

N A S D

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Free-Riding

Seventeen New Questionnaires Authorized

Vigorous application of the Association's anti-free-riding policy continues with investigation of seventeen additional "hot issues" authorized by the Executive Committee of the Board of Governors.

The offerings currently under study are Anken Chemical & Film Corporation, Atlantic Research Corporation, Chemical Milling International Corporation, Coil Winders, Inc., Eichler Homes, Inc., The Fed-Mart Corporation, Greater All American Markets, Inc., Hermetic Seal Corporation, Keystone Custodian Funds, Inc., Laguna Niguel Corporation, Loral Electronics Corporation, Magma Power Company, Moog Servocontrols, Inc., Permanent Filter Corporation, Philco Corporation, Surrey Oil & Gas Corp. and Wometco Enterprises, Inc. In addition, a study of the distribution of United Control Corporation is underway.

District Committees are now studying the results of free-riding investigations previously conducted.

The need for all registered representatives to understand both the Association's Free-Riding and Withholding Interpretation and the provisions of Section 10, Article III of the Rules of Fair Practice cannot be emphasized too strongly. Disclosure of the names of registered representatives who have sold securities to "insider" accounts is required in the questionnaire, since registered representatives are equally bound with their employing firms to make a bona fide public offering of all new issues.

SEC REQUESTS NEW LEGISLATION

NASD Submits Comments at Senate Hearing

The SEC has requested legislation from Congress on five of the Acts which it administers, including eleven proposed amendments to the Securities Act of 1933 and thirty-one proposed changes in the Securities Exchange Act of 1934.

At a hearing on June 16 before the Securities Subcommittee of the Senate Committee on Banking and Currency, the Association took issue with certain of these proposals.

In general, the Association's position is one in favor of amendments which serve to clarify and to improve existing legislation but strongly opposes new legislation granting the SEC unlimited rule-making power without setting forth specific guides or standards.

\$87,300 Tab, Plus Costs

Eight complaints filed against a member within a 10 months period involving the most flagrant churning cases in the history of the Association, excessive mark-ups, and a series of violations of other NASD Rules, have resulted in the most severe penalties ever assessed by the NASD against a member and its registered representatives.

The penalties, imposed by the Board of Governors on appeal, carried expulsion of the member and a fine of \$25,000. In addition, fines totaling \$62,300 were imposed against eleven registered representatives and the registrations of nine of these representatives were revoked. Costs of the proceedings were also assessed against the member and its two principal officers.

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While the Association submitted comments on all proposals affecting the '33 and '34 Acts, of particular interest to members are the following Sections of the Bill seeking to amend the '34 Act.

Section 6 of the Bill would confer on the Commission broad powers to prescribe rules to provide safeguards with respect to financial responsibility. The Association opposed its enactment when originally introduced as it offered no standards to guide the Commission in exercising these broad powers. The SEC has now added a statement specifying that no rule will require a ratio of aggregate indebtedness to net capital to be more restrictive than 20 to 1. NASD now supports the Commission's proposal.

Section 7 would make it unlawful to borrow, lend or hold customers' securities in contravention of such rules as the Commission may prescribe, and would replace the present provision prohibiting the lending of securities without the customer's consent. The Association pointed out that this Section represents a request by the Commission for practically unlimited power to govern by rule. NASD opposed the enactment of the Section, stating that requirements, in matters like this one, should be enacted by Congress and not left to be written by the Commission without some definite guides or standards. As a result of the opposition of the industry, the Commission has informed the Senate that it will re-examine this Section.

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In eight of the accounts examined for churning by the District Committee, wherein customers were taken out of investment grade securities and traded in and out of highly speculative stocks at excessive mark-ups, it is estimated that customers of the respondents lost \$216,000 while the firm and its representatives realized a profit of \$181,500. Transactions in one of these accounts resulted in the rotation of the customer's holdings three and one-half times within two years. Estimated loss to the customer was \$73,000 and the profit to the firm and its representative was \$61,000.

"These acts of churning," the Committee stated in its decision, "have a built-in loss factor from the inception of a transaction as the customer has suffered an immediate loss with the taking of these excessive mark-ups by the Respondents. In a good number of cases, considering the highly speculative security and the high mark-up, these built-in losses are insurmountable."

Some 2,300 principal transactions reviewed by the Committee disclosed that 2,100 of these were same-day riskless transactions with over fifty per cent of them executed at mark-ups in excess of ten per cent.

Several representatives were also found to have made unsuitable recommendations to customers without disclosing material facts, offered guarantees in connection with "switches" and converted customer's funds to the firm's use, in addition to other violations of Association Rules.

The District Committee vividly summarized, in its decision, the respondents' conduct as "utter and callous disregard for not only the Association's Rules, but all accepted business ethics."

The Board of Governors upheld the decision of the District Committee with some modification of the fines imposed at the District level.

MORE QUOTES, MORE COVERAGE

Regional meetings were conducted by the National Quotations Committee during May and June to review and strengthen the Association's quotations program at the national, regional, and district levels. At the full-day meetings, which took place in San Francisco, Chicago, Dallas and New York, Emmet K. Whitaker, Chairman of the National Quotations Committee, and John H. Hodges, Jr., Secretary, outlined the Committee's plans and objectives for NASD quotations as well as means for expanding press coverage.

Discussions centered on the Association's National List, describing why it was established, how it operates, and its future development. A major objective of the National List project, the Chairman explained, is to have quotations on the most widely-owned, nationally-active Over-the-Counter securities transmitted over the wires of the Associated Press. This would make the quotations available to almost every important newspaper throughout the nation.

"Success in the project is considered to be the most important step which the Association can take

to improve newspaper coverage of Over-the-Counter quotations on a national basis," Mr. Whitaker emphasized, "and we will continue our efforts to convince Associated Press and newspapers throughout the nation of the reader interest which exists in Over-the-Counter quotations."

Also brought to the attention of the groups was a statement from the Board, requesting that all Over-the-Counter quotations furnished to the press as a public service be released under the NASD masthead. District Quotations Committees were asked to assist in the establishment of local quotations committees wherever needed in their Districts.

Each of the Regional Committees requested that members of the Association be advised that application forms for securities, believed to warrant regional quotations coverage in *The Wall Street Journal*, be filed with their respective Regional Committees. Application forms and information regarding requirements for the regional lists are available at the Association's District Offices in New York, Chicago, Dallas, and San Francisco.

Selling Group Agreements

The Board of Governors believes that dealers fail to observe the spirit, if not the intent, of the Rules of Fair Practice when purchasing shares from investment company underwriters with whom they have selling group agreements in order to fill orders, at a discount, from other dealers who are not parties to the same selling group agreement.

It is the Board's opinion that this situation may be corrected by underwriters and distributors through amendments to selling group agreements and strict enforcement of these agreements. Such amendments would specify that parties to the agreement may purchase shares at a discount only to fill orders in hand from members of the public.

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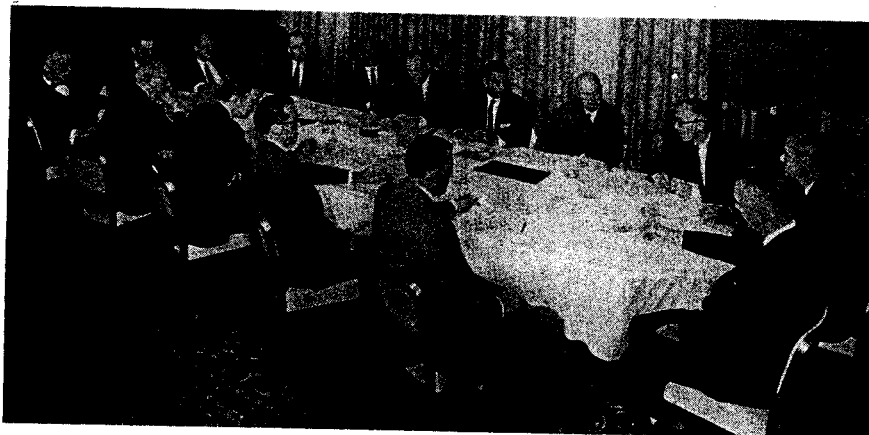
Growth Continues; Costs Assessed Against Registered Representatives

Record numbers of registered representatives continue to enter the securities business. An average of 3,075 a month have filed with NASD since January 1, 1959. February was the highest month this year with 3,718 new registrations. While new records were set in 1958, it does not appear that these records will stay on the books very long.

Costs of proceedings in a complaint case may be assessed directly against any registered representative whose registration is revoked or who is named a cause of the com-

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QUOTATIONS MEETINGS COAST-TO-COAST



PACIFIC COAST REGIONAL QUOTATIONS MEETING SAN FRANCISCO

Left to right, front:

Messrs. Conway, Ellis, Webster, Hill and Berle. *Right side:* Messrs. Summerell and Whitaker. *Rear:* Messrs. Rohde, Ragen, Gibson, Vicino, Morrill and Hodges. *Left side:* Messrs. Resh and Weir.

MIDWEST REGIONAL QUOTATIONS MEETING CHICAGO

Left to right:

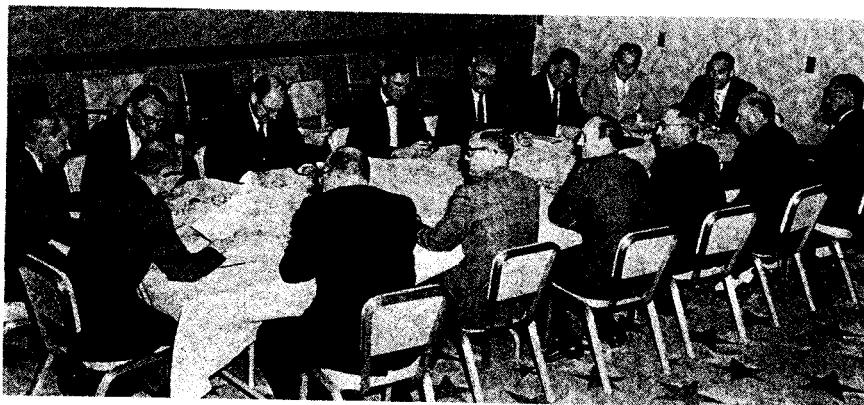
Messrs. Torrey, Van Heyde, Kruse, Bohrer, Howe, Cowden, Hodges, Whitaker, Stevenson, Darfler, McCorry, Brady, Hunter and Clendenin.



SOUTHWEST REGIONAL QUOTATIONS MEETING DALLAS

Left to right, head of table:

Messrs. Whitaker and Hodges. *Rear:* Messrs. Turner, DeShong, Peters, Nelson, Cole, Fagan and Atchison. *Front:* Messrs. Jacques, Bayne, Dunlap, Josey, Brown and Schweickhardt.



EASTERN REGIONAL QUOTATIONS MEETING NEW YORK CITY

Left to right, standing:

Messrs. Doyle, Smith, Rouse, May, Kennedy, Emen and Gilleran. *Seated, front:* Messrs. Peters, Rieber, Ward and Morris. *Seated at head table:* Messrs. Harris, Cowden, Hodges, Whitaker and Cunningham.



"Withdrawal Plans"

The Investment Companies Committee of the Board of Governors has notified underwriters and distributors of investment company shares that no "withdrawal plan" statistics, either hypothetical or actual, may be distributed. This bar includes data prepared for so-called "dealer only" or "wholesaler only" use, as well as any data prepared for distribution to the public.

Negotiations are currently underway between the Committee and the SEC to develop methods of presentation to the public that will be fair and in conformance with the SOP.

Pending completion of these discussions, members are cautioned that any statistical information inadvertently in circulation must be withdrawn. No general institutional advertising of such plans is authorized, and care should be exercised to insure that such plans are offered only when their suitability to the needs and financial conditions of customers is definitely known.

"Withdrawal plans" usually provide for periodic payments of a fixed amount to the investor and for the sale of a portion of his shares whenever income from the investor's holdings is insufficient to meet this fixed payment.

300,000 Distributed



Three hundred thousand copies of the booklet "NASD . . . What it is . . . What it does to protect the public" have been distributed by members. Additional copies are offered in quantities of 100 or more at \$5.00 per one hundred copies. Members may imprint their firm name on the back cover before distributing the booklet to customers and others.

Legislation

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Section 16 would authorize the Commission, the Association, and any registered exchange to determine who was a cause of an action that results in denial or discontinuance of membership of a broker or dealer. The Association stated that this is a desirable amendment.

Section 17 would specifically provide for review by the Commission of proceedings under NASD Rules against a registered representative or any other person associated with a member. This makes it clear that such associated persons have full rights to review of disciplinary decisions by the Association in the same manner as members. The Association is in complete agreement with this amendment.

Section 30 would impose a forfeiture penalty of \$100 a day against a person who fails to file information required to be filed under the Act. This penalty is similar to one now provided for failure to file information pursuant to an undertaking in a registration statement. The Association suggested that the Commission be required to notify a person of his failure to file all required information prior to the imposition of a penalty. Further, the Section should also specify the reports and documents to which it will apply and require the Commission to show that the failure to file was intentional and not due to inadvertence. In addition, the Commission should be required to elect between civil and criminal penalties. The Commission requested further opportunity to consider this Section in the light of suggestions made by industry at the hearing.

Representing the NASD at the hearing were Alexander Yearley, IV, Chairman of the Board of Governors; James G. Dern, a member of the Board and Chairman of the Association's Legislation Committee; Wallace H. Fulton, Executive Director; and Marc A. White, Counsel. Senator Harrison A. Williams of New Jersey is Chairman of the Subcommittee.

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plaint in cases where the allegations as to his employer-member are dismissed—so the Executive Committee decided. All costs must, of course, be paid by a representative whose registration is revoked before he may attempt to re-enter the business.

Applicants for registration who fail the qualification examination must now pay the \$10 fee each time they retake the test.

The NASD Qualification Examination has been adopted under the new Georgia State Law requiring an examination of all persons seeking to enter the securities business in Georgia. The Association is now administering its examination to candidates for registration with the State of Georgia from non-member firms at the usual \$10 examination fee. This agreement, of course, also takes care of candidates for registration with NASD members.

Variable Annuity Life Insurance Company and Equity Annuity Life Insurance Company, defendants in the recent Supreme Court case, have filed for registration with the SEC under the '33, and '40 Acts. The corporate structure of the companies and related matters have raised numerous problems still to be worked out with the Commission. The Association is watching these developments closely.

A revised edition of the complete NASD Manual has been distributed to members, offering an easier-to-read type, a new enlarged index, more cross-references and more reference tabs. The Rules of Fair Practice governing the business conduct of members and representatives, however, remain the same. New manual binders to replace those worn, shabby, broken or otherwise unsuitable are available at cost from the Executive Office for \$2.50 each.