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Committee Investigations Reveal Sending of Improper Confirmations by Members

Also Show that in Some Cases Firms Are Not Clear as to Whether They Are Acting as Brokers or Dealers

Mostly Confined to Smaller Houses

Investigations of complaints by Association committees and other representatives reveal that in a number of cases members are sending improper confirmations to their customers and that in some cases they were not clear as to whether they were acting as a broker or dealer in their transactions. The sending of improper confirmations violates not only Association, but also SEC, rules, and the practice is not confined to any particular section of

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Will Not Change SEC Policy, Chairman Eicher Declares

Edward C. Eicher, recently elected Chairman of the SEC, stated that there will be no changes in the present policy of the Commission. Mr. Eicher succeeds Jerome N. Frank who has been appointed to the Federal Circuit Court of Appeals for the Second District.

Chairman Eicher was appointed a member of the SEC in December, 1938, for the term ending June, 1940, when he was reappointed for five more years. He was born in Washington County, Iowa, on December 16, 1878, attended the Washington (Iowa) Academy and the Morgan Park (Illinois) Academy, and graduated from the University of Chicago in 1904, where he had studied law. He is a member of the Iowa, Illinois, and Supreme Court of the United States bars. He served as a member of the House of Representatives, 73d, 74th and 75th Congresses.

Mr. Eicher was one of the first SEC members to openly advocate competitive bidding for utility securities. He has demonstrated a special interest in administration of the Holding Company Act and has been a strong advocate of getting compliance with Section 11, the so-called "death sentence" clause.

Protection for Members

Prompt action by the Association has in a number of cases spared members the embarrassment, to say the least, of becoming involved with the SEC because of apparent violation of the Commission's rules and regulations. Generally, these matters have been uncovered by the SEC itself and turned over to the Association for action.

The latest of these cases concerned what appeared to be manipulation of the market by a member firm under the guise of stabilization during the distribution of a new issue of securities. As a matter of fact, some members of the Commission's staff seemed to be of the opinion that many of the purchases made by the firm, as syndicate manager, were effected for the purpose of "inducing others to buy the bonds that were still in the process of distribution," particularly in view of the fact that they were made at successively higher prices, and thus violated both the Securities Act and Exchange Act.

At the suggestion of the Commission the Association was asked to handle the matter. An investigation convinced the Association that the firm had made the purchases inadvertently and in ignorance and without intending to manipulate the market. The Association, accordingly, warned the firm that it must comply with the SEC's rules and regulations and that it should exercise greater care and supervision over its activities so that there would be no repetition of these actions. Further, the firm was warned that similar actions in the future might well lead to serious consequences, possibly resulting in severe penalties.

The disposition of this case was reported to the SEC which expressed itself as satisfied with the action taken.

Excessive Profits Taken In Shopping Against Orders

Some rather interesting developments have been brought to light by a review of the cases referred to the Association by the SEC. A large majority of all these cases seem to have

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Business Conduct of NASD Members to Receive Stricter Supervision Under New Policy

Baird Letter Urges Vigorous Action Against Unscrupulous Dealers for Good of Whole Business

Board of Governors Holds Meeting

Organization work completed and educational program well under way, the Association has decided major emphasis in the future will be placed on the stricter regulation of the business conduct of members, according to a letter to District Committee Chairmen from Robert W. Baird, Chairman of the Board of Governors.

Mr. Baird's letter follows in part:

"The Association has now been operating for nearly two years. We feel that we have gotten well past the problems incidental to organization and

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Wadsworth Offers Amendments To Various Securities Acts

Representative Wadsworth (R., N. Y.) recently introduced amendments to the various securities acts into Congress designed to: (1) simplify prospectuses; (2) authorize publication of simple descriptive newspaper advertisements of securities offerings; (3) simplify registration procedure; (4) reduce the "incubation" period; (5) forbid changing or adoption of rules without giving persons affected a fair chance to be heard; (6) forbid publication of charges of wrongdoing until proven; and (7) provide for prompt relief to persons injured by acts of the SEC or its staff.

He also proposed repeal of the "insiders" trading clause of the Exchange Act, exemption from registration of issues up to $500,000 and the amendment of the preamble of the Exchange Act to instruct the Commission that its duty is to encourage and foster orderly, active, stable and liquid securities markets for the protection of investors, as well as to police these markets to prevent fraud and other abuses.

District 4 Uniform Practice Committee Meets Problems Concerning Regulation T

Provisions Relating to Liquidations in Cash Transactions Appear in Conflict With Minnesota Law

Recommends Legends for Confirmations

EDITOR'S NOTE: *The following article relates the efforts of District No. 4's (Minnesota, Montana, North Dakota and South Dakota) Uniform Practice Committee to solve the problem which arose when Federal Reserve Board's Regulation T conflicted with a state law.*

Dealers in Minnesota have a problem in connection with Regulation T of the Federal Reserve Board, which problem may exist for dealers in some of the other states, though we understand it does not exist for dealers in all states. This is in connection with the provision of Regulation T whereby securities in cash transactions, if not paid for by the customer within a certain time, are required to be sold or the transaction cancelled.

It is doubtful whether under Minnesota law a dealer or broker, who does not have a contract with his customer expressly authorizing him to do so, has the right to liquidate the transaction as required by Regulation T without the customer's consent or without instituting suit.

Committee Recommendations

To meet this situation, the Uniform Practice Committee of District No. 4 has recommended that express provisions with respect to cancellation and closing out be contained in contracts between securities dealers and their customers in Minnesota, and has suggested that the following paragraph be shown on confirmation forms covering sales as principal:

> "If full payment is not made on or prior to the date required by Regulation T of the Federal Reserve Board, we reserve the right, without further notice, to cancel this transaction, or, at our option, to sell out the securities covered hereby and hold you liable for the resulting loss or pay over the excess to you, as the case may be."

On confirmations covering purchases as broker for the customer the same paragraph is recommended, omitting the phrase "to cancel this transaction, or, at our option."

Protective Clause Urged

The Committee has also recommended that on confirmations covering purchase as principal and sale as broker for the customer a similar protective clause be used, stating that if the securities concerned are not delivered on or prior to the settlement date shown on the confirmation, the dealer reserves the right without further notice to cancel the transaction or to buy in the securities and hold the customer liable for resulting loss, or to pay over the excess, as the case may be.

A further recommendation has been made that in advance of the use of such legends on confirmation forms, a uniform letter explaining the necessity of this change in the light of Regulation T be sent by dealers to all customers. In addition, it has been recommended that confirmation forms bear language required by the recent hypothecation rules of the S. E. C.

New Policy

(*Continued from Page 1*)

that although much remains to be done in an educational way, we have made a good start in that direction. We, of course, plan to continue the so-called 'conference work' of the Association and endeavor in every way possible to assist the Securities and Exchange Commission and state authorities in matters affecting our business. But from this point on our major emphasis must be placed on regulating the business conduct of our members if we are to achieve the primary purpose for which the Association was formed. . . . Federal regulation is the alternative and while it is true that this additional regulation will be largely due to the actions of a small percentage of our business . . . the effect will be to place unnecessary burdens on the honest and upright member.

Vigorous Prosecution Urged

"In line with this policy, it was decided, that all District and Local Business Conduct Committees should be ever watchful to discover violations of the Association's Rules and that violators should be vigorously prosecuted and punished. In this connection, the matter of excessive or unconscionable profits is one to which the Business Conduct Committees should particularly address themselves.

"It is also planned to have a meeting of all District Secretaries in the immediate future at which meeting instructions will be given as to the proper manner of making investigations and handling formal as well as informal complaints.

"In other words, we want to use every available resource to get those out of the Association who persist in injuring both the public and those in the business, and thus make the transaction of business easier for those who conduct themselves in a proper and professional way. In this endeavor we cannot succeed unless we have the complete and enthusiastic cooperation of every member and every committee of the Association."

Board Meeting Held

Mr. Baird's letter was written following discussion of this matter at the Spring meeting of the Board of Governors over which he presided. Other activities at the meeting included the presentation of the report of the Securities Acts Committee by Stewart Hawes of New York City, its Chairman. This committee has been negotiating with the SEC on proposed changes in the various securities acts.

The following reports of national standing committees were also heard: Quotations Committee, Frank Weedon of San Francisco, Chairman; Technical Committee, Henry L. Rosenfeld, Jr. of New York City, Chairman; Business Conduct Committee, Donald C. Bromfield of Denver, Chairman; Uniform Practice Committee, Joseph T. Johnson of Milwaukee, Chairman; and Investment Trust Underwriters Committee, Henry T. Vance of Boston, Chairman. The Board also approved the actions of the Executive Committee, Mr. Baird, Chairman, and Finance Committee, Laurence M. Marks of New York City, Chairman, since the last meeting of the Board.

Wallace H. Fulton, Executive Director, reported on the progress of the Association and reviewed the handling of the trade practice complaints brought in various Districts.

Excessive Profits

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as one of their more important aspects the fact that members involved took excessive profits by obtaining orders from customers and then shopping around in an endeavor to extract the greatest profit possible from the trade.

Most of these firms have been found to be inadequately financed and they rarely maintain any inventory. These firms very often resort to practices designed to convince their customers that every effort was being made to get them the most favorable price, when actually the prime concern was profit to the firm.

Several instances have come to light where members have taken orders for listed securities when the customers didn't know the securities were traded on an exchange, confirmed the trade as principal and realized a profit far in excess of one that normally would be charged.

District No. 13 Deals With Problem of Lack of Advance Notice of Dividend Payments

Double-Barrelled Program Undertaken to Educate Companies on Need for Conformity in Declarations

Receives Good Response from Work

EDITOR'S NOTE: *The following article relates the experiences of District No. 13 (New York, New Jersey and Connecticut) in dealing with the problem of companies giving insufficient or no advance notice of dividend payments. It is presented here for the benefit of any other District which may have similar problems.*

Some corporations whose capital issues are traded Over-The-Counter have the unfortunate habit of declaring dividend, interest and similar payments to holders of record on the date the Board of Directors made the declaration, or a few days prior or subsequent thereto. This practice has become most troublesome and is disruptive to orderly trading.

About two years ago the New York Curb Exchange started a campaign to educate its companies whose issues were in their "Unlisted Department", into conformity with the requirements for their listed securities. The problem can never arise on the New York Stock Exchange because everything they have is listed and one of the requirements for listing is that ten days public notice be given as to dividend, interest or similar payments except in extraordinary circumstances. Following the Curb's action, which has gone a long way towards completely eliminating the problem there, the National Securities Traders Association has been contacting companies with the same objective.

NASD Undertakes Program

In October of 1940 the NASD undertook a like program. Two steps were taken, one to incorporate a direct question on a company's dividend practice into our quotation application form; two to compile a list of those companies whose securities we quote, which did not conform to the good practices of advance notice. Eighty-two letters were sent out to concerns bringing to their attention the fact that the practice of Stock Exchanges had evolved from years of trial and error, and calling for cooperation in adopting the standards which Exchanges had created.

Twenty-one replies were received with answers dividing into three categories; those promising to cooperate, others that they would consider the matter, and the final group, predominately insurance companies, that they had always declared dividends according to a set procedure, and saw no reason for changing. Some companies justified their action of short or no notice on the ground that in order to get payments to holders by Christmas or New Year's the usual ten days could not be allowed between declaration and record date. It is realized that a few companies, because of inventory, adjustments and taxes, might not be able to determine what sum will be available for stockholders until late December, but this is the exception and not the rule.

Follow-Up Letter Sent

On February 17th a follow-up letter, sent to those who had not replied to the first, brought forth nineteen more answers. This letter frankly stated the consequences of a company not making public dividend declaration sufficiently in advance of the record date. We pointed out that where there is not sufficient advance notice to get the name of the new owner on record, confusion and annoyance is generally created. The old stockholder finds himself deprived of his dividend, and is apt to look unfavorably on the source which recommended sale. The new shareholder gets a delayed payment until his broker-dealer has adjusted due bills, solely because of the procedure of the company he had just bought into. An added burden is placed on the cashier's department of various houses because of the need for due bills, and a selling broker or dealer runs the risk of losing the amount of the dividend because the old holder doesn't want to give it up.

Nineteen replies came back from this second letter, on the whole more favorable than the first letter. The ratio changed from 11 favorable, 2 noncommital, and 8 negative to 10, 2, and 1 respectively.

To Interview Companies

It is planned to continue from now on with personal contacts, *i. e.* to interview local companies when delayed notice comes to our attention. Two cases came up last month both dealing with utility stocks, in one it was the company's initial dividend, and in the other a plan of merger-reorganization resulted in an increase in the number of stockholders from six to over eight hundred. The man in charge of the first company's finances had been pressed the week after the declaration and giving public notice slipped his mind. As a result the following week, when the news got out, he became tied up a whole day answering questions relative to the declaration and he is still being bothered with inquiries. He has assured us that it will never happen again. In the second situation the company had acted as it always had; declared a dividend to holders of record on the day the Board met. Numerous telephone calls soon brought to this company's attention the fact that they were now a publicly held concern and a change of policy is promised.

To date not one letter has justified the practice, with the exception of the year-end situation mentioned above, and if any member knows of a reason for not giving sufficient advance notice to security holders of pending payments it would be greatly appreciated if he would get in touch with the New York Office of the Association.

Any suggestions or help towards eliminating "short notice" dividend declarations will be welcome.

Dropping of Quotes Reveals Much Interest in Local List

District No. 10 Gets Unexpected Results In Trying to Improve Service

A move by District No. 10 (Ohio and eastern Kentucky) to improve its quotation service in Louisville had the unexpected result of revealing widespread public interest in the local quotations. In an effort to confine the daily quotations in that city to the more actively traded securities, the local quote list was cut nearly in half. This was so sharply protested by members of the public that five of the dropped quotations had to be reinstated. In addition, the Louisville newspapers, in return for the cut in the listings, gave a full line to each security instead of the half column width used before.

Although the local committee did not cut the list in an effort to ascertain the interest of the public in the quotes, this method has long been used by newspapers themselves to determine reader interest. In other words, the newspapers occasionally drop a feature for a few days to determine if it is being followed and, if sufficient protest develops, reinstate it. This method is regarded in newspaper circles as a sure test of popularity.

The local committee in Cleveland increased the quotations list in that city from 13 to 36 securities after submitting ballots to all members in that city. Despite the large increase in the total of securities quoted, only those securities were adopted which received majority approval.

SUMMARY OF ALL COMPLAINTS

Executive Director Reports Results in Handling Complaints To Date to Governing Board

Gives Number, Disposition of Cases of Alleged Violations of Rules of Fair Practice in Each District

EDITOR'S NOTE: *The following excerpt from the report of Wallace H. Fulton, Executive Director, to the Board of Governors at its Spring meeting comprises a complete summary of all complaints which have been handled to date. It is presented here in the nature of a report to members on this subject in connection with the new policy of the Association of stricter regulation of the Business Conduct of members.*

District No. 1. (Idaho, Oregon and Washington)

In District No. 1 there were three complaints—one formal, and two informal. The formal complaint is a P. S. I. case and has been called up for review by the Board of Governors. In one informal complaint, no action was taken; and in the other informal complaint, the Committee had no jurisdiction over the matter.

District No. 2. (California and Nevada)

In District No. 2, twenty-four complaints have been filed—thirteen formal, and eleven informal. Of the thirteen formal complaints, four are P. S. I. cases and have been called up for review by the Board of Governors. The other nine formal complaints have been disposed of as follows: three complaints were withdrawn; one membership was cancelled; one fine of $250 was imposed; in one case a member was fined $36 and expelled from membership; in one case a fine of $250 and a letter of censure were imposed; in one case a fine of $500 was imposed and the member was suspended from membership in the Association for a period of ten days; and in another case the complaint was settled between the parties involved by the respondent's paying to complainant the amount of $1,000. Of the eleven informal complaints in this District, one complaint was withdrawn; four members were censured; one complaint was settled between the complainant and respondent by respondent's paying $1,024.50 to complainant; the Association had no jurisdiction in one case; complainant failed to press charges and the matter was dropped in one case; in another case the matter was settled by the parties involved; and in two cases no action was taken.

District No. 3. (Arizona, Colorado, New Mexico, Utah and Wyoming)

In District No. 3 only one complaint has been filed. This was handled informally and the complaint was dismissed.

District No. 4. (Minnesota, Montana, North Dakota and South Dakota)

In District No. 4, four complaints have been filed. These four complaints are all formal complaints regarding the P.S.I. matter and are now before the Board of Governors on review.

District No. 5. (Kansas, Oklahoma and western Missouri)

In District No. 5, three complaints have been filed—two formal, and one informal. The two formal complaints are P.S.I. cases and have been called up for review by the Board of Governors. The informal complaint was disposed of by imposing a penalty of censure on the respondent member.

District No. 6. (Texas)

In District No. 6 only one complaint has been filed. This was a formal complaint and the penalty imposed by the District Business Conduct Committee upon the respondent member was suspension from the Association for a period of six months.

District No. 7. (Arkansas, eastern Missouri and western Kentucky)

In District No. 7, twelve complaints have been filed—six formal, and six informal. The six formal complaints are all P.S.I. cases and have been called up for review by the Board of Governors. In the six informal complaints, three letters of censure were imposed; a settlement was reached in one case; it was determined that respondent was not guilty in one case; and in another case the Committee decided that complainant had no cause for complaint against respondent.

District No. 8. (Illinois, Indiana, Iowa, Michigan, Nebraska and Wisconsin)

In District No. 8, forty-three complaints have been filed—twenty-nine formal, and fourteen informal. Of the twenty-nine formal complaints, twenty-one are P.S.I. cases, which are now before the Board of Governors on review. In four P.S.I. cases, the complaints were dismissed. The other four formal complaints were disposed of as follows: one fine of $2,000 was imposed; one fine of $300 was imposed; one membership was cancelled; and one complaint was withdrawn. In the fourteen informal complaints, seven letters of censure were imposed; one complaint was withdrawn; one member was exonerated; no action was taken in three cases; in one case the allegations of the complaint were erroneous; and one complaint is still pending.

District No. 9. (Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina and Tennessee)

In District No. 9, three complaints have been filed. These three complaints were all handled informally; in two cases, letters of censure were imposed; and in one case, it was determined that there was no cause for the complaint.

District No. 10. (Ohio and eastern Kentucky)

In District No. 10, three complaints have been filed—two formal, and one informal. The two formal complaints are P.S.I. cases and have been called up for review by the Board of Governors. A penalty of censure was imposed on the respondent in the informal complaint.

District No. 11. (District of Columbia, Maryland, North Carolina, Virginia and West Virginia)

In District No. 11, six complaints have been filed—two formal, and four informal. The two formal complaints are P.S.I. cases and have been called up for review by the Board of Governors. In each of the four informal complaints, a letter of censure was sent to the respondent.

District No. 12. (Delaware and Pennsylvania)

In District No. 12, fourteen complaints have been filed—three formal, and eleven informal. The three formal complaints are all P.S.I. cases; two of them have been called up for review by the Board of Governors, and the other has been dismissed. In the eleven informal complaints, four letters of censure were sent to respondent members; one letter of warning was sent; in one case, respondent was released from all future actions, suits, etc. by complainant; no action was taken in two cases; two complaints were settled between the parties involved; and one case has been set down for a future check to determine respondent's compliance with the Rules of Fair Practice of the Association.

District No. 13. (Connecticut, New Jersey and New York)

In District No. 13, seventy-three complaints have been filed—forty-one formal, and thirty-two informal. Of the forty-one formal complaints, thirty-four are P.S.I. cases; four of these have been dismissed, and the other thirty have been called up for review by the

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Lane Issues Two Opinions Clarifying Certain Sections Of SEC Hypothecation Rules

Also Sheds Light on Meaning of Certain Phrases Used in the Investment Company Act of 1940

Given at the Request of the Association

At the request of the Association, Chester T. Lane, General Counsel of the SEC, recently issued two clarifying opinions concerning certain sections of the Commission's hypothecation rules and the meaning of certain phrases used in the Investment Company Act of 1940.

The first opinion was given in response to questions raised as to the meaning of the terms "appropriated by such member, broker or dealer to a customer" in paragraph (b) (2) (ii) of the hypothecation rules defining securities carried for the account of customers.

The principal effect of the interpretation, according to the SEC, is that under paragraph (b) (2) (ii) securities sold by a dealer to a customer under instructions to deliver the securities promptly against full payment of the purchase price either directly to the customer or his agent or under a sight draft to which the securities are attached, would not, generally speaking and under the customary practice in the business, become "securities carried for the account of any customer" until their delivery to the buying customer or his agent. The opinion states that under these circumstances the securities ordinarily would not be "appropriated" to the customer within the meaning of the rules until delivery occurs.

Subject to Rules

On the other hand, where the sale by a dealer is not accompanied by instructions for prompt delivery of the securities to the customer, identification or other form of earmarking the securities for the particular customer, either physically or by bookkeeping entry, would generally amount to "appropriation" to the customer within the meaning of the rules. After any such identification of particular securities as the securities of the buying customer, the securities sold would be securities "carried for the account of" the customer and any pledge of such securities would be subject to the rules.

The second opinion concerned the meaning of the phrase "a current offering price described in the prospectus" as used in Section 22 (d) of the Investment Company Act. This section provides in part, and subject to certain exemptions, that no redeemable securities of a registered investment company which are being currently offered to the public may be sold by the principal underwriter or dealer to any person other than a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus.

In the case of many open-end management investment companies the amount of sales load which is a component portion of the public offering price varies with the dollar amount of the securities purchased, the practice being to charge a smaller sales load on larger purchases. The opinion of the General Counsel, in response to an inquiry as to whether this practice is permissable under Section 22 (d), takes the position that such practice is not forbidden by the section, but that the varying sales loads to be charged must be clearly and specifically disclosed in the prospectus and must be charged to all purchasers without discrimination.

32 More Registered Advisers

The SEC recently announced that as of April 19, 1941, 741 investment advisers were registered under the Investment Advisers Act of 1941. This compares with 709 on February 18. During this period, 44 applications for registration became effective, four were withdrawn and eight were cancelled.

SEC Passes on Trust Rule; Becomes Effective on June 1

The SEC passed on our investment trust rule as provided for in the Maloney Act—that is, it has considered it and not disapproved of it—after a public hearing held late in March. The rule becomes effective June 1, 1941. The rule, which was approved by a three-to-one vote of the membership, governs certain phases of the underwriting and distribution of securities of open-end investment trusts.

General tenor of the Commission's opinion issued concerning the rule was that while it might not solve all of the problems involved it was at least a step in the right direction and for this reason should not be disapproved. In the opinion, however, the SEC was referring primarily to paragraphs (e), (h) and (j) (2) of the rule. Paragraphs (e) and (h) are concerned with the method of pricing redeemable securities of open-end investment companies for the purpose of sale and redemption.

Twice-a-Day Pricing

Paragraph (e), simply stated, will require that shares sold through members of the Association be priced at least twice a day. Paragraph (h), in effect, requires that shares be redeemed at a price based upon actual asset value at the time of redemption, or at a price based upon the asset value upon which the current offering price of shares is based, whichever is lower.

Paragraph (j) (2), in effect, prohibits any dealer who is not a party to a sales agreement with the principal underwriter, and any investor, from redeeming outstanding shares of open-end investment companies unless the dealer or investor is a record owner of the shares in question.

Complaint Summary

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Board of Governors. The remaining seven formal complaints were disposed of as follows: three memberships were cancelled; one member was suspended from the Association for a period of six months; and three complaints are still pending. In the thirty-two informal complaints, eleven letters of censure were sent to respondent members; one complaint was withdrawn; no action was taken in six cases; two letters of caution were sent to respondent members; two members adjusted the manner of conducting their business; in one case, the Association had no jurisdiction; one case resulted in the filing of a formal complaint; and eight cases are still pending.

District No. 14. (Maine, Massachusetts, New Hampshire, Rhode Island and Vermont)

In District No. 14, twenty-one complaints have been filed—fifteen formal and six informal. Of the fifteen formal complainants, seven are P.S.I. cases. Three of these P.S.I. cases have been dismissed, and the other four have been called up for review by the Board of Governors. The remaining eight formal complaints have been disposed of as follows: in one case a fine of $150 was imposed; two complaints were withdrawn; one membership was cancelled; two cases were settled between the parties involved; one complaint was dismissed; and one case was disposed of informally. In the six informal complaints, letters of censure were sent to respondent members in four cases; one case resulted in the filing of a formal complaint; and one case is still pending.

Work of Conduct Committee In Handling a Typical Trade Practice Complaint Described

Case Illustrates Practice Followed by Certain Dealers to Deceive Customers and Reap Unconscionable Profits

Member Fined $250 for Violating Rules

This case illustrates a practice followed by certain dealers for the purpose of deceiving their customers so as to reap unconscionable profits.

The complaint, which was brought on evidence presented by a customer of a member, rapidly narrowed down to two points when a hearing was held. It developed that a salesman for the member had taken an order to sell 100 shares of a railroad stock and had given the customer a receipt noting that he had received the stock "to be sold at 67 or better." The stock was bought by the member at this price and confirmed as principal. The stock was sold by the member on the same day at 60, but the member, in turn sold his customer 100 shares of another railroad stock at 60 net, which he had bought at 47¼ on the same day.

The District Business Conduct Committee involved concluded that the receipt, in the form in which it was issued, imputed an agency relationship and that the prices involved in the purchase and sale were evidence that the member had used them as a means to induce a transaction which the customer otherwise might not have been willing to make.

Explanations Offered

The member, called upon to explain these transactions, claimed that it had been understood that he was to act on a principal basis with his customer and that, if the receipt indicated otherwise, it was the result of carelessness on the part of the salesman. However, his explanation of the other charge was less satisfactory and somewhat inconsistent. He claimed, among other things, that the two transactions had been made contingent on each being carried out, that for this reason neither the purchase nor sale was complete at that time, and that he intended later to adjust or rectify the matter to his satisfaction.

The member testified that he had gone to his customer about a week later, had shown him the circumstances surrounding the disposition of the first railroad stock and offered to rescind the purchase. Apparently, however, he did not tell the customer the circumstances surrounding the sale of the second railroad stock and the customer found out about this himself. The entire transaction was then adjusted on both sides. The first sale by the customer to the member was confirmed as agent at 60 with no commission and the sale by the member to his customer was confirmed as principal at 49¼, or a two-point markup.

Fine of $250 Imposed

The committee concluded that there was no violation of the rules in the original purchase by the member as principal in that there had been no clear understanding as to on what basis the transaction was to be effected. However, the committee found that there had been a violation of the rules in respect to the second charge in that deceptive and fraudulent devices had been used to effect the transactions. As a penalty, the committee censured the member and fined him $250.

The committee also sent the member a letter recommending that his general office practice should be considered and revised so that (1) there could be no question as to whether a transaction was to be on an agency or principal basis; (2) control of salesmen in the issuance of receipts and other matters and in inducing transactions with customers would be positive; (3) over-quoting or misquoting a security to a customer whether inadvertent or not, "a vicious practice", would be stopped; and (4) the affixing and cancelling of Internal Revenue stamps would conform with the Bureau's regulations.

SEC Adopts Two Amendments To Its Hypothecation Rules

Designed to Simplify Compliance Without Lessening Customers' Safeguards

The SEC recently announced the adoption of two amendments to its hypothecation rules after informal discussion with certain representatives of the securities business. The amendments are designed to simplify the conduct of brokerage business under the rules without detracting from the essential customers' safeguards which they are intended to provide, the Commission said.

The first amendment is clarifying in character and states specifically that where a broker transmits securities for the purpose of reducing liens on securities carried for the account of customers, it will have the same effect as the transmission of funds for that purpose.

The second amendment will facilitate the carrying of omnibus accounts by one broker for another broker. Prior to this amendment, the rules in effect required a broker carrying an omnibus account composed of the securities of customers of the forwarding broker to make a physical segregation of the securities of the pledging broker from the securities held for that broker's customers.

The SEC said that on examination it appeared that this requirement presented certain practical difficulties, particularly upon rehypothecation, and did not seem to result in any substantial additional legal protection to customers. The amendment deletes this requirement for physical segregation.

The amendments became effective on publication March 28, 1941.

Competitive Bidding Rule

Turning down compromises offered by and disregarding the protests of the vast majority of those in the securities business, the SEC recently promulgated Rule U-50 under the Holding Company Act. The new rule calls for competitive bidding on all issues of utility securities subject to the act in excess of $1,000,000 and makes certain other exemptions. It subjects private as well as public placements to its provisions.

Improper Confirmations

(*Continued from Page 1*)

the country. As a general rule, however, the practice is mostly confined to the smaller and less well-informed securities dealers.

The question as to when a person in the securities business is acting as a broker and when he is acting as a dealer and his duties in each instance was discussed in the Question and Answer column on Page 2, Volume I, Number 2, of the N. A. S. D. NEWS, dated June 22, 1940. A review of this article is recommended if any doubts as to your status in any transactions exist.

On the subject of confirmations. Generally, when acting as broker or agent, one requirement is that confirmations should make it clear that the securities in question were either bought *for* or sold *for* the account and risk of the customer. When acting as dealer or principal, confirmations should make it clear that the member is either buying *from* or selling *to* his customer. It is recommended, however, that rather than rely on this generality, members should seek advice from their counsel.