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SECURITIES ACT COMMITTEE COMPLETES ORGANIZATION; ELECTS HAWES CHAIRMAN

Sets Up Method of Operation; Assigns Special Subjects to Individuals to Avoid Duplication of Effort

Small Issues' Exemption Studied

Organization work completed, the Association's special Securities Acts Committee has been hard at work. At its recent initial meeting, the Committee elected Stewart S. Hawes of Blyth & Co., Inc., New York, permanent chairman and set up the method of operation it would follow.

In order to avoid duplication of effort and to speed the work at hand, the problems to be considered by the Committee have been assigned to its individual members for investigation and written report before they are taken up by the entire group.

The individual assignments are as follows: John S. Loomis of The Illinois Company of Chicago, Chicago, and Rush S. Dickson of R. S. Dickson & Co., Incorporated, Charlotte, under the general heading of 'Problems Relating to Distribution," were given the subjects of "Dissemination of Information Prior

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SEC POLICY UNDER NEW WAITING PERIOD OUTLINED

The Securities and Exchange Commission recently announced the general policy which it proposes to follow under the discretionary authority given it by the amended Section 8 (a) of the Securities Act of 1933, which became effective with the signing of the Investment Company Act of 1940 on August 22.

Heretofore, the Securities Act had provided, in effect, that no registration statement, except for certain foreign governmental issues, could become effective until 20 days after its filing.

The amended section now provides that the effective date of the registration statement shall be the twentieth day after the filing thereof or such

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Investment Advisers Act of 1940

BRIEF DIGEST OF LAW GIVEN TO CLEAR UP CONFUSION AS TO WHO MUST REGISTER

Statements Must Be Received by SEC by October 2 To Continue in Business After November 1

EDITOR'S NOTE: *In an effort to clear up some of the confusion which seems to exist as to who must register under the Investment Advisers Act of 1940, when they must register and the terms of the Act itself, a brief summary of this law is presented herewith.*

The Congress recently enacted the Investment Advisers Act of 1940 which becomes effective on November 1, 1940. On and after that date, it is unlawful for individuals or organizations doing business as investment advisers (other than those exempted by the provisions of the statute), unless they are registered with the Securities and Exchange Commission, to use the mails or any means or instrumentality of interstate commerce, including the facilities of any national securities exchange, in connection with their business.

The necessity for immediate registration by investment advisers affected by the Act must be emphasized. Since in general registration statements filed under the Act do not become effective until thirty days after their receipt by the Commission, such statements should be received by the Commission on or before October 2 of this year if the investment adviser wishes to continue to use the mails and the facilities of interstate commerce after November 1. The Commission has in preparation a form of registration statement which will probably be available about September 23. Although public announcement of the availability of this form will be made promptly on its completion, it is suggested that investment advisers who are subject to the Act write to the Commission immediately for copies of this and other forms adopted under the Act.

Who Must Register

Any individual, partnership, corporation or other form of organization which for compensation engages in the business of advising others either directly or through publications or writings as to the value of securities or as to the advisability of investing in, buying, or selling securities, or who for compensation and as part of a regular business disseminate analyses or reports concerning securities, must register with the Commission before they may use the mails or the facilities of interstate commerce, including stock exchanges, in connection with their business. However, newspapers, magazines and financial publications of general and regular circulation are ex-

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SEC RELEASE DISCUSSES SECRET PROFITS, BUCKETING

Opinion in Hope & Co. Registration Revocation Also Goes into Principal vs. Agent

EDITOR'S NOTE: *We have, from time to time, received many questions as to what constitutes a fair profit, when a dealer may be considered to be overreaching, etc. We have been unable to answer these questions directly as no definite standards or criteria have ever been set down by the Securities and Exchange Commission. However, in its memorandum opinion accompanying its order revoking the broker-dealer registration of G. Alex Hope, doing business as Hope & Company, the commission discusses such matters as overreaching, secret profits, bucketing and the principal vs. agent relationship of dealers and their customers. Excerpts from that opinion are presented here as giving an indication of the SEC attitude toward these matters.*

"The order for hearing alleged that the Commission had cause to believe that the registrant had willfully violated the anti-fraud provisions of Section 17 (a) of the Securities Act of 1933, Section 15 (c) (1) of the Securities Exchange Act of 1934, and Rule X-15C1-2 (a) and (b) of the Commission's Rules under the Securities Exchange Act, in engaging in fraudulent acts and practices in various transac-

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INVESTMENT ADVISERS ACT

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empt from registration. Brokers and security dealers are exempt if their investment advice is given solely as an incident of their regular business and no special fee is charged for such advice. Also exempt are banks, certain bank holding company affiliates, individuals or organizations which act as investment advisers solely for investment and insurance companies, and lawyers, accountants, engineers, and teachers whose investment advice, if any, is solely incidental to the practice of their professions. Finally, specific exemptions are provided for the following: (1) individuals or organizations which give advice solely with reference to securities issued or guaranteed by the United Stataes or corporations in which it is interested; (2) individuals or organizations all of the clients of which are residents of the state in which they do business provided no advice is given with respect to securities traded on national securities exchanges; and (3) individuals or organizations which do not hold themselves out as investment advisers generally to the public and which have had less than 15 clients during the preceding year.

Denial or Revocation of Registration

The Act provides that the Commission, after a hearing, may deny revoke or suspend the registration of any investment adviser if he or any partner, officer, director or controlling person of such investment adviser had been convicted within ten years of the Commission's action of a crime involving the purchase or sale of a security or involving his conduct as an investment adviser, underwriter, broker, dealer or as an officer, director or employee of any investment company, bank or insurance company. The power to deny, revoke or suspend registration is also vested in the Commission if at the time of its action the investment adviser or any partner, officer, director or controlling person thereof is enjoined by a court for identical reasons.

Compensation and Investment Advisory Contracts

After the effective date of the Act, no contract between an investment adviser subject to the provisions of the Act and his client which is entered into, extended or renewed by the use of the mails or the facilities of interstate commerce may contain any provision for compensation to the investment adviser based on a share in the capital gains of, or appreciation of the funds of the client. However, compensation based on the total value of the client's funds averaged over a definite period or as of a definite date or dates is not forbidden. Such contracts may not be assigned without the consent of the clients involved. Where the investment adviser is a partnership, contracts must provide that the clients be notified of any change in the membership of the partnership. Where the investment adviser is an organization having voting securities, its contracts with its clients must provide for notification to such clients of any transfer of a controlling block of such voting securities.

Prohibited Transactions

The Act makes it unlawful for an investment adviser to employ any scheme or to engage in any practice which defrauds or operates as a fraud upon any client or prospective client or to sell or buy from any client any security as principal without disclosing this fact to, and obtaining the consent of his client. This last prohibition is inapplicable to brokers or dealers if they are not acting as investment advisers in connection with the transaction.

Representations of Government Approval

Although the Act permits investment advisers to state that they are registered with the Commission, it is made unlawful for any registered investment adviser to represent or imply in any manner that he has been sponsored, recommended, approved or that his abilities or qualifications have in any respect been passed upon by the Government.

Use of Name "Investment Counsel"

The Act makes it unlawful for any investment adviser to represent that he is an investment counsel or to use the name "investment counsel' as descriptive of his business unless he is primarily engaged in the business of giving continuous advice as to the investment of funds on the basis of the individual needs of each client.

SECURITIES ACTS COMMITTEE

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to Effective Date of Registration Statement," "Use of Circulars, Summaries and Offering Letters Relating to Both Registered and Non-Registered Securities" and "Representations and Liabilities on Non-Registered Securities."

C. Newbold Taylor of W. H. Newbold's Son & Co., Philadelphia, under the "Distribution" heading was given "Problems Relating to Sections 9 (a) and 16 (b) of the Exchange Act." Mr. Dickson, under the general heading of "Problems Relating to Underwriting," was also given "Increase in Dollar Amount of Exempted Securities under Section 3 (b) of the Act." Mr. Taylor and Wilbur du Bois of Dillon, Read & Co., New York, (substituting for Paul Nitze of the same firm) under the "Underwriting" heading, were given "Private Sales."

Other Assignments

E. C. Brelsford of F. Eberstadt & Co., Incorporated, New York, under the general heading of "Subsidiary Problems," was assigned "Problems Relating to Sales of Securities by Controlling Persons." Mr. Brelsford, Mr. du Bois, Mr. Hawes, Robert F. Brown of Kuhn, Loeb & Co., New York, James N. Land of Mellon Securities Corporation, Pittsburgh, and Karl A. Weisheit of Smith, Barney & Co., New York, under the "Underwriting" heading, were assigned "Waiting Period and Elimination of Examination by SEC of Registration Statements on Certain Issues," "Simplification and Coordination of Statements under Securities Act, Exchange Act and Public Utility Holding Company Act" and "Liabilities of Underwriters and Dealers under Section 11 and 12 of the (Securities) Act." In addition, under the "Subsidiary Problems" heading, the same men were given "Sub-Underwriters."

Further Breakdown

The second item in the above, "Simplification and Coordination of Statements" is further broken down to include, "Combination of Registration Statement and Prospectus," "Integration of Registration Statement under Securities Act with Registration Statement or Declaration under Exchange Act and Public Utility Act," "Short Form of Prospectus," "Repeal of Schedule 'A' of Securities Act and Simplification and Clarification of Form A-2" and "Consideration of Forms other than A-2 under Securities Act." Mr. Brelsford's assignment, "Problems relating to Sales of Securities by Controlling Persons" is further broken down to "Clarification of Definition of 'Control'" and "Registration of Entire Amounts of Securities Held by Controlling Persons."

Two Responsibilities

The Securities Acts Committee is charged with two primary responsibilities: (a) To study and confer with members of the SEC and its staff and others in order to ascertain the areas of agreement and disagreement as between the Commission on the one hand and the business on the other, relating to amendments to the Securities Act and Exchange Act; and (b) After such study and conferences to make written reports to the Board of Governors of the Association recommending amendments to such Acts.

This committee operates through the Executive Committee which has been designated as the Policy Committee having complete charge of all recommendations as to possible changes in the securities acts. It is expected that the SEC will be advised, among other matters on such subjects as (1) Where, both generally and specifically, the se- the securities acts.

DISTRICTS BEHIND POLICIES LAID DOWN BY GOVERNORS

Enthusiastic support for policies laid down by the Board of Governors is revealed by a survey of the activities of the 14 Districts of the Association.

For example, many Districts are pushing active educational campaigns and many others are laying plans for such campaigns. These programs range from the holding of a series of meetings for the purpose of minutely examining the work of the Association and rules and reglations under which dealers do business to general meetings open to all members in the District.

In one District a series of meetings was held in the larger cities by District Committeemen and District members of the Board. Another program called for meetings with other groups of securities dealers to familiarize them with the activities of the NASD. Some Districts are supplementing their education work by means of personal calls on members by their secretaries. Some Districts have set up special education committees.

Publishing Quotations

The problem of collection, compilation and dissemination of quotations on over-the-counter securities has been actively attacked. A number of Districts are now publishing quotes in the newspapers of their larger cities daily. Others have done most of the preliminary work and expect to start publication shortly. Some Districts reported that they ran into difficulties in initiating a quotations service, but were able to iron them out as they gained experience. The experience gained by the Districts in publishing quotations will determine in a large measure the policies and procedure to be laid down by the national Quotations Committee.

Results of Program

The following results have been achieved in the quotations field: quotations are being supplied daily to newspapers by Districts Nos. 2, 3, 5, 6, 12 and 13 (District No. 13 also supplies wire services with a selected list of stocks for national dissemination and in District No. 2, both the Northern and Southern Divisions are issuing quotations, with the Southern Division having added about 60 new ones to its list); District No. 1, arrangements have been made for regular weekly publication of quotes in Spokane, Seattle and Portland newspapers; District No. 4, expects to complete arrangements soon for publication of daily quotes in local press; District No. 7, actively engaged in trying to set up some system for daily publication of quotes; District No. 8, plans to start publishing daily quotes soon; District No. 10, preparing lists to run in the daily papers of the various communities; District No. 11, supplying quotes to papers weekly; and District No. 14, continuing the study and supervision of quotations in the various cities in the District.

SEC POLICY

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earlier date as the Commission may determine, but requires the Commission to give due regard to the adequacy of information concerning the issuer which has previously been made available to the general public, the ease with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of the holders thereof can be understood, and to the public interest and the protection of investors.

Text of Policy Statement

The text of the Commission's statement of policy follows:

"The Congress having amended Section 8 (a) of the Securities Act of 1933 to confer upon the Commission discretion to accelerate the effective date of registration statements filed under the Securities Act of 1933, the Commission declares that, pursuant to such discretionary authority, it will be the general policy of the Commission to accelerate the effective date of registration statements filed under the Securities Act of 1933 in accordance with the following procedure:

Determination of Date

"In determining the date on which a registration statement shall become effective, the Commission will consider, having due regard to the public interest and the protection of investors.

(a) "The adequacy of the disclosure and compliance with the requirements of the Act, and compliance with the applicable form and instruction book and rules pertaining thereto at the time the registration statement is initially filed;

Advisability of Acceleration

(b) "The advisability of permitting the acceleration of material amendments filed after the initial filing date; and

(c) "The character and date of information previously or concurrently filed under any Act administered by the Securities and Exchange Commission or by any other Federal Agency or which is generally available to the public.

Policy on Amendments

"It is expected that examination by the Commission of registration statements and amendments (if any) which have been prepared with due regard to the matters set forth in (a) above, will ordinarily be completed within a few days after the filing date, so that as soon as an appropriate amendment correcting the deficiencies, if any, and an amendment setting forth the price, if the price and terms of offering were not set forth in the statement as initially filed (or matters relating to price such as redemption or sinking fund, call prices, conversion prices or such other matters relative to price or terms of offering as the Commission may by rules and regulations determine) are filed, the Commission will, subject to the above statement of policy and the requirements of the Act, consent to the filing of the amendments and declare the statement effective as soon as practicable.

Indenture Requirements

"The requirements of the Trust Indenture Act of 1939 have materially increased the examination work of the Registration Division of the Commission with respect to registration statements of securities to be issued under indentures which must be qualified under that Act. It will further the effectuation of the above policy if drafts of such indentures are submitted in reasonably final form for consideration and discussion with the staff as far as possible in advance of the actual filing of the registration statement.

"The Registration Division of the Commission has, in the past, made its services available to proposed issuers of securities and their counsel and accountants in order to give them advice with respect to questions which might arise in connection with the preparation of registration statements. The Commission will continue this service insofar as possible and will endeavor to assist proposed registrants, in advance of filing, in the solution of specific technical questions which may arise.

Cooperation Pledged

"It will be the Commission's policy to cooperate with registrants in order that the effectiveness of registration statements filed under the Securities Act may be expedited as much as possible consistent with the public interest and the protection of investors.

"For additional guidance, consultation with the Commission at or before the time of filing may enable the Commission, whenever possible, to indicate the approximate date on which the registration may become effective."

QUESTIONS AND ANSWERS

QUESTION NO. 1: Is it necessary for a firm already registered with the SEC as an over-the-counter broker or dealer to register again with the Commission as an investment adviser under the Investment Advisers Act of 1940, if said firm receives special compensation for advising certain of its clients with respect to their investments?

ANSWER: Yes, if such firm has fifteen or more such clients from whom it gets special compensation (in addition to ordinary brokerage commissions or ordinary dealer profits) for such advice.

REASON: Such firm would fall within the definition of the term "investment adviser" as contained in Section 202 (a) (11) of the Act, and would, therefore, be required to register with the Commission as an investment adviser under Section 203 of the Act.

* * *

QUESTION NO. 2: May a member of the Association who is registered with the Commission as an over-the-counter broker or dealer and who is also registered with the Commission as an investment adviser represent that he is an investment counsel, if such member is primarily engaged in the business of underwriting, distributing, or trading in securities?

ANSWER: No.

REASON: The Investment Advisers Act of 1940 makes it unlawful for any investment adviser to represent that he is an investment counsel or to use the name "investment counsel" as descriptive of his business, unless he is primarily engaged in the business of giving continuous advice as to the investment of funds on the basis of the individual needs of each client.

SEC DISCUSSION

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tions as follows: (1) while acting as broker in the purchase and sale of securities he falsely represented to his customers the cost of such securities, or the proceeds of the sales, thereby making secret profits for himself; (2) while purporting to effect purchases and sales as a broker he in fact acted as a principal, dealing with his customers for his own account; (3) he falsely represented that he had effected purchases of certain named securities as broker for the accounts of various customers when he well knew that he had not purchased such securities—a practice commonly known as 'bucketing'; (4) in exercising his discretionary authority over the account of one of his customers, he sold to her, from his own inventory or position, various securities at prices greatly in excess of the prevailing prices therefor. The registrant filed an answer and consent to revocation of registration, in which he acknowledged receipt of notice of the proceeding, waived opportunity for hearing, admitted the existence of the facts set forth in the Commission's order, and consented to the entry of an order by the Commission revoking registration.

Principal vs. Agent

"A broker is an agent and it is, of course, a general principal of law that an agent may not, in the absence of consent of the person whom he purports to represent, deal with such person as a principal. This is so irrespective of any injury or loss to the principal.[1] It follows that when a broker-dealer represents to a customer that he is effecting a transaction as broker, and, without the knowledge or consent of the customer buys from or sells to the customer as a principal, he is making a misrepresentation of a material fact and is engaging in a fraudulent practice which violates Section 17 (a) of the Securities Act, Section 15 (c) of the Securities Exchange Act and Rule X-15C1-2 thereunder."

[1] *See Hall v. Paine, 224 Mass. 62, 112 N. E. 153, 158 (1916). "A broker's obligation to his principal requires him to secure the highest price obtainable, while his self-interest prompts him to buy at the lowest possible price. The law does not trust human nature to be exposed to the temptations likely to arise out of such antagonistic duty and influence. This rule applies even though the sale may be at auction and in fact free from any actual attempts to overreach or secure personal advantage, and where the full market price has been paid and no harm resulted. . . . "*

"It is not improper, of course, for a registrant who is both a broker and a dealer to act on one occasion as agent for a customer, and on another occasion as a principal, providing that, in each instance, the relationship is agreed to by the customer at or before the completion of the particular transaction. . . . .

Excess Profits

"With respect to the fourth category of the fraudulent transactions set forth above, the registrant has admitted that while exercising discretionary authority over a customer's account, he transferred his own securities to the account at prices greatly in excess of the prevailing prices. A broker-dealer exercising supervision over a discretionary account is, of course, an agent and under the principles already discussed these transactions constitute a violation of the statutory provisions cited. But these transactions in which the registrant charged his customer a price having no reasonable relationship to the prevailing market price violate the statutory provisions for still another reason. Thus, even if the customer had been informed that the registrant was dealing with her as principal in these transactions, as we have stated in *Duker & Duker,* 5 S. E. C. _____, Securities Exchange Act Release No. 2350 (1939): 'Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. . . . A dealer may not exploit the ignorance of his customer to exact unreasonable profits resulting from a price which bears no reasonable relation to the prevailing price.'[2] It is not, of course, the amount of profit *per se* which we condemn. A change in market conditions may increase the market price of a security over the amount paid for it by the dealer to a point where he can fairly sell it to his customer at a substantial increase over the purchase price. In the *Duker & Duker* case, where the dealer charged an uninformed customer a price which bore no reasonable relationship to the prevailing price, the fraud lay not in the amount of the profit realized but in the inherent misrepresentation as to the current market price of the security.

NASD Rules

[2] *Compare the Rules of Fair Practice of the National Association of Securities Dealers, Inc., Article III, Par. 4: "In 'over-the-counter' transactions, whether in 'listed' or 'unlisted' securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit. . . ."*

"This case represents a particularly vicious instance of fraud and overreaching. We find that the registrant has wilfully violated Section 17 (a) of the Securities Act of 1933, and Section 15 (c) (1) of the Securities Exchange Act of 1934 and Rules X-15C1-2 thereunder, and that it is in the public interest to revoke the registration."