

counts and Statistics, will be issued in the near future.

Since this amendment is administrative in nature, affecting a rule of agency organization and procedure, the Board finds that notice and public procedure are unnecessary and that an immediate effective date is in the public interest.

Accordingly, the Civil Aeronautics Board amends part 385 of its Organization Regulations, Delegations and Review of Action under Delegation; Nonhearing Matters (14 CFR Part 385) as follows:

"Bureau of Enforcement" is replaced by "Bureau of Consumer Protection" wherever it appears.

(Sec. 204(a), Federal Aviation Act of 1958, as amended, 72 Stat. 743 (49 U.S.C. 1324); Reorganization Plan No. 3 of 1961, 75 Stat. 837, 26 FR 5989 (49 U.S.C. 1324 (note)).)

By the Civil Aeronautics Board.

PHYLLIS T. KAYLOR,
Secretary.

[FR Doc. 78-29196 Filed 10-13-78; 8:45 am]

[6351-01-M]

Title 17—Commodities and Securities Exchanges

CHAPTER I—COMMODITY FUTURES TRADING COMMISSION

PART 32—REGULATION OF COMMODITY OPTION TRANSACTIONS

Amendment to Rule Providing an Exemption From Suspension of Commodity Option Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The CFTC is amending its regulations to reduce the net worth requirement from \$10 million to \$5 million for grantors of options on physical commodities as a condition for exemption from the general commodity option suspension. This action is based on a petition for rulemaking to reduce the net worth requirement.

EFFECTIVE DATE: October 6, 1978.

CONTACT:

Fred M. Santo, Assistant General Counsel, Office of General Counsel, Commodity Futures Trading Commission, 2033 K Street NW., Washington, D.C. 20581, telephone 202-254-5543.

SUPPLEMENTARY INFORMATION: Rule 32.11 of the interim commodity option regulations generally makes unlawful the solicitation or acceptance of orders for, or the acceptance of pay-

ment for, the purchase or sale of commodity options on and after June 1, 1978 (43 FR 16153 et seq. (April 17, 1978)). Rule 32.12 provides an exemption from the general suspension of the offer or sale of commodity options on physical commodities ("dealer options") where the grantor and the seller of an option satisfy certain conditions set forth in the rule. (43 FR 23704 et seq. (June 1, 1978)). One of these conditions, set forth in § 32.12(a)(1), requires a grantor to have a net worth of at least \$10 million. On September 7, 1978, the Commission received a petition for interim rulemaking, filed pursuant to 17 CFR 13.2 (1977), to amend § 32.12(a)(1) to reduce the net worth requirement from \$10 million to \$5 million. The Commission has determined to grant the petition by amending § 32.12(a)(1).

Section 32.12 was adopted by the Commission in anticipation of possible congressional action designed to allow certain persons to continue to offer and sell dealer options notwithstanding any general ban that may be in effect. This was done in order to assure that these dealers would not be required unnecessarily to cease operations during the relatively brief period before a congressional exemption judgment could be made whether to exempt a class of option dealers from any general ban on option sales that Congress might enact.¹ To make certain that the Commission exemption would not be broader than the exemption Congress seemed likely to adopt, § 32.12 incorporated the most stringent provisions of the bills reported out of the Senate Committee on Agriculture, Nutrition, and Forestry,² and the House Committee on Agriculture,³ and added additional protections the Commission believed essential for customer protection.

Section 32.12(a)(1) incorporated the \$10 million net worth requirement set forth in the Senate Committee proposal. However, the final congressional action on the minimum net worth requirement as contained in Pub. L. 95-405, 92 Stat. 865 (September 30, 1978), establishes a minimum net worth requirement of \$5 million. This law further requires that the Commission issue regulations concerning the granting and offering of dealer options which shall include certain statutorily

¹The option suspension was scheduled to (and in fact did) go into effect June 1, 1978. The effective date of any amendments to the Commodity Exchange Act would be subsequent to that date, but prior to October 1, 1978. Accordingly, the Commission adopted § 32.12 effective June 1, 1978.

²S. 2391, 95th Cong., 2d Sess. § 2(3) (1978). See S. Rep. No. 95-850, 95th Cong. 2d Sess. (1978).

³H.R. 10385, 95th Cong., 2d Sess. § 2(3) (1978). See H.R. Rep. No. 95-1181, 95th Cong., 2d Sess. (1978).

prescribed criteria. While the Commission is making its determinations concerning dealer options, § 32.12 will continue in effect. Since it is clear, however, that any net worth provision adopted by the Commission would have to establish "a net worth of at least \$5 million" the Commission has decided to amend § 32.12(a)(1) at this time to reflect that figure.

Inasmuch as this amendment to § 32.12(a)(1) is a substitute rule which relieves a restriction, good cause exists to find that the notice and public participation requirements of 5 U.S.C. 553 (1976) are impracticable, unnecessary, or contrary to the public interest. On that basis, it may also be made effective on less than 30 days' notice. See 5 U.S.C. 553(d)(1) (1976).

In consideration of the foregoing, the Commission, pursuant to the authority contained in sections 2(a)(1), 4c(b) and 8a of the Commodity Exchange Act, 7 U.S.C. 2, 6c(b), and 12a (1976), hereby amends Part 32 of Title 17 of the Code of Federal Regulations by revising § 32.12(a)(1) to read as follows:

§ 32.12 Exemption from suspension of commodity option transaction.

(a) ***

(1) The grantor has a net worth of at least \$5 million.

* * * * *

Issued in Washington, D.C., on October 6, 1978, by the Commission.

WILLIAM T. BAGLEY,
Chairman, Commodity
Futures Trading Commission.

[FR Doc. 78-29118 Filed 10-13-78; 8:45 am]

[8010-01-M]

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-5985, IC-10419, File No. S7-578]

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

Certain Special Offerings to Mutual Fund Shareholders; Interpretation of Statutes

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; interpretation of statutes.

SUMMARY: The Commission announces that it is interpreting statuto-

ry provisions governing the pricing of publicly offered mutual fund shares to permit any fund to sell its shares to its existing shareholders at no sales load or at sales loads which are lower than those being charged to new shareholders. The Commission is soliciting the comments of interested persons on this interpretation. In a separate release the Commission is withdrawing a proposed rule governing certain offerings similar to the types of offerings which are the subject of this interpretation. (The offerings covered by the proposed rule were called "open seasons." For convenience the offerings covered by the interpretation issued in this release will also be referred to as open seasons.) In a related matter the Commission is amending the rules governing advertising by investment companies to permit the sending of notices of open seasons to shareholders and interpreting the statutory definition of a prospectus not to include a notice of such an offering which is sent to a shareholder who has previously been sent a current statutory prospectus. These actions taken together conclude proceedings which ensued from a recommendation contained in a Commission staff report on the mutual fund distribution system. These actions will make it clear that the requirement that fund shares be sold at a public offering price set forth in the prospectus does not prohibit offerings consistent with pertinent statutory conditions to existing shareholders at prices which reflect sales loads different from those imposed on purchases by new shareholders.

DATES: Effective October 4, 1978; comments by November 30, 1978.

ADDRESSES: Interested persons should submit their views and comments about the Commission's interpretive position that mutual funds may sell shares to existing shareholders at sales loads which differ from those imposed on sales to new shareholders in triplicate to George A. Fitzsimmons, Secretary, Washington, D.C. 20549. All submissions should refer to File No. S7-578 and will be made available for public inspection at the Commission's Public Reference Section, Room 6101, 1100 L Street NW., Washington, D.C. 20005.

FOR FURTHER INFORMATION CONTACT:

Richard W. Grant, Esq., 202-755-0242, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On August 19, 1975, the Commission published a proposal to: (1) Adopt Rule 22d-4 under the Investment Company Act of 1940 (15 U.S.C. 80a-1

et seq.) (the "Act"); and (2) amend Rule 134 (17 CFR 230.134) under the Securities Act of 1933 (15 U.S.C. 77a et seq.) (the "Securities Act").¹ Proposed Rule 22d-4 would have provided a limited exemption from Section 22(d) of the Act to permit an investment company issuing redeemable securities and underwriters and dealers in such securities to offer such securities to shareholders of that company, or of another company whose shares were underwritten by the same underwriter, at no sales load or at a sales load lower than that being charged new shareholders, subject to certain conditions. The amendment of Rule 134 was necessary to permit the sending of notices of such offerings to shareholders.

As more fully discussed below, the Commission has determined not to adopt Rule 22d-4² but has decided to interpret the Act to permit similar offerings to existing shareholders. The proposed amendment to Rule 134 continues to be necessary and appropriate and is being adopted in this release.

BACKGROUND

On November 4, 1974, the Commission transmitted to the United States Senate a report of its staff entitled "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940."³ The Report contained a number of administrative and legislative recommendations pertaining to Section 22(d) which were designed to eliminate certain inequities and inefficiencies in the existing mutual fund distribution system. A number of these recommendations reflected a

degree of change from the staff's traditional view that Section 22(d) required that, in general, any sales load on the sale of mutual fund shares follow a single schedule of charges with respect to all sales to the public.

One such recommendation related to what the report termed "open seasons." The report concluded that it would be appropriate to permit mutual funds to charge no sales load to repeat investors or to charge them a sales load which was lower than that being imposed on purchases by new shareholders on the theory that repeat investors may not need or receive significant selling services when they purchase additional shares of the same fund. To implement this recommendation, the Commission proposed Rule 22d-4, which would have allowed shares to be offered to existing shareholders of a particular fund or any other fund in the same complex at a reduced load or no load, subject to the following limitations: (1) Shareholders to whom such an offer was directed would have had to have owned shares for at least six months; (2) shareholders would have had to be notified of the offer at least 30 days before it became effective; and (3) the offer would have had to remain in effect for at least 30 days. As stated earlier, the Commission proposed at the same time to amend Rule 134 to permit notices to shareholders of "open seasons."

DISCUSSION

COMMENTS ON PROPOSED RULE 22D-4

Of the 30 comments received, 20 were opposed to adoption of Rule 22d-4, including 9 of the 11 comments received from dealers and 8 of the 10 comments from fund managers and distributors. Most of the comments in opposition expressed concern about the effects open sessions could have on dealers. One argument was that open seasons would deprive dealers of opportunities to earn commissions on repeat sales thereby reducing dealers' incentives to make initial sales and provide follow-up services after sales. Another major argument advanced in opposition to the proposal was that dealers would face difficult ethical problems in making sales, especially repeat sales, at the full sales load if they knew that a fund offered open seasons.

The Commission has considered these objections and concluded that they do not establish any grounds of law or policy which would justify imposing restrictions on open seasons. It appears to the Commission that the question of whether offerings to existing shareholders at no-load or at a reduced load would reduce dealers' incentives and, if so, whether such offerings should be made is a matter of

¹Securities Act Release No. 5607, Investment Company Act Release No. 8394, (40 FR 40555, Sept. 3, 1975).

²The Commission is withdrawing proposed Rule 22d-4 in a separate release (Investment Company Act Release No. 10420).

³Section 22(d) of the Act provides:
(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11(b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

business judgment for individual funds. Concerning ethical problems which might be faced by dealers selling shares of funds which offer open seasons, the Commission recognizes that compliance with Commission rules and NASD requirements may require dealers to make difficult decisions in dealing with their customers. However, the Commission does not believe that the existence of open seasons would alter the nature of those obligations or make them impossible to fulfill in the absence of restrictive regulations.

**DECISION TO ISSUE INTERPRETATION
RATHER THAN ADOPT PROPOSED RULE
22D-4**

After reconsideration of this matter, the Commission is now of the view that Section 22(d) of the Act, and Section 22(d)(ii) specifically, already permits funds to offer shares to existing shareholders at prices which reflect reduction or elimination of the sales loads being imposed on sales to new shareholders. The Commission has also concluded that the conditions on open seasons set forth in proposed Rule 22d-4 are not necessary or appropriate. Accordingly, the Commission has decided to withdraw proposed Rule 22d-4 and issue this interpretation in order to make clear its view of the meaning of Section 22(d)(ii). In issuing this interpretation, the Commission wishes to stress that it is not expressing favor or disfavor of open seasons. As indicated above, the Commission believes that whether or not funds offer open seasons is a matter of business judgment.

Section 22(d) generally prohibits sales of mutual fund shares at other than a public offering price disclosed in the prospectus. This section has traditionally been interpreted as requiring that, in general, any sales loads with respect to all sales to the public. However, Section 22(d) also provides that: "Nothing in this subsection shall prevent a sale made . . . (i) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings . . ." The Commission has concluded that the plain meaning of Section 22(d)(ii) compels the conclusion that special offerings by mutual funds to existing shareholders in the nature of open seasons are permissible, provided only that such offerings be made to all shareholders and that they be "proportionate."⁴

⁴The statute appears to contemplate that open seasons could exist simultaneously with normal public offerings. Any staff interpretations which could be construed as suggesting the contrary are hereby superseded.

The Commission has also concluded that the conditions on open seasons contained in proposed Rule 22d-4 are neither necessary nor appropriate. Rule 22d-4 would have required that offers be made only to shareholders who had owned shares for at least 6 months. This condition was designed to prevent investors from treating dealers unfairly by purchasing small amounts of shares at the full sales load and then purchasing more shares at a reduced load or at no-load. Other conditions designed to insure fair treatment of shareholders required 30 days' notice of an open season and a 30-day term for an open season. Upon reconsideration, the Commission has concluded that conditions of these types would make open seasons unduly complicated and inflexible and would not necessarily achieve their objectives. The Commission now believes that reliance on the terms of Section 22(d)(ii) should be sufficient to insure fairness to all parties.

Funds could deal with the problem of investors making small initial purchases and larger subsequent purchases during open seasons by limiting the number of shares existing shareholders could purchase in open seasons. Section 22(d)(ii) requires offerings to existing shareholders to be proportionate to their holdings. Nothing would prevent funds from permitting shareholders to purchase only a small number of shares relative to their holdings.

On the other hand, it does not appear to be necessary to set arbitrary notice and duration requirements in order to prevent unfair discrimination against certain classes of existing shareholders. Compliance with the requirement in Section 22(d)(ii) that offerings be made to "all" shareholders should insure that open seasons offerings give sufficient notice to investors and have sufficient duration to insure that the terms of the offering do not, in effect, favor some shareholders over others.

REQUEST FOR COMMENT

The Commission believes that the foregoing interpretation of Section 22(d)(ii) comports with the plain meaning of the statute; however, because proposed Rule 22d-4 was controversial and because of the passage of time since comment was received on the proposed rule, the Commission believes it is appropriate to give interested persons another opportunity to present their views; therefore, the Commission is requesting comments on this matter. The interpretation is effective, however, as of October 4, 1978.

**COMMUNICATIONS TO SHAREHOLDERS
ABOUT OPEN SEASONS**

Communications to shareholders about open seasons may vary depending on such factors as whether open seasons are continuous, periodic, or occasional, or whether shareholders have received current prospectuses. The following discussion is intended to explain the applicability of Securities Act prospectus requirements to open seasons and to explain certain administrative actions taken to facilitate sending notices of open seasons to shareholders.

PROSPECTUS DISCLOSURE

Information about open seasons could be very material to persons contemplating purchases of mutual fund shares. Accordingly, the prospectus of any mutual fund which offers, or plans to offer, shares to existing shareholders at reduced sales loads or no-load pursuant to section 22(d)(ii) should make appropriate disclosure. What is appropriate will depend on the nature of the offering. For example, a fund which has a continuous open season should be able to make quite specific disclosure of the terms of the offering, including the sales load, if any. On the other hand, a fund which contemplates having open seasons only occasionally may not be able to provide very detailed information about such offerings. If a fund does not make a continuous offer and the precise dates of any offer are not set forth in the regular prospectus, shareholders should be given specific notice of each such offering, and at the same time a sticker should be added to the prospectus giving the dates of the offering.⁵

NOTICES OF OPEN SEASONS

A fund which has an open season may wish to send a notice to shareholders, regardless of whether the open season is continuous, periodic, or occasional. Such a notice might be considered a prospectus within the meaning of section 2(10) of the Securities Act⁶ and be required to meet the requirements of section 10 of the Securities Act unless one of the exceptions in section 2(10)(a) or 2(10)(b) was available. The Commission has taken certain actions as discussed below to facilitate the sending of notices which are not full statutory prospectuses.

**INTERPRETATION OF SECTION 2(10) OF
THE SECURITIES ACT**

Many mutual funds send their shareholders current effective pro-

⁵As indicated below, the notice to shareholders can be given merely by sending them a copy of the sticker if an otherwise current effective prospectus already has been sent.

⁶Section 2(10) defines the term "prospectus" to include "any communication . . . which offers any security for sale . . ."

spectuses. Section 2(10)(a) of the Securities Act excepts from the definition of a prospectus a communication which is preceded or accompanied by a statutory prospectus. Accordingly, notices of open seasons need not be accompanied by statutory prospectuses if shareholders have already been sent current effective prospectuses. If the current prospectus does not describe precisely the terms of the open season, as might be the case if a fund has open seasons periodically or occasionally, the notice should take the form of, or be accompanied by, a sticker describing the precise terms of the offering.

AMENDMENT OF RULE 134

In order to permit funds which have not sent current effective prospectuses to shareholders to send notices of open seasons, the Commission is adopting an amendment to rule 134 under the Securities Act.¹ The amendment simply includes a notice of open seasons among communications not deemed to be a prospectus. Such a notice must include the legend required by rule 134, and a current effective prospectus (including any applicable stickers) should be sent to shareholders expressing their interest in the offer.² Of course, even if shareholders are notified of the offer by means of a rule 134 communication, the terms of the offer must be set forth in a sticker to the prospectus, if this information is not otherwise contained in the prospectus.

COMMISSION ACTION

The Commission hereby amends rule 134 under the Securities Act, effective October 4, 1978, pursuant to the authority set forth in Section 2(10) (15 U.S.C. 77b(10)(b)), and Section 19(a) (15 U.S.C. 77s(a)) of the Securities Act of 1933 as follows. Paragraph (a)(3)(iii) of § 230.134 of Chapter II of Title 17 of the Code of Federal Regulations is hereby amended to add new paragraph (a)(3)(iii)(H), to follow paragraph (a)(3)(iii)(G). The word "and" preceding paragraph (a)(3)(iii)(G) is deleted, and paragraph

¹Rule 134 was adopted pursuant to section 2(10)(b) of the Securities Act which excepts from the definition of a prospectus communications which contain only certain limited specified information and such other information as the Commission permits by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors. Communications which comply with rule 134 are deemed not to be prospectuses. This amendment to rule 134 was proposed along with rule 22d-4.

²An order for shares pursuant to section 22(d)(ii) can be filled without sending a prospectus to the shareholder placing the order if he has already been sent a current effective prospectus and any stickers which have been added.

(a)(3)(iii) is amended to read as follows:

§ 230.134 Communications not deemed a prospectus.

- • • • •
- (a) * * *
- (3) * * *
- (iii) * * * and (H) written notice of the terms of an offer made solely to all registered holders of the securities, or of a particular class or series of securities, issued by the company proportionate to their holdings, offering to sell additional shares to such holders of securities at prices reflecting a reduction in, or elimination of, the regular sales load charged: *Provided*, That, (1) if any printed material permitted by paragraphs (a)(3)(iii) (A) through (H) of this section is included, such communication shall also contain the following legend set in a size type at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisements:

For more complete information about [Name of Company] including charges and expenses [get] [obtain] [send for] a prospectus [from (Name and Address)] [by sending this coupon]. Read it carefully before you invest or [pay] [forward funds] [send money].

Or, (2) * * *

• • • • •

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

OCTOBER 4, 1978.
[FR Doc. 78-29098 Filed 10-13-78; 8:45 am]

[8010-01-M]

[Release Nos. 34-15219; IC-10428; File No. S7-6541]

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

Securities Confirmations

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; rule rescission.

SUMMARY: The Commission is adopting several new delivery and disclosure requirements for confirmations sent to customers by brokers and dealers when they buy for or from their customers or sell for or to those customers any security (other than U.S. Savings Bonds or municipal securities). Under the new requirements, brokers and dealers must make disclosures relating to odd-lot differentials, remuneration received in certain prin-

cipal transactions, and market making activities. The rule also revises current requirements pertaining to the use of quarterly statements in lieu of immediate confirmations for transactions effected pursuant to "investment company plans." In addition, the Commission is rescinding an existing rule that sets forth confirmation delivery and disclosure requirements that are superseded by the new requirements.

EFFECTIVE DATE: December 18, 1978.

FOR FURTHER INFORMATION CONTACT:

Jeffrey L. Steele, Esq., Office of the Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549, 202-755-7587.

SUPPLEMENTARY INFORMATION:

The Commission today announced the adoption of amendments to rule 10b-10 (17 CFR 240.10b-10) under the Securities Exchange Act of 1934 (the "Act"), and the rescission of rule 15c1-4 (17 CFR 240.15c1-4) under the Act. The amendments to rule 10b-10 prescribe certain disclosures to be made by a broker or dealer when effecting transactions in securities (other than U.S. Savings Bonds or municipal securities) for or with a customer, and revise existing requirements for the use of quarterly statements in connection with "investment company plans." Together with the amendments adopted today, rule 10b-10, which was adopted by the Commission on May 5, 1977, becomes effective on December 18, 1978 (with the exception of certain paragraphs of the rule which became effective on June 1, 1977).¹ Rule 15c1-4, which sets forth existing confirmation delivery and disclosure requirements, is rescinded, effective December 18, 1978.

Pursuant to its authority under the Act, the Commission is taking the actions summarized below:

(1) *Disclosure of odd-lot differentials.* As amended, rule 10b-10 will require brokers and dealers to disclose, in confirming an odd-lot transaction in which an odd-lot differential has been charged, that an odd-lot differential has been charged and that the amount of the differential is available upon oral or written request.²

(2) *Disclosure of mark-ups and mark-downs in "riskless" principal transactions.* As amended, rule 10b-10 will require a dealer trading for its own account to disclose the mark-up

¹See Securities Exchange Act Release Nos. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977); and 14942 (July 7, 1978), 43 FR 30270 (July 14, 1978).

²Paragraph (c) of rule 10b-10 prescribes the time periods within which information requested by a customer must be given or sent to the customer.

or mark-down in a "riskless" principal transaction in an equity security unless the dealer is acting as a market maker in the security being purchased or sold. In a separate release, issued today, the Commission is soliciting further comment on whether to require such disclosure in the case of transactions in nonmunicipal debt securities and municipal securities.³

(3) *Disclosure of market maker status.* As amended, rule 10b-10 will also require a dealer trading for its own account in an equity security to disclose whether it is a market maker in the security being purchased or sold (otherwise than by reason of its acting as a block positioner in that security).

(4) *Investment company plans.* The Commission has adopted revised procedures permitting the use of quarterly statements in lieu of immediate confirmations for certain transactions in securities issued by investment companies.

(5) *Disclosure of best bid and offer prices.* The Commission has withdrawn at this time its proposal to require confirmation disclosure by brokers and dealers of the best bid and offer prices displayed in NASDAQ or an equivalent interdealer quotation system at the time of a transaction in a security that is not listed on an exchange.

(6) *Disclosure of remuneration paid by third parties to dealers.* The Commission has withdrawn at this time its proposal to require disclosure of remuneration paid by third parties to dealers.

(7) *Rescission of rule 15c1-4.* The Commission has rescinded Rule 15c1-4 under the Act. That rescission takes effect on December 18, 1978, the date on which Rule 10b-10, as amended, becomes generally effective.

I. BACKGROUND AND PURPOSE OF RULE 10b-10

On September 16, 1976, the Commission announced a proposal (1) to adopt Rule 10b-10 to establish revised confirmation delivery and disclosure requirements for broker-dealers effecting transactions for or with the account of a customer and (2) to rescind Rule 15c1-4, which sets forth the Commission's basic confirmation requirements.⁴ After receiving and considering the comments of interested persons, the Commission adopted Rule 10b-10 with certain revisions on May 5, 1977, and reiterated its intention to rescind Rule 15c1-4.⁵ The rule's effective date, however, was subsequently

postponed until December 18, 1978.⁶ When it adopted Rule 10b-10, the Commission also decided not to adopt at that time certain of the provisions contained in Rule 10b-10 as originally proposed, such as the proposal to require disclosure of markups and mark-downs in "riskless" principal transactions. It stated, however, that it would republish those proposals in revised form for further comment, and did so on June 23, 1977.⁷ The Commission has now concluded, after considering the views of commentators, to adopt certain of those proposed requirements.

The Commission believes that the confirmation is an important disclosure document. By requiring brokers and dealers to disclose facts to a customer at or before the completion of a transaction, as defined in the rule, the confirmation rule is intended to deter and prevent deceptive and fraudulent acts and practices. At the same time, confirmations can have important informational value to customers beyond whatever value they may have as an investor protection measure. Among other things, confirmations should assist customers in evaluating the costs and quality of services provided by brokers and dealers in connection with the execution of securities transactions.

Numerous factors may be pertinent to the making of an investment decision. In addition to various factors pertaining to the suitability of a security for the customer's investment needs, customers may wish to take into account, as information material to their investment decisions, variations in transaction costs incurred in trading different types of securities and variations in the transaction charges of competing broker-dealers. While confirmations provide investors with only an after-the-fact record of transaction costs, they nevertheless can serve to make investors aware of those costs in making future investment decisions.

II. COMMISSION ACTION ON THE PROPOSED DISCLOSURE REQUIREMENTS

A. ODD-LOT DIFFERENTIALS

Paragraph (a)(3) of Rule 10b-10, as amended requires the disclosure of whether any odd-lot differential has been charged and that the amount of the differential is available upon oral or written request. Where an odd-lot differential is charged in connection with an odd-lot transaction, the practice within the securities industry has been for dealers to add that differen-

tial to the round lot price of the security. The Commission has concluded that disclosure of whether any odd-lot differential has been charged by a dealer should be made so long as that charge remains an amount added to or subtracted from the price of a security.⁸ If the odd-lot differential were instead reflected in the Commission charge disclosed or exempted from disclosure pursuant to paragraph (a)(4)(ii) of the rule,⁹ it would not have to be separately identified.

The Commission understands that some dealers do not charge any differential, that some charge either 12½ cents per share or 25 cents per share and that some charge a differential only under certain circumstances. Perhaps in part because of these disparities in practices, questions have been raised concerning the economic rationale for the odd-lot differential. One commentator asserted, "From all indications, it would seem that an odd-lot charge is a carryover concept from the days of fixed rates that will not survive in the marketplace of tomorrow."¹⁰ Another commentator expressed the view that it would be preferable to eliminate the odd-lot differential altogether rather than to require its disclosure.¹¹ The Commission is not now prepared to conclude that it is improper to charge an odd-lot differential, but it does believe customers should be made aware of whether an odd-lot differential has been charged and that the amount is available on oral or written request.

The proposed amendment to Rule 10b-10 would have required that the amount of the odd-lot differential, if any, be disclosed on each confirmation. Of the seven commentators that addressed the proposed disclosure requirement, most pointed out that there were practical difficulties in determining whether an odd-lot differential has been charged, identifying the amount of any odd-lot differential charged, and recording that information on the confirmation.¹² Commenta-

³The Commission understands that odd-lot differentials per se are generally not charged on transactions in debt securities although the prices for small orders in debt securities vary from prices negotiated on large orders. The odd-lot differential requirement is not intended to reach those differences in pricing. See comment letter of Sullivan & Cromwell.

⁴Paragraph (a)(4)(ii) prescribes the remuneration disclosures (including brokerage commissions) to be made by a customer's broker.

⁵Comment letter of the National Association of Securities Dealers, Inc. (the "NASD"). The NASD pointed out, however, that the price to be paid for 100 shares of a security could be different than the price which may be negotiated for orders involving either more or less than 100 shares.

⁶See comment letter of J. & W. Seliman & Co.

⁷See, e.g., comment letters of Sullivan & Cromwell; Merrill Lynch, Pierce, Fenner & Footnotes continued on next page

⁸See Securities Exchange Act Release No. 15220 (Oct. 6, 1978).

⁹Securities Exchange Act Release No. 12808 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

¹⁰Securities Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977).

¹¹Securities Exchange Act Release Nos. 14942 (July 7, 1978), 43 FR 30270 (July 14, 1978); 14573 (Mar. 16, 1978), 42 FR 11931 (Mar. 23, 1978); and 14184 (Nov. 17, 1977), 42 FR 60734 (Nov. 29, 1977).

¹²Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

tors pointed out that differentials are not charged on all odd-lot orders. Furthermore, it was stated that when odd-lot orders have been placed with, and executed by, a specialist, the specialist typically does not indicate whether an odd-lot differential has been charged, or the amount of such differential, when it reports the execution to the customer's broker.¹³ It was asserted that even if the amount of an odd-lot differential could be determined, the absence of uniform practices by specialists in charging odd-lot differentials would make it difficult and expensive to design a computer system to capture each charge.¹⁴ On the other hand, it was asserted that manual recodation of the amount of odd-lot differentials could lead to increased chances for error.¹⁵ Commentators who perceived such difficulties generally believed that it would be sufficient to indicate on the confirmation that an odd-lot differential may have been charged and that the amount, if any, would be available on request.¹⁶

The Commission, nevertheless, believes that it is important that customers at least be made aware of whether an odd-lot differential has in fact been charged so that they may understand the nature of the costs associated with the execution of securities transactions on their behalf. Accordingly, as amended, Rule 10b-10 will require brokers and dealers to disclose on a customer's confirmation whether an odd-lot differential has been charged to the customer and, if so, that the amount is available upon oral or written request. As noted above, an exception to this disclosure requirement is provided if the differential or fee is included in the remuneration disclosed, or exempted from disclosure, pursuant to paragraph (a)(4)(ii) of the rule.

The Commission recognizes that requiring broker-dealers to disclose whether an odd-lot differential has in fact been charged on an odd-lot transaction is more burdensome than requiring that broker-dealers disclose that such a differential may have been charged. The former requires broker-dealers to make a specific entry in confirming an odd-lot transaction on which a differential has in fact been charged, whereas the latter could be satisfied by a standard legend without any specific notation on each odd-lot confirmation. At the same time, requiring disclosure of whether an odd-

lot differential has been charged may be somewhat less burdensome than the odd-lot provision as originally proposed, which would have required disclosure in each case of the specific amount of any differential charged. While broker-dealers may have to incur reprogramming and other costs in preparing for either requirement, the requirement adopted by the Commission may involve less risk of error and appears to the Commission to represent, at this time, an appropriate balancing of the need to provide adequately for disclosure to investors and the need to be cautious in imposing regulatory burdens on brokers and dealers.¹⁷

B. MARKUPS OR MARKDOWNS BY DEALERS EFFECTING "RISKLESS" PRINCIPAL TRANSACTIONS

Paragraph (a)(5)(i) of Rule 10b-10, as adopted, requires a dealer (other than a market maker)¹⁸ acting as a principal for his own account to disclose the amount of any markup, markdown, or similar remuneration received in a transaction in an equity security when, after receiving an order to buy or sell a security from a customer, the dealer purchases the security from another person to offset a contemporaneous sale to such customer or sells the security to another person to offset a contemporaneous purchase from such customer.

The Commission has concluded that it is necessary and appropriate for the protection of investors to require disclosure of the amount of markups or markdowns in "riskless" principal transaction in equity securities. Disclosure of markups and markdowns will enable customers to make their own assessments of the reasonableness of transaction costs in relations to the services offered by broker-dealers. The level of transaction costs for a particular transaction may vary among broker-dealers and may also vary in accordance with the nature of the security being purchased or sold. The Commission believes that it can be important for customers to be aware of such variations in transaction costs to the extent practicable and believes disclosure of markups and markdowns in "riskless" principal transactions in equity securities will help accomplish that goal.

¹⁷As proposed, the odd-lot differential disclosure requirement was phrased in terms of any odd-lot differential paid "directly or indirectly" by the customer. The Commission has deleted those words and refrained from adding them to other parts of the confirmation rule since the rule by its terms would reach any direct or indirect payment of the various types covered even without the addition of the words "directly or indirectly." See also section 20 of the Act.

¹⁸The term "market maker" is defined in section 3(a)(38) of the Act (15 U.S.C. 78c(a)(38)).

In addition, as is discussed further below, the Commission believes that competition among broker-dealers may well be an effective supplement to existing regulatory controls on markups and markdowns in limiting the opportunity for unreasonable charges. In the absence of disclosure of markups and markdowns in such transactions, the possibility of real competition with respect to the level of such charges appears remote. "Riskless" principal transactions, as defined in the rule, are in many respects equivalent to transactions effected on an agency basis,¹⁹ and customers should be made aware of the costs incurred regardless of technical variations employed by broker-dealers in structuring such transactions.²⁰

A substantial portion of the transactions in equity securities effected by broker-dealers for retail customers are effected on exchanges and in the over-the-counter markets on an agency basis and the commissions charged are disclosed to the customer. Consequently, the absence of such disclosure of compensation in "riskless" principal transactions may mislead unsophisti-

¹⁹The Commission does not mean to suggest, however, that all disclosures pertaining to "riskless" principal transactions should be identical to those required for agency transactions. For example, the Commission has not proposed any general requirement that broker-dealers effecting "riskless" principal transactions disclose the identity of the "other side."

²⁰The language of the markup disclosure requirement has been revised to eliminate certain ambiguities. As adopted, it applies whenever a broker-dealer not acting as a market maker, after having received an order to buy from a customer, purchases the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from such customer, sells the security to another person to offset a contemporaneous purchase from the customer. That requirement would apply regardless of variations in mechanical techniques for structuring and sequencing transactions that are designed to offset one another. For example, a broker-dealer filling a customer's purchase order would not avoid the requirement by effecting a sale to his customer immediately before purchasing the security from another person instead of first purchasing the security from the other person for resale to the customer and then selling it to the customer. Similarly, a broker-dealer would not avoid the requirement in filling a customer's sale order by first purchasing the security from the customer for resale to another person and then selling it to that other person instead of first selling it to the other person and then purchasing it from his customer. In addition, the provision adopted makes clear that disclosure of the markup or markdown would be required regardless of whether the same share certificates were delivered to the other side of the "riskless" principal transaction in circumstances where the broker-dealer's principal transactions were structured as offsetting transactions.

Footnotes continued from last page

Smith Inc; First Manhattan Co.; and White, Weld & Co., Inc.

¹³See comment letters of Sullivan & Cromwell; and First Manhattan Co.

¹⁴See, e.g., comment letter of Merrill Lynch, Pierce, Fenner & Smith Inc.

¹⁵See comment letter of J. & W. Seligman & Co.

¹⁶See comment letters of the NYSE; and Merrill Lynch, Pierce, Fenner & Smith Inc.

cated customers into believing that no such compensation is being paid. Even if the investor is not so misled, he is left with uncertainty as to how the broker-dealer is being compensated as well as the amount of such compensation. This uncertainty can have an adverse effect on investor confidence in the over-the-counter market.

Commentators, however, asserted that for several reasons this requirement is both unnecessary and inappropriate. First, commentators urged that the markup disclosure requirement is not necessary to protect investors. It was suggested that the Rules of Fair Practice of the NASD already provide sufficient protection against overreaching by dealers.²¹ In that connection, commentators referred particularly to the NASD's rule requiring a broker-dealer, when acting for his own account, to "buy or sell at a price which is fair" and the "markup rule" or "five percent policy," embodied in an interpretation thereunder. Commentators stated that the NASD's markup rule has been vigorously and effectively enforced.²² Similarly, it was suggested that the "best execution rule" of the NASD²³ "has been effective in preventing dealers' overreaching and has resulted in customers receiving best execution in the over-the-counter market."²⁴ Some commentators also expressed the view that industry competition is sufficient to limit opportunities for abuse.²⁵ In addition, it was suggested that brokers and dealers are constrained to keep markups within reasonable limits because they are aware that the public has access to external sources for quotations in many securities.²⁷ It was also pointed out that in any event customers are free to request disclosure of the remuneration received by broker-dealers, and customers may stipulate the amount of the markups they are willing to pay.²⁸

²¹ See e.g., comment letters of Peterson & Co.; Reinholdt & Gardner; Mabon, Nugent & Co.; Roose, Wade & Co.; White Weld & Co., Inc.; and the NASD.

²² See article III, section 4, of the NASD Rules of Fair Practice, NASD Manual (CCH) §2154.

²³ See, e.g., comment letters of the NASD; Merrill Lynch, Pierce, Fenner & Smith Inc.; and Weinrich, Zitzmann, Whitehead, Inc.

²⁴ See Interpretation .03 under article III, section 1 of the NASD Rules of Fair Practice, NASD Manual (CCH) §2151.

²⁵ See comment letter of the Securities Industry Association, citing the statement made by Gordon S. Machlin, President, NASD, at the Commission's hearings on off-board trading rules (August 16, 1977), Securities and Exchange Commission File No. 4-180.

²⁶ See Comment letters of Authurs, Lesstrange & Short; Peterson & Co.; and Reinholdt & Gardner.

²⁷ See comment letters of Reinholdt & Gardner; Mr. G. Shelby Friedrichs; and White, Weld & Co. Inc.

²⁸ See comment letter of Sutro & Co., Inc.

In proposing the markup disclosure requirement for "riskless" principal transactions, the Commission did not intend to replace any of the NASD investor protection provisions enumerated above. The markup disclosure requirement is intended to supplement those provisions. Nor did the Commission intend to imply that broker-dealers routinely charge excessive or unreasonable markups or markdowns in securities transactions with their customers. As the same time, disclosure of markups and markdowns is an appropriate means of insuring that customers have an opportunity to identify and object to any unreasonably high charges. That opportunity may well serve as a significant means of protecting investors against unfair and unreasonable pricing practices. It may also, as a practical matter, permit those broker-dealers which consistently observe the highest standards of practice to compete more effectively against broker-dealers which on occasion or more frequently charge unreasonably high markups or markdowns. In that way, the "riskless" principal disclosure requirement may help to insure that brokers and dealers adhere to appropriate standards of professional responsibility.

Furthermore, the Commission does not view the "riskless" principal disclosure requirement solely as a means to address abusive practices; as noted above, the "riskless" principal requirement is important also to permit investors themselves to make informed judgments about the transaction services they receive and pay for. Disclosure of markups and markdowns in "riskless" principal transactions should assist investors in comparing the costs they incur in transactions effected by broker-dealers on either an agency or "riskless" principal basis and in assessing those costs in relation to the quality of services provided by competing broker-dealers.²⁹

²⁹ The markup rule of the NASD does not impose any precise upper limit on the range of permissible markups. As the NASD Rules of Fair Practice indicate, the markup policy is "a guide—not a rule" (see interpretation of article III, section 4, NASD Rules of Fair Practice). Some commentators observed that flexibility in any markup policy is desirable in view of the variety of factors relevant to a determination of what constitutes an appropriate markup. The "riskless" principal disclosure requirement should, nevertheless, be useful to investors in evaluating transaction costs in all situations regardless of compliance or noncompliance with NASD rules.

In that connection, the Director of the Corporation and Securities Bureau of the Department of Commerce of the State of Michigan observed:

"From various investigations and enforcement proceedings in this State, a pattern appeared whereby small brokerage firms have been purchasing low-rated securities and using high pressure sales techniques to

The assertion that existing competitive forces may deter unreasonable markups might be true in some instances but does not lead the Commission to conclude that this disclosure requirement is unnecessary. Current quotations are, of course, not always available to public investors for all securities; in addition, many investors, particularly individuals, may not always be able to acquire inside or inter-dealer quotations on over-the-counter securities. In light of the reluctance evident in numerous comment letters to reveal markups to the public,³⁰ it is not clear that all, or even most, customers would be able to obtain such information in the absence of a requirement of the sort imposed by Rule 10b-10. Unless such information is made available, it seems unlikely that customers can, without great difficulty, compare the costs of effecting transactions that are structured as "riskless" principal transactions.³¹

The second principal concern of commentators was that the markup disclosure requirement would impose costs upon dealers that outweighed the benefits of disclosure. It was observed that to disclose the markup or markdown would increase the expense of confirming transactions.³² Some suggested that disclosure of markups would adversely affect the income of dealers, in that, as a general rule, markups, although reasonable, might be difficult to justify, and as a result,

place them with unsophisticated and inexperienced investors. During the sales period the market price in thinly traded securities was maintained by small purchases. The securities were sold to the public at NASD maximum markup, producing high yields to the firm, followed shortly by substantial investor losses in the millions of dollars.

"I would note also that certain small firms have engaged in the practice of advertising highly rated securities in local papers, drawing in unsophisticated investors, and selling them to the public in riskless transactions at maximum NASD markups, despite the fact that most firms in the area were charging a commission at significantly lower rates."

³⁰ For example, Weinrich, Zitzmann, Whitehead, Inc. stated in its comment letter that "the customer has no fundamental right to this information."

³¹ See also Securities and Exchange Commission, Report of Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 2, 88th Cong., 1st sess. 676 (1963). As noted earlier, brokers acting as agents have been required to disclose commissions on confirmations. Some commentators questioned, however, whether customers are able to judge the fairness of a markup (see, e.g., comment letter of Investment Income Services, Inc.). On the other hand, an investor's ability to judge markups may well improve as a result of disclosure.

³² See, e.g., comment letters of Mr. Keith Wentz; Richards, Merrill & Peterson, Inc.; Investment Income Services, Inc.; and Jelferies & Co., Inc.

might have to be decreased.³³ Several commentators stated that in no other business are gross profits required to be disclosed, and they argued that it is unfair to single out the securities industry in this way.³⁴ A decrease in markups reportedly would destroy the incentive of securities salesmen, and, consequently, the public's interest in purchasing securities would decline.³⁵ It was also asserted that, because brokers provide numerous uncompensated services, profitable principal transactions are necessary to recoup expenses.³⁶

These arguments appear to the Commission to be overstated. The markup disclosure requirement is not applicable to all principal transactions engaged in by broker-dealers, but solely to those transactions in which the dealer structures as two back-to-back principal transactions what is in economic substance an agency transaction. Furthermore, these arguments all appear to be premised upon the assumption that if customers knew what they are routinely being charged on "riskless" principal transactions, they would object because they would invariably view markups or markdowns as unfair and be able without any reasonable basis to force dealers to lower markups currently charged. While competitive forces might cause markups to be lowered in some instances, the Commission has not adopted this disclosure requirement on the basis of any predictions as to its effects on the level of markups. Instead, the Commission has based its decision to adopt the requirement in large part on the belief that investors should have an opportunity to make their own informed judgments as to the reasonableness of transaction charges.

The fact that markup disclosures may or may not be made in other industries does not answer the question whether such a requirement is appropriate for securities transactions. Because of the special nature of securities, analogies to the standards of conduct prevailing in other industries may not be pertinent. Indeed, by the very nature of a broker-dealer's relationship with its securities customers, and particularly its retail customers, the broker-dealer is frequently in an advisory role where principles of

caveat emptor and arm's length bargaining are simply not applicable. Although a securities professional generally may act both as broker and as dealer with his securities customers, the Commission, the self-regulatory organizations and the courts have recognized that the existence of special duties toward those customers does not turn on the capacity in which the securities professional acts.³⁷ In addition to those grounds for finding analogies to other industries not pertinent in this context, there is a practical ground. Whereas the prices of many retail goods are relatively stable, permitting customers to "comparison shop," securities prices are sufficiently volatile to make comparison shopping on the basis of net price extremely difficult in many instances, particularly for retail customers.

Predicting that the cost of preparing confirmations would rise and income would fall as a result of the markup disclosure requirement, many commentators also predicted that the structure of the securities industry would be altered. Some predicted that mergers would increase;³⁸ others predicted that the financial condition of small securities firms would be threatened.³⁹ Commentators also predicted that the liquidity in locally and inactively traded securities would be adversely affected by this disclosure requirement.⁴⁰ It was suggested that the increased costs occasioned by the difficulty of effecting transactions in these securities justifies a greater markup than for exchange-listed or more widely traded over-the-counter securities. The Commission believes, however, that even if markups for these securities are justified, investors are entitled to know the amounts of such charges. The depth of the markets for, and liquidity of, locally traded securities and the continued ability of small broker-dealers to compete are matters of concern to the Commission, but the

assertions made by commentators are highly speculative, depending in large part on predictions about future investor preferences. Those predictions and certain other competitive implications of the "riskless" principal requirement are further discussed later in this release.⁴¹

Debt Securities. Finally, the Commission notes that several commentators have argued that a disclosure requirement for "riskless" principal transactions should not apply to debt securities.⁴²

The Commission first proposed to require confirmation disclosure of markups and markdowns in "riskless" principal transactions in September 1976, when it published its proposal to adopt Rule 10b-10.⁴³ As originally proposed, Rule 10b-10 would have required disclosure of markups and markdowns in "riskless" principal transactions in equity and debt securities, including municipal securities. When the Commission adopted Rule 10b-10 in May 1977,⁴⁴ it provided that Rule 10b-10 would not apply to municipal securities. At the same time, the Commission determined to revise and republish for further public comment the "riskless" principal markup disclosure provision.⁴⁵ The proposal, as then revised, applied to both equity securities and non-municipal debt securities.

Shortly after the Commission proposed those amendments, the MSRB undertook to determine whether confirmation disclosure of markups and markdowns should be required in the case of municipal securities. On August 3, 1977, the MSRB solicited public comment on that question and later held two public meetings in October 1977. Following those meetings, the MSRB sent to the Commission a letter dated November 16, 1977, summarizing some of the arguments made by commentators opposed to disclosure of markups and markdowns. On February 10, 1978, the MSRB sent to the Commission a letter in which it

³³See, e.g., *Arleen W. Hughes*, 27 SEC. 629 (1948), *aff'd sub nom. Arleen W. Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949); *Charles Hughes & Co., Inc.*, 13 SEC 676 (1943), *aff'd sub nom. Charles Hughes v. SEC*, 139 F.2d 434 (2d Cir. 1943); *Duker v. Duker*, 6 SEC 386 (1939); *Chasins v. Smith Barney & Co. Inc.*, 305 F. Supp. 489 (S.D.N.Y. 1969), *aff'd*, 438 F. 2d 1167 (2d Cir. 1971); *Opper v. Hancock Securities Corp.*, 250 F. Supp. 668 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966); *Cant v. A. G. Becker & Co., Inc.*, 374 F. Supp. 36 (N.D. Ill. 1974). See generally NASD Rules of Fair Practice, NASD Manual (CCH), para. 2001 et seq.

³⁴See comment letters of Martin Nelson & Co.; and Mabon, Nugent & Co.

³⁵See, e.g., comment letters of Wulff, Hansen & Co.; Mr. G. Shelby Friedrichs; Handle, Lundborg & Co.; and Smyth, Akins & Lerch, Inc.

³⁶See, e.g., comment letters of the NASD; Elmer E. Powell & Co.; Mabon, Nugent & Co.; Lowell M. Listrom & Co.; and Reinholdt & Gardner.

⁴¹See text accompanying note 51.

⁴²See, e.g., comment letters of Goldman, Sachs & Co.; John Nuveen & Co., Inc.; Mabon, Nugent & Co.; Merrill Lynch, Pierce, Fenner & Smith Incorporated; the Municipal Securities Rulemaking Board (the "MSRB"); the Securities Industry Association; and Sullivan & Cromwell. A number of persons who did not comment on this proposed amendment to Rule 10b-10 commented on a similar provision published by the Commission when it proposed to adopt Rule 10b-10. See Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

⁴³See Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (Sept. 22, 1976).

⁴⁴See Securities Exchange Act Release No. 13508 (May 5, 1977), 42 FR 25318 (May 17, 1977).

⁴⁵See Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

³⁷See, e.g., comment letters of Lowell H. Listrom & Co., Inc.; Sutro & Co., Inc.; Investment Income Service, Inc.; Barrett & Co.; and Handel, Lundborg & Co.

³⁸See, e.g., comment letters of Adams, Hess, Moore & Co.; Imperial Investment Co.; Mabon, Nugent & Co.; Elmer E. Powell & Co.; and Weinrich, Zitzmann, Whitehead, Inc.

³⁹See, e.g., comment letters of Wulff, Hansen & Co.; Mabon, Nugent & Co.; and Carolina Securities Corp.

⁴⁰See comment letter of Martin Nelson & Co.

stated its conclusion that "the imposition of a requirement to disclose remuneration in principal transactions in municipal securities is unnecessary and inappropriate."⁴⁶

The Commission has determined to defer a final decision on whether to require disclosure of "riskless" principal compensation in transactions in debt securities, including municipal securities, in order to solicit more specific public comment on that matter. The MSRB has provided its views, as well as those of several commentators in the municipal securities industry, on the application of such a requirement to transactions in municipal securities. Nevertheless, the Commission received very limited comment on the application of "riskless" principal disclosures to nonmunicipal debt securities. In a separate release, issued today, the Commission is soliciting further comment on those matters in connection with specific rule proposals that would require such disclosure for "riskless" principal transactions for municipal and nonmunicipal debt securities.⁴⁷

Exclusion of market makers. The "riskless" principal markup disclosure requirement does not apply to a transaction in a security for which a dealer acts as a "market maker." The term "market maker" is defined in section 3(a)(38) of the act to mean "any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis."

The Commission has provided an exemption for market makers because the "riskless" principal disclosure requirement might otherwise create substantial compliance problems for market makers. In making a two-sided market, involving price quotations for both the bid and the offer, a market maker may often engage in transactions that effectively offset one another, giving the appearance of being "riskless" principal transactions, even though the market maker did not structure any particular pair of transactions as offsetting. "Riskless" principal transactions. As a result, the problem of identifying when a "riskless" principal disclosure might have to be made could create substantial practical and interpretive difficulties for a bona fide market maker. For that reason, the Commission has determined to provide an exemption from the "riskless" principal disclosure re-

quirement for broker-dealers which are in fact acting as market makers in the security in which customer transactions are being effected. At the same time, the Commission cautions that those not actually making a bona fide market in a security will not qualify for the market maker exemption.

As noted above, the statutory definition of the term "market maker" includes "any dealer acting in the capacity of block positioner." While the term "block positioner" is not defined in the act, the term is generally used to describe a broker-dealer who facilitates the execution of a block transaction in an equity security by positioning at least some part of the block, that is by committing its own capital to fill a part of a customer's block sale order or effecting a short sale (or a sale from inventory) to fill part of a customer's block purchase order.⁴⁸

Because a block transaction in a particular security is generally distinguishable from other transactions in that security, the Commission has not attempted to define the term "block" or the term "block positioner" for purposes of rule 10b-10. A determination as to whether a quantity of a security is a block necessarily rests to some degree on the purpose for which the determination is being made and frequently involves the number of shares as well as the dollar value of the shares traded.⁴⁹ In an effort to provide some objective guidance, the Commission notes that an order involving a quantity of securities having a market value of \$200,000 should generally be considered to involve a block for purposes of rule 10b-10.⁵⁰ The Commission stresses, however, that the \$200,000 guide is intended merely to provide a general standard for those seeking to establish their entitlement to the market maker exemption in rule 10b-10 on the basis of their acting as block positioners and should not be considered to be the exclusive measure for rule 10b-10 or for other purposes in circumstances where a different result would be appropriate.

In assembling the "other side" of a block transaction, broker-dealers are frequently able to fill portions of a block order by affecting transactions with other customers, leaving only a residual portion to be positioned for

⁴⁶Block positioners are sometimes described as "upstairs market makers" since they augment the market making capacity offered by exchange specialists and other dealers who make two-sided markets.

⁴⁷See, e.g., NYSE Rule 127, 2 NYSE Guide (CCH) ¶2127; and Proposed Rule 13e-2(d), Securities Exchange Act Release No. 10539 (Dec. 6, 1973), 2 Federal Securities Law Reporter (CCH) ¶79,600.

⁴⁸See Rule 17a-17(b)(1), 17 CFR 240.17a-17(b)(1); Regulation U of the Board of Governors of the Federal Reserve System, 12 CFR 221.3(z)(2).

the broker-dealer's own account. Particularly if the block transaction is effected in the over-the-counter market, it appears possible for the broker-dealer to structure such transactions with customers on the "other side" either as agency transactions at disclosed commissions or as "riskless" principal transactions. Accordingly, questions might arise as to whether any such "riskless" principal transactions should be exempt as block positioning (and thus market making) transactions or, instead, treated separately as nonblock positioning transactions and thus subject to the disclosure requirement of rule 10b-10, even though the broker-dealer has positioned, at its own risk, some portion of the block order. As a general matter, the Commission believes that the phrase "acting in the capacity of block positioner," as it relates to the market maker exemption from the "riskless" principal disclosure requirement, should be interpreted to make the exemption available for portions of a block trade which may take the form of "riskless" principal transactions with persons on the "other side" where the broker-dealer has positioned at its own bona fide risk more than a nominal part of the block order.

Competitive implications. Several commentators stated that the "riskless" principal proposal could have anticompetitive effects.⁵¹ Since the proposed disclosure requirement did not apply to market making transactions of bona fide inventory transactions, some commentators suggested that adoption of the requirement might result in a disparity between broker-dealers who routinely deal from a bona fide inventory or act as market makers and those who do not and instead effect "riskless" principal transactions.⁵²

While, for practical considerations, the disclosure requirement applies only to "riskless" principal transactions and not to bona fide inventory or market making transactions, the Commission is not persuaded that that disparity will necessarily result in any unjustifiably anticompetitive or discriminatory effect. It has been pointed out that many regional and smaller broker-dealers often effect "riskless" principal transactions, but it appears that some larger, nationally based firms effect either "riskless" principal or agency transactions in securities in which regional firms make markets. In addition, it is by no means clear that the disclosure of markups and mark-downs will cause customers of firms making such disclosures to go elsewhere.

⁵¹See n. 41, supra.

⁵²See, e.g., comment letter of Mabon, Nugent & Co.

⁴⁶The MSRB's letters of November 17, 1977, and February 10, 1978, have been filed in Securities and Exchange Commission File No. S7-654.

⁴⁷See Securities Exchange Act Release No. 15220 (Oct. 6, 1978).

Predictions that such a pattern could develop depend in large measure on the speculative assumption that customers will inappropriately conclude that the prices they receive from dealers who disclose markups and markdowns are necessarily inferior to the prices they obtain when dealing "net" with other broker-dealers whose markups and markdowns remain undisclosed. In that connection, the Commission notes that one leading broker-dealer for several years has followed a policy of disclosing markups and markdowns in principal transactions in equity securities, apparently without adverse effects on its competitive position.⁵³

At the same time, disclosure of markups and markdowns in "riskless" principal transactions may enhance competition in the pricing of services provided by broker-dealers. In the absence of markup or markdown disclosure in "riskless" principal transactions, it remains difficult for customers to assess the level of transaction costs incurred in relation to the services provided in connection with those transactions.

On balance, and in the absence of any clear support for the proposition that investors will generally make inappropriate decisions regarding disclosed transaction costs, the Commission does not believe that this disclosure requirement will impose any burden on competition that would not be necessary or appropriate in furtherance of the purposes of the act.

C. MARKET MAKING

Paragraph (a)(5)(ii) of rule 10b-10 in the form proposed would require that a dealer effecting a transaction in an equity security disclose whether he is a market maker in that security.⁵⁴ This provision codifies certain principles of existing case law.⁵⁵ While commentators generally did not object to it, a few questioned the need to apply the requirement to those broker-dealers which are market makers solely by reason of their acting as block positioners.⁵⁶ The Commission has concluded that it would be appropriate to exclude from the disclosure requirement a dealer which, in the transaction in question, is a market maker, within the meaning of section 3(a)(38) of the act, solely by reason of its acting as a block positioner.

⁵³In addition, exchange member firms dealing in listed equity securities apparently have not been competitively disadvantaged in doing business at disclosed commissions while third market firms were dealing at net prices in the same securities.

⁵⁴The term "market maker" is defined in section 3(a)(38) of the act.

⁵⁵See *Chasins v. Smith Barney & Co., Inc.*, 438 F.2d 1167 (2d Cir. 1971).

⁵⁶See comment letters of Salomon Brothers; and the Securities Industry Association.

D. PREVAILING MARKET PRICES

The Commission has decided to withdraw its proposal to amend rule 10b-10 to require disclosure on confirmations of the best bid and offer prices displayed on level 2 of NASDAQ, or on an equivalent inter-dealer quotation system, at the time the transaction was effected.⁵⁷

Numerous commentators urged for several reasons that the Commission not adopt this proposal. First, it was suggested, in light of the protection provided by the NASD's markup policy⁵⁸ and best execution rule⁵⁹ and the availability of quotations,⁶⁰ that this requirement is unnecessary. It was also conjectured that enforcement of this provision would prove cumbersome.⁶¹

Second, it was stated that the proposal could increase substantially the costs of doing business for some broker-dealers. It was suggested that, inasmuch as some broker-dealers now subscribe only to level 1 of NASDAQ, this provision would require them either to absorb the expense of subscribing to level 2 of NASDAQ or to forego trading in all securities except those traded on a national securities exchange or those not listed on any electronic quotation service.⁶² Commentators further suggested that the proposal might also require some broker-dealers to acquire new computer facilities⁶³ or to adapt their existing computer facilities so that they could interface with NASDAQ level 2 or some other information system for the purpose of capturing quotations at the time orders are executed.⁶⁴ If quotations were instead entered manually, it was noted, the likelihood for error might increase substantially and broker-dealers might have to adopt

⁵⁷See paragraph (a)(4) of the proposed amendments to rule 10b-10, Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

⁵⁸Article III, sec. 4 of the NASD Rules of Fair Practice, NASD Manual (CCH) ¶ 2154. See comment letters of Merrill Lynch, Pierce, Fenner & Smith Inc.; Reinholdt & Gardner; Roose, Wade & Co.; and the National Securities Traders Association.

⁵⁹Article III, sec. 1 of the NASD Rules of Fair Practice, interpretation .03, NASD Manual (CCH) ¶ 2151. See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc.; and the National Securities Traders Association.

⁶⁰See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc.; Reinholdt & Gardner; and Herzog, Heine & Co., Inc.

⁶¹See comment letters of the NASD; and the National Securities Traders Association.

⁶²See comment letters of Wulff, Hansen & Co.; Jefferies & Co., Inc.; J. & W. Seligman & Co.; the NASD; the National Securities Traders Association; and S. C. Parker & Co., Inc.

⁶³See comment letters of Reinholdt & Gardner; and Goldman Sachs & Co.

⁶⁴See comment letter of Merrill Lynch, Pierce, Fenner & Smith, Inc.

costly procedures to verify the information recorded.⁶⁵ Finally, several commentators contended that, for transactions involving more than 100 shares, inside market quotations for 100 shares would be irrelevant⁶⁶ and might mislead customers as to the quality of executions they were receiving.⁶⁷ In addition, it was conjectured that requiring the disclosure of inside market prices might pressure broker-dealers to lower retail prices to inside market levels.⁶⁸ If retail prices fell closer to inside market levels, commentators suggested, broker-dealers might be discouraged from effecting transactions in over-the-counter securities, and the liquidity of markets in those securities might thereby be endangered.⁶⁹

While the Commission has not concluded that any or all of these arguments obviate the ultimate need for disclosure of best bid and offer prices, it has determined to withdraw the proposed requirement at this time. The Commission intends, however, to give additional consideration to the disclosure of "inside" or inter-dealer quotations as other legal and technological developments occur.

E. REMUNERATION PAID BY THIRD PARTIES TO DEALERS

The Commission has decided to withdraw its proposal to require disclosure of the source and amount of certain remuneration received or to be received by a dealer from any person other than the customer.⁷⁰ That provision was intended to require disclosure of special or irregular inducements paid by a third party to a dealer in connection with a securities transaction.

In withdrawing its proposal to require confirmation disclosure of such payments, the Commission stresses that it is not in any way suggesting that such disclosure would not be required under other Commission rules or provisions of the act. Indeed, the Commission believes that a failure to

⁶⁵See comment letters of Arthurs, Lestrangle & Short; Jefferies & Co.; and Merrill Lynch, Pierce, Fenner & Smith, Inc.

⁶⁶See, e.g., comment letters of S. C. Parker & Co., Inc.; the NASD; Merrill Lynch, Pierce, Fenner & Smith, Inc.; Reinholdt & Gardner; and Goldman, Sachs & Co.

⁶⁷See, e.g., comment letters of Merrill Lynch, Pierce, Fenner & Smith, Inc.; Sutro & Co., Inc.; J. & W. Seligman & Co.; NASD; and the National Securities Traders Association.

⁶⁸See, e.g., comment letters of Arthurs, Lestrangle & Short; Morgan, Olmstead, Kennedy & Gardner, Inc.; and Herzog, Heine & Co., Inc.

⁶⁹See comment letters of Morgan, Olmstead, Kennedy & Gardner, Inc.

⁷⁰See paragraph (a)(5)(i) of the rule as proposed to be adopted in Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (June 30, 1977).

disclose special payments intended to induce dealers to effect transactions with customers would violate the anti-fraud provisions of the act.

At the same time, however, the Commission intends to consider whether broker-dealers should be required to disclose the amount of special compensation paid by a broker or dealer to an account executive or any other person associated with the broker or dealer in connection with customer transactions in a security designated by the broker-dealer where (1) investment recommendations for the purchase or sale of that security are made to customers and (2) such compensation exceeds the normal or customary remuneration that would otherwise have been paid by the firm to that employee or associated person. Among other things, it appears that many customers may regard the amount of such additional remuneration as important in evaluating investment recommendations made to them. Before proposing any such requirement, however, the Commission would appreciate receiving any data, views or arguments interested persons may care to make concerning such a requirement.

III. PROPOSAL TO PERMIT THE DELIVERY OF QUARTERLY CONFIRMATIONS FOR INVESTMENT COMPANY PLANS

Paragraph (b) of rule 10b-10, as amended, permits brokers and dealers to use quarterly statements instead of immediate confirmations for transactions effected pursuant to investment company plans as defined in paragraph (d)(5) of the rule. Investment company plans, as defined, include (1) individual, tax qualified retirement plans, (2) contractual or systematic plans pursuant to which a customer agrees to buy specified securities in specified amounts at regular intervals and (3) certain group plans where the members of the group purchase securities collectively through a person designated by the group provided that the purchase arrangements meet several specific requirements.

The Commission has previously permitted the use of quarterly statements rather than immediate confirmations in some circumstances in order to reduce regulatory costs that appear to outweigh the benefits to investor protection. The Commission has examined the existing quarterly statement provisions of rule 15c1-4 in light of its understanding that the quarterly statement procedure has not been used. The Commission has sought to revise those procedures for investment company plans to the extent it believes appropriate in view of the need to maintain adequate protection for investors and has determined to adopt paragraph (b) and the definitions set

out in paragraph (d) substantially in the form proposed.

Most of the comments concerning the investment company plan provisions were to the effect that, unless revised still further, the procedure for quarterly statements would remain unused. At the outset, some commentators suggested that the definition of "investment company plan" in paragraph (d)(5) of the rule is too limited to make the quarterly procedure useful.⁷¹ It was suggested that the quarterly procedure would not be economically feasible because qualifying plans do not represent a significant proportion of all accounts and are not readily identifiable. One commentator suggested that the quarterly statement procedure could appropriately be made available for all transactions in securities offered by investment companies where payments are made directly to the investment company by the customer.⁷² While the Commission appreciates the concerns for cost savings prompting these suggestions, it nevertheless believes that the cost savings of eliminating the requirement to send immediate confirmations in all such situations would not sufficiently outweigh the risks to investor protection.

Some commentators also stated that they regarded the language in paragraph (d)(5)(i), which stated that an investment company plan includes "an individual retirement or pension plan qualified under the Internal Revenue Code," to be vague and possibly subject to restrictive interpretation.⁷³ Those commentators suggested that this language might be regarded as permitting use of the quarterly confirmation procedure only with respect to individual retirement accounts established under the Employee Retirement Income Security Act of 1974 ("ERISA"), and perhaps corporate pension plans. In response to that comment, paragraph (d)(5)(i) has been revised to reflect more clearly the Commission's intention that it not have any application to pension plans established for more than one individual. That provision does, however, permit the use of quarterly confirmations with respect to any retirement or pension plan established for a single individual and qualifying under the Internal Revenue Code regardless of whether that plan is also subject to provisions of the Internal Revenue Code added by ERISA.

Most persons commenting upon the investment company plan provisions of proposed rule 10b-10 regarded the "negative" confirmation procedure set

forth in paragraph (d)(5)(iii)(B) as a continuing deterrent to the employment of quarterly confirmation for group plans.⁷⁴ While it was acknowledged that decreasing this requirement to a single confirmation following a period of investment inactivity might result in some cost reduction over current "negative" confirmation procedures, some commentators contended that the principal cost of compliance with this requirement arise from the necessity to establish and operate a confirmation system that includes even a single "negative" confirmation.⁷⁵

The Commission received comments from one company currently employing the quarterly confirmation procedure.⁷⁶ That commentator stated generally that it had been able to reduce its costs "considerably" through the use of quarterly statements and that they had been "well received" by customers. It also stated that it sends negative confirmations to participants in its group plans in each quarter in which there is not any account activity and stated that it did "not find the proposed negative confirmation requirements particularly onerous * * *". That experience suggests that these expenses may not be as prohibitive as some have predicted, and the Commission continues to believe that a "negative" confirmation is appropriate for the protection of investors in this context.

Finally, concern was reflected in several comments on proposed paragraph (d)(5)(iii)(C) of the rule, which required, among other things, that the "arrangement" be terminated if payment is not received from a group plan's designated person within 10 days of the date designated for delivery of payment. Some persons indicated that it was unclear whether the "arrangement" required to be terminated referred to the use of quarterly statements or the entire purchase plan.⁷⁷ It was noted that this provision would require careful attention to precisely when payments were due, a difficult matter for plans involving employers not following uniform pay-

⁷¹Concern was also expressed regarding the applicability of the so-called "negative" confirmation requirement of paragraph (d)(5)(iii)(B) to individual retirement and pension plans described in paragraph (d)(5)(i). See comment letter of American Council of Life Insurance. Paragraph (d)(5)(iii)(B) is included in rule 10b-10 as part of a proviso applicable by its terms only to paragraph (d)(5)(ii); accordingly, it is not a condition to plans under paragraphs (d)(5)(i) or (ii).

⁷²See generally comment letters of the NASD; and the Investment Company Institute.

⁷³See comment letter of the Variable Annuity Life Insurance Co. ("VALIC").

⁷⁴See comment letters of the NASD; and VALIC.

⁷⁵See comment letters of the NASD; and USAA Investment Management Co.

⁷⁶See comment letter of the NASD.

⁷⁷See comment letters of the NASD; and the Investment Company Institute.

ment patterns.⁷⁸ It would also require installation of a confirmation system to back up the quarterly statement procedure should payments not be made within the prescribed period.⁷⁹

The Commission believes that if payment is not received within 10 days of the date specified in the plan, quarterly statements should not be used in lieu of immediate confirmations. The wording of paragraph (d)(5)(iii)(C) has been revised, however, to avoid possible confusion, and the rule, as adopted, will require immediate confirmations to be sent for at least the next three succeeding payments in the event a payment is not received within the prescribed time limits. Thereafter, quarterly statements could again be used in lieu of immediate confirmations. The Commission continues to believe that investors are entitled to assurances that payments made by them or on their behalf are promptly applied to the purchase of securities. The requirement that payments be made within 10 days of a date certain specified for delivery of payment is intended to provide this assurance. The Commission believes that it is realistic to expect employers or other designated persons to deliver payments within 10 days of the dates specified for payment and that it is reasonable to require broker-dealers to advise customers if payments are not received under these circumstances.

IV. STATUTORY BASIS

The Securities and Exchange Commission, acting pursuant to the act, and particularly sections 3, 9, 10, 11, 15, 17, and 23 thereof (15 U.S.C. 78c, 78i, 78j, 78k, 78o, 78q, and 78w), hereby adopts amendments to § 240.10b-10 of Title 17 of the Code of Federal Regulations, effective December 18, 1978. The Commission also rescinds § 240-15cl-4, effective December 18, 1978. The revisions made in these amendments as originally proposed are either technical in nature or make less restrictive existing or proposed requirements; accordingly, the Commission finds, pursuant to the Administrative Procedure Act (5 U.S.C. 551 et seq.), that further notice and public procedure are not necessary.

The Commission also finds that the amendments to rule 10b-10 do not impose any burdens on competition not necessary or appropriate in furtherance of the purposes of the act. The confirmation rule, as adopted, imposes some regulatory burdens and costs on broker-dealers, but the Commission has determined that the rule does not impose any inappropriate burdens on competition. The Commission believes that the disclosures required by rule 10b-10, as amended, are

necessary and appropriate not only to protect investors against certain abuses but also to provide investors with information concerning transaction costs. The disclosure of odd-lot differentials may in fact increase competition among dealers which charge such differentials and those who do not. While some commentators have suggested that the "riskless" principal disclosure requirement will burden competition, those concerns are based largely on speculative judgments about future investor preferences. On balance, the Commission believes that any burdens imposed by rule 10b-10, as amended, are justified in view of, among other things, the important role confirmations serve in protecting the investing public.

17 CFR Part 240 is amended by revising § 240.10b-10 to read as follows:

§ 240.10b-10 Confirmation of transactions.

(a) It shall be unlawful for any broker or dealer to effect for or with the account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security (other than U.S. Savings Bonds or municipal securities) unless such broker or dealer, at or before completion of such transaction, gives or sends to such customer written notification disclosing—

(1) Whether he is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for his own account;

(2) The date and time of the transaction (or the fact that the time of the transaction will be furnished upon written request of such customer) and the identity, price, and number of shares or units (or principal amount) of such security purchased or sold by such customer; and

(3) Whether any odd-lot differential or equivalent fee has been paid by such customer in connection with the execution of an order for an odd-lot number of shares or units (or principal amount) of a security and that the amount of any such differential or fee will be furnished upon oral or written request; *Provided, however*, That such disclosure need not be made if the differential or fee is included in the remuneration disclosed, or exempted from disclosure, pursuant to paragraph (a)(4)(ii); and

(4) If he is acting as agent for such customer, for some other person, or for both such customer and some other person.

(i) The name of the person from whom the security was purchased, or to whom it was sold, for such customer or the fact that such information will be furnished upon written request of such customer; and

(ii) The amount of any remuneration received or to be received by him from such customer in connection with the transaction unless remuneration paid by such customer is determined, pursuant to a written agreement with such customer, otherwise than on a transaction basis; and

(iii) The source and amount of any other remuneration received or to be received by him in connection with the transaction; *Provided, however*, That if, in the case of a purchase, the broker was not participating in a distribution, or in the case of a sale, was not participating in a tender offer, the written notification may state whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer; and

(5) If he is acting as principal for his own account—

(i) The amount of any mark-up, mark-down, or similar remuneration received in a transaction in an equity security if he is not a market maker in that security and if, after having received an order to buy from such customer, he purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from such customer, he sold the security to another person to offset a contemporaneous purchase from such customer; and

(ii) In the case of a transaction in an equity security, whether he is a market maker in that security (otherwise than by reason of his acting as a block positioner in that security).

(b) A broker or dealer may effect transactions for or with the account of a customer without giving or sending to such customer the written notification described in paragraph (a) of this section if—

(1) Such transactions are effected pursuant to a periodic plan or an investment company plan; and

(2) Such broker or dealer gives or sends to such customer within 5 days after the end of each quarterly period a written statement disclosing each purchase or sale, effected for or with, and each dividend or distribution credited to, or reinvested for, the account of such customer (pursuant to the plan) during the period; the date of each such transaction; the identity, number and price of any securities purchased or sold by such customer in each such transaction; the total number of shares of such securities in such customer's account; any remuneration received or to be received by the broker or dealer in connection therewith; and that any other information required by paragraph (a) of this section will be furnished upon written request; *Provided, however*,

⁷⁸ See comment letter of VALIC.

⁷⁹ See comment letter of the NASD.

That the quarterly written statement may be delivered to some other person designated by the customer for distribution to the customer; and

(3) In the case of transactions effected pursuant to an investment company plan—

(i) Payments for the purchase of securities by such customer or by such customer's designated agent are made directly to, or made payable to, the registered investment company, or the principal underwriter, custodian, trustee, or other designated agent of the registered investment company; and

(ii) The intention to give or send to the customer the written statement referred to in paragraph (b)(2) of this section, in lieu of the written notification required by paragraph (a) of this section, is disclosed in writing to such customer.

(c) A broker or dealer shall give or send to a customer information requested pursuant to this rule within 5 business days of receipt of the request; *Provided, however*, That in the case of information pertaining to a transaction effected more than 30 days prior to receipt of the request, the information shall be given or sent to the customer within 15 business days.

(d) For the purposes of this rule—

(1) "Customer" shall not include a broker or dealer;

(2) "Completion of the transaction" shall have the meaning provided in rule 15c1-1 under the Act;

(3) "Time of the transaction" means the time of execution, to the extent feasible, of the customer's order;

(4) "Periodic plan" means any written authorization for a broker acting as agent to purchase or sell for a customer a specific security or securities (other than securities issued by an open end investment company or unit investment trust registered under the Investment Company Act of 1940), in specific amounts (calculated in security units or dollars), at specific time intervals and setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them); and

(5) "Investment company plan" means any plan under which securities issued by an open-end investment company or unit investment trust registered under the Investment Company Act of 1940 are purchased or sold by a customer pursuant to—

(i) An individual retirement or individual pension plan qualified under the Internal Revenue Code;

(ii) A contractual or systematic agreement under which the customer purchases at the applicable public offering price, or redeems at the applicable redemption price, such securities in specified amounts (calculated in security units or dollars) at specified time intervals and setting forth the

commissions or charges to be paid by such customer in connection therewith (or the manner of calculating them); or

(iii) Any other arrangement involving a group of two or more customers and contemplating periodic purchases of such securities by each customer through a person designated by the group; *Provided*, That such arrangement requires the registered investment company or its agent—

(A) To give or send to the designated person, at or before the completion of the transaction for the purchase of such securities, a written notification of the receipt of the total amount paid by the group;

(B) To send to anyone in the group who was a customer in the prior quarter and on whose behalf payment has not been received in the current quarter a quarterly written statement reflecting that a payment was not received on his behalf; and

(C) To advise each customer in the group if a payment is not received from the designated person on behalf of the group within 10 days of a date certain specified in the arrangement for delivery of that payment by the designated person and thereafter to send to each such customer the written notification described in paragraph (a) of this section for the next three succeeding payments.

(e) The Commission may exempt any broker or dealer from the requirements of paragraphs (a) and (b) of this section with regard to specific transactions of specific classes of transactions for which the broker or dealer will provide alternative procedures to effect the purposes of this section; any such exemption may be granted subject to compliance with such alternative procedures and upon such other stated terms and conditions as the Commission may impose.

(Secs. 3, 9, 10, 11, 15, 17, 23, 48 Stat. 891, 89 Stat. 97, 121, 137, 156 (15 U.S.C. 78c, 78i, 78j, 78k, 78o, 78q, 78w).)

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

OCTOBER 6, 1978.

[FR Doc. 29123 Filed 10-13-78; 8:45 am]

[4830-01-M]

Title 26—Internal Revenue
CHAPTER 1—INTERNAL REVENUE
SERVICE, DEPARTMENT OF THE
TREASURY

SUBCHAPTER A—INCOME TAX

(T.D. 7568)

PART 1—INCOME TAX; TAXABLE
YEARS BEGINNING AFTER DECEMBER
31, 1953

Definition of "Other Security of the
United States" for Purposes of De-
termining Book-Entry Security

AGENCY: Internal Revenue Service,
Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations that add the Federal Home Loan Mortgage Corporation to the list of entities an obligation of which may qualify as an "other security of the United States" for purposes of the regulatory definition of "book-entry security." Under the new regulations, obligations of the Federal Home Loan Mortgage Corporation may be identified upon their sale or transfer (for basis and holding period purposes) by their lot numbers.

DATE: The regulations apply to sales and transfers of book-entry securities made after December 31, 1970.

FOR FURTHER INFORMATION
CONTACT:

Walter H. Woo of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3734).

SUPPLEMENTARY INFORMATION: Under existing § 1.1012-1(c)(7), taxpayers who sell or transfer book-entry securities of qualifying entities may identify those securities (for basis and holding period purposes) merely by specifying their lot numbers. Paragraph (c)(7)(iii)(a) of § 1.1012-1 defines book-entry securities to include Treasury bonds, notes, certificates of indebtedness, or bills issued under the Second Liberty Bond Act, or "other security of the United States." The amendment modifies § 1.1012-1(c)(7)(iii)(b) to add the Federal Home Loan Mortgage Corporation to the list of entities obligations of which may qualify as an "other security of the United States" for purposes of the definition of the term "book-entry security."

This amendment merely liberalizes the identification rules for purposes of determining basis and holding period in the case of certain securities. Accordingly, it is found unnecessary to issue this Treasury decision with

notice and public procedure. Additionally, this regulation is not a significant regulation under paragraph 8 of the proposed Treasury Directive appearing in the FEDERAL REGISTER for May 24, 1978 (43 FR 22319) because it does not materially change existing policy.

DRAFTING INFORMATION

The principal author of this regulation is Walter H. Woo of the Legislation and Regulations Division, of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

ADOPTION OF AMENDMENTS TO THE REGULATIONS

Accordingly, 26 CFR Part 1 is amended by revising paragraph (c)(7)(iii)(b) of § 1.1012-1 to read as follows:

§ 1.1012-1 Basis of property.

* * * * *

- (c) *Sale of stock.* * * *
- (7) *Book-entry securities.*
- (iii) * * *

(b) The term "other security of the United States" means a bond, note, certificate of indebtedness, bill, debenture, or similar obligation which is subject to the provisions of 31 CFR Part 306 or other comparable Federal regulations and which is issued by (1) any department or agency of the Government of the United States, or (2) the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Federal Land Banks, the Federal Intermediate Credit Banks, the Banks for Cooperatives, or the Tennessee Valley Authority;

* * * * *

Because this Treasury decision merely liberalizes the identification rules for purposes of determining basis and holding period in the case of certain securities, it is found unnecessary to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

(Sec. 7805, Internal Revenue Code of 1954 (68A Stat. 917 (26 U.S.C. 7805)).)

JEROME KURTZ,
Commissioner of Internal
Revenue.

Approved: October 5, 1978.

DONALD C. LUBICK,
Assistant Secretary of the
Treasury.

[FR Doc. 78-29190 Filed 10-11-78; 4:26 pm]

[4810-35-M]

**Title 31—Money and Finance:
Treasury**

**CHAPTER II—FISCAL SERVICE;
DEPARTMENT OF THE TREASURY**

**TREASURY TAX AND LOAN
ACCOUNTS**

**Announcement of Effective Date of
Final Rules and Amendments to
Certain Provisions Concerning Col-
lateral Pledged**

AGENCY: Fiscal Service, Department of the Treasury.

ACTION: Announcement of effective date of final rules and amendments to certain provisions concerning collateral pledged under 31 CFR Part 203.

SUMMARY: In the FEDERAL REGISTER of May 2, 1978 (43 FR 18960) the Treasury Department issued final regulations (31 CFR Parts 203, 214, 317, and 321) and interim regulations (31 CFR 226) to implement the investment provisions of Pub. L. 95-147 of October 28, 1977. The regulations issued on May 2, 1978, called for an effective date of July 6, 1978, provided the Congress had appropriated funds to cover the payment of fees for certain services rendered under the regulations. Since the Congress had not appropriated the necessary funds, a notice was published in the FEDERAL REGISTER on June 19, 1978 (43 FR 26309) deferring that effective date.

The Congress has now made the necessary funds available. Accordingly, the effective date of both the final and interim rules issued on May 2 as amended by this notice is November 2, 1978.

The intent of Pub. L. 95-147 is to permit the Treasury to earn interest by the investment of its operating cash balances and, at the same time, pay fees for certain services which have not heretofore been compensable.

Subpart D of 31 CFR Part 203 relating to collateral pledged as security by depositaries for tax and loan accounts as published in the FEDERAL REGISTER of May 2 is being amended. First, by this amendment, the maturity of the type of collateral security accepted under subparagraph 9 of § 203.15(d) (i.e., commercial and agricultural paper and bankers' acceptances) is being extended from one year to two years. Second, by this amendment, a

new paragraph (i.e., paragraph (f)) is being added to § 203.15 to describe actions which will be taken, upon the insolvency of a depository, to perfect the Treasury's security interest in the proceeds of the collateral which that depository has pledged as security for tax and loan funds.

Further, 31 CFR Part 226, entitled "Recognition of Insurance Covering Treasury Tax and Loan Depositaries" which was published as an interim rule on May 2 is hereby being adopted as a final rule.

EFFECTIVE DATES: The provisions of the rules which were published in the FEDERAL REGISTER of May 2 (43 FR 18960) and as amended by this notice are effective on November 2, 1978.

FOR FURTHER INFORMATION CONTACT:

Mr. John Kilcoyne, Assistant Fiscal Assistant Secretary (Banking), Office of the Secretary, Department of the Treasury, Washington, D.C. 20220, 202-566-2849.

Additionally, financial institutions having questions as to operating procedures may direct such questions to the Federal Reserve Bank or Branch serving the geographical area in which the institution is located.

SUPPLEMENTARY INFORMATION: By this notice, the effective date of the regulations issued on May 2, 1978, as amended, is being established. Certain paragraphs of the regulations issued on May 2, 1978, cited specific dates which were predicated on the presumption that those regulations were to be effective on July 6, 1978. Consequently, due to the postponement of the effective date to November 2, 1978, those paragraphs are hereby being revised to reflect dates consistent with the revised effective date.

In the preamble to the final regulations issued on May 2, 1978, it was stated that the Treasury was considering what action it could take to expand categories of eligible collateral. While the Treasury's study of collateral is continuing, the Department is now extending the maturity limitation of the collateral security accepted under subparagraph (9) of § 203.15(d) from one year to two years: at 90 percent of face value.

Further, by this amendment, the Treasury is adding a new paragraph (paragraph f) to § 203.15 to describe general requirements pertaining to the perfection of the Treasury's security interest in the proceeds of pledged collateral in the event of the insolvency of the depository. This is an amendment of a technical nature which is intended to preserve, subsequent to the insolvency of a depository, the Treasury's interest in the proceeds of the collateral that a tax and loan deposi-