issue") regardless of whether such securities are acquired by the member as an underwriter, as a selling group member, or from a member participating in the distribution as an underwriter or a selling group member, or otherwise. The failure to make a bona fide public distribution when there is a demand for an issue can be a factor in artificially raising the price. Thus, the failure to do so, especially when the member may have information relating to the demand for the securities or other factors not generally known to the public, is inconsistent with high standards of commercial honor and just and equitable principles of trade and leads to an impairment of public confidence in the fairness of the investment banking and securities business. Such conduct is, therefore, in violation of Article III, Section 1 of the Association's Rules of Fair Practice and this Interpretation thereof which establishes guidelines in respect to such activity.]

[As in the case of any other Interpretation issued by the Board of Governors of the Association, the implementation thereof is a function of the District Business Conduct Committees and the Board of Governors. Thus, the Interpretation will be applied to a given factual situation by individuals active in the investment banking and securities business who are serving on these committees or on the Board. They will construe this Interpretation to effectuate its overall purpose to assure a public distribution of securities for which there is a public demand.]

[Interpretation]

[Except as provided herein, it shall be inconsistent with high standards of commercial honor and just and equitable principles of trade and a violation of Article III, Section 1 of the Association's Rules of Fair Practice for a member, or a person associated with a member, to fail to make a bona fide public distribution at the public offering price of securities of a public offering which trade at a premium in the secondary market whenever such secondary market begins regardless of whether such securities are acquired by the member as an underwriter, a selling group member or from a member participating in the distribution as an underwriter or selling group member, or otherwise. Therefore, it shall be a violation of Article III, Section 1 for a member, or a person associated with a member, to:]

[1. Continue to hold any of the securities so acquired in any of the members' accounts;]

[2. Sell any of the securities to any officer, director, general partner, employee or agent of the member or of any other broker-dealer, or to a person associated with the member or with any other broker-dealer, or to a member of the immediate family of any such person;]

[3. Sell any of the securities to a person who is a finder in respect to the public offering or to any person acting in a fiduciary capacity to the managing underwriter, including, among others, attorneys, accountants and financial consultants, or to a member of the immediate family of any such person;]

[4. Sell any securities to any senior officer at a bank, savings and loan institution, insurance company, registered investment company, registered investment advisory firm or any other institutional type account, domestic or foreign, or to any person in the securities department of, or to any employee or any other person who may influence or whose activities directly or indirectly involve or are related to the function of buying or selling securities for any bank, savings and loan institution, insurance company, registered investment company, registered investment advisory firm, or other institutional type account, domestic or foreign, or to a member of the immediate family of any such person;]

[5. Sell any securities to any account in which any person specified under paragraphs 1, 2,

3, or 4 hereof has a beneficial interest;]

[Provided, however, a member may sell part of its securities acquired as described above to:]

[(a) persons enumerated in paragraphs 3 or 4 hereof; and]

[(b) members of the immediate family of persons enumerated in paragraph 2 hereof provided that such person enumerated in paragraph 2 does not contribute directly or indirectly to the support of such member of the immediate family; and]

[(c) any account in which any person specified under paragraph 3 or 4 or subparagraph (b) of this paragraph has a beneficial interest; if the member is prepared to demonstrate that the securities were sold to such persons in accordance with their normal investment practice with the member, that the aggregate of the securities so sold is insubstantial and not disproportionate in amount as compared to sales to members of the public and that the amount sold to any one of such persons is insubstantial in amount.]

[6. Sell any of the securities, at or above the public offering price, to any other broker-dealer; provided, however, a member may sell all or part of the securities acquired as described above to another member broker-dealer upon receipt from the latter in writing assurance that such purchase would be made to fill orders for bona fide public customers, other than those enumerated in paragraphs 1, 2, 3, 4 or 5 above, at the public offering price as an accommodation to them and without compensation for such.]

[7. Sell any of the securities to any domestic bank, domestic branch of a foreign bank, trust company or other conduit for an undisclosed principal unless:]

[(a) An affirmative inquiry is made of such bank, trust company or other conduit as to whether the ultimate purchasers would be persons enumerated in paragraphs 1 through 5 hereof and receives satisfactory assurance that the ultimate purchasers would not be such persons, and that the securities would not be sold in a manner inconsistent with the provisions of paragraph 6 hereof; otherwise, there shall be a rebuttable presumption that the ultimate purchasers were persons enumerated in paragraphs 1 through 5 hereof or that the securities were sold in a manner inconsistent with the provisions of paragraph 6 hereof;]

[(b) A recording is made on the order ticket, or its equivalent, or on some other supporting document, of the name of the person to whom the inquiry was made at the bank, trust company or other conduit as well as the substance of what was said by that person and what was done as a result thereof;]

[(c) The order ticket, or its equivalent, is initialed by a registered principal of the member; and]

[(d) Normal supervisory procedures of the member provide for a close follow-up and review of all transactions entered into with the referred to domestic banks, trust companies or other conduits for undisclosed principals to assure that the ultimate recipients of securities so sold are not persons enumerated in paragraphs 1 through 6 hereof.]

[8. Sell any of the securities to a foreign broker-dealer or bank unless:]

[(a) In the case of a foreign broker-dealer or bank which is participating in the distribution as an underwriter, the agreement among underwriters contains a provision which obligates the said foreign broker-dealer or bank not to sell any of the securities which it receives as a participant in the distribution to persons enumerated in paragraphs 1 through 5 above, or in a manner inconsistent with the provisions of paragraph 6 hereof; or]

[(b) In the case of sales to a foreign broker-dealer or bank which is not participating in the distribution as an underwriter, the selling member:]

[(i) makes an affirmative inquiry of such foreign broker-dealer or bank as to whether the ultimate purchasers would be persons enumerated in paragraphs 1 through 5 hereof and receives satisfactory assurance that the ultimate purchasers of the securities so purchased would not be such persons, and that the securities would not be sold in a manner inconsistent with the provisions of paragraph 6 hereof;]

[(ii) a recording is made on the order ticket, or its equivalent, or upon some other supporting document, of the name of the person to whom the inquiry was made at the foreign broker-dealer or bank as well as the substance of what was said by that person and what was done as a result thereof; and]

[(iii) the order ticket, or its equivalent, is initialed by a registered principal of the member.]

[The obligations imposed upon members in their dealings with foreign broker-dealers or banks by this paragraph 8(b) can be fulfilled by having the foreign broker-dealer or bank to which sales

falling within the scope of this Interpretation are made execute Form FR-1, or a reasonable facsimile thereof. This form, which gives a blanket assurance from the foreign broker-dealer or bank that no sales will be made in contravention of the provisions of this Interpretation, can be obtained at any District Office of the Association or at the Executive Office. The acceptance of an executed Form FR-1, or other written assurance, by a member must in all instances be made in good faith. Thus, if a member knows or should have known of facts which are inconsistent with the representations received, such will not operate to satisfy the obligations imposed upon him by this paragraph.]

[Scope and Intent of Interpretation]

[In addition to the obvious scope and intent of the above provisions, the intent of the Board of Governors in the following specific situations is outlined for the guidance of members.]

[Issuer Directed Securities]

[This Interpretation shall apply to securities which are part of a public offering notwithstanding that some or all of those securities are specifically directed by the issuer to accounts which are included within the scope of paragraphs 3 through 8 above. Therefore, if a person within the scope of those paragraphs to whom securities were directed did not have an investment history with the member or registered representative from whom they were to be purchased, the member would not be permitted to sell him such securities. Also, the "disproportionate" and "insubstantial" tests would apply as in all other situations. Thus, the directing of a substantial number of securities to any one person would be prohibited as would the directing of securities to such accounts in amounts which would be disproportionate as compared to sales to members of the public. This Interpretation shall also apply to securities which are part of a public offering notwithstanding that some of those securities are specifically directed by the issuer on a non-underwritten basis. In such cases, the managing underwriter of the offering shall be responsible for insuring compliance with this Interpretation in respect to those securities.]

[Notwithstanding the above, sales of issuer directed securities may be made to restricted persons without the required investment history after receiving permission from the Board of Governors. Permission will be given only if there is a demonstration of valid business reasons for such sales (such as sales to distributors and suppliers or key employees, who are in each case incidentally restricted persons), and the member seeking permission is prepared to demonstrate that the aggregate amount of securities so sold is insubstantial and not disproportionate as compared to sales to members of the public, and that the amount sold to any one of such persons is insubstantial in amount.]

[Investment Partnerships and Corporations]

[A member may not sell securities of a public offering which trade at a premium in the secondary market whenever such secondary market begins ("hot issue"), to the account of any investment partnership or corporation, domestic or foreign (except companies registered under the Investment Company Act of 1940) including but not limited to, hedge funds, investment clubs, and other like accounts unless the member complies with either of the following alternatives;]

[(A) prior to the execution of the transaction, the member has received from the account a current list of the names and business connections of all persons having any beneficial interest in the account, and if such information discloses that any person enumerated in paragraphs (1) through (4) hereof has a beneficial interest in such account, any sale of securities to such account must be consistent with the provisions of this Interpretation, or]

[(B) prior to the execution of the transaction, the member has obtained a copy of a current opinion from counsel admitted to practice law before the highest court of any state stating that counsel reasonably believes that no person with a beneficial interest in the account is a restricted person under this Interpretation and stating that, in providing such opinion, counsel:]

[(1) has reviewed and is familiar with this Interpretation;]

[(2) has reviewed a current list of all persons with a beneficial interest in the account supplied by the account manager;]

[(3) has reviewed information supplied by the account manager with respect to each person with a beneficial interest in the account, including the identity, the nature of employment, and any other business connections of such persons; and]

[(4) has requested and reviewed other documents and other pertinent information and made inquiries of the account manager and received

responses thereto, if counsel determines that such further review and inquiry are necessary and relevant to determine the correct status of such persons under the Interpretation.]

[The member shall maintain a copy of the names and business connections of all persons having any beneficial interest in the account or a copy of the current opinion of counsel in its files for at least three years following the member's last sale of a new issue to the account, depending upon which of the above requirements the member elects to follow. For purposes of this section, a list or opinion shall be deemed to be current if it is based upon the status of the account as of a date not more than 18 months prior to the date of the transaction.]

[The term beneficial interest means not only ownership interests, but every type of direct financial interest of any persons enumerated in paragraphs (1) through (4) hereof in such account, including, without limitation, management fees based on the performance of the account.]

[Violations by Recipient]

[In those cases where a member or person associated with a member has been the recipient of securities of a public offering to the extent that such violated the Interpretation, the member or person associated with a member shall be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation as well as the member who sold the securities since their responsibility in relation to the public distribution is equally as great as that of the member selling them. In those cases where a member or a person associated with a member has caused, directly or indirectly, the distribution of securities to a person falling within the restrictive provisions of this Interpretation, the member or person associated with a member shall also be deemed to be in violation of Article III, Section 1 of the Rules of Fair Practice and this Interpretation. Receipt by a member or a person associated with a member of securities of a hot issue which is being distributed by an issuer itself without the assistance of an underwriter and/or selling group is also intended to be subject to the provisions of this Interpretation.]

[Violations by Registered Representative Executing Transaction]

[The obligation which members have to make a bona fide public distribution at the public offering price of securities of a hot issue is also an obligation of every person associated with a member who causes a transaction to be executed. Therefore, where sales are made by such persons in a manner inconsistent with the provisions of this Interpretation, such persons associated with a member will be considered equally culpable with the member for the violations found taking into consideration the facts and circumstances of the particular case under consideration.]

[Disclosure]

[The fact that a disclosure is made in the prospectus or offering circular that a sale of securities would be made in a manner inconsistent with this Interpretation does not take the matter out of its scope. In sum, therefore, disclosure does not affect the proscriptions of this Interpretation.]

[Explanation of Terms]

[The following explanation of terms is provided for the assistance of members. Other words which are defined in the By-Laws and Rules of Fair Practice shall, unless the context otherwise requires, have the meaning as defined therein.]

[Public Offering]

[The term public offering shall mean all distributions of securities whether underwritten or not; whether registered, unregistered or exempt from registration under the Securities Act of 1933, and whether they are primary or secondary distributions, including intra-state distributions and Regulation A issues, which sell at an immediate premium, in the secondary market. It shall not mean exempted securities as defined in Section 3(a)(12) of the Securities Exchange Act of 1934.]

[Immediate Family]

[The term immediate family shall include parents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children. In addition, the term shall include any other person who is supported, directly or indirectly, to a material extent by the member, person associated with the member or other person specified in paragraphs 2, 3, or 4 above.]

[Normal Investment Practice]

[Normal investment practice shall mean the history of investment of a restricted person in an account or accounts maintained with the member making the allocation. In cases where an account was previously maintained with another member, but serviced by the same registered representative

as the one currently servicing the account for the member making the allocation, such earlier investment activity may be included in the restricted person's investment history. Usually the previous one-year period of securities activity is the basis for determining the adequacy of a restricted person's investment history. Where warranted, however, a longer or shorter period may be reviewed. It is the responsibility of the registered representative effecting the allocation, as well as the member, to demonstrate that the restricted person's investment history justifies the allocation of hot issues. Copies of customer account statements or other records maintained by the registered representative or the member may be utilized to demonstrate prior investment activity. In analyzing a restricted person's investment history the Association believes the following factors should be considered:]

[(1) The frequency of transactions in the account or accounts during that period of time. Relevant in this respect are the nature and size of investments.]

[(2) A comparison of the dollar amount of previous transactions with the dollar amount of the hot issue purchase. If a restricted person purchases $1,000 of a hot issue and his account reveals a series of purchases and sales in $100 amounts, the $1,000 purchase would not appear to be consistent with the restricted person's normal investment practice.]

[(3) The practice of purchasing mainly hot issues would not constitute a normal investment practice. The Association does, however, consider as contributing to the establishment of a normal investment practice, the purchase of new issues which are not hot issues as well as secondary market transactions.]

[Disproportionate]

[In respect to the determination of what constitutes a disproportionate allocation, the Association uses as a guideline 10% of the member's participation in the issue, however acquired. It should be noted, however, that the 10% factor is merely a guideline and is one of a number of factors which are considered in reaching determinations of violations of the Interpretation on the basis of disproportionate allocations. These other factors include, among other things:]

[the size of the participation;]

[the offering price of the issue;]

[the amount of securities sold to restricted accounts; and,]

[the price of the securities in the aftermarket.]

[It should be noted that disciplinary action has been taken against members for violations of the Interpretation where the allocations made to restricted accounts were less than 10% of the member's participation. The 10% guideline is applied as to the aggregate of the allocations.]

[Notwithstanding the above, a normal unit of trading (100 shares or 10 bonds) will in most cases not be considered a disproportionate allocation regardless of the amount of the member's participation. This means that if the aggregate number of shares of a member's participation which is allocated to restricted accounts does not exceed a normal unit of trading, such allocation will in most cases not be considered disproportionate. For example, if a member receives 500 shares of a hot issue, he may allocate 100 shares to a restricted account even though such allocation represents 20% of that member's participation. Of course, all of the remaining shares would have to be allocated to unrestricted accounts and all other provisions of the Interpretation would have to be satisfied. Specifically, the allocation would have to be consistent with the normal investment practice of the account to which it was allocated and the member would not be permitted to sell to restricted persons who were totally prohibited from receiving hot issues.]

[Insubstantiality]

[This requirement is separate and distinct from the requirements relating to disproportionate allocations and normal investment practice. In addition, this term applies both to the aggregate of the securities sold to restricted accounts and to each individual allocation. In other words, there could be a substantial allocation to an individual account in violation of the Interpretation and yet be no violation on that ground as to the total number of shares allocated to all accounts. The determination of whether an allocation to a restricted account or accounts is substantial is based upon, among other things, the number of shares allocated and/or the dollar amount of the purchase.]

[SALES BY ISSUERS IN CONVERSION OFFERINGS]

[Definitions]

[(a) For purposes of this Subsection, the

following terms shall have the meanings stated:]

[(1) "Conversion offering" shall mean any offering of securities made as part of a plan by which a savings and loan association or other organization converts from a mutual to a stock form of ownership.]

[(2) "Eligible purchaser" shall mean a person who is eligible to purchase securities pursuant to the rules of the Federal Home Loan Bank Board or other governmental agency or instrumentality having authority to regulate conversion offerings.]

[Conditions for exemption]

[(b) This Interpretation shall not apply to a sale of securities by the issuer on a non-underwritten basis to any person who would otherwise be prohibited or restricted from purchasing a hot issue security if all of the conditions of this Subsection (b) are satisfied.]

[Sales to members, associated persons of members, and certain related persons]

[(1) If the purchaser is a member, person associated with a member, member of the immediate family of any such person to whose support such person contributes, directly or indirectly, or an account in which a member or person associated with a member has a beneficial interest:]

[(A) the purchaser shall be an eligible purchaser;]

[(B) the securities purchased shall be restricted from sale or transfer for a period of 150 days following the conclusion of the offering; and]

[(C) the fact of purchase shall be reported in writing to the member where the person is associated within one day of payment.]

[Sales to Other Restricted Persons]

[(2) If the purchaser is not a person specified in Subsection (b)(1) above, the purchaser shall be an eligible purchaser.]

PROPOSED NEW SECTION [E] OF NASD RULES OF FAIR PRACTICE

Item 5 on ballot

Free-Riding and Withholding

Sec. [E].

Application

(a)(1) This section shall apply to the sale, purchase, and receipt by members and persons associated with members of a hot issue security.

(2) For purposes of this section, a "hot issue security" is defined as a security of a public offering which trades at a premium in the secondary market within a reasonable time during the initial phase of trading whenever such secondary market begins.

EXPLANATION

New Section [E] codifies the language that now appears in the NASD Manual as an Interpretation of the Board of Governors — "Free-Riding and Withholding" — under Article III, Section 1 of the NASD Rules of Fair Practice (Free-Riding and Withholding Interpretation). Because of the length and complexity of the Free-Riding and Withholding Interpretation and new Section [E], each subsection is discussed separately. The new section appears as Item 5 on the ballot.

Subsection (a) of new Section [E] is based on the current introduction to the Free-Riding and Withholding Interpretation, but eliminates what appears to be unnecessary language. It also clarifies that the provision applies both to purchases of "hot issues" by associated persons and members that are not participating in the offering as well as to purchases and sales by members and associated persons who are participants in the offering.

A major change in the subsection over the provision earlier submitted for comment is the addition of language to define "hot issue securities" as securities of a public offering that trade at a premium in the secondary market within a reasonable time during the initial phase of trading in such secondary market. The change has been made in response to several comments and is designed to introduce a greater degree of specificity into the definition by clarifying that the time period used to determine whether an offering is a "hot issue" following the commencement of aftermarket trading is not open ended and is determined by a standard of reasonableness that takes into account all relevant facts and circumstances.

PROPOSED NEW TEXT

Withholding by members

(b) No member that has acquired a hot issue security as an underwriter or a selling group member or from a broker or dealer participating in the distribution as an underwriter or selling group member, or otherwise, shall fail to make a bona fide public distribution by continuing to hold any part of the security in any of the member's proprietary accounts, including investment, trading, arbitrage, and similar accounts.

EXPLANATION

This provision expands upon the existing prohibition and incorporates certain language now appearing in the Introduction to the Free-Riding and Withholding Interpretation.

PROPOSED NEW TEXT

Sales to associated persons of brokers and dealers and certain other persons

(c)(1) No member or associated person of a member shall sell or cause the sale of a hot issue security to any person who is an officer, director, general partner, registered principal, registered representative, or employee of a member or of any other broker or dealer, or to any other natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member or by any other broker or dealer.

(2) No member or associated person of a member shall sell or cause the sale of a hot issue security to a member of the immediate family of any person subject to subsection (1) above; provided that a member or associated person of a member may sell a hot issue security to any such member of the immediate family (i) if the person is not supported, directly or indirectly, by any person covered under subsection (c)(1) above, and (ii) if the member or associated person can demonstrate that the sale was in accordance with the person's established investment practice with the selling member and that the amount of the hot issue security sold to any one of such persons is insubstantial.

EXPLANATION

Subsection (c)(1) of new Section [E] parallels the existing language of the Free-Riding and Withholding Interpretation, with certain changes. The current language that prohibits sales to any officer, director, general partner, or employee of a member has been retained but the existing language also prohibiting sales to any "person associated with a member" has been deleted. New language has been added to specifically cover "any other natural person in the investment banking or securities business who is directly or indirectly controlling or controlled by a member" as persons to whom "hot issues" may not be sold. The new language codifies the NASD's long-standing interpretation that limited partners, non-voting stockholders, and subordinated lenders are not covered unless they are in a control relationship with a member.

Subsection (c)(2) of Section [E] carries forward the existing restrictions concerning sales to members of the immediate family of persons covered by Subsection (c)(1). The restrictions are combined with language now appearing in the proviso clause following paragraph 5 of the Free-Riding and Withholding Interpretation that permits sales to members of the immediate family under certain circumstances. The prohibition on selling a "hot issue" to any of the enumerated persons contained in both subsections (c)(1) and (c)(2) has been expressly made applicable to an "associated person of a member," although the existing language of the Free-Riding and Withholding Interpretation speaks only of sales by members. This is intended to clarify the responsibilities of registered representatives and other associated persons in making sales of "hot issues" to ensure compliance with new Section [E], which appears under the heading "Violations by Registered Representative Executing Transaction" in the Free-Riding and Withholding Interpretation.

The substitution of the "associated person" language also clarifies that the responsibility to ensure compliance with new Section [E] goes beyond the registered representative who executes the sale. The addition of the words "cause to sell" codifies the long-standing NASD position that members and associated persons who direct other participants in the offering to make sales are not relieved of responsibility because the sales are executed by someone else.

PROPOSED NEW TEXT

Sales to persons assisting in the distribution

(d) No member or associated person of a member shall sell or cause the sale of a hot issue security to any person who is a finder with respect to the public offering, or to any person who is acting in a fiduciary capacity to the managing underwriter in connection with the particular public offering, including, among others, attorneys, accountants, and financial consultants and advisers, or to a member of the immediate family of any such person; provided that a member or associated person of a member may sell the security to any person subject to this subsection if the member or associated person of a member can demonstrate

that the sale was in accordance with the person's established investment practice with the selling member and that the amount of the hot issue security sold to any one of such persons is insubstantial.

EXPLANATION

Subsection (d) of proposed new Section [E] carries forward the existing restrictions of paragraph 3 of the Free-Riding and Withholding Interpretation and also combines into a single provision language now appearing in the proviso clause following paragraph 5 that allows sales where there is an investment history and the amount sold to the restricted person is insubstantial. In addition, pursuant to proposed Subsection (g) following, aggregate sales to all restricted and prohibited persons must be insubstantial and and not disproportionate. Subsection (d) also clarifies the Board's intent in adopting paragraph 3 that the restriction on sales of "hot issues" applies only to attorneys and accountants performing services for the managing underwriter. It does not apply to attorneys and accountants for participating underwriters or selected dealers. The proposed Subsection also clarifies the Board's intent that the restriction on sales applies only where the attorney or accountant is performing services with respect to the particular public offering being sold and does not apply to attorneys and accountants simply because they performed services in prior public offerings handled by the same managing underwriter.

PROPOSED NEW TEXT

Sales to officers and employees of financial institutions

(e) No member or associated person of a member shall sell or cause the sale of a hot issue security (1) to any person who is a senior officer of any foreign or domestic bank, savings and loan institution, trust company, insurance company, registered investment company, registered investment advisory firm, or who is a senior officer of any other institutional type account, domestic or foreign, or (2) to any person in the securities department of, or to any employee or other person who may influence or whose activities directly or indirectly involve or are related to the function of buying or selling securities for any foreign or domestic bank, savings and loan institution, trust company, insurance company, registered investment company, registered investment advisory firm, or other institutional type account, domestic or foreign, or (3) to a member of the immediate family of any such person; provided that a member or associated person of a member may sell the security to a person subject to this Subsection if: (i) the member or associated person of a member can demonstrate that the sale was in accordance with the person's established investment practice with the selling member and that the amount of the hot issue security sold to any one such person is insubstantial; or (ii) the issuer of the security is the employer, an affiliate of the employer or a proposed affiliate of the employer of the person or of a person who is a member of the immediate family of the person regardless of whether such person has an investment history with the member and without limitation as to the amount sold to any one such person.

EXPLANATION

Proposed Subsection (e) of new Section [E] carries forward the existing restrictions of paragraph 4 of the Free-Riding and Withholding Interpretation and also combines into a single provision language appearing in the proviso clause following paragraph 5. The listing of financial institutions has been enlarged to include "trust company." The language has also been changed to clarify that the restriction applies to sales to officers and employees of foreign banks and other foreign institutions. The new language also clarifies that the restrictions of Subsection (e) apply to sales to the institution's officers and employees and do not apply to sales to the institution for which they work when purchasing for its own account.

A major change in new Subsection (e) from the original proposal published for comment relates to the restricted status of officers and employees of financial institutions that are engaged in a public offering of their own securities. This change is in response to a comment received that officers and employees of financial institutions have a valid business reason for desiring to purchase the securities issued by their employers or issued by affiliates of their employers. The existing restrictions prevent the senior officers of the specified institutions, and employees involved in buying and selling securities for such employer institutions, from pur-

chasing the publicly offered securities of their employer, or its affiliates, if they do not have an investment history with the member making the sales or the amount desired to be purchased is considered not insubstantial.

Accordingly, proposed Subsection (e) now expands the language of the proviso clause at the end of the subsection to allow purchases by any person subject to the provisions of the subsection if the issuer of the security is the employer, or an affiliate of the employer, or if they are members of the immediate families of persons who are employees or senior officers of the issuer or an affiliate of the issuer. The effect of this change is to exempt persons covered by Subsection (e)(ii) from the requirements that they have an investment history and that the amount sold to any such person is insubstantial. It is intended, however, that such persons will continue to be considered restricted persons under Subsection (g) of proposed Section [E], discussed below, which imposes an aggregate limitation on the amount of securities a member may sell to all restricted persons.

Under the expanded provision language, persons who now are included as members of the immediate families of senior officers and employees of financial institutions would be granted the same exemption both with respect to purchases of their own employers' securities and with respect to purchases of securities issued by financial institutions.

PROPOSED NEW TEXT

Sales to beneficial interest accounts

(f) No member or associated person of a member shall sell or cause the sale of a hot issue security to any account in which any person specified under Subsections (b), (c), (d), or (e) hereof has a beneficial interest; provided that a member or associated person of a member may sell a hot issue security to any such account (other than an account in which any person specified under subsections (b) or (c)(1) has a beneficial interest, or an account in which a beneficial interest is held by a member of the immediate family of any person specified under Subsection (c)(1) who is supported, directly or indirectly, by such person) if the member or associated person of a member can demonstrate that the sale was in accordance with the account's established investment practice with the selling member and that the amount of the hot issue security sold to any one such account is insubstantial.

EXPLANATION

Subsection (f) carries forward existing paragraph 5 of the Free-Riding and Withholding Interpretation with certain language changes to clarify that the exception that permits sales of "hot issues" to beneficial interest accounts, if the investment history and insubstantiality tests are met, does not apply to any beneficial interest account in which the beneficial interest is held by a member, an officer, director, or employee of a member or immediate family members, if supported by such officers, directors, or employees.

PROPOSED NEW TEXT

Overall limitation on sales

(g) Notwithstanding compliance with the foregoing requirements, a member or associated person of a member may sell a hot issue security to persons specified under Subsections (c)(2)(i), (d), (e), or (f) only if the aggregate of the securities sold to all such persons by the member is insubstantial in amount and not disproportionate compared to the member's sales to members of the public.

EXPLANATION

Proposed Subsection (g) is based on the part of the proviso following paragraph 5 of the Free-Riding and Withholding Interpretation that places an overall limitation on aggregate sales to restricted persons. The requirement has been placed in a separate subsection to clarify that it is separate and distinct from the requirement that a restricted person can receive a "hot issue" security only if the person has an investment history and the amount sold to the person is insubstantial. The new structure is designed to clarify the existence of four separate tests, i.e., (1) investment history, (2) sales insubstantial as to each recipient, (3) total sales not disproportionate, and (4) total sales insubstantial. In addition, new Subsection (g) attempts to clarify that the disproportionate and substantiality tests are to be measured against the selling member's sales, rather than the amount of the offering.

PROPOSED NEW TEXT

Sales to non-participating members

(h) No member or associated person of a

member shall sell or cause the sale of a hot issue security to any member that is not participating in the distribution unless the member or associated person of a member receives, prior to the sale, written assurance from the non-participating member that none of the ultimate purchasers will include the non-participating member or any person specified under Subsections (b), (c), (d), (e), or (f) hereof and that the securities acquired by the non-participating member will be used only to fill orders for bona fide public customers at the public offering price as an accommodation to them and without any compensation to the non-participating member.

EXPLANATION

Proposed Subsection (h) incorporates the part of paragraph 6 of the Free-Riding and Withholding Interpretation restricting sales of "hot issues" to broker-dealers that are members of the NASD. The part dealing with sales to non-member broker-dealers has been separated and moved to new Subsection (m). The new provision applies to any "non-participating member" in the distribution since this was the original intended scope of paragraph 6 of the Interpretation.

PROPOSED NEW TEXT

Sales to foreign and domestic banks, foreign brokers and dealers, and other conduits for undisclosed principals

(i)(1) No member or associated person of a member shall sell or cause the sale of a hot issue security to (i) any foreign or domestic bank or trust company, (ii) any foreign broker or dealer which is not a registered broker or dealer, or (iii) any other conduit for undisclosed principals, domestic or foreign, unless:

(A) the member, prior to any sale, affirmatively inquires of the bank, trust company, broker, dealer, or other conduit whether any of the ultimate purchasers in the particular offering will be persons specified under Subsections (b) through (f) hereof, and the member receives satisfactory assurance from the bank, trust company, broker, dealer, or other conduit that none of the ultimate purchasers will be persons specified under Subsections (b) through (f) hereof and that the securities will not be sold in a manner inconsistent with Subsection (h) hereof; provided, however, that a member will be presumed to have complied with this paragraph (i)(1)(A) if the member, acting in good faith, has accepted from the bank, trust company, broker or dealer, or other conduit an executed agreement providing blanket assurance that no sales of any hot issue security will be made in contravention of Section [E]; provided further, that said presumption shall not be applied if the member knows of facts which are inconsistent with the representations or assurances received;

(B) the member makes a notation on the order ticket or some other supporting document of the name of the person at the bank, trust company, broker, dealer, or other conduit to whom the inquiry was made and the substance of what was said by that person, and what was done as a result thereof;

(C) a registered principal of the member initials the order ticket or other document; and

(D) the member's supervisory procedures provide for a review of all transactions entered into with the bank, trust company, broker, dealer, or other conduit to assure that there has been compliance with this Subsection (i).

(2) If the inquiry discloses that any of the ultimate purchasers will be persons specified under Subsections (b) through (f) hereof, or that the securities will be sold in a manner inconsistent with Subsection (h) hereof, the member shall be prohibited from selling any part of the securities to the bank, trust company, broker, dealer, or other conduit.

(3) In the case of a foreign broker or dealer or foreign bank which participates in the distribution as an underwriter, the obligations of members and associated persons of members to make an affirmative inquiry under Subsection (1)(A) above shall be deemed satisfied if the agreement among underwriters contains a provision which obligates such foreign broker or dealer or foreign bank not to sell any of the securities to any person specified under Subsections (b) through (f) hereof, or in a manner inconsistent with Subsection (h) hereof.

EXPLANATION

The provisions of Subsection (i) are designed to eliminate duplicative language by combining the existing language of paragraph 7 of the Free-Riding and Withholding Interpretation, dealing with domestic banks and other conduits for undisclosed principals, and paragraph 8 thereof, dealing with foreign banks and foreign broker-dealers. The language is broadened to expressly cover foreign trust companies and other foreign

conduits. The reference to foreign broker-dealers that are not registered with the SEC is intended to clarify that the restrictions are not applicable to foreign broker-dealers that are registered with the SEC and that are members and covered by Subsection (h) if they are members, or by Subsection (m) if they are non-members. New Subsection (h)(2) simply makes explicit that if any of the ultimate purchasers are restricted persons, a member is absolutely prohibited from making a sale of a "hot issue" security to the conduit.

In response to comments received, the language of Subsection (i) has been revised to clarify that if a member has obtained a blanket agreement under paragraph (l)(A) of the subsection, the member is not required to obtain a new agreement for each offering. Under paragraph 8 of the Interpretation, the obligations to obtain assurances have always been deemed satisfied by a blanket agreement from foreign banks, and the language of the new subsection, as revised, is intended to make this equally applicable to domestic banks.

PROPOSED NEW TEXT

Sales to certain investment companies

(j) No member or associated person of a member shall sell or cause the sale of a hot issue security to any domestic or foreign investment company (except an investment company registered under the Investment Company Act of 1940), including but not limited to a hedge fund, investment partnership, or corporation, investment club, or any similar type account, unless the member or associated person complies with either of the following alternatives:

(1) prior to any sale, the member has received from the account a current list of the names and business connections of all persons having any beneficial interest in the investment company, and if such information discloses that any person specified under Subsections (b), (c), (d), or (e) hereof has a beneficial interest in the investment company, any sale of securities to the investment company must be consistent with the provisions of this Section (E); or

(2) prior to the execution of the transaction, the member has obtained a copy of a current opinion from counsel admitted to practice law before the highest court of any state stating that counsel reasonably believes that no person with a beneficial interest in the account is a restricted person under this Section (E) and stating that, in providing such opinion, counsel:

(A) has reviewed and is familiar with this Section (E);

(B) has reviewed a current list of all persons with a beneficial interest in the account supplied by the account manager;

(C) has reviewed information supplied by the account manager with respect to each person with a beneficial interest in the account, including the identity, the nature of employment, and any other business connections of such persons; and

(D) has requested and reviewed other documents and other pertinent information and made inquiries of the account manager and received responses thereto, if counsel determines that such further review and inquiry are necessary and relevant to determine the correct status of such persons under this Section (E).

(3) The member shall maintain a copy of the names and business connections of all persons having any beneficial interest in the account or a copy of the current opinion of counsel in its files for at least three years following the member's last sale of a new issue to the account, depending upon which of the above requirements the member elects to follow. For purposes of this section, a list or opinion shall be deemed to be current if it is based upon the status of the account as of a date not more than 18 months prior to the date of the transaction.

EXPLANATION

The provisions of Subsection (j) are based on current language that appears after the text of the Free-Riding and Withholding Interpretation under the heading "Scope and Intent of Interpretation" and the subheading "Investment Partnerships and Corporations." It has been reworded to clarify the provision and to broaden its scope to cover legal entities other than corporations and partnerships to reflect the original intent of the provision.

The last sentence of the existing language in the Free-Riding and Withholding Interpretation, which defines "beneficial interest," also has been moved to a new section of definitions.

PROPOSED NEW TEXT

Sales directed by issuers and others

(k)(1) Every member and associated person of a member who at the direction of an issuer, underwriter, or any other person sells or causes the sale

of a hot issue security to any person specified under Subsections (c) through (j) and (m) hereof shall comply with all the requirements of this section to the same extent as if the sale were made by the member or associated person of a member without any such direction.

(2) Notwithstanding paragraph (1) above, sales of issuer directed securities may be made to restricted or prohibited persons without the required investment history after receiving permission from the Board of Governors. Permission will be given only if there is a demonstration of valid business reasons for such sales (such as sales to distributors and suppliers or key employees who are in each case incidentally restricted or prohibited persons) and the member seeking permission is prepared to demonstrate that the aggregate amount of securities so sold is insubstantial and not disproportionate as compared to sales to members of the public, and that the amount sold to any one of such persons is insubstantial in amount.

EXPLANATION

The provisions of Subsection (k) are based on current language that appears after the text of the Free-Riding and Withholding Interpretation under the heading "Scope and Intent of Interpretation" and the subheading "Issuer Directed Securities." It has been reworded to clarify that members selling issuer-directed shares must comply in all respects with the applicable requirements to the same extent as if the sales had not been directed. It also has been broadened to cover sales directed by underwriters and others.

Subsection (k), as originally circulated for comment, unintentionally omitted language from the Free-Riding and Withholding Interpretation that gave the Board of Governors authority to grant exemptions to permit issuer-directed sales under limited circumstances. Accordingly, the authority to grant exemptions now appears in Subsection (k) as it was originally intended. The provision has been clarified to cover both prohibited and restricted persons.

PROPOSED NEW TEXT

Responsibility for non-underwritten securities

(l)(1) Any sale of any part of a hot issue security made on an underwritten basis by an issuer or selling shareholder to any person specified under Subsections (c) through (j) and (m) hereof shall be deemed a sale made by any member also participating in sales or the distribution, and such member shall comply with all the requirements of this section to the same extent as if the sales were made directly by the member. If more than one member is participating in the distribution in a syndicate or similar undertaking, the responsibility for compliance with this subsection rests with the managing underwriter, or the equivalent.

(2) Notwithstanding paragraph (1) above, non-underwritten sales of securities may be made to persons who are restricted or prohibited under this Section if permission has been granted by the Board of Governors based upon the standards set forth under Subsection (k)(2) hereof.

EXPLANATION

The provisions of Subsection (i) are based on the last two sentences of the first paragraph under the existing Free-Riding and Withholding Interpretation under the subheading "Issuer Directed Securities." It also incorporates the Board's authority to grant exemptions under certain circumstances as contained in the Interpretation and to clarify that the exemptive authority covers both issuer-directed and non-underwritten sales.

PROPOSED NEW TEXT

Sales to non-member brokers and dealers

(m) No member or associated person of a member shall sell or cause to be sold any hot issue security at or above the public offering price to any registered broker or dealer which is not a member of the Corporation.

EXPLANATION

The provision of Subsection (m) is based on the first part of paragraph 6 of the existing interpretation.

PROPOSED NEW TEXT

Receipt of hot issue securities by associated persons of members

(n) No associated person of a member shall purchase or acquire any hot issue security during the distribution period, whether acquired from a member, broker, dealer, or from an issuer selling its own securities without the assistance of an underwriter, or otherwise.

EXPLANATION

The provision of Subsection (n) is based on the first and third sentences of language in the

existing Free-Riding and Withholding Interpretation that appears under the heading "Scope and Intent of Interpretation" and the subheading "Violations by Recipients." The changes are intended to make the requirements more specific. The second sentence of the existing language that imposes liability on any member or person associated with a member who causes a "hot issue" to be sold to a restricted or prohibited person is codified in the phrase "cause to be sold" that appears throughout new Section (E).

PROPOSED NEW TEXT

Disclosure no defense

(o) This section shall be applicable to all sales, purchases, and receipts of any hot issue security by members and associated persons of members notwithstanding any disclosure made in any offering circular or prospectus, whether or not filed with the Corporation.

EXPLANATION

The provision of Subsection (o) is based on language in the existing Free-Riding and Withholding Interpretation that appears under the heading "Scope and Intent of Interpretation" and the subheading "Disclosure."

PROPOSED NEW TEXT

Definitions

(p) The following definitions of terms used in Section (E) are provided for the assistance of members. Other words which are defined in the By-Laws and Rules of Fair Practice shall, unless the context otherwise requires, have the meaning as defined therein.

(1) **Public Offering**: The term "public offering" shall mean all distributions of securities whether underwritten or not; whether registered, unregistered, or exempt from registration under the Securities Act of 1933, and whether they are primary or secondary distributions, including intrastate distributions and Regulation A offerings. It shall not mean offerings of exempted securities as defined in Section 3(a)(12) of the Securities Exchange Act of 1934.

(2) **Immediate Family**: The term "immediate family" shall include parents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children. In addition, the term shall also include any other person who is supported, directly or indirectly, to a material extent by a member, person associated with a member, or other person specified in Subsections (c), (d), or (e) above.

(3) **Established Investment Practice**: "Established investment practice" shall mean the history of investment of a restricted person in an account or accounts maintained with the member making the allocation. However, in cases where an account was previously maintained with another member, but serviced by the same registered representative as the one currently servicing the account for the member making the allocation, such earlier investment activity may be included in the restricted person's investment history. Usually the previous one-year period of securities activity is the basis for determining the adequacy of a restricted person's investment history. Where warranted, however, a longer or shorter period may be reviewed. It is the responsibility of the registered representative effecting the allocation, as well as the member, to demonstrate that the restricted person's investment history justified the allocation of hot issues. Copies of customer account statements or other records maintained by the registered representative or the member may be utilized to demonstrate prior investment activity. In analyzing a restricted person's investment history, the following factors should be considered:

(A) The frequency of transactions in the account or accounts during that period of time. Relevant in this respect are the nature and size of investments.

(B) A comparison of the dollar amount of previous transactions with the dollar amount of the hot issue purchase. If a restricted person purchases $1,000 of a hot issue and his account revealed a series of purchases and sales in $100 amounts, the $1,000 purchase would not appear to be consistent with the restricted person's normal investment practice.

(C) The practice of purchasing mainly hot issues would not constitute an established investment practice. The purchase of new issues that are not hot issues as well as secondary market transactions may contribute to the establishment of an established investment practice.

(4) **Disproportionate**: In respect to the determination of what constitutes a disproportionate allocation, a guideline of 10% of the

member's participation in the issue, however acquired, may be used. The 10% factor is merely a guideline and is one of a number of factors. These other factors include, among other things: (i) the size of the participation; (ii) the offering price of the issue; (iii) the amount of securities sold to restricted accounts; and (iv) the price of the securities in the aftermarket. The 10% guideline is applied as to the aggregate of allocations to restricted accounts. Notwithstanding the above, a normal unit of trading (100 shares or 10 bonds) will normally not be considered a disproportionate allocation regardless of the amount of the member's participation.

(5) **Insubstantiality**: The requirements that allocations be insubstantial are separate and distinct from the requirements relating to disproportionate allocation and established investment practice. In addition, this term applies both to the aggregate of the securities sold to restricted accounts and to each individual allocation. Although the total amount sold to restricted persons may satisfy the disproportionate requirement, the amount may still be considered substantial. The determination of whether an allocation to a restricted account or accounts is substantial is based upon, among other things, the number of shares allocated and the dollar amount of the purchase. Notwithstanding the above, the allocation of a normal unit of trading (100 shares or 10 bonds) to restricted persons will not be considered a substantial allocation, regardless of the amount of the member's participation or the size of the offering.

(6) **Beneficial Interest**: The term "beneficial interest" means not only ownership interest, but also every type of direct financial interest of any persons specified in this Section, including, without limitation, management fees based on the performance of the account.

EXPLANATION

These definitions are based on the language of the definitions appearing in the existing Free-Riding and Withholding Interpretation except that the term "established investment practice" in Subsection (p)(3) has been substituted for the existing "normal investment practice" because it appears more consistent with the intent of the requirement. The term "beneficial interest" has also been taken from its current location in the Free-Riding and Withholding Interpretation under the subheading "Investment Partnerships and Corporations."

PROPOSED NEW TEXT

Sales by issuers in conversion offerings

(q)(a) For purposes of this subsection, the following terms shall have the meanings stated:

(1) "Conversion offering" shall mean any offering of securities made as part of a plan by which a savings and loan association or other organization converts from a mutual to a stock form of ownership.

(2) "Eligible purchaser" shall mean a person who is eligible to purchase securities pursuant to the rules of the Federal Home Loan Bank Board or other governmental agency or instrumentality having authority to regulate conversion offerings.

(b) Conditions for exemption. This Section shall not apply to a sale of securities by the issuer on a non-underwritten basis to any person who would otherwise be prohibited or restricted from purchasing a hot issue security if all of the conditions of this Subsection (b) are satisfied:

(1) Sales to members, associated persons of members, and certain related persons. If the purchaser is a member, person associated with a member, member of the immediate family of any such person to whose support such person contributes, directly or indirectly, or an account in which a member or person associated with a member has a beneficial interest:

(A) the purchaser shall be an eligible purchaser:

(B) the securities purchased shall be restricted from sale or transfer for a period of 150 days following the conclusion of the offering; and

(C) the fact of purchase shall be reported in writing to the member where the person is associated within one day of payment.

(2) Sales to other restricted persons. If the purchaser is not a person specified in Subsection (b)(1) above, the purchaser shall be an eligible purchaser.

EXPLANATION

The provisions of Subsection (q) parallel those of the amendment to the Free-Riding and Withholding Interpretation that became effective September 25, 1986. See NASD *Notice to Members* 86-73 (October 16, 1986) for the background and an explanation of the amendment.

PROPOSED AMENDED TEXT

NASD Manual, ¶ 2152, p. 2051
Item 6 on ballot
Recommendations to Customers
Sec. 2.

In recommending to a customer the purchase, sale, or exchange of any security, a member or person associated with a member shall have reasonable grounds for believing that the recommendation is suitable for [such] the customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

EXPLANATION

Section 2 contains a minor language change and the addition of a specific reference to "associated persons."

CURRENT TEXT

NASD Manual, ¶ 2153, p. 2054
No Vote Required
Charges for Services Performed
Sec. 3.

Charges, if any, for services performed, including miscellaneous services such as collection of monies due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safekeeping, or custody of securities, and other services, shall be reasonable and not unfairly discriminatory between customers.

EXPLANATION

No change is being proposed to this section.

CURRENT TEXT

NASD Manual, ¶ 2154, pp. 2054-2058
[Fair Prices and Commissions]
[Sec. 4.]

[In "over-the-counter" transactions, whether in "listed" or "unlisted" securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefore.]

[. . . Interpretation of the Board of Governors]
[NASD Mark-up policy]

[The question of fair mark-ups or spreads is one which has been raised from the earliest days of the Association. No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances.]

[However, it was recognized that the amount of mark-up was at least a starting point from which an answer to the question could be sought and that progress might be made if the general practice of the business on mark-ups could be established. To find this out, the Association, in 1943, made a membership-wide questionnaire examination of mark-ups in retail or customer transactions. Questionnaires were filed by 82 percent of the membership covering transactions which varied widely with respect to price, dollar amount, type of security, and degree of market activity. They included both listed and unlisted securities, with the latter, however, in the substantial majority. This information revealed that 47 percent of the transactions computed were made at mark-ups of 3 percent or less and 71 percent of the transactions were effected at mark-ups of 5 percent or less.]

[In a letter to the membership on October 25, 1943, the Board of Governors made known the results of its survey and expressed its philosophy on what constitutes a fair spread or profit. The Board stated that it would be impractical and unwise, if not impossible, to define specifically what constitutes a fair spread on each and every transaction because the fairness of a mark-up can be determined only after considering all of the relevant factors. Under certain conditions a mark-up in excess of 5 percent may be justified, but on the other hand, 5 percent or even a lower rate is by no means always justified. The Board instructed District Business Conduct Committees to enforce Section 1 of Article III of the Rules of Fair Practice

with respect to mark-ups, keeping in mind that 71 percent of the transactions computed from the questionnaires were effected at a mark-up of 5 percent or less. The philosophy which the Board expressed has since been referred to as the "5% Policy."]

[The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in the letter to members of October 25, 1943. The Board is aware, however, of the need for continually re-examining the mark-up policy and its application in the light of current economic conditions and with the benefit of experience gained from enforcement of the existing Policy. The Board has carefully considered the Policy adopted in 1943 and subsequent interpretations with respect thereto. It can find no justification for a change in the basic Policy. However, it recognizes that any clarification will materially aid members in complying with the Policy and the various committees in fulfilling their responsibility to exercise judgment in determining the fairness of mark-ups.]

[Based upon its review of the entire matter, the Board has adopted the Interpretation set forth below.]

[The Interpretation]

[Article III, Section 1 of the Rules of Fair Practice states that:]

["A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."]

[Article III, Section 4 of the Rules of Fair Practice states that:]

[A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.]

[Article III, Section 4 of the Rules of Fair Practice states that:]

[In 'over-the-counter' transactions, whether in 'listed' or 'unlisted' securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefore.]

[In accordance with Article VII, Section 3(a) of the By-Laws, the following interpretation under Article III, Sections 1 and 4 of the Rules of Fair Practice has been adopted by the Board:]

[It shall be deemed conduct inconsistent with just and equitable principles of trade for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.]

[A. General Considerations]

[Since the adoption of the "5% Policy" the Board has determined that:]

[1. The "5% Policy" is a guide — not a rule.]

[2. A member may not justify mark-ups on the basis of expenses which are excessive.]

[3. The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of other bona fide evidence of the prevailing market, a member's own contemporaneous cost is the best indication of the prevailing market price of a security.]

[4. A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."]

[5. Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one.]

[B. Relevant Factors]

[Some of the factors which the Board believes that members and the Association's committees should take into consideration in determining the fairness of a mark-up are as follows:]

[1. The type of security involved —]

[Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to

sales of common stock.]

[2. The availability of the security in the market —]

[In the case of an inactive security the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.]

[3. The price of the security —]

[While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower-priced securities may require more handling and expense and may warrant a wider spread.]

[4. The amount of money involved in a transaction —]

[A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.]

[5. Disclosure —]

[Any disclosure to the customer, before the transaction is effected, of information which would indicate (a) the amount of commission charged in an agency transaction or (b) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in the light of all other relevant circumstances.]

[6. The pattern of mark-ups —]

[While each transaction must meet the test of fairness, the Board believes that particular attention should be given to the pattern of a member's mark-ups.]

[7. The nature of the member's business —]

[The Board is aware of the differences in the services and facilities which are needed by, and provided for, customers of members. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of a member's mark-ups.]

[C. Transactions to Which the Policy is Applicable]

[The Policy applies to all securities handled in the over-the-counter market, whether oil royalties or any other security, in the following types of transactions:]

[1. A transaction in which a member buys a security to fill an order for the same security previously received from a customer —]

[This transaction would include the so-called "riskless" or "simultaneous" transaction.]

[2. A transaction in which a member sells a security to a customer from inventory —]

[In such case the amount of the mark-up should be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the member from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.]

[3. A transaction in which a member purchases a security from a customer —]

[The price paid to the customer or the mark-down applied by the member must be reasonably related to the prevailing market price of the security.]

[4. A transaction in which the member acts as agent —]

[In such a case, the commission charged the customer must be fair in light of all relevant circumstances.]

[5. Transactions wherein a customer sells securities to, or through, a broker/dealer, the proceeds from which are utilized to pay for other securities purchased from, or through, the broker/dealer at or about the same time —]

[In such instances, the mark-up shall be computed in the same way as if the customer had purchased for cash and in computing the mark-up there shall be included any profit or commission realized by the dealer on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.]

[D. Transactions to Which the Policy is Not Applicable]

[To the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.]

[This Interpretation does no more than express what is clearly implied in Sections 1 and 4 of Article III of the Rules of Fair Practice. The Interpretation is made, however, in order to emphasize the obligation which is assumed by every member of this Association in every transaction with a customer.]

PROPOSED NEW SECTION 4 TO THE NASD RULES OF FAIR PRACTICE

Item 7 on ballot

Fair Prices and Commissions

Sec. 4.