

NASD NOTICE TO MEMBERS 97-10

SEC To Approve Amendments To NASD Rules To Facilitate Compliance With SEC Regulation M

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☒ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ☒ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☐ Registration
- ☐ Research
- ☒ Syndicate
- ☐ Systems
- ☒ Trading
- ☒ Training

Executive Summary

The Securities and Exchange Commission's (SEC) Regulation M, which regulates the market activities of persons with an interest in the outcome of an offering of securities, became effective on March 4, 1997. The new Rule replaced SEC Rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21. The NASD has filed with the SEC proposed amendments, to be effective March 4, 1997, to NASD[®] rules regarding corporate financing, The Nasdaq Stock Market, Inc. (Nasdaq[®]), and the OTC Bulletin Board[®] (OTCBB[®]) that are designed to assist members in complying with Regulation M. In general, the amendments to NASD rules establish a new requirement for members to obtain an Underwriting Activity Report from the Corporate Financing Department of NASD Regulation, Inc. (NASD RegulationSM) with respect to a proposed distribution subject to SEC Rule 101; modify current Nasdaq requirements with respect to the entry of a stabilizing or penalty bid and requests for excused withdrawal of quotations or designation of quotations as those of a passive market maker; and establish new requirements for notification with respect to penalty bids and syndicate covering transactions for Nasdaq and OTCBB securities. It is anticipated the amendments will be effective March 4, 1997.

Introduction

On December 20, 1996, the SEC approved new Regulation M to replace Rules 10b-6, 10b-6A, 10b-7, 10b-8, and 10b-21 (the trading practice rules) under the Securities Exchange Act of 1934,¹ which were rescinded. New Regulation M, which consists of Rules 100 through 105, governs the activities of underwriters, issuers, selling securityholders, and others that have an interest in the outcome of an offering of securities. Regulation M became effective March 4, 1997.

This Notice provides a summary of the provisions of Regulation M and describes the amendments to the NASD rules to be approved by the SEC effective March 4, 1997 that are intended to facilitate compliance by members with the new requirements of Regulation M. The text of the amendments are attached to this Notice. Also attached are copies of notification forms to be used by members to submit required notifications by fax or by electronic communication to the NASD. **Members should only rely on the text published by the SEC in the *Federal Register* as the final version of the amendments.**

Background

Regulation M represents the culmination of more than a two-year effort by the SEC to review and modernize the trading practice rules, which had been in effect for over 40 years. In recent years, the trading practice rules have come under attack from many market participants for the limitations they place on distribution and ordinary market-making activities of underwriters and others and the increased costs that are imposed as a result. Particular concern has been directed at the effect of the trading practice rules on international offerings. Because foreign markets generally do not have comparable rules, and because the trading practice rules are deemed to apply to foreign distributions that occur only in part in the U.S., the rules have potentially serious international competitive consequences that have necessitated a series of interpretations and amendments designed to improve the effect of the rules in the context of international offerings.

Rule 101—Distribution Participant Restrictions

The SEC has divided Rule 10b-6 into two rules, Rules 101 and 102, which

cover the activities of (i) distribution participants and their affiliated purchasers and (ii) issuers and selling shareholders and their affiliated purchasers, respectively. Rule 101 of Regulation M applies trading restrictions to underwriters, prospective underwriters, syndicate members and their affiliated purchasers. The most significant change from Rule 10b-6 is that the restrictions of Rule 101 on bids for, purchases of, or attempts to induce a bid or purchase by a restricted person, do not apply to certain securities (*e.g.*, investment grade rated debt) that presently are subject to regulation by Rule 10b-6.

The “cooling-off” periods of Rule 10b-6 that were triggered by the anticipated commencement of the distribution have been replaced with a three-tier “restricted period” that is calculated from the date on which the subject security is priced. Under Regulation M, the SEC has adopted a dual standard of world-wide average daily trading volume and public float value. Actively traded securities, *i.e.*, securities with an average daily trading volume (ADTV) of at least \$1 million and a public float value of at least \$150 million, are no longer subject to any restricted period, although trading in such actively traded securities remains subject to the anti-fraud and anti-manipulation provisions of the federal securities laws.

Securities with an ADTV of at least \$100,000, with a public float value of at least \$25 million, are subject to a restricted period of one day prior to the date on which the subject security’s price is determined and all other securities that do not meet the ADTV or public float value tests are subject to a restricted period of five days. The SEC determined that the thrust of the restricted period should focus on daily trading activity since higher-priced securities that trade more frequently are more difficult to manipulate. Also, the public float

volume test is intended to capture within Rule 101 those securities that experience unusual trading volume relative to their public float.²

In calculating the ADTV, distribution participants may use either a two-calendar month period or a 60-day rolling period, to be calculated within 10 days of the filing of the offering. Moreover, the SEC is not designating acceptable information sources for determining ADTV, so long as the participant has a reasonable basis for believing that the information is reliable. As set forth below, NASD Regulation will issue an Underwriting Activity Report to the manager of the underwriting syndicate that provides the domestic ADTV and public float value for a security that is subject to SEC Rule 101 to assist members’ compliance with SEC Rule 101.

Rule 101 also includes exemptions from the imposition of the “restricted period” for: (i) exempted securities; (ii) exercises of options and other securities, including rights received in connection with a rights offering; (iii) transactions in the ordinary course of business in baskets of securities involving the offered security; (iv) transactions involving sales of Rule 144A securities of foreign and domestic issuers to qualified institutional buyers or persons deemed not to be U.S. persons; and (v) redeemable securities issued by an open-end investment company or unit investment trust. The restrictions on other debt securities are substantially narrowed.

The trading restrictions of Rule 101 are only applicable to a “covered security,” defined to include the security that is the subject of a distribution and “reference securities.” The SEC defines “reference security” to include a security into which a subject security may be converted, exchanged, or exercised, or which, under the terms of the subject securi-

ty, may in whole or in significant part determine the value of the subject security. This new focus on subject and reference securities narrows the potential universe of securities in which trading must be restricted during a distribution in comparison to the securities covered under Rule 10b-6, which included any security of the “same class or series” as the security being distributed and any “right to purchase” such security. As a result, trading in derivative securities (*e.g.*, convertible securities, options, and warrants) during the distribution of an underlying security and of “rights to purchase” the securities of a target company in a merger or exchange offer is no longer restricted by Rule 101.

Bids for and purchases of outstanding nonconvertible debt securities are not restricted by Rule 101 unless the security being purchased is identical in all of its terms to the security being distributed. Further, investment grade nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities are specifically excluded from coverage by the Rule. In the situation where Rule 101 is applicable to outstanding debt, the restricted period will generally be less than five days. In addition, an existing exclusion for research reports has been expanded to allow the dissemination of information in the ordinary course of business during the restricted period.

Rule 101 includes an important new exception for “inadvertent” violations of *de minimis* size, including bids that are not accepted, and one or more purchases that in the aggregate over the restricted period total less than 2 percent of the security’s ADTV, provided that the distribution participant had in place policies and procedures reasonably designed to achieve compliance with the Rule.

Rule 102 — Issuer And Selling Securityholder Restrictions

Rule 102 limits bids and purchases by issuers, selling securityholders, and their affiliated purchasers during the applicable restricted period in a manner similar to Rule 101. Unlike Rule 101, however, Rule 102 does not provide an exemption for actively traded **subject** securities (although an exemption is available for actively traded reference securities) or for transactions in investment grade debt and preferred stock. Although transactions under employee benefit or dividend reinvestment plans generally are exempt, this exemption does not extend to plans that are open to persons other than employees and securityholders and that involve direct distributions from the issuer or an affiliate.

Rules 101 and 102 permit a member affiliated with an issuer or selling securityholder to comply with the provisions of Rule 101, rather than Rule 102, provided that the member is not itself the issuer or selling shareholder.

Rule 103 — Passive Market Making In Nasdaq Stocks

Rule 103 of Regulation M, which replaces Rule 10b-6A, permits “passive” market-making activity in Nasdaq stocks in connection with distributions during the restricted periods to alleviate liquidity problems that may exist in the market during those periods. The new Rule permits passive market making for any Nasdaq-listed security distribution that is conducted as a fixed-price offering underwritten on a firm-commitment basis. Rule 103 generally limits a market maker’s bids and purchases to the highest current independent bid (a bid from a market maker that is not participating in the distribution).

Rule 103 allows passive market making throughout the restricted period,

in contrast to Rule 10b-6A, which prohibited passive market making upon the commencement of offers and sales. Although Rule 103 retains the core provisions of Rule 10b-6A in a number of respects, the SEC eliminated the requirement in Rule 10b-6A that limited availability of the Rule to Nasdaq stocks that meet minimum share price and public float criteria, where Nasdaq market makers that are participating in the distribution account for at least 30 percent of the total trading volume in the security. Rule 103 continues to generally limit a passive market maker’s bids and purchases to the highest current independent bid and limit the amount of net purchases a passive market maker can make on any day to 30 percent of its ADTV, although an initial ADTV limit of 200 shares is now available for less active market makers. The bid display size limitation has also been retained.

In connection with the initial ADTV limit of 200 shares, Rule 103 also provides that all passive market makers whose initial ADTV limit is between 1 and 199 shares are allowed a net purchasing capacity of 200 shares. The new Rule allows passive market makers to make bids or purchases at a price above the highest independent bid where necessary to comply with any SEC or NASD rule relating to the execution of customer orders, such as the order handling rules. The SEC also permits a passive market maker that is involved in a contemporaneous purchase and sale of a security to “net” the transactions for purposes of the ADTV calculation as long as the two transactions are reported within 30 seconds of each other.

Rule 104 — Stabilizing Transactions/Syndicate Covering Transactions/Penalty Bids/Recordkeeping

Rule 104 replaces Rule 10b-7 to regulate stabilization activities during a

distribution. The new Rule retains the requirement that only one stabilizing bid is permitted in any market at the same price at the same time. The new Rule permits a stabilizing bid to be initiated, maintained, reduced, or raised based on the current price in the principal market for the security (domestic or foreign), as long as the bid does not exceed the offering price of the security or the stabilizing bid in the principal market. The Rule provides that the appropriate price level for initiating a stabilizing bid is the security’s principal market, with certain variations for different market situations. Thus, the most significant change from Rule 10b-7 is the ability under Rule 104 to increase a stabilizing bid to the level of the highest independent bid in the principal market.

For the first time, the SEC has imposed disclosure and recordkeeping requirements in connection with syndicate short-covering transactions and the enforcement of “penalty bids.” Rule 104 requires any person effecting a syndicate covering transaction or intending to enforce a penalty bid to disclose that fact to the self-regulatory organization with direct oversight over the principal market in the U.S. for the security. Moreover, Rule 104 requires a new legend in the offering document referencing disclosures to a discussion in the “plan of distribution” section of the prospectus regarding stabilization activities and aftermarket activities and their potential effects on the market price. Similar disclosure is required in a document sent to a purchaser regarding stabilizing transactions in connection with the offering. It is anticipated that the SEC will delay implementation of the new notification requirements (but not the disclosure requirements) until April 1, 1997.

Managing underwriters will be required by amendments to SEC

Rule 17a-2 to keep records of syndicate covering transactions and penalty bids, as well as stabilizing information. The information will be required to be retained for three years. These recordkeeping requirements are effective April 1, 1997.

Rule 105 — Short Sales

Rule 105 has been adopted to replace Rule 10b-21 to limit short selling prior to a public offering by sellers who cover their short positions by purchasing securities in the offering. Rule 105 reduces the period of coverage to five business days prior to pricing, instead of the current period, which extends from the date of the filing of the registration statement until the commencement of offers and sales. Moreover, Rule 105 does not apply to short sales of derivative securities.

Amendments To NASD Rules General

The amendments to the Nasdaq rules eliminate the requirement that members' submit their request to enter a stabilizing or penalty bid, on the day prior to the requested action. Furthermore, in connection with stabilizing and penalty bids, the amendments replace the current requirement for written notification with a requirement for notification followed by written confirmation. These changes are made to permit the NASD to respond to the quicker timetable that is increasingly characteristic of securities distributions and, particularly, to provide members the maximum flexibility required for shelf offerings.

In addition, the amendments to the Nasdaq and OTCBB rules distinguish between the obligations of members that are distribution participants and members that are affiliated purchasers (as those terms are defined in SEC Rule 100 adopted

under Regulation M). While a member that is a distribution participant may stabilize the price of a security and engage in passive market making, a member that is considered an affiliated purchaser is not permitted to conduct these market-related activities during a distribution.

The amendments also clarify that the requirements for stabilizing, excused withdrawal, passive market making, penalty bids, and syndicate covering transactions in a Nasdaq or OTCBB security apply regardless of whether a Nasdaq or OTCBB security is the subject of the distribution or is a reference security (as those terms are defined in SEC Rule 100 adopted under Regulation M). Similarly, the requirement that a member request an Underwriting Activity Report, as discussed below, from the NASD Regulation Corporate Financing Department applies regardless of whether a publicly traded security is a subject or reference security under SEC Rule 101.

Nasdaq Rules

NASD Rule 4200—Definitions

Amendments are adopted to Rule 4200 of the Nasdaq rules to: (1) delete the definition of "penalty bid" because SEC Rule 100 contains a definition of penalty bid; (2) amend the definition of "stabilizing bid" to refer to the definition of "stabilizing" in SEC Rule 100; (3) delete the definition of "pre-effective stabilizing bid" as unnecessary and confusing; and (4) adopt new paragraph (b) Rule 4200 to incorporate the definitions of important terms from SEC Rule 100 adopted under Regulation M for purposes of the Nasdaq rules. Moreover, for purposes of the Nasdaq rules, the NASD has adopted a definition of the term "Underwriting Activity Report" to reference the report that will be provided by the Corporate Financing Department to the managing underwriter of a distribution of a publicly

traded subject or reference security that is subject to SEC Rule 101 and includes forms that are to be used by members to comply with their notification obligations under Nasdaq rules. The requirement that members obtain the Report is adopted in Rule 2710(b)(11), discussed below.

NASD Rule 4614—Stabilizing Bids

Rule 4614 of the Nasdaq rules has been amended to add new paragraph (a) that requires a market maker that intends to stabilize the price of a Nasdaq security in compliance with SEC Rule 104 to submit a request to Nasdaq Market Operations to enter a one-sided bid identified on Nasdaq as a stabilizing bid. Paragraph (b) retains the requirement that only one market maker in an issue may enter a stabilizing bid. Several provisions that impose limitations on stabilizing bids have been organized under a new heading in paragraph (c).

The notice provisions in renumbered subparagraph (d)(1) have been revised to permit submission to Nasdaq Market Operations of a market maker's request to enter a stabilizing bid at any time. Currently, Rule 4614 requires that Nasdaq Market Operations be notified on the day prior to the first day on which the stabilizing bid is to appear. This requirement is no longer necessary. It is, however, the obligation of the member to provide the staff sufficient time to enter its one-sided stabilizing bid on Nasdaq and the staff of Nasdaq Market Operations will enter a member's stabilizing bid as soon as possible after receipt of the request from the member.

The requirement in subparagraph (d)(1) that the request for entry of a stabilizing bid be in writing has been deleted and is replaced by a requirement that the request be confirmed in writing by the end of the day on which the stabilizing bid is entered. In light of the speed at which many

secondary offerings and shelf distributions are priced and distributed and the volatility of the market, the NASD believes it is important that members be provided the ability to move quickly in response to changing market conditions and the requirements of such offerings. The provision permits a member to submit its written request on an Underwriting Activity Report provided by the Corporate Financing Department or to provide another form of written notice to Nasdaq Market Operations that contains the information related to its request to stabilize the price of a security.

Rule 4619—Excused Withdrawals and Passive Market Making

Market makers are not permitted by the Nasdaq rules to withdraw their quotations unless the withdrawal is excused. In the absence of obtaining an excused withdrawal, a member is prohibited by Nasdaq rules from acting as a market maker in the security for 20 business days. Rule 4619 of the Nasdaq rules regulates requests for excused withdrawals of quotations by market makers and the request by market makers for identification of their quotations as those of a passive market maker.

Subparagraph (d)(1) of Rule 4619 has been amended to: (1) distinguish between the obligations of a member that is a distribution participant and a member that is an affiliated purchaser; (2) clarify that the primary obligation to obtain excused withdrawal and/or identification of quotations as those of a passive market maker is imposed on the managing underwriter of the distribution, regardless of whether the managing underwriter is also a Nasdaq market maker in the security; (3) clarify that the rule applies regardless of whether the Nasdaq security is a subject or reference security; (4) replace the “cooling off” periods of Rule 10b-6 with the one-day and five-day restricted

periods of Regulation M; and (5) clarify that passive market-making quotations must be identified on Nasdaq.

In addition, the amendments provide that notification to Nasdaq Market Operations must occur no later than the business day before the first entire trading session of the one-day or five-day restricted period under SEC Rule 101 of Regulation M. This amendment deletes the provision that previously required notification to Nasdaq Market Operations by noon Eastern Time (ET) on the business day before the beginning of the cooling off period. An example of the timing for the notification is as follows: If a one-day restricted period commences at the close of Nasdaq at 4 p.m. (ET) on Monday, notice should be provided to Nasdaq Market Operations with respect to excused withdrawal or passive market-making status for Tuesday by 6 p.m. Monday (ET), with the offering being priced and sold after 4 p.m. (ET) on Tuesday. The five-day restricted period is calculated in a similar manner.³ The provision permits notification to be received later than the business day before the first entire trading session of the restricted period if such later notification is necessary under the specific circumstances so long as the NASD will be able to maintain its regulatory program to provide surveillance of excused withdrawals and passive market making.

Subparagraph (d)(1) continues to require that a member submit its request for excused withdrawal or identification of quotations as those of a passive market maker in writing. The request is required to be submitted in the form of the Underwriting Activity Report that is obtained from the Corporate Financing Department pursuant to the amendment to Rule 2710(b)(11). Moreover, the managing underwriter remains obligated to advise each market maker that is a distribution participant or affiliated

purchaser that its quotations will be automatically withdrawn. In addition, market makers that are distribution participants must be advised if their quotations will be identified as those of a passive market maker. A market maker that is a distribution participant has the option to notify Nasdaq Market Operations that it does not intend to be a participant in the distribution or does not intend to engage in passive market making.

New subparagraph (d)(3) of Rule 4619 permits the NASD to treat as an excused withdrawal the action of a market maker to withdraw its quotations, if the withdrawal is necessary to ensure compliance with its obligations as a stabilizer, passive market maker, or to comply with the restricted periods of SEC Rule 101. This provision, for example, would permit a member that exceeds its “net purchases” limitation as a passive market maker or that has provided insufficient time to Nasdaq Market Operations to withdraw its quotations to satisfy the one-day or five-day restricted period to immediately withdraw its quotations. However, to ensure that members understand that they remain obligated to request withdrawal of their quotations through Nasdaq Market Operations as required in Rule 4619(a) and (d) and should only rely on this provision in an unanticipated situation, the provision clarifies that the granting of such an excused withdrawal does not prevent the NASD from taking such action as is necessary (*e.g.*, initiating a disciplinary action) against the member and its associated persons for failure to comply with the requirement to withdraw quotations through Nasdaq Market Operations.

Rule 4623—Penalty Bids and Syndicate Covering Transactions

New Rule 4623 has been adopted to implement SEC Rule 104 of Regulation M that requires the principal market for a security to be notified of

any penalty bid or syndicate covering transaction in connection with a new offering of securities. The new Rule requires the submission of this notification in writing to the Corporate Financing Department with respect to a Nasdaq security before imposing the penalty bid or engaging in the first syndicate covering transaction. Although not required by SEC Rule 104, a market maker has the option to request that Nasdaq Market Operations include an identifier with respect to a penalty bid in order to advise the market of the member's exercise of its contractual right. Finally, the notification or request may be submitted on an Underwriting Activity Report or in another written form. If the SEC delays effectiveness of the notification requirements for penalty bids and syndicate covering transactions, the NASD's rule requiring such notification will not be effective until April 1, 1997.

OTCBB Rules

The NASD has amended subparagraph (b)(1) of Rule 6540 of the OTCBB rules to require that a member that is to be a distribution participant or is an affiliated purchaser in a distribution of OTCBB-eligible securities subject to SEC Rule 101 (unless another member has assumed this responsibility) must provide written notice to Nasdaq Market Operations before the pricing of the distribution and that the notice shall include the intended date and time of pricing of the offering. In addition, the member must withdraw its quotations to comply with the restricted periods of Regulation M, and is prohibited from entering a stabilizing bid in the OTCBB. Moreover, the member is required to provide written notice to the Corporate Financing Department of its intention to impose a penalty bid or engage in syndicate covering transactions before imposing the penalty bid or engaging in the

first syndicate covering transactions. Finally, the notices required by this provision may be submitted on an Underwriting Activity Report or in another written form. If the SEC delays effectiveness of the notification requirements for penalty bids and syndicate covering transactions, the NASD's rule requiring such notification will not be effective until April 1, 1997.

The Corporate Financing Rule

The Underwriting Activity Report, to be used for different forms of notifications required by the Nasdaq and OTCBB amendments, has previously been employed by the Corporate Financing Department to provide information to Nasdaq market makers as to whether the security met the per share and public float requirements for the two-day or nine-day restricted periods under Rule 10b-6 and whether the ADTV of the market makers participating in the offering met the requirements for passive market making under Rule 10b-6A. The use of the Underwriting Activity Report has been expanded to permit the NASD to provide information to members to assist them in complying with the restricted periods of SEC Rule 101. The Report issued to the managing underwriter will include the calculation of the ADTV and public float value for each subject and reference security that is publicly traded before the offering and will indicate whether the security qualifies under SEC Rule 101 as an actively-traded security or for the one-day or five-day restricted periods. The Nasdaq and OTCBB amendments give members the option of using the Underwriting Activity Report to submit the member's request to stabilize a Nasdaq security, provide notification of the member's intent to impose a penalty bid or conduct syndicate covering transactions with respect to Nasdaq securities, and to request an identifier

be associated with a penalty bid in a Nasdaq security. In addition, a member may use the Underwriting Activity Report to provide the notification of an offering and of its intention to impose a penalty bid or conduct syndicate covering transactions with respect to OTCBB securities. Finally, the Underwriting Activity Report may be used by the managing underwriter to submit a request for excused withdrawal of quotations or identification of quotations as those of a passive market maker.

To initiate a process for the issuance of the Underwriting Activity Report, the NASD has amended the filing requirements of Corporate Financing Rule 2710 to add new subparagraph (b)(11) that requires a member acting as a manager (or in a similar capacity) of a distribution of securities subject to SEC Rule 101 to submit a request to the Corporate Financing Department for an Underwriting Activity Report. If no member is acting as managing underwriter, each member that is a distribution participant or an affiliated purchaser is required to submit the request unless another member has assumed responsibility for compliance with the requirement. The request must be submitted with respect to any security considered a subject or reference security under SEC Rule 101 that is publicly traded. Thus, the requirement to request an Underwriting Activity Report applies to follow-on or secondary distributions of a publicly traded security (*i.e.*, the publicly traded security is the subject security under SEC Rule 101) and to publicly traded securities that are reference securities in a distribution subject to SEC Rule 101. The requirement to request an Underwriting Activity Report applies regardless of whether the subject or reference security is listed on Nasdaq, quoted in the OTCBB, traded in the over-the-counter market, or listed on a stock exchange. Finally, the requirement to

submit a request for an Underwriting Activity Report applies regardless of the availability of an exemption from filing of a public offering in subparagraph (b)(7) of the Corporate Financing Rule.

Transmission Of Regulatory Notices Under Regulation M

NASD Regulation has standardized the information content of notices required to be submitted under its rules to comply with Rules 101, 103, and 104, *i.e.*, notification of withdrawal of quotations, identification of quotations as those of a passive market maker, request for entry of a stabilizing bid, and notification of penalty bids and syndicate covering transactions. The individual notices may be submitted to Nasdaq Market Operations or the Corporate Financing Department, as applicable, as an attachment to the Underwriting Activity Report issued by the Corporate Financing Department and will consist of a Regulation M Restricted Period Commencement Notification and Regulation M Trading Notification. In an effort to provide greater efficiency to syndicate managers and other distribution participants, the NASD has engaged CommScan, Inc. (CommScan), a New York-based company that owns and operates an electronic communications system currently connecting the syndicate departments of approximately 450 subscriber firms, to establish an electronic system for transmission of the Underwriting Activity Report between the regulatory organizations and broker/dealers. The NASD previously analyzed CommScan's system and engaged CommScan to develop a software application known as NASDesk/Compliance Desk, that facilitates electronic communication between lead managers and all syndicate members and the Corporate Financing Department before and during a public offering of securities⁴ for the purpose of com-

pliance with the Free-Riding and Withholding Interpretation under IM-2110-1.⁵

The NASD has expanded the use of NASDesk/Compliance Desk to provide electronic communications and database capability with respect to compliance with NASD rules that implement SEC Regulation M and to add a link to Nasdaq Market Operations. NASDesk permits the NASD to communicate with members through a pre-existing electronic communication system known as SynWire. As a result, the electronic communications transmitted through this system are generally referred to as wires. When the NASD transmits a wire to a member firm, the member is able to download the wire into a pre-formatted database known as SynDesk. Similar to the procedures for the Free-Riding and Withholding Interpretation, Compliance Desk will provide members with preformatted wire templates that permit the member firm to fill in data fields with pertinent distribution-related compliance information required by NASD rules related to Regulation M. Once the wire templates are completed with the information, the communication protocol designed into Compliance Desk will permit the member firm to access the SynWire transmission system and send the information directly to the Corporate Financing Department and Nasdaq Market Operations.

Thus, the notifications described below that are intended to provide compliance with NASD rules and SEC Rules 101, 103, and 104 will be able to be electronically transmitted to the NASD and will provide real-time notice and audit trail information to the NASD and to broker/dealers. Initially, at the advent of this program, if a member is not a Compliance Desk subscriber, it may submit the information by fax to CommScan, who will manually input the information into the notification

form and transmit it to the NASD. Moreover, until the Compliance Desk system for Regulation M compliance is implemented, members will provide the notifications required by the amendments by fax using the notification forms provided by the NASD. A copy of the forms is attached to this Notice.

The Regulation M Restricted Period Commencement Notification is required to be filed with Nasdaq Market Operations by the managing underwriter with respect to a Nasdaq security to request an excused withdrawal on behalf of the distribution participants and affiliated purchasers and advise whether a distribution participant proposes, instead, to engage in passive market making, to comply with the member's requirements under Rule 4619(d)(1). In addition, the Notification is required to be filed with Nasdaq Market Operations by members participating in an offering of an OTCBB security under Rule 6540 to provide the intended date and time of the pricing of the offering.

The Regulation M Trading Notification is required to be filed by any member with the Corporate Financing Department under Rule 4623 and Rule 6540 to provide advice on penalty bids and syndicate short covering transactions for Nasdaq and OTCBB securities. In addition, the form is to be used to request the entry of a stabilizing bid or an identifier for a penalty bid for a Nasdaq security that is directed to Nasdaq Market Operations. This form also will be provided to the managing underwriter of a distribution of securities listed on a national securities exchange when a request for an Underwriting Activity Report is received and is required to be submitted to the Corporate Financing Department with the time and date of the pricing of the offering and the pricing amount to permit the NASD to carry out its

surveillance obligations with respect to such offerings.

A request for the Underwriting Activity Report Request Form can also be submitted through Comm-Scan by the underwriting manager of an offering not otherwise subject to the filing requirements of the Corporate Financing Rule in order to obtain the Underwriting Activity Report from the Corporate Financing Department. The Regulation M Restricted Period Commencement Notification or Trading Notification is required to be attached to the Underwriting Activity Report received by the member when the applicable notification is submitted to Nasdaq Market Operations or the Corporate Financing Department.

The fees to be charged by Comm-Scan for each wire (*i.e.*, each notification or request) sent over their system will be assessed a typical cost of \$15 to \$20 per wire, and could be less or more depending on the amount of information contained in the wire. The Compliance Desk charges are generally treated by the managing underwriter as expenses of the underwriting and are charged back to the syndicate.

Questions regarding this Notice may be directed to Charles L. Bennett, Director, or Richard J. Fortwengler, Corporate Financing Department, at (301) 208-2700; Dorothy L. Kennedy, Assistant Director, Nasdaq Market Operations, at (203) 385-6243; or Suzanne E. Rothwell, Associate General Counsel, NASD Regulation, at (202) 728-8247.

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 or reference security that is subject to SEC Rule 101 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 this subparagraph, 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.”

(c) No change.

4000. THE NASDAQ STOCK MARKET

4200. DEFINITIONS

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

[(a) - (x)] (1) - (23)

[(y) “Penalty bid” means a stabilizing bid that permits the managing underwriter to reclaim a selling concession granted to a syndicate member in connection with the sale of securities in an underwritten offering when the syndicate member resells such securities to the managing underwriter.]

[(z) “Pre-effective stabilizing bid” means a stabilizing bid entered prior to the effective date of an offering.]

[(aa)] (24) “Reported security” means an equity security for which quotations are entered into the Consolidated Quotations Service.

(25) “SEC Rule 100,” “SEC Rule 101,” “SEC Rule 103,” and “SEC Rule 104” mean the rules adopted by the Commission under Regulation M, and any amendments thereto.

[(bb)] (26) “Solicitation expenses” means direct marketing expenses incurred by a member in connection with a limited partnership rollup transaction, such as telephone calls, broker/dealer fact sheets, members’ legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

[(cc)] (27) “Stabilizing bid” means [a bid entered for the purpose of supporting the price of a security to facilitate an offering of such security as permitted by SEC Rules 10b-6 and 10b-7] the terms “stabilizing” or to “stabi-

lize” as defined in SEC Rule 100.

[(dd)] (28) “Transaction costs” means costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

(29) “Underwriting Activity Report” is a report provided by the Corporate Financing Department of NASD Regulation, Inc. in connection with a distribution of securities subject to SEC Rule 101 pursuant to Rule 2710(b)(11) and includes forms that are submitted by members to comply with their notification obligations under Rules 4614, 4619, and 4623.

(b) For purposes of Rules 4614, 4619, and 4623, the following terms shall have the meanings as defined in SEC Rule 100: “affiliated purchaser,” “distribution,” “distribution participant,” “independent bid,” “net purchases,” “passive market maker,” “penalty bid,” “reference security,” “restricted period,” “subject security,” and “syndicate covering transaction.”

4600. NASDAQ MARKET MAKER REQUIREMENTS

4614. Stabilizing Bids

(a) [Eligibility]

[A market maker may enter a stabilizing bid in Nasdaq, which bid will be identified with the appropriate

identifier on the Nasdaq quotation display.]

Market Maker Obligation/Identifier

A market maker that intends to stabilize the price of a Nasdaq security that is a subject or reference security under SEC Rule 101 shall submit a request to Nasdaq Market Operations for the entry of a one-sided bid that is identified on Nasdaq as a stabilizing bid in compliance with the standards set forth in this Rule and SEC Rules 101 and 104.

(b) Eligibility

Only one market maker in an issue may enter a stabilizing bid.

(c) Limitations on Stabilizing Bids

(1) A stabilizing bid [will] shall not be [displayed] entered in Nasdaq unless at least one other market maker in addition to the market maker entering the stabilizing bid is registered as a market maker in the [issue] security and enter[s]ing quotations that are considered an independent bid under SEC Rule 104.

[(b)2] [Character]

[A stabilizing bid, pre-effective stabilizing bid, or a penalty bid may be entered in Nasdaq.] A stabilizing bid must be available for all freely tradable outstanding securities of the same class being offered.

(3) A market maker shall not enter a stabilizing bid at the same time that it is quoting any other bid or offer in the security.

[(c) d) [Notice] Submission of Request to Association

(1) A market maker that wishes to enter a stabilizing bid shall [so notify the] submit a request to Nasdaq Market Operations [in writing prior to the

first day on which the stabilizing bid is to appear in Nasdaq] for the entry in the Nasdaq quotation display of a one-sided bid identified as a stabilizing bid. The market maker shall confirm its request in writing no later than the end of the day on which the stabilizing bid is entered by submitting an Underwriting Activity Report to Nasdaq Market Operations that includes the information required by subparagraph (d)(2). [and the fact that the market maker is a manager of the distribution]

(2) In lieu of submitting the Underwriting Activity Report as set forth in subparagraph (d)(1), [T] the market maker may provide written [notice] confirmation to Nasdaq Market Operations that shall include:

(A) the [name] identity of the security and its Nasdaq symbol;

(B) [the date on which the security’s registration will become effective, if it is already included in Nasdaq] the contemplated effective date of the offering and the date when the offering will be priced;

[(C) whether the stabilizing bid will be a penalty bid or a penalty-free bid]

(C) the date and time that an identifier should be included on the Nasdaq quotation display; and

(D) a copy of the cover page of the preliminary or final prospectus [or shelf registration statement] or similar offering document, unless the Association determines otherwise.

[(2) In the case of a pre-effective stabilizing bid, the notice shall include (A) the name of the security and its Nasdaq symbol; (B) the contemplated effective date of the offering; (C) whether it is contemplated that the pre-effective stabilizing bid will be converted to a stabilizing bid and, if so, whether the stabilizing bid will be

a penalty bid or a penalty-free bid; and (D) a copy of the preliminary prospectus, unless the Association determines otherwise.]

[(3) A market maker that has provided the written notice prescribed above shall also contact Nasdaq Market Operations for authorization on the day the market maker wishes to enter the stabilizing bid.]

[(d) Dual Bids in the Same Issue. A market maker shall not enter a stabilizing bid at the same time that it is quoting any other bid or offer in the issue.]

[(e) Volume Reporting for Stabilizing Bids. A market maker entering a stabilizing bid shall report all purchases made on the stabilizing bid and enter "zero volume" for sales during the period in which the stabilizing bid is in effect.]

4619. Withdrawal of Quotations and Passive Market Making

(a) - (c) No change.

(d) Excused withdrawal status or passive market maker status may be granted to a market maker that is a distribution participant (or, in the case of excused withdrawal status, an affiliated purchaser) in order to comply with SEC Rules [10b-6] 101, [or Rule 10b-6A(T)] 103, or 104 under the Act on the following conditions:

(1) A [market maker] member 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 and any member that is a distribution participant or that is an affiliated purchaser in such a distribution that does not have a manager shall [: (A)] provide written notice to Nasdaq Market Operations [of the prospective distribution] no later than the business day prior to the first entire trading session

of the one-day or five-day restricted period under SEC Rule 101, unless later notification is necessary under the specific circumstances. [and the fact that the market maker is a manager of the distribution, the Nasdaq security or securities that are subject to SEC Rule 10b-6 no later than 5 business days following the filing of a registration statement with the Association pursuant to Rule 2710, or, if the member is not required to file the registration statement with the Association, no later than 5 business days following the filing of offering documents with the appropriate regulatory authority; and, (B) no later than noon Eastern Time on the business day prior to the beginning of the cooling off period:]

[(i)] (A) [request] The notice required by subparagraph (d)(1) of this Rule shall be provided by submitting a completed Underwriting Activity Report that includes a request on behalf of each market maker that is a distribution participant or an affiliated purchaser to withdraw[al of] the market maker[s']s quotations, or [identification of] that includes a request on behalf of each market maker that is a distribution participant that its [the market makers'] quotations be identified as those of a passive market maker [by providing written notice to Nasdaq Market Operations of the identity of the market makers that are distribution participants], and includes the contemplated date and time of the commencement of the [cooling off period] restricted period. [and the identity of the market makers that intend to act as passive market makers; and]

[(ii)](B) The managing underwriter shall advise [the] each market maker that [they have] it has been identified as a distribution participant[s] or an affiliated purchaser to Nasdaq Market Operations and that [their] its quotations will be automatically

withdrawn or identified as passive market maker quotations, [upon the request made by the manager] unless [they submit to] a market maker that is a distribution participant notifies [the Association the notice specified in] Nasdaq Market Operations as required by subparagraph [(3)] (d)(2), below.

[(2) If the security is being distributed pursuant to an offering for which no registration statement or offering document is required to be filed, each market maker that is a distribution participant shall, no later than noon Eastern Time on the business day prior to the beginning of the cooling off period, provide written notice to Nasdaq Market Operations of its participation in the distribution, the contemplated date and time of the commencement of the cooling off period, the Nasdaq security or securities that are subject to SEC Rule 10b-6, and request withdrawal of its quotations or identification as a passive market maker.]

[(3) 2] A market maker that has been identified to Nasdaq Market Operations as a distribution participant shall [provide written notice to] promptly notify Nasdaq Market Operations and the manager of its intention not to participate in the prospective distribution or not to act as a passive market maker [no later than 4:00 p.m. Eastern Time on the business day prior to the beginning of the cooling off period] in order to avoid having its quotations withdrawn or identified as the quotations of a passive market maker, or in order to have its excused withdrawal status rescinded.

(3) If a market maker that is a distribution participant withdraws its quotations in a Nasdaq security in order to comply with the net purchases limitation of SEC Rule 103 or with any other provision of SEC Rules 101, 103, or 104 and promptly noti-

fies Nasdaq Market Operations of its action, the withdrawal shall be deemed an excused withdrawal. Nothing in this subparagraph shall prohibit the Association from taking such action as is necessary under the circumstances against a member and its associated persons for failure to contact Nasdaq Market Operations to obtain an excused withdrawal as required by subparagraphs (a) and (d) of this Rule.

(4) [In the event the manager of a distribution is not a market maker, each market maker that is a distribution participant shall comply with paragraph (d)(1) unless another market maker has assumed responsibility for compliance.] The quotations of a passive market maker shall be identified on Nasdaq as those of a passive market maker.

[For purposes of this Rule, the term “cooling off period” refers to the periods specified in SEC Rule 10b-6(a)(4)(xi), the terms “distribution” and “distribution participant” refers to these terms as defined in SEC Rule 10b-6(c)(5) and (c)(6) and the term “passive market maker” refers to this term as defined in SEC Rule 10b-6A(T).]

4623. 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;

(2) the date the member is intending to impose the penalty bid and/or conduct syndicate covering transactions; 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 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 end of the day on which 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) No change.

(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 or reference security of such distribution shall (unless another member has assumed responsibility for compliance with this paragraph):

(i) provide written notice to Nasdaq Market Operations prior to the pricing of the distribution that includes the intended date and time of the pricing of the offering;

(ii) withdraw all quotations in the OTCBB-eligible security to comply with the applicable restricted period under SEC Rule 101 and not enter a stabilizing bid pursuant to SEC Rule 104 in the OTCBB; and

(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.

(E) The written notice required by subparagraphs (b)(1)(D)(i) and (iii) 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) For purposes of subparagraph (D), 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:

“affiliated purchaser,” “distribution,” “distribution participant,” “penalty bid,” “reference security,” “restricted period,” “stabilizing,” “subject security,” and “syndicate covering transaction.”

Endnotes

¹ Securities Act Release No. 7375 (December 20, 1996); 62 FR 520 (January 3, 1997).

² The public float is the aggregate amount of common equity securities held by non-affiliates as would be reported by an issuer on SEC Form 10-K.

³ See, definition of “business day” in SEC Rule 100 for purposes of calculation of the restricted period under SEC Rule 101. It is anticipated that this definition will be amended effective March 4, 1997. The term “business day” for purposes of the Nasdaq rules refers to a calendar day on which trading

occurs on Nasdaq.

⁴ CommScan’s data systems are the most complete database of equity offerings and provide the NASD with information on all offerings filed with the SEC.

⁵ Members should review *Notice to Members 96-18* for a more complete description of the operation of the SynWire and CommScan.

© *National Association of Securities Dealers, Inc. (NASD)*, March 1997. All rights reserved.

UNDERWRITING ACTIVITY REPORT REQUEST FORM

ATTENTION: NASD REGULATION CORPORATE FINANCING DEPARTMENT

CITY, STATE
DATE
BK: GSC-3335

=====
== REQUEST FOR UNDERWRITING ACTIVITY REPORT ==
=====

RE: # OF SHARES
ISSUER
TYPE OF SECURITY
SYMBOL

PURSUANT TO FILING REQUIREMENTS OF NASD CONDUCT RULE
2710(B)(11), AND ACTING, IN OUR CAPACITY AS MANAGER WE REQUEST AN
UNDERWRITING ACTIVITY REPORT ON THE ABOVE SUBJECT/REFERENCED
SECURITY:

FILING DATE:	XXXXXXXXXX
ANTICIPATED TAKEDOWN:	XXXXXXXXXX
ANTICIPATED PRICING DATE:	XXXXXXXXXX

SIGNATURE:	XXXXXXXXXX
TITLE:	XXXXXXXXXX
CONTACT (IF DIFFERENT FROM ABOVE):	XXXXXXXXXX

MEMBER NAME

Via CommScan, L.L.C.

REGULATION M RESTRICTED PERIOD COMMENCEMENT FORM

ATTENTION: NASDAQ MARKET OPERATIONS
CITY, STATE
STATE
BK: GSC-3333

=====
== REGULATION M RESTRICTED PERIOD COMMENCEMENT ==
=====

RE: # OF SHARES
ISSUER
TYPE OF SECURITY
SYMBOL

PURSUANT TO THE PROVISIONS OF SEC RULES 101 AND 103 UNDER
REGULATION M, YOU ARE ADVISED OF OUR INTENTION TO COMMENCE THE
RESTRICTED PERIOD ON 00/00/00 AT XX:XX XX.

PURSUANT TO RULE 4619(D) WE ADVISE YOU THAT THE FOLLOWING DEALERS
ARE DISTRIBUTION PARTICIPANTS OR AFFILIATED PURCHASERS AND THEIR
QUOTES SHOULD BE WITHDRAWN FROM THE MARKET OR DESIGNATED AS PASSIVE
MARKET MAKING QUOTES AS INDICATED:

MEMBERS	PASSIVE OR EXCUSED
MEMBER 1	XXXXXXXX
MEMBER 2	XXXXXXXX
MEMBER 3	XXXXXXXX
MEMBER N	XXXXXXXX

SIGNATURE:	XXXXXXXXXXXX
TITLE:	XXXXXXXXXXXX
CONTACT (IF DIFFERENT FROM ABOVE):	XXXXXXXXXXXX

MEMBER NAME

Via CommScan, L.L.C.

REGULATION M TRADING NOTIFICATION FORM

ATTENTION: NASD REGULATION CORPORATE FINANCING DEPARTMENT
NASDAQ MARKET OPERATIONS DEPARTMENT

CITY, STATE
DATE
BK: GSC-3334

=====
== REGULATION M TRADING NOTIFICATION ==
=====

RE: # OF SHARES
ISSUER
TYPE OF SECURITY
SYMBOL

OFFER PRICE: XXXXXXXXXXXX
LAST TRADE BEFORE OFFER: XXXXXXXXXXXX
EFFECTIVE DATE: XXXXXXXXXXXX
EFFECTIVE TIME: XXXXXXXXXXXX
TRADE DATE: XXXXXXXXXXXX

PURSUANT TO THE PROVISIONS OF SEC RULE 104 UNDER REGULATION M, YOU ARE ADVISED OF OUR INTENTION TO ENGAGE IN THE BELOW LISTED ACTIVITY ON THE DATE SHOWN:

ACTIVITY	DATE	TIME
FIRST STABILIZING TRANSACTION:	XXXXXXX	XXXXX
FIRST COVERING TRANSACTION:	XXXXXXX	
FIRST PENALTY BID TRANSACTION:	XXXXXXX	XXXXX (OPTIONAL)

SIGNATURE: XXXXXXXXXXXX
TITLE: XXXXXXXXXXXX
CONTACT (IF DIFFERENT FROM ABOVE): XXXXXXXXXXXX
TELEPHONE NUMBER XXX-XXX-XXXX

MEMBER NAME

Via CommScan, L.L.C.