



SPECIAL REPORT

TO NASD MEMBERS

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., NEW YORK, N.Y.

SR1, February, 1969

To All NASD Members and Branch Offices:

The Association is presently discussing with six national and regional stock exchanges a tentative plan to utilize the facilities of these organizations to set up regional clearing centers for the over-the-counter securities markets all across the United States that would be tied into a national OTC clearing network as soon as possible.

The establishment of this OTC stock clearing system is one of the most important steps ever undertaken by the Association, and compares to the ambitious program now underway to develop an automated quotations system for the over-the-counter markets by late 1970.

The stock exchanges involved in these discussions are the American, Boston, Detroit, the Philadelphia-Baltimore-Washington Stock Exchange, the Midwest Stock Exchange and the Pacific Coast Stock Exchange. We have also discussed clearing plans with the New York Stock Exchange which has indicated that it will give assistance to the Association's program wherever possible.

A study recently completed for us by Arthur D. Little, Inc., a consulting firm in Cambridge, Massachusetts, concluded that one of the major causes of the present paper work backlog in the over-the-counter markets and the mounting problem of failure to promptly deliver securities owed to customers, was the absence of a national clearing facility for unlisted stocks that would encompass all types of broker/dealers in various sections of the country.

NASD plans for a national clearing set-up call for the immediate expansion of the NOTC Corporation in New York, which presently utilizes the facilities of the American Stock Exchange Clearing Corporation. Since the National OTC Clearing Corporation currently processes in excess of 2½ million shares a day in the New York area, we have requested that the NOTC and the American Stock Exchange consider, on an interim basis, expanding their present OTC clearance operation beyond the New York metropolitan area with the view that these transactions can eventually be incorporated into the contemplated nationwide system.

In addition, we hope to adopt a clearing procedure similar to the one now being used by the Pacific Coast Stock Exchange which is termed a Net-By-Net System. Basically, this is a method of settlement whereby each clearing member's net balance in securities and money is brought forward on a daily perpetual inventory basis. The clearing corporation takes a position in the trading comparison so that the net balances of a clearing member are handled only with the clearing corporation. In effect, the clearing corporation acts in the capacity of another broker and all settlements of net balances for a clearing member are transacted with the corporation instead of between two participating member firms as is the case with other clearing operations. This net-by-net clearing method is the most adaptable to the needs of the over-the-counter markets.

The clearing problem in the over-the-counter markets, according to the Arthur Little study, centers in the fact that almost half of the transactions between firms are inter-regional in nature; for example, one firm may be in New York or Chicago and the firm on the other side of the trade may be in Boston or Los Angeles, thus seriously restricting the use of present OTC clearing facilities that by nature cannot accommodate inter-regional trading.

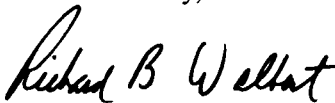
The Little study estimates that five billion shares per year are traded in the OTC markets and a surprisingly high degree of these are inter-regional trades (approximately 42 percent of all trades) and a surprisingly low percentage are purely local trades where both sides of the transaction are in the same city. Thus, only about 25 percent of all trades are, for example, New York City to New York City; and local trading in the top twenty cities in the country still represents less than 50 percent of the total.

The Little study pointed out that the fundamental problem in securities clearing today is the interaction of two basic factors: (1) The inherent disparity between the ease with which broker/dealers can make a trade (sell) and the difficulty of settling the trade (making delivery of the certificates); and (2), the public's desire to turn over their accounts faster than ever before. Today a securities certificate may be traded ten times in a twenty day period—the length of time that may be required for the first trade to clear. This disparity is being further aggravated by the increased work load experienced by the industry.

It is the NASD's hope to have its inter-regional OTC stock clearing operation set up within a year, and, by that time to also tie each regional clearing center together in a national network. Some regional centers will be in operation prior to this time. Tentative plans call for the Pacific Coast Stock Exchange facility to be used as the pilot regional center established by the NASD. It is also our intention to seek cooperation and participation from the banking industry and to incorporate certain bank clearing operations into the national OTC clearing network.

The conclusions of the Little study have been presented to a special NASD Committee, consisting of the present and recent Board Chairmen and headed by Robert M. Gardiner, managing partner of Reynolds & Co. in New York City. Other members of the Committee are the present NASD Chairman, Kenneth H. Sayre, a partner of Irving Lundborg & Co. in San Francisco; Phil E. Pearce, president of G. H. Crawford Co., Inc. in Columbia, South Carolina; Allan C. Eustis, Jr., a Vice President of Spencer Trask & Co., Inc. in New York City and G. Shelby Friedrichs, a partner of Howard, Weil, Labouisse, Friedrichs and Company in New Orleans, Louisiana.

Sincerely,



Richard B. Walbert
President