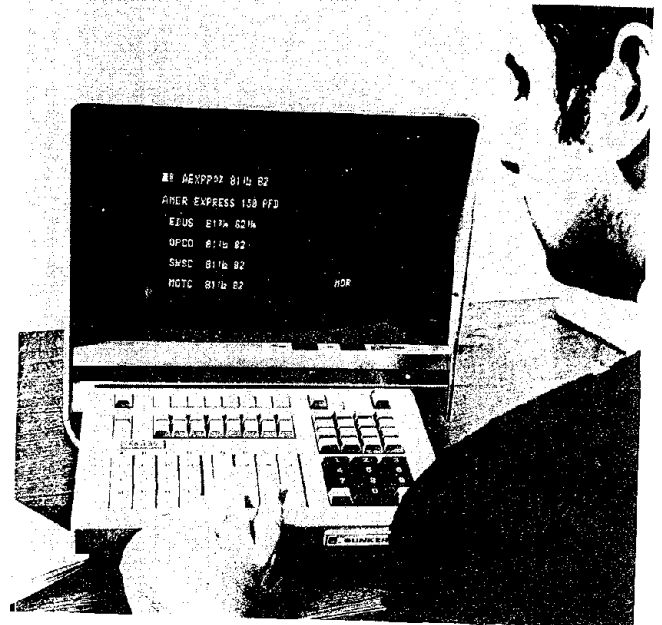
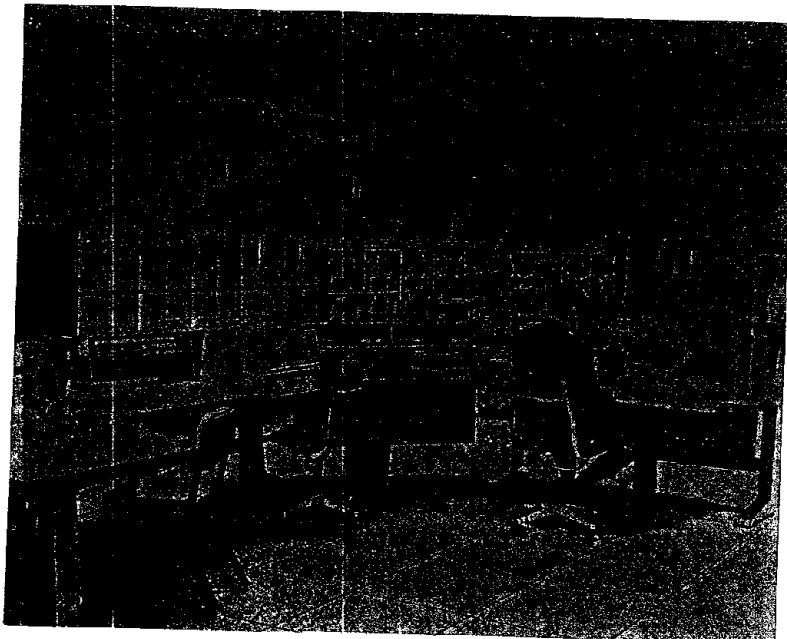


NASD
1970
REPORT TO
MEMBERS
CONDENSED VERSION





CHAIRMAN'S REPORT

"Change" was the watchword for the securities industry during 1970. The year's activities resulted in the development of an "Electronic Stock Market", which has expanded the influence and importance of the over-the-counter market. Strides were also made in developing a nationwide OTC clearing system. More stringent regulations were designed to avert financial and back-office problems in member firms. Investors, for the first time, became protected by law from losses resulting from possible bankruptcy of brokerage firms.

The NASD, which is the only regulatory agency having a diverse membership representing all segments and products in the securities industry, continued to use its responsibility to fuse the opinions of its members into cohesive goals and needed improvements for the industry and the public.

A major change in the NASD in 1970 was the shift in leadership. The NASD Board regretfully accepted the resignation of Richard B. Walbert, who relinquished his post as NASD President in the spring to accept the Presidency of Halsey, Stuart & Co. in Chicago. Shortly after his departure, the Board of Governors, with the help of a Special Selection Committee, chose Gordon S. Macklin, formerly a partner in McDonald and Company in Cleveland, as the new President of the Association. I have found Gordon Macklin extraordinarily well equipped to spur the Association on to reach its proper position as a pivotal point in the over-the-counter market and the entire securities industry.

The primary accomplishment for the over-the-counter market and the NASD during 1970 was, of course, the completion of NASDAQ. The system was actually working by the end of 1970, although the official start-up date didn't occur until February 8, 1971. On that date, NASDAQ quotations were first released to the press. NASDAQ's completion gave me my greatest personal satisfaction as Chairman of the Board. I feel that NASDAQ has changed the entire OTC market because investors, brokerage firms and the NASD now have vital information on the inner workings of the OTC market which has not been available in the past. President Macklin and his staff, as well as the Bunker-Ramo Corporation (the NASDAQ contractor) should be commended for their fine work in bringing to fruition the first "Electronic Stock Market" in the country.

Because of the swelling volume in late 1969 and early 1970, the NASD's nationwide OTC clearing system has assumed increased importance. As a significant step in developing the clearing program, the National Clearing Corporation acquired the National OTC Clearing Corporation in New York City in late August. This acquisition has given us the opportunity to incorporate a functioning clearing organization into our overall program.

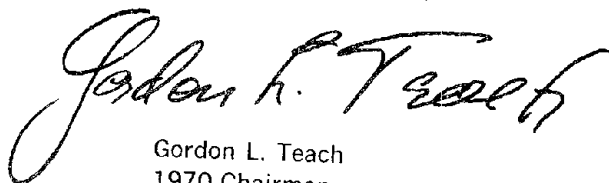
Investor protection took a significant step forward in 1970 with the enactment of the Securities Investor Protection Act. The NASD actively participated in working with a special industry task force and the Congress in designing a corporation to safeguard investors from financial loss resulting from financial instability in a brokerage firm. Under the new law, investors are protected in a similar manner to customers of banks and savings and loan companies.

Traditional methods of regulating as well as managing the securities business have come under fire this year from the Congress and from some industry leaders. I firmly believe that the concept of self-regulation is working for the public and the industry, and with the increased cooperation and communication between the various regulatory organizations, that it will grow in effectiveness in the future. Let us continue working together for the good of the whole instead of one of its parts.

The NASD, in spearheading major projects to improve the industry, has demonstrated during the past year that self-regulation is a constructive force in moving the industry forward to meet goals that are responsive to the desires and needs of the public and investing community.

The continuing task of the Association, as I envision it, is to constantly re-examine our position in the industry's regulatory framework and not only to respond quickly and positively to the changes taking place within the financial community, but to create those changes through long range planning and leadership. It should be our goal to predict and adapt to change and to help our members and investors utilize new developments to advantage.

Respectfully submitted,



Gordon L. Teach
1970 Chairman



PRESIDENT'S REPORT

SELF-REGULATION

With the unprecedented expansion of the securities industry in 1968 and 1969 and the resultant fails problems, self-regulation in 1970 came under close scrutiny by Congress, the Securities and Exchange Commission and the investing public. In answer to this challenge, the NASD not only increased its regulatory efforts during the year, but also launched new studies aimed at increasing the Association's efficiency in self-regulation.

The Association's regulatory responsibility in 1970 covered 4,470 members—an increase of 122 over the previous year. Branch offices hit a new high in May of 1970 but ended up the year at 6,990 for a 254 decrease from 1969. Registered representatives, which have increased over 125 percent in the past 5 years, continued to increase in 1970. During the year about 24,000 were registered to bring the total to a record level of 197,570 for an increase of 13 percent.

Examination of Member Firms

The cornerstone of self-regulation is the Association's examinations of member firms, and the past year was the Association's most active year in terms of examinations and complaint actions. We conducted a total of 4,114 examinations, including 2,113 regular and 496 special exams of main offices. Under the regular examination program, 47 percent of members' main offices were visited on a routine basis for a complete review of all phases of each firm's business.

Four hundred forty formal complaints were filed, compared to 264 in 1969 and 138 in 1968. In addition, 95 summary complaints—the procedure used in minor, technical infractions—were initiated during the year compared to 36 last year. During the year the Districts closed 328 formal complaints, more than double the number closed the previous year.

During 1970 the Securities and Exchange Commission ruled on three of the Association's disciplinary actions that had been appealed. In one case, the SEC dismissed the appeal while in another case the SEC upheld the NASD's decision. In the third ruling the SEC affirmed the findings of the Association but reduced the penalty.

In disposing of complaints last year, District Committees or the Board of Governors expelled 15 members and revoked the registrations of 38 repre-

sentatives. Nineteen members and 50 representatives were suspended during the year for various periods, and 210 members and 94 representatives were censured. Two hundred thirteen members and 98 representatives were fined, with total fines and costs collected from January 1, 1970 through December 31, 1970 amounting to \$500,243.23. As of December 31, 1970 there were 337 complaints open at the District level, 236 (70%) of which were less than six months old.

The special surveillance program that began in 1968 giving particular attention to members' capital and operational problems continued in 1970. The program includes such measures as scheduling advisory meetings with executive personnel, upholding emergency rules which subject members to disciplinary action and trading restrictions for excessive fails to deliver and/or receive, and requiring certain members to report fails statistics on a monthly basis. From June of 1968 to December of 1970, 4,920 inspections have been carried out under the program, and 154 firms were placed under operating restrictions. As of December 31, 1970 only 6 firms were under operating restrictions, and the dollar volume of fails to deliver under our monitoring program dropped from a high of 869 million in January of 1968 to 184 million by the end of December, 1970. This dramatic downswing occurred because of the slackening in volume and increased efforts by NASD members to put their back offices in order.

Because of the upsurge of trading volume in late 1970 and early 1971, the Association is keeping a close watch on member firms' back office operations to make sure that the paperwork problems of the past are not repeated.

The strengthening of District staffs, which have been built up considerably in recent years, was continued in 1970. As of year-end, there were 125 examiners in the field, up from 90 a year ago. All but one District office now have Assistant Directors to aid in the administrative workload, and an assistant is planned for the remaining office.

To maintain pace with the growth in the field force, the NASD is further strengthening the Department of Regulation, which works closely with the Districts. The Department is directing special attention to updating our examination procedures, including emphasis on the many new and sophisticated problems emerging in such areas as corporate finance; mutual funds and insurance orientated activities; oil, gas and real estate syndications and similar tax-shelter programs.

The NASD is also examining the capital structure of non-exchange firms. The Association formed a special Committee on Capital Standards in the fall of 1970 to review the capital requirements necessary for entering the securities business and the adequacy of present regulations in all areas of financial responsibility applied to NASD members. The committee has been studying the implications of all factors relating to the financial stability of members and has reported its preliminary findings to the NASD Board of Governors.

Qualification Examination Program

The Association routinely administers qualification examinations for all applicants for registration as principals or registered representatives with the NASD. Through changing, up-dating and intensifying the degree of difficulty of these examinations, the Association endeavors to continually up-grade the quality of those entering or managing the over-the-counter securities business.

Last year at the NASD's examination centers, the Association administered 60,364 of its own examinations and 25,084 examinations for other organizations, such as the stock exchanges or the various states.

The NASD believes that the qualification examination program has encouraged firms to better train their employees and, consequently, has raised the level of competence of securities salesmen who deal directly with the public.

The importance of thorough training in developing capable and ethical representatives cannot be underestimated. In keeping with the goal of the Qualification Examination Program to raise the level of competence of individuals entering the securities business, the Board of Governors has authorized a comprehensive study of the functions of registered representatives, with particular emphasis on how individuals are trained for their work. The purposes of this study are to determine the training needs of the registered representative, to evaluate the level of training in the industry, to establish the feasibility of NASD involvement in this training process, and to provide the basis for possible changes in the NASD's registration and qualification procedures. The target date for completion of the study is late summer of 1971.

Uniform Practice

The NASD's Uniform Practice Committee, a standing group of operations

personnel representing member firms across the country, has dealt with a growing number of projects affecting securities processing in addition to its commitment to administer and maintain a review of the Uniform Practice Code. The Code, a set of regulations which governs a member in his dealings with other members, standardizes certain mechanics for completing over-the-counter transactions. Areas covered by the Code include dividend reporting, ex-dividend dates, settlement dates, due-bills, trade comparisons, delivery rules for stocks and bonds, reclamations, buy-ins and sell-outs.

The Committee has been an interested party in the development and implementation of the CUSIP number, which uniquely identifies each security issue traded publicly. A number of members have been successful in completely converting to CUSIP for their internal processing and in order to further facilitate certificate identification and handling, the number now appears on certificates of those issues which are quoted in the news services. The interest in having a common system for identifying securities should foster the expanded use of CUSIP.

A proposed rule now pending with the SEC would require issuers of OTC securities to report dividend information to the NASD on a timely basis. This step would strengthen the means of obtaining dividend news since, in many cases, the Association now relies on the good will of corporations to forward such information. The contemplated advance reporting would insure broader coverage of dividends, would avoid late ex-dates, allow members to make transfers to meet record dates, and cut down customers' problems related to dividends. The required approvals of the proposal are expected in the near future.

A set of Uniform Transfer Requirements developed by a Joint Banking-Securities Industry group studying transfers has been forwarded to the membership. The requirements have narrowed down what documentation, especially with "legal" registrations, certain banks require in order to make expeditious transfers. This group is studying other ways to streamline transfer methods.

In addition to the Joint Industry Committee which studies transfers, Uniform Practice Committee members and the staff participate with groups studying deliveries, dividends and security protection. Some projects under consideration include making more efficient use of large denomination certificates for deliveries, constructing an educational brochure on what constitutes good delivery on bonds, and devising a new system for handling due-bills representing interest payable on bonds.

The Security Protection Committee has been instrumental in securing a pilot program for a computerized data-bank for the verification of lost and stolen securities. The system was designed for the Security Protection Committee with the help of Sci-Tek, Inc. Should the pilot program prove to be successful, the data-bank will be made available to all members of the financial community.

Arbitration

For the past two years the Association has offered an arbitration program for the voluntary submission of disputes between members or a member and a customer arising out of securities transactions. This program was introduced in response to an anticipated need for a forum providing for the prompt, fair and economical disposition of securities disputes.

Although the Association is still a relative newcomer in the field of arbitration, the administrative experience which has been gained, coupled with member requests, has prompted the recommendation that a program be adopted so that a member firm can be compelled to arbitrate a dispute stemming from a securities transaction with another member. A comprehensive study of all arbitration laws, on both the state and federal level, was conducted to determine the possible effect of changing the Association's arbitration program to include mandatory submission of disputes. The importance of this study arises from the necessity of complying with the varying jurisdictional requirements before controversies submitted for arbitration can be properly resolved.

As proposed by our Arbitration Committee, a program of required arbitration would apply only to disputes arising after the date of the program's inauguration. Controversies which originate before this date would continue to be eligible for submission on a voluntary basis.

Member comments in reply to a recent special report dealing with the concept of mandatory arbitration have been submitted to the Board of Governors along with proposed changes to the Arbitration Code. Should these proposals be approved by the Board, they will be submitted to the member-

ship for comment and subsequently for a vote.

Corporate Financing

Since 1962 the NASD, through its Committee on Corporate Financing, has reviewed the compensation arrangements of member firms for their services in regard to underwritings. These reviews are for the purpose of determining whether the arrangements entered into are fair and reasonable in light of the Rules of Fair Practice. The Committee membership has expanded greatly over the past two years and presently numbers twenty individuals. Under the present volume, it is required to hold meetings on a weekly basis in order to accomplish these reviews.

During 1970, the Corporate Financing Department received 2,127 new registrations for review. This figure represents a substantial reduction from last year's peak volume of 3,900 issues. However, past market conditions have not decreased the volume as much as expected, and companies continue to file at a steady pace.

Of the issues received, 632, or approximately 32 percent, received an unfavorable comment of some degree. The Committee reviews the terms of offerings in advance of any sales to the public and then issues an opinion on the fairness of the arrangements. It is therefore significant to note that of those receiving an unfavorable comment (although a number of issues are still pending), not one offering in 1970 went to market without the appropriate modifications being made. This not only demonstrates the effectiveness of the program but also illustrates the willingness of the members to cooperate and to comply with the requirements.

Some of the 1970 volume is attributable to the number of intrastate issues filed during the year. In addition, a large percentage of the volume was due to the tremendous increase in the number of tax shelter oriented programs (such as oil and gas, real estate, cattle and other similar programs) which accounted for only a small percentage of the offerings in past years. This year alone, over 500 such programs were filed for review, with the largest portion directed toward real estate syndication. The number of these filings demonstrates the increase in popularity of these new securities. Also, the levels of compensation and the types of arrangements being constructed illustrate the need for definite underwriting guidelines in these particular areas.

Consequently guidelines, as they would apply to these areas, were approved by the Board for issuance to the membership for comment. On December 16, 1970 such proposals, entitled "Amendments to the Interpretation of the Board of Governors with Respect to Review of Corporate Financing," were circulated to the membership, their counsels and other interested parties. Comments on these guidelines are now being reviewed by the staff and the Committee, and an analysis of these responses will be made available for the Board's consideration.

Keeping in line with the Association's cooperation with state securities commissions, the staff of the Department and representatives from the Oil and Gas Institute attended a conference to help draft guidelines for the registration of oil and gas participation offerings for use at the state level. A similar program has been called for to draft guidelines in the area of real estate syndication, specifically limited partnership interests.

In view of the greatly increased sales of limited partnership interests in oil and gas drilling funds to the public in the past two or more years, the Board of Governors established an Oil and Gas Committee. Since the bulk of oil and gas programs are sold through NASD members, the Association has an obligation concerning ethical practices in connection with their distribution. This Committee's function is to determine, initially, whether the Association's existing rules are adequate and can properly be applied to these securities and, secondly, what, if anything, the Association can do to insure the proper discharge of its responsibility in connection with these distributions. A similar committee to study real estate syndications has been formed.

Another special committee of the Board of Governors, the Committee to Study Self-Underwriting, was established in late 1970. The reasons for the formation of this Committee are: (1) to restudy the policy which prohibits member firms from underwriting their own securities or underwriting those of a parent or subsidiary of that member; (2) to determine whether this is the proper approach to the problem and; (3) if not, to recommend an alternative. After consideration of all aspects of the policy, proposals will be made and circulated to the membership for comment.

Financial Reporting

An annual financial reporting program, required by the Securities and

Exchange Commission, was inaugurated by the NASD during 1970. All NASD members were required to file information (on Form 17A-10) regarding income and expenses with the Association by spring of 1970.

By the end of December, 95 percent of the NASD members had filed this information. Some firms did not respond because they had gone out of business, and the Association is contacting the remaining firms that failed to file.

Data from the reports were delivered to the SEC during the fall and winter of the year. The names of firms submitting information have been, and will be, kept confidential by the Association.

Statistics generated by these reports have already proved useful to the Association, and should be more valuable in the future. So far, they have been used to support NASD arguments in certain legal cases; to provide background for the Securities Investor Protection Corporation and for the NASD's new mutual fund economic study (see section on Legislation). Statistics compiled from the program will be relayed to NASD members for management use.

During the year, the Association also began requiring members to file quarterly financial reports (Form Q) with the NASD. These forms are a shortened version of the annual financial reports, and are used primarily to give the NASD's Department of Regulation warning of impending financial and/or back-office problems in member firms.

Variable Contracts and Investment Companies

A trend apparently developing in the industry is toward one-stop financial service for customers. Insurance companies, through licensing their salesmen to also sell mutual fund shares and variable contracts, have accelerated this trend. Two Association departments—the Investment Companies and Advertising Department and the Variable Contracts Department—have been engaged in assimilating NASD insurance affiliated members into the Association and in formulating guidelines for this newest segment of the membership.

There are now 217 members of the Association who are either insurance companies or their subsidiaries. Over 60,000 insurance agents affiliated with these companies are registered with the Association—more than 30 percent of the total registered representatives. In addition, there are an uncounted number of representatives who are now licensed to sell insurance but who are employees of non-insurance company firms or their subsidiaries. In 1970 we saw the beginning of a reverse trend, with some general securities firms and their representatives becoming licensed to sell insurance.

During the year a Subcommittee of the Variable Contracts Committee met with District Directors and their staff to discuss the insurance aspects of complaints involving both equities and insurance.

The Variable Contracts Committee met five times in 1970 and discussed a wide variety of subjects. Resolutions to the Board which received a favorable vote included the recommendation to adopt the variable contracts rule (new Section 29 of Article III of the Rules of Fair Practice) which is now in effect. The Board also voted to exempt those life insurance companies, which are themselves registered as broker/dealers, from the requirement to file quarterly financial reports.

The Investment Companies and Advertising Department is responsible for reviewing sales literature both for general brokerage firms and investment companies. The Department was also involved during the year in preparatory steps for the mutual fund economic study under the new mutual fund law (see Legislation section). The Department also closely watched litigation affecting the mutual fund industry, and established a liaison group to work on problems shared by mutual funds and variable contracts.

Sales literature submitted to the Association for review remained at a high level during 1970. Investment company sales literature, which the Department examines for conformance to the SEC Statement of Policy, amounted to 12,406 separate advertisements during the year. In addition 2,485 examples of general advertising, which is reviewed for compliance with NASD guidelines, were examined by the Department.

A joint subcommittee, composed of members from the Investment Companies Committee and the Variable Contracts Committee, was formed in 1970 to provide an interchange of ideas on similar problems faced by the two groups. One of the problems studied by the subcommittee was the SEC's proposed rule to amend Rule 22d-1 under the Investment Company Act of 1940 to impose stringent requirements regarding investments in mutual funds or variable products by employees of the companies offering these products. The NASD commented on the proposed rule indicating that those employees of an investment company its investment adviser and principal underwriter should be allowed to purchase that investment company's shares either without a sales load or at a discount. On the other hand, the NASD

stressed that exemptions from Rule 22d-1 should not include sales made to persons whose activities are unrelated to the investment company. The final SEC rule, which became effective on February 8, 1971, retains exemptions for employees whose activities are related to the investment company—including life insurance salesmen selling mutual fund shares, transfer agents, and specified supervisory personnel. The new rule cancels all exemptions for employees not directly involved with the investment company's activities.

An amendment to Section 26 of the Rules of Fair Practice, which regards forward pricing, was ratified by the membership in 1970. The amendment conformed Section 26 to Rule 22c-1 of the Investment Company Act which requires that mutual funds calculate net asset value at least once a day by the New York Stock Exchange closing time. This simply means that an investor purchasing mutual fund shares before the NYSE closing time would pay the price determined at that day's close. If he should place an order after the closing time, his charge would be based on the net asset value calculated at the next day's closing time.

The Investment Companies Department has taken special interest in two cases before the Securities and Exchange Commission—one regarding Mutual Funds Advisory, Inc. (the affiliated broker/dealer for The Fundpack Incorporated) and the other involving First Multifund of America and the First Multifund Advisory Corporation. Both cases involve a possible exemption from Section 22d of the Investment Company Act which requires that mutual fund shares be sold at the offering price stated in the fund's prospectus. The Association, which is acting as a participant in each case, opposes any exemptions to Section 22d other than those currently allowable.

NASDAQ

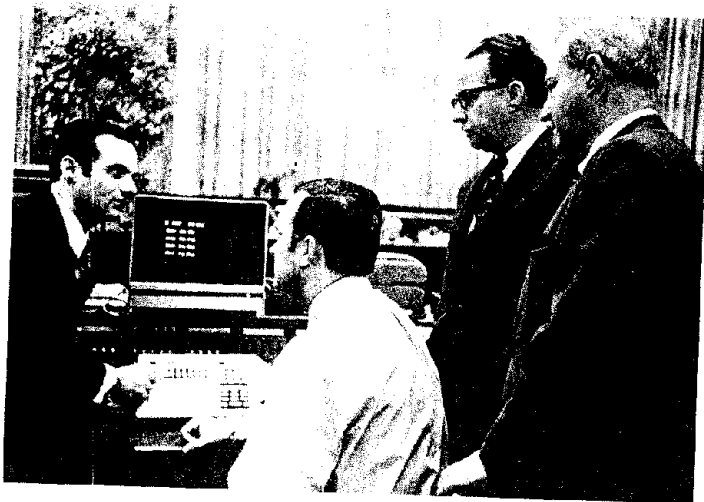
During 1970 after more than 7 years of planning, developing, and testing, the final pieces of the NASD's Automated Quotation System were put into place. And on February 8, 1971, at 10:00 a.m., NASDAQ became a reality.

Work on the system actually began as early as 1963 when the Securities and Exchange Commission's Special Study of the Securities Markets stressed the need for automation in the over-the-counter market. An Automation Committee headed by Robert M. Gardiner, a previous NASD Board Chairman, was formed and began a study to determine the areas where automation would prove most valuable and effective. With the groundwork laid, the Committee retained Arthur D. Little Inc., a management consultant firm, to make an in-depth analysis of the practicality of designing an automated quotations system for the over-the-counter market. Though the highly complex nature of the OTC market with its wide differences in size, location and interest of broker/dealers presented a major challenge, the study showed both the need for and the feasibility of an automated quote system.

With the approval of the Board of Governors, the Automation Committee next began the complex task of developing NASDAQ. After holding many interviews with brokerage firms throughout the country and engaging in discussions with the SEC staff and Commissioners, the Committee drew up specifications for the system. In 1968, culminating these years of intensive research and study, the Association signed a contract with The Bunker-Ramo Corporation to build a 20 million dollar electronic communications system to tie together the over-the-counter market into one vast electronic stock market.

The heart of the NASDAQ system is located in Trumbull, Connecticut, where a staff of 100 programmers and technicians man the central computer complex. Smaller computers are also manned by the Bunker-Ramo field force in New York City, Chicago, Atlanta, Dallas and San Francisco which in turn feed quotes and queries into the Trumbull automation center. The data center at Trumbull contains back-up equipment in every vital element to insure continuous service. Two computers, either one of which can handle the operation, form the nucleus of the system. If public power fails, a giant bank of storage batteries supplies the power until a turbo-generator system comes on line. Temperature and humidity are controlled by a dual system of chillers and boilers. All stock data is recorded magnetically in duplicate and there are rigid security systems and routines that keep equipment safe from tampering and the information safe from unauthorized persons.

At start-up, NASDAQ was providing over 700 broker/dealers with quotes on approximately 2,400 stocks. The system consists of three levels of service—one for the registered representatives, one for retail traders, and one for market makers. Level I is used by securities salesmen to obtain representative bid and asked prices on NASDAQ securities. These quotes are available through existing desk-top units used for information on listed stocks. The



Operation of the NASDAQ system is explained by a representative of the Bunker-Ramo Corporation to traders in a NASDAQ subscribing firm. All broker/dealers with NASDAQ terminals were trained to use the system before the NASDAQ start-up date.

distributors are Scantlin Electronics, Inc., Ultronics Systems Corp. and Bunker-Ramo. All distributors receive their information from the NASDAQ computers and relay these quotes from their own computers. Level II lists all market makers' bid and asked quotes for NASDAQ securities, but does not provide for the input of quotes. Level III provides the same information as Level II, but allows a market maker to enter his quotes into the system.

Through NASDAQ, traders have access to a wider sampling of bid and asked prices from market makers without making numerous telephone calls. They have to make only one call to complete a trade. Registered representatives can quickly retrieve current bid and asked quotes on NASDAQ securities for their customers, allowing the security salesman to give both better and quicker service. Investors, for the first time, can get current bid and asked quotes on all the OTC securities in the NASDAQ system. They will be able to follow trends in the OTC market through volume figures and OTC stock indices. The result will, of course, be greater investor confidence in the entire OTC market. The wealth of current and accurate information on OTC securities and the market trends which will be more visible should encourage institutional investors to participate more in OTC trading.

Over-the-counter stock indices will be available through the NASDAQ system and will be released to the major wire services on an hourly basis. Daily and weekly summaries will also be made available. The indices will be computed every 5 minutes and will be separated into the following categories: Composite, Industrials, Banks/Insurance, Other Finance, Transportation and Utilities.

There will be new problems to cope with and new decisions to make as the system grows and matures. One decision that is not too far away is whether securities listed on other exchanges should be carried on the NASDAQ system. To study this question, the Board of Governors voted to include 36 exchange listed securities on a test basis in NASDAQ. These securities will be quoted on NASDAQ for a 90 to 180 day test period beginning on April 5, 1971. Characteristics of OTC trading in listed stocks in contrast to exchange markets will be emphasized by the study. To determine if third market securities should be permanently kept in the system, the NASD will examine transactions in these securities by non-exchange members before and after their inclusion in NASDAQ. The Association is also evaluating the responsibilities of its surveillance program for NASDAQ as they would relate to third market securities carried on the system.



The NASDAQ logo (left) will soon become a symbol that is widely recognized by investors and the general public. The logo will be used in the nationwide consumer education program and will be prominently displayed in the offices of NASDAQ subscribing firms.

OTC Consumer Education Program

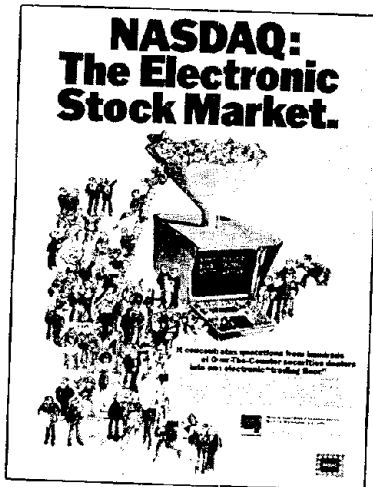
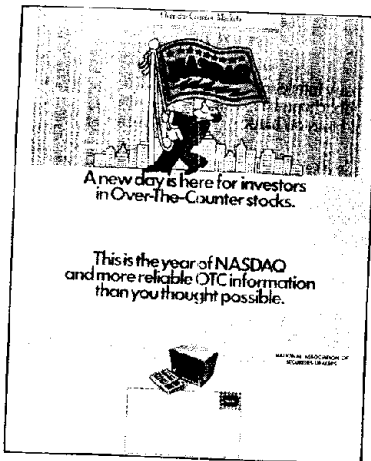
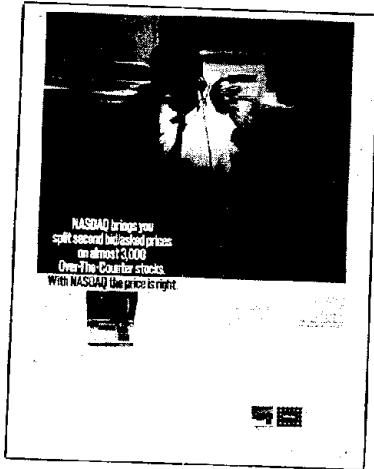
Also for the first time in the history of the over-the-counter market, a nationwide consumer education program is being developed to inform and educate the public about the opportunities available in the OTC market. The target audiences for the program are the general public, investors and NASD members. Because of the significance of the new NASDAQ system, the education program has been timed to begin after NASDAQ is operating smoothly. Current estimates place the beginning of the consumer-education campaign in the summer or early fall of 1971.

The NASD Board of Governors unanimously approved the education concept last May, stressing that a communications gap between the industry and investors should be closed. The Governors agreed that the program should first introduce the NASDAQ system, and later should familiarize investors with other aspects of the over-the-counter market's operation.

The education program, which is the responsibility of the Association's Information Committee, is being developed by Doremus & Company in New York City, one of the nation's largest firms specializing in financial advertising. The estimated investment in this ambitious communications effort is \$1,000,000—an amount which is being collected through voluntary contributions primarily from NASDAQ subscribing firms.

Since May, Doremus & Company has been developing advertisements and other communications tools for use in the program. The firm also completed production of a multi-media presentation explaining the rationale and design of the program to NASDAQ subscribers. During the year, the program was





Tools used in the comprehensive educational program to kindle interest in the OTC market will include advertisements in publications with nationwide distribution, and an educational film entitled "The Electronic Stock Market."

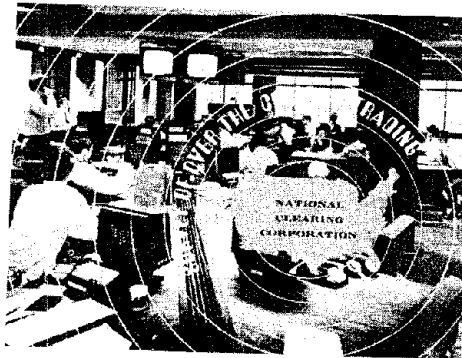
shown to members in the New York City and Washington, D. C. areas. In 1971, the presentation will be shown to NASDAQ subscribers in other geographic areas around the country.

The presentation highlights the techniques that will be used in the educational program. Among them are: (1) Advertisements in nationally known publications, such as *Life*, *The Wall Street Journal*, *U. S. News and World Report*, *Time*, *Forbes*, *Institutional Investor* and the *Investment Dealers' Digest*. (2) Local radio and television commercials and newspaper advertisements which will dovetail with the national campaign for use by broker/dealers. (3) Booklets describing NASDAQ and the OTC market for use by broker/dealers with their customers. (4) An educational film spotlighting NASDAQ called "The Electronic Stock Market." This film will be available to NASDAQ subscribers. (5) A packaged seminar program for use by broker/dealers to educate and inform investor groups, clubs, civic groups and students.

The program will also include an ongoing public relations effort which will be coordinated by the National Security Traders Association. In July, the Traders decided to merge their educational efforts into the overall consumer campaign, realizing that the two Associations could have a greater impact on investors by working together. The NSTA's assistance will strengthen the NASD communications effort, since the traders have had ten years of successful experience in publicizing the OTC market.

Some of the public relations activities that are planned in conjunction with the program are: liaison with the press regarding OTC developments; creation of feature stories on the OTC market; a speakers bureau which would make industry leaders available for speeches about the OTC market; and an information bureau to answer investor questions. Doremus & Company is also lending its assistance to this aspect of the educational campaign.

This far-reaching communications effort is a significant step forward in removing investor misunderstanding about the OTC market and in acquainting the general public with this too little understood, but vital, segment of the securities business.



The "Survey of Over-The-Counter Trading," which pinned down OTC trading patterns during a sample week in 1969, was published by the National Clearing Corporation in 1970.

National Clearing Corporation

High trading volume in 1968 and 1969 resulted in paperwork problems for NASD member firms, consternation on the part of investors who received late stock certificates and efforts by the Association to improve the situation.

Paramount in importance for the reduction of paperwork problems is the National Clearing Corporation which was established in 1969 by the Association to develop a nationwide clearing system for the over-the-counter market. NCC is an outgrowth of a study conducted by Arthur D. Little, Inc. regarding methods to reduce industry back-office problems. The ADL study strongly recommended that the NASD establish a continuous net settlement system for clearing over-the-counter securities transactions. The study predicted that such a system could eventually reduce "fails to deliver and receive" in the industry by as much as 50 percent.

This proposed system will merge open securities positions daily and carry them forward on a perpetual basis, leaving all items in the system until settlement occurs. The system will begin with the reporting of trades by clearing members and will end with the clearance of securities delivered with a corresponding money settlement daily to a Clearing Center. All settlements, receipts and deliveries of securities will be made directly to a Clearing Center.

Other NCC services will include dividend accounting and processing of transfer instructions. The system is also being designed to include a securities depository feature.

The initial approach of the National Clearing Corporation will be to organize Clearing Centers to operate independently within specific geographic areas. NCC plans to fully develop trade reporting and clearing processing within each area and then to expand coverage by linking these centers in order to settle trades between other geographical areas. In the future the system will be expanded to handle all over-the-counter trades admitted to the clearing system within and among all geographical parts of the country. Current plans indicate that the first NCC clearing center will be established in 1971.

Since May of 1970, NCC and the Pacific Coast Stock Exchange have been working together in designing the clearing system. At that time, PCSE signed an agreement with NCC to make available computer programs and other necessary material used in its clearing system. PCSE, which has had experience operating a net-by-net settlement system similar to NCC's planned continuous net settlement system, has freed some of its personnel to work with NCC staffers in adapting its clearing program to fit the needs of the new nationwide OTC system.

As another step in implementing its new service, NCC acquired the National OTC Clearing Corporation last fall. NOTC, which operates in the New York area, was established in 1961 to aid in the clearing of OTC securities transactions in that area. The National Clearing Corporation plans to have the present experienced NOTC staff operate the NOTC's current balance order clearing system until NCC's continuous net settlement system can be inaugurated in New York.

NCC recently conducted a survey of OTC trading patterns within the United States. The purpose of this survey was to enable the National Clearing Corporation to pinpoint the cities in which to locate area centers to most effectively serve the OTC market. Results of the survey (which was published by NCC as "Survey of Over-The-Counter Trading") indicate that New York should contain one of the first centers because it is the heart of trading in the country. Statistics taken from member firms reporting data during the sample week of November 3-7, 1969, indicate that New York was on both sides of as many as 42 percent of the total transactions. Accordingly, the Clearing Corporation plans to establish a clearing center in the New York City area. The survey also supported NCC's opinion that a center should be opened on the West Coast. The Midwest is another target for one of the initial NCC clearing centers.

The NASD has been exploring the role of NCC in the overall securities industry with the Banking and Securities Industry Committee. This high level group, which consists of representatives from the securities and banking industries, was organized to solve problems faced by both industries. One of BASIC's high priority goals is establishing a nationwide securities depository. NCC has kept BASIC up to date on the requirements of its clearing system and has explored how NCC might interface with a central securities depository.

Legislation

Late in 1970, the 91st Congress passed two bills which will vitally affect the securities industry. One was the "mutual fund bill," which had travelled a long and tortuous road before final enactment. The other established a Securities Investor Protection Corporation (modeled after the Federal Deposit Insurance Corporation) which will insure investors up to \$50,000 in combined cash and securities in case of financial problems in a SIPC member firm. President Nixon signed both bills into law late in the year.

The new mutual fund law amends the Investment Company Act of 1940. The main areas of interest relate to mutual fund sales charges; regulation of contractual, or front-end load investment plans; and distinct fiduciary standards for investment advisers for mutual funds.

The Association had testified before the Congressional committees responsible for this legislation, stressing its general support of the legislation, with the exception of a provision which would have allowed savings and loan associations and banks to operate mutual funds. This section was omitted from the final legislation, but the question remains to be decided by the United States Supreme Court. The Association also had expressed its willingness to determine a "non-excessive" mutual fund sales charge—a responsibility which is delegated to the NASD under the new law.

In anticipation of passage of the legislation, the Association has been planning to carry out a mutual fund economic study for more than a year. The consensus of the Board of Governors and the staff was that such a study should be undertaken by independent consultants, working with NASD guidance. In December of 1970, after interviewing many consulting firms, the

Association hired the consulting firm of Booz, Allen & Hamilton, Inc. Booz Allen will be working with Foster Associates, Inc., an economic consulting firm based in Washington, D. C. Foster Associates will contribute primarily in the area of theoretical and practical regulatory practices, which is the firm's forte. The initial stages of the study are now in progress.

The legislation charges the NASD with making and enforcing rules to prevent excessive sales loads on the distribution of open-end investment company shares. These rules are to be made effective not later than 18 months after President Nixon signed the Act—which places the deadline in mid-summer of 1972. Tentatively, the Association aims to finish the study by January of 1972 and afterwards to formulate the necessary rules.

The section of the law which regulates contractual plans allows the sponsors of such plans to operate under two alternatives:

(1) The first alternative retains the 50 percent maximum first-year sales load and the 9 percent overall sales charge provisions previously in effect. If a periodic plan certificate is sold with such a load, the following refund provisions apply: The holder may surrender the certificate at any time within the first eighteen months after issuance and receive the value of his account plus the excess of any sales load above 15 percent of his total payments. The registered investment company issuing the certificate, or any depositor of an underwriter for such company must give written notice of these redemption rights. This notification must be made to each certificate holder who has missed three payments or more within 30 days following the expiration of fifteen months after the issuance of the certificate.

(2) A second alternative allows not more than 20 percent of any one payment to be deducted for sales load, and provides that the entire deduction during the first four years may not exceed 64 percent of the total payments. Again, the total sales charge may not exceed 9 percent of the total investment over the life of the plan. Under this alternative a seller would be entitled to deduct a 16 percent sales load each year for the four-year period or 20 percent in each of the first three years and 4 percent in the fourth year.

The law also gives a specific fiduciary duty to a fund's investment adviser, which would allow either the Securities and Exchange Commission or a shareholder to sue an investment adviser for a breach of fiduciary duty—particularly regarding compensation for his services.

SIPC

The Securities Investor Protection Act is an example of cooperation among the various industry self-regulatory agencies, the Securities and Exchange Commission, the U.S. Department of the Treasury and the Congress. Passage of the legislation acquired urgent overtones when the demise of several New York Stock Exchange members strained the Exchange's Special Trust Fund which was established to reimburse customers suffering financial losses.

The industry formed a Task Force to gather statistics regarding brokerage firms' financial positions and to formulate suggestions for an insurance corporation to protect investors. The Task Force, which consisted of representatives from the various exchanges and the NASD, aided in creating the Securities Investor Protection bill which was signed in 1970. The SEC also drafted their version of similar legislation. After meeting on the legislation, representatives of the SEC, the Industry Task Force and the U.S. Treasury Department drafted a compromise bill which was presented to Congress for its consideration.

In its final form, the law requires that all registered brokers/dealers and members of national securities exchanges as of December 30, 1970, and thereafter, must be members of SIPC unless exempt under the Act. Exemptions apply to broker/dealers who deal exclusively with the sale of mutual funds, the sale of variable annuities or insurance, or which advise investment companies.

SIPC will be funded through assessments on its members. By April 29, 1971, the fund is required to contain \$75 million. Initially, the fund will consist of a combination of assessments, monies to be transferred from existing trust funds, and confirmed bank lines of credit. Eventually, the fund will be expanded to \$150 million through assessments, and lines of credit will be phased out.

The initial assessment will not exceed $\frac{1}{8}$ of 1 percent of a firm's 1969 gross revenues from the securities business. Later, assessments of $\frac{1}{2}$ of 1 percent will be levied until the fund reaches \$150 million. The SIPC Board has the authority to ask the SEC to increase the assessment to a maximum of 1 percent if such a move becomes necessary and would not be injurious to the business.

The legislation provides \$1 billion in credit from the U.S. Treasury if necessary. This would only be used if the SIPC fund should prove inadequate. Such a loan would be repaid by SIPC members and possibly through an SEC special transaction charge applied to securities transactions over \$5,000.

The appropriate self-regulatory agencies will examine all members of SIPC for compliance with financial responsibility rules. The SEC has oversight over the Corporation, access to all of its books and records and the power to alter its rules.

Heading the first SIPC Board of Governors is Byron D. Woodside, a former SEC Commissioner. Other members of the Board are: Glenn E. Anderson, President and Director of the Carolina Securities Corporation; Andrew J. Melton, Jr., Chairman of the Executive Committee of Smith, Barney & Co.; Bruce K. MacLaury, Deputy Undersecretary of the Treasury for Monetary Affairs; J. Charles Pardee, Adviser to the Federal Reserve Board; Donald T. Regan, Chairman of the Board of Merrill Lynch, Pierce, Fenner & Smith; and George J. Stigler, Professor of Economics, University of Chicago.

In January of this year, Senator Harrison A. Williams, Jr. (D.-New Jersey) announced that the Senate Securities Subcommittee, which he chairs, would be conducting a study of the securities industry, concentrating on the financial structure of brokerage firms. The Subcommittee decided that there was a need for such a study after hearing testimony on the SIPC legislation. Also covered by the study, which is expected to take two years, will be back office procedures; the role of the traditional stock certificate; and the effectiveness of self-regulatory organizations in coping with industry problems. Questionnaires regarding free credit balances and the hypothecation of customers' securities have been sent to 50 brokerage firms, and hearings for the study are expected to begin in the spring of this year.

Litigation

During the year, the U.S. District Court ruled in favor of the NASD in the case, Norman C. Harwell, et al vs. Growth Programs, et al. This is a class action involving contractual plans, which questions the Association's authority to restrict members from using or encouraging the use of the withdrawal and reinvestment privilege for purposes inconsistent with its intent.

The Court held that the NASD was acting properly under the authority granted by the Maloney Act and that the Association's interpretation was reasonable. The decision was appealed to the United States Court of Appeals for the Fifth Circuit. Arguments have been held and a decision is pending. The NASD does not believe it has any liability in this case.

The NASD, as well as the Investment Company Institute, has been involved for over a year in litigation regarding the question of a bank's being allowed to operate a mutual fund—specifically the First National City Bank of New York City, which has been operating a commingled investment account. Two cases, NASD vs. Securities and Exchange Commission, and the Investment Company Institute vs. Camp, regarding this subject were jointly decided by the United States Court of Appeals of the District of Columbia in 1969 in favor of the First National City Bank. Both the NASD and the ICI proceeded to ask the United States Supreme Court to hear the cases, and the Court decided to do so. Arguments have been heard by the Supreme Court, and a decision is pending. The outcome has particular significance for the securities business because of the omission of provisions permitting banks to operate mutual funds in the new mutual fund law (see Legislation section).

In a proceeding before the SEC, the Division of Trading and Markets has alleged that the NASD does not have the authority to prohibit its members

from selling mutual funds and variable annuities to subsidiaries of Aetna Life and Casualty Company who are not members of the Association. The NASD strongly maintains that, under the Maloney Amendment to the Securities Exchange Act of 1934, the Association has the authority to prohibit its members from joining in a securities distribution with any non-member. The NASD has filed a brief in the case which is now before an SEC hearing examiner.

The Association is also presently involved in litigation with Shumate & Company, Inc., a small broker/dealer in Dallas, Texas (Shumate & Company, Inc. vs. National Association of Securities Dealers, Inc.). Shumate & Company has claimed that the NASD, by excluding listed securities from the NASDAQ system, has violated the antitrust laws. The company also claims that the Association's election procedures should be changed on the theory that the Association is dominated by New York Stock Exchange members. The Association contends that, under the Maloney Act and because of approval by the Securities and Exchange Commission of its actions and procedures, the NASD has antitrust immunity. A motion to dismiss the case has been filed and argued. The Court took the matter under advisement. The NASD believes it has meritorious defenses in this proceeding.

In another case, in Chicago (Wolf et al vs. National Association of Securities Dealers, Inc.), customers of Norville & Co. are suing the Association to recover their losses, stemming from bankruptcy of the firm. The Association does not believe that it has any liability in the case.

The spirit of 1970 has been one of increased cooperation between all organizations and firms involved with the securities business. Several outstanding examples of this industry teamwork immediately come to mind. NASDAQ, which fulfills a major NASD goal, would never have been possible without the years of preparation by members of the NASDAQ Committee, the advice of the Securities and Exchange Commission, and the support of the National Security Traders Association. In addition, the Association's new clearing system has been aided by the Pacific Coast Stock Exchange, and by the foresight of National OTC Corporation stockholders that cooperated fully in the acquisition of the NOTC by the National Clearing Corporation.

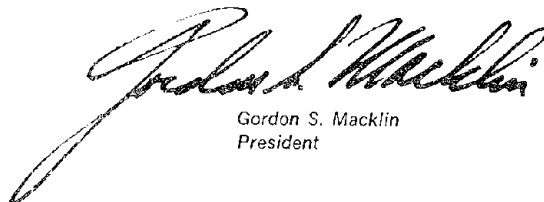
On a broader scale, the year marked the beginning of the Banking and Securities Industry Committee—a high level group including leaders in both the securities and banking industries which is dedicated to solving problems the two industries have in common. Among the projects being tackled by the BASIC Committee are the reduction of DK's—when one side claims no knowledge of a trade—and the planning of a nationwide securities depository.

The Industry Task Force, consisting of representatives from all of the self-regulatory agencies, is still another example of industry interaction obtaining positive results. The Task Force was instrumental in providing Congress with suggestions regarding investor protection—many which were incorporated into the new Securities Investor Protection Act.

The year has also brought about a unified partnership between the National Security Traders Association and the NASD, which are both sharing in the task of informing the public about new developments in the over-the-counter market. Under this arrangement, selected NASD committeemen sit on NSTA committees, and vice versa—a situation which facilitates the flow of ideas between the two organizations and which should result in a more comprehensive, successful consumer education campaign.

Continued cooperation and exchange of ideas between industry organizations is the path that the NASD and all of the self-regulatory agencies must follow in order to strengthen the industry and to fulfill the primary responsibility of protecting the public.

Sincerely,



Gordon S. Macklin
President

1970 STATISTICAL REVIEW

MEMBERSHIP STATISTICS—1970

New Members		587
Mergers or Consolidations		22
Terminations		443
Normal Resignation	274	
Death of Sole Proprietor	13	
Retirement or Death of Principal	27	
Absorbed by Another Member	54	
Capital Rule	3	
Not doing OTC Business	7	
Other	2	
For Cause	63	
By SEC	10	
NASD Action	16	
Non-Payment Fines & Costs	4	
Failure to File Assessment Report	12	
Non-Payment of Assessment	21	
Total Out		465
Net Gain		122
Membership 12/31/69		4,348
Membership 12/31/70		4,470
Re: Total Out		
Type of Organization		
Corporations	270	
Partnerships	61	
Sole Proprietorships	133	
Other	1	
Length of Membership		
Less than One Year	80	
One to Two Years	73	
Two to Three Years	41	
Three to Five Years	33	
Five to Ten Years	79	
Over Ten Years	159	

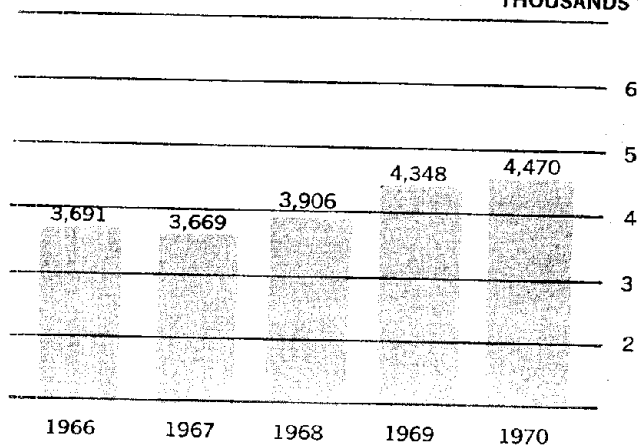
EXAMINATIONS ADMINISTERED BY THE NASD FOR THE FIVE YEAR PERIOD BEGINNING

January 1, 1966 and ending December 31, 1970

YEARS	QUALIFICATION EXAMS FOR NASD	EXAMS ADMINISTERED FOR OTHER INSTITUTIONS	TOTAL
1966	23,359	16,858	40,217
1967	25,544	20,289	45,833
1968	58,561	31,342	89,903
1969	66,748	35,288	102,036
1970	63,653	26,862	90,515

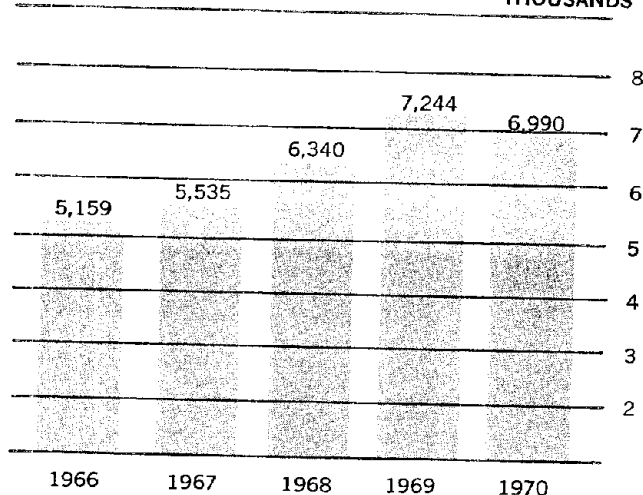
MEMBER FIRMS

THOUSANDS



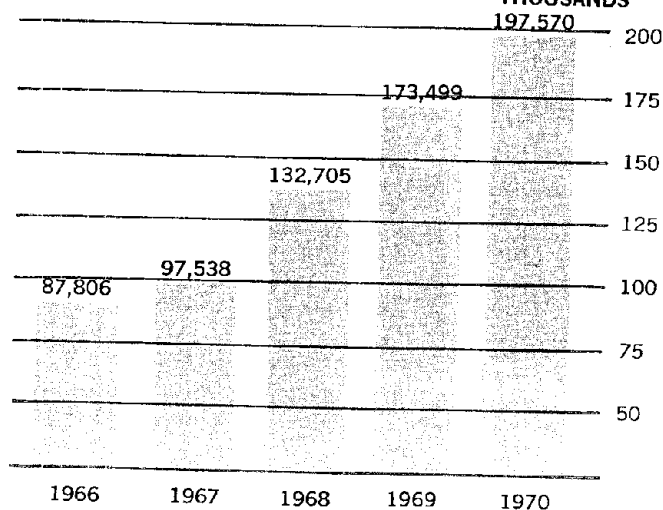
BRANCH OFFICES

THOUSANDS



REGISTERED REPRESENTATIVES

THOUSANDS



NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS INC.
1735 K STREET N.W., WASHINGTON, D.C. 20006