

# NASD NOTICE TO MEMBERS 97-34

## Depository Trust Company To Launch Initial Public Offering Tracking System

### Suggested Routing

- ☒ Senior Management
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### Executive Summary

On June 2, 1997, The Depository Trust Company (DTC) will launch its Initial Public Offering (IPO) Tracking System. Starting June 2, managing underwriters should be aware that for securities to be eligible for listing on The Nasdaq Stock Market, Inc., they must be "depository eligible" under NASD<sup>®</sup> Rules 4310(c)(23) and 11310(d). Managing underwriters will no longer be able to delay designating a security as depository eligible after it begins trading after an IPO in the immediate secondary market. Transactions will be required to settle by book-entry rather than by physical delivery.

### Discussion

In 1993, in response to the recommendations of the Legal and Regulatory Subgroup of the U.S. Working Committee, Group of Thirty Clearance and Settlement Project (Subgroup), the NASD and the national securities exchanges adopted rules requiring members to settle transactions in depository eligible securities via book-entry through a securities depository.

To encourage the move toward book-entry settlement of all transactions, the Subgroup recommended that securities be depository eligible as a condition for listing on The Nasdaq Stock Market<sup>SM</sup> and the exchanges. In 1995, the SEC approved amendments to the Nasdaq<sup>®</sup> listing requirements to require a domestic security to be depository eligible and, therefore, required to settle by book-entry to be listed on The Nasdaq Stock Market. The other exchanges and DTC adopted similar requirements. In addition, the NASD's Uniform Practice Code requires that a depository eligible security be settled by book-entry. The approval of the rule change was announced in *Notice to Members* 95-55.

When the requirement was adopted, however, underwriters asked that newly issued securities be exempted from the depository eligible, book-entry settlement requirement because they often required physical delivery settlement in the immediate aftermarket following an IPO to monitor repurchases of distributed shares by the underwriting syndicate (flipping). Accordingly, when the listing requirement for depository eligible securities was adopted, IPO securities were required to have a CUSIP number as an indicia of their depository eligibility, but were not deemed to be depository eligible until designated by the managing underwriter or three months had elapsed, whichever was earlier. This exemption now disappears by its terms as a result of DTC's development of an automated system for monitoring flipping.

Piloted since June 1996, the IPO Tracking System (which successfully tracked 38 issues during the pilot phase) is now ready for roll-out to the entire market and will provide managing underwriters with an automated method for monitoring flipping. Accordingly, under the terms of Rule 4310(c)(23), to be eligible for listing on Nasdaq on and after June 2, 1997, new issue securities must be depository eligible and required to be settled by book-entry on the date secondary market trading begins. In addition, under the terms of Rule 11310(d), unlisted securities that are depository eligible must be settled by book-entry on the date secondary market trading begins. Because transactions in such securities must be book-entry settled under NASD and exchange Rules, managing underwriters will no longer be able to track IPOs via physical delivery.

DTC published a memorandum to its Participants dated April 21, 1997, advising them of the roll-out of the

IPO Tracking System. Members should refer to that memorandum, and the contact numbers listed therein, if they have any questions concerning the IPO Tracking System. A copy of the memorandum follows this *Notice*.

Questions regarding the application of NASD Rules may be directed to Dorothy L. Kennedy, Assistant Director, Nasdaq Market Operations, The Nasdaq Stock Market, at (203) 385-6243; or Elliott R. Curzon,

Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8451.

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# THE DEPOSITORY TRUST COMPANY

## IMPORTANT

### Important Executive Notice

**B#:** 0737-97  
**DATE:** April 21, 1997  
**TO:** All Participants  
**FROM:** Glenn E. Mangold, Executive Vice President  
**ATTENTION:** Managing Partner/Director; Cashier; Syndicate and Operations Managers  
**SUBJECT:** Implementation of DTC's Initial Public Offering (IPO) Tracking System

On June 2, 1997, DTC will bring to full implementation its IPO Tracking System, which monitors "flipping" in an automated fashion. In Important Notice B# 1906-96, dated October 31, 1996, DTC stated that DTC anticipated full implementation in mid-1997 if the pilot was successful.

As the system has tracked 38 issues successfully, the pilot stage will conclude on May 30. The pilot began in June 1996 and has slowly increased in scope, with more issues being tracked simultaneously.

On and after June 2, lead managers will be bound by the rules of the securities exchanges and the National Association of Securities Dealers, Inc. (NASD) that require new issues to be distributed by book-entry through a registered securities depository in order to be listed for trading on the exchanges or made eligible for inclusion in Nasdaq. As a result, lead managers will no longer have the ability to track issues physically.

It is imperative, then, that every lead manager be prepared to properly use the system. **To uphold the integrity of the system by minimizing inaccurate use of the system, DTC requires that lead managers successfully process at least one distribution in test mode before using the system for an actual IPO. Lead managers that have not tested with the IPO Tracking System will therefore not be able to track IPOs through any means on or after June 2.**

Lead managers have indicated to DTC in response to a telephone survey that they are prepared to differing degrees. To date:

- 22% of lead managers have tracked or are in the process of tracking issues during the pilot phase in a production environment.
- 10% of lead manager have successfully tested in a test environment.
- 13% of lead managers are service bureau users waiting for their service bureaus to test.
- 10% of lead managers have indicated they will test before the end of April.

- 11% of lead managers have indicated they will test during May.
- 29% of lead managers have been advised by DTC personnel to set up a test but have not yet done so.
- 5% of lead managers are in special situations that make testing unnecessary.

Lead managers that have successfully tested account for approximately 71% of new issuances. DTC anticipates that by June 2 this figure will approximate 90%.

If your organization acts as a lead manager for IPOs and has not already tested with the system, call DTC's Underwriting Department immediately, at the number noted below, to set up a test.

**All Participants—not just those acting as lead managers—should be ready to interface with DTC relative to all aspects of the system.** Documentation is available on the automated interfaces to the system as well as the PTS update and inquiry capabilities.

Participants can direct calls on IPOs to various departments, depending on the nature of the specific inquiry. The following is a guide:

|                                                                                    |                                                                                                                                                                                   |
|------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| “Work-in-progress”<br>(urgent) calls (help with<br>IPO functions)                  | DTC's Training Department, 1-800-545-1276, outside New<br>York State and (212) 709-1135 in New York                                                                               |
| Testing/setting up new<br>issues                                                   | DTC's Underwriting Department at (212) 898-3705                                                                                                                                   |
| Basic information calls                                                            | Your Participant Services representative; DTC's Underwriting<br>Department at (212) 898-3705                                                                                      |
| Business issue calls (major<br>proposals, project history,<br>regulatory mandates) | Catherine Brown, (212) 709-1687, Sheryl Kort, (212) 709-<br>1040, Val Stevens, (212) 709-1110, Product Development;<br>or Melissa Rosenberg, (212) 709-1105, Participant Services |
| Computer-to-Computer<br>Facility                                                   | Sandy Weinberger, Participant Interface Planning,<br>(212) 558-2699                                                                                                               |
| Settlement questions                                                               | DTC's Settlement Department, (212) 558-5816                                                                                                                                       |

On June 2 and for an appropriate time thereafter, DTC will have staff designated specifically to answer IPO-related inquiries.