

# NASD NOTICE TO MEMBERS 97-80

## SEC Approves Amendments To Syndicate Short Covering Requirements And Other Related Amendments; Effective Immediately

### Suggested Routing

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### Executive Summary

On October 3, 1997, the Securities and Exchange Commission (SEC) approved, on an accelerated basis, amendments to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules 2710, 4624, and 6540 that replace the requirement that members provide the NASD with information on the amount of the syndicate short position with a requirement that members maintain this information in their files.<sup>1</sup> In addition, the amendments clarify that members are required to request an Underwriting Activity Report (UAR) with respect to a security that is considered "actively-traded" under Rule 101 of SEC Regulation M and excludes all exchange-listed securities from the obligation to request a UAR. Finally, the amendments clarify that members are required to submit pricing information with respect to any security that is considered "actively-traded" under Rule 101, regardless of whether listed on a national securities exchange. The amendments are immediately effective. The text of the amendments is attached to this *Notice*.

Questions regarding this *Notice* may be directed to Suzanne E. Rothwell, Chief Counsel, Corporate Financing, NASD Regulation, Inc., and Richard J. Fortwengler, Associate Director, Corporate Financing, NASD Regulation<sup>SM</sup>, at (202) 974-2700.

### Background And Description Of Amendments

On April 1, 1997, NASD rules designed to facilitate compliance with the SEC's Regulation M became effective.<sup>2</sup> Rule 104 of Regulation M requires members acting as managing underwriters to notify the appropriate regulator of the market for the security in distribution of a member's intention to engage in syndicate short covering transactions.

To allow NASD members to comply with their notification obligations under Rule 104, the NASD adopted Rule 4624 of The Nasdaq Stock Market<sup>SM</sup> and Rule 6540 of the OTC Bulletin Board<sup>®</sup> Service to require that members provide the requisite notification to the NASD, but also to require that members include the amount of the syndicate short position on the Regulation M Trading Notification. This latter information is not required to be provided under SEC Regulation M.

Members of the industry have expressed concern regarding the ability of member firms to provide accurate data on the amount of a syndicate short position at the time the Regulation M Trading Notification is required. In order to address the concerns of the industry, Rule 4624 of The Nasdaq Stock Market and Rule 6540 of the OTC Bulletin Board Service have been amended to delete the current requirement to provide immediate information on the amount of syndicate short positions. In its place, Rule 2710 has been amended to establish a new requirement in subparagraph (b)(13) that, no later than 30 days after the effective date of the offering, the managing underwriter shall retain information, as required by the Corporate Financing Department of NASD Regulation, on the amount of the syndicate short position and that such information be retained in the same manner as the underwriter's syndicate covering transaction records under SEC Rule 17a-2.

Rule 17a-2 requires that a managing underwriter separately maintain information on stabilizing transactions and syndicate covering transactions. It is anticipated that the managing underwriter will maintain with its records of syndicate covering transactions, as required by Rule 17a-2, a record of the amount of the syndicate short position. We intend

to require that the information to be retained by the managing underwriter consist of whether the syndicate short position was no greater than the over-allotment option, or whether a naked short position was less than 1 percent, between 1 percent and 5 percent, between 5 percent and 10 percent, or over 10 percent of the offering size. The rule change to Rule 2710 includes a sunset provision to eliminate the requirement to retain information on the amount of short positions at the conclusion of the study of syndicate short covering practices, but no later than January 1, 2000.

In addition, Subparagraph (b)(11) of Rule 2710 has been amended to conform its rule language to that of Subparagraph (b)(12) and to the NASD's original intent regarding the scope of that provision. This change clarifies that the managing underwriter is required to request a UAR with respect to a distribution of a security that is considered an "actively-traded" security under SEC Rule 101.<sup>3</sup> Currently, the language of Subparagraph (b)(11) is misleading in that it only imposes this requirement with respect to securities that are "subject to SEC Rule 101."

Moreover, subparagraph (b)(11) of Rule 2710 has been amended to exclude exchange-listed securities from the requirement that managing underwriters obtain a UAR. The managing underwriter of an offering of exchange-listed securities will, nonetheless, continue to be responsible under subparagraph (b)(12) to advise the Market Regulation Department of information regarding the pricing and termination of the offering. Conforming amendments are made to subparagraph (b)(12) in light of this proposed rule change to subparagraph (b)(11). Finally, subparagraph (b)(12) is also revised to clarify that the managing underwriter of any offering of securities consid-

ered "actively-traded" under SEC Rule 101, must also advise the Market Regulation Department of information on pricing and termination.

The amendments are effective as of the date of SEC approval.

## Text Of Amendments

(Note: New text is underlined; deletions are bracketed.)

### 2710. Corporate Financing Rule— Underwriting Terms And Arrangements

(a) No change.

#### (b) Filing Requirements

(1) through (10) No change.

#### (11) Request for Underwriting Activity Report

Notwithstanding the availability of an exemption from filing under subparagraph (b)(7) of this Rule, a member acting as a manager (or in a similar capacity) of a distribution of a publicly traded subject security or reference security that is subject to SEC Rule 101 or an "actively-traded" security under SEC Rule 101 (except for a security listed on a national securities exchange) shall submit a request to the Corporate Financing Department for an Underwriting Activity Report with respect to the subject and/or reference security in order to facilitate compliance with SEC Rules 101, 103, or 104, and other distribution-related Rules of the Association. The request shall be submitted at the time a registration statement or similar offering document is filed with the Department, the SEC, or other regulatory agency or, if not filed with any regulatory agency, at least two (2) business days prior to the commencement of the restricted period under SEC Rule 101. The request shall include a

copy of the registration statement or similar offering document (if not previously submitted pursuant to subparagraph (b)(5) of this Rule). If no member is acting as managing underwriter of such distribution, each member that is a distribution participant or an affiliated purchaser shall submit a request for an Underwriting Activity Report, unless another member has assumed responsibility for compliance with this subparagraph. For purposes of subparagraphs (b)(11) and (12), SEC Rules 100, 101, 103, and 104 are rules of the Commission adopted under Regulation M and the following terms shall have the meanings as defined in SEC Rule 100: "distribution," "distribution participant," "reference security," "restricted period," and "subject security."

#### (12) Submission of Pricing Information

A member acting as a manager (or in a similar capacity) of a distribution [subject to subparagraph (b)(11)] of securities that are listed on a national securities exchange and considered a subject security or reference security that is subject to SEC Rule 101 or an "actively-traded" security under SEC Rule 101 or a distribution of any other securities that are considered "actively-traded" under SEC Rule 101 shall provide written notice to the Market Regulation Department of NASD Regulation, Inc., no later than the close of business the day the offering terminates, that includes the date and time of the pricing of the offering, the offering price, and the time the offering terminated, which notice may be submitted on the Underwriting Activity Report.

#### (13) Submission of Information on Syndicate Covering Transactions

A member acting as a manager (or in a similar capacity) of a distribution of a publicly traded subject security or

reference security that is subject to SEC Rule 101 or an “actively-traded” security under SEC Rule 101 shall, no later than thirty (30) days after the effective date of the offering, maintain information as required by the Corporate Financing Department of NASD Regulation, Inc. on the amount of the syndicate short position in a manner consistent with SEC Rule 17a-2.\*

(c) and (d) No change.

#### **4000. The Nasdaq Stock Market**

##### **4624. Penalty Bids and Syndicate Covering Transactions**

(a) A market maker acting as a manager (or in a similar capacity) of a distribution of a Nasdaq security that is a subject or reference security under SEC Rule 101 shall provide written notice to the Corporate Financing Department of NASD Regulation, Inc. of its intention to impose a penalty bid on syndicate members or to conduct syndicate covering transactions pursuant to SEC Rule 104 prior to imposing the penalty bid or engaging in the first syndicate covering transaction. A market maker that intends to impose a penalty bid on syndicate members may request that its quotation be identified as a penalty bid on Nasdaq pursuant to paragraph (c) below.

(b) The notice required by paragraph (a) shall include:

(1) the identity of the security and its Nasdaq symbol; and

(2) the date the member is intending to impose the penalty bid and/or conduct syndicate covering transaction[]; and

(3) the amount of the syndicate short position, in the case of syndicate covering transactions].

(c) Notwithstanding paragraph (a), a market maker may request that its quotation be identified as a penalty bid on Nasdaq [display] by providing notice to Nasdaq Market Operations, which notice shall include the date and time that the penalty bid identifier should be entered on Nasdaq and, if not in writing, shall be confirmed in writing no later than the close of business the day the penalty bid identifier is entered on Nasdaq.

(d) The written notice required by [paragraphs (a) and (c) of] this Rule may be submitted on the Underwriting Activity Report [by including the information required by subparagraphs (b)(1) and (b)(2) or paragraph (c)].

#### **6500. OTC Bulletin Board Service**

##### **6540. Requirements Applicable to Market Makers**

(a) and (b) - No change.

(1) Permissible Quotation Entries

(A) - (C) - No change.

(D) Any member that intends to be a distribution participant in a distribution of securities subject to SEC Rule 101, or is an affiliated purchaser in such distribution, and is entering quotations in an OTCBB-eligible security that is the subject security or reference security of such distribution shall, unless another member has assumed responsibility for compliance with this paragraph:

(i) No change

(ii) No change

(iii) provide written notice to the Corporate Financing Department of NASD Regulation, Inc. of its intention to impose a penalty bid or to conduct syndicate covering transactions pursuant to SEC Rule 104 prior to imposing the penalty bid or engaging in the first syndicate covering transaction. Such notice shall include information as to the date the penalty bid or first syndicate covering transaction will occur [and the amount of the syndicate short position]; and

(iv) No change

(E) The written notice required by subparagraphs (b)(1)(D)(I), (iii) and (iv) of this rule may be submitted on the Underwriting Activity Report provided by the Corporate Financing Department of NASD Regulation, Inc. [by including the information required by those subparagraphs].

(F) No change.

(2) through (4) No change.

##### **Footnote To Rule Language**

\* This rule will expire no later than January 1, 2000.

##### **Endnotes**

<sup>1</sup> Securities Exchange Act Release No. 39197 (October 3, 1997).

<sup>2</sup> Securities Act Release No. 38360 (March 4, 1997), and amended Securities Act Release No. 38399 (March 14, 1997).

<sup>3</sup> An “actively-traded” security is a subject or reference security with a value of average daily trading volume of at least \$1 million, which is issued by an issuer whose common equity securities have a public float of at least \$150 million.

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