

# NEWS ID

No. 3

1959

PUBLISHED BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. WASHINGTON, D. C.

## FREE-RIDING AND WITHHOLDING

### Thirty-Four "Hot Issues" Under Investigation

Free-Riding questionnaires covering the distribution of thirty-four recent "hot issues" have been sent to 436 members of the Association. A total of 1016 participations will be examined in this latest group of questionnaires authorized by the Executive Committee of the Board of Governors.

The issues now under study include Accurate Specialties; Anken Chemical & Film; Atlantic Research; Century Chemical; Certified Industries; Chemical Milling International; Coil Winders; Curtis Industries; DeJur Amisco; Dynacolor Corporation; Elion Instruments; Federated Investors; The Fed-Mart Corporation; Glass-Tite Industries; Greater All American Markets; Harman-Kardon; Hermetic Seal; Hexcel Products; Industro Transistor; Infrared Industries; Keystone Custodian Funds; Loral Electronics; Marshall Industries; Moog Servo-controls; Paddington Corporation; Permanent Filter; Pyrometer Company of America; Raytherm Corporation; Sea View Industries; Telectro Industries; Telemeter Magnetics; Templeton, Damroth Corporation; Trans-Sonics and Wometco Enterprises.

The SEC's staff, also inquiring into the circumstances surrounding the distribution of "hot issues," reported (SEC Ex. Act Rel. 6097) that its study disclosed certain practices which may involve violations of the Federal securities laws. The

(Continued on Page 4, Col. 2)

## ANDERSON 1960 CHAIRMAN

Sheets, Dern, Jacques, Fulton Also Named



Glenn Anderson, a native of Asheville, N. C., received his Bachelor of Arts degree from Duke University in 1934. He has been with his present firm and its predecessor since his graduation from college.

He was one of the founders and first president of the Securities Dealers of the Carolinas, and is a past president of the Raleigh-Durham Bond Club.

Mr. Anderson is a director of Piedmont Aviation, Superior Cable Corporation, Anvil Brand, Inc. and other companies. He is secretary of the North Carolina Securities Advisory Committee and vice president of the Raleigh United Fund.

Mr. Anderson will be the 22nd Chairman of the Board of Governors.

Pictures of other officers are on Pages 2 and 3.

Glenn E. Anderson, of Raleigh, N. C., has been nominated to be Chairman of the Board of Governors in 1960. He succeeds Alexander Yearley, IV, of Atlanta.

Nominees for other offices:

### *Vice-Chairmen*

Ralph C. Sheets—New York  
James G. Dern—Chicago

### *Treasurer*

James F. Jacques—Dallas

### *Executive Director*

Wallace H. Fulton—Washington

Glenn Anderson is president of Carolina Securities Corporation. He served as Chairman of District Committee No. 10 in 1954 and became a member of the Board of Governors in 1958. He is presently Chairman of the National Business Conduct Committee.

Ralph Sheets, Vice-President of Blyth & Co., Inc., is a past Chairman of District Committee No. 12. He is serving as a member of the Legislation Committee and as Chairman of the Special Committee to Study Part-Time Dealers and Salesmen.

Jim Dern, a partner of Smith, Barney & Co., was Chairman of District Committee No. 8 in 1957 and is currently Chairman of the Board's Legislation Committee.

Jim Jacques, Vice-President of First Southwest Company, is a past Chairman of District Committee No. 6. He is Chairman of the Finance Committee.

Wallace Fulton, renominated as Executive Director, continues in the office he has held since the formation of the Association in 1939.

## NO PROFITS GUARANTEED

All transactions with customers, regardless of the price level of the security, must be executed at prices which are reasonably related to the current market, taking into consideration all relevant circumstances.

This is a standard applied by District Business Conduct Committees in reviewing each examination of members' books and records.

One recent inspection report of a firm dealing mainly in \$1 and \$2 stocks disclosed mark-ups ranging from 7% to 67% and dollar profits ranging from \$14.25 on a 38-share transaction to \$1500 on a 4,000-share transaction. The average transaction involved \$380 with a profit of \$93, or 32%.

A complaint was filed by a District Business Conduct Committee naming this member and its principal officer as respondents. During the hearing which followed, the member argued that the Association's mark-up policy failed to take into consideration the current cost of operating a business—pointing out that his business was operating at a loss.

In its decision, the Committee granted that, under Section 4 of the Rules of Fair Practice, the fairness of a mark-up should be determined on the basis of all relevant circumstances, including the fact that the firm is entitled to a profit. It was then emphasized, however, that there is no implied guarantee of an overall net profit regardless of unreasonable expense items (such as excessive commissions to salesmen, excessive salaries to officers, excessive telephone expense) or loss on inventory positions which may be incurred by a firm.

Section 4 of the Rules, which points out that a member is entitled to a profit, is a statement of circumstance, not a statement of a principle that a member is entitled to a profit no matter what the mark-up is or what other factors are involved.

## VICE-CHAIRMAN



**Ralph Sheets** graduated from the University of Illinois and entered the securities business in Chicago in 1927. He was with the National City Company of New York between 1930 and 1934 and moved to Blyth & Co., Inc., New York in 1936; became national salesmanager in 1945; and a vice-president of the firm in 1950.

## VICE-CHAIRMAN



**Jim Dern**, a native of Salt Lake City, entered the securities business in 1936 with Dillon, Read & Co., New York, after receiving a Liberal Arts degree from George Washington University. Between 1943 and 1946, he served as a 1st. Lieutenant in the U.S. Army Air Corps. He joined Smith, Barney & Co., Chicago, in 1946, and became a partner of the firm in 1953.

The Committee, in this case, extensively explored the relevant circumstances and concluded that the prices charged to customers were not fair and were not reasonably related to the current market.

The penalties imposed by the District Business Conduct Committee: expulsion of the firm and revocation of the registration of the firm's principal officer. On appeal, the Board of Governors affirmed the decision and penalties imposed at the District level.

### NASD News

Published periodically by the Board of Governors under the supervision of the Information Committee.

Andrew M. Baird, *Chairman*  
1707 H Street, N.W.,  
Washington 6, D. C.

## LETTERS OF INTENTION

Dealers offering investment company shares are reminded to inform customers investing \$25,000 or more of the availability of "letters of intention." These "letters" are arrangements between underwriters, dealers and customers under which the latter indicate their intention to purchase certain substantial dollar amounts of investment company shares during a 13-month period and if the intention is exercised, the customers are entitled to reduced sales charges according to the terms of the contract.

"Letters of intention" cannot be backdated under SEC Rule 22d-1. Hence, a customer buying \$25,000

(Continued on Page 4, Col. 3)

## TREASURER



**Jim Jacques**, born in Texarkana, Texas, attended school in Chicago and entered the securities business there in 1929. He moved back to Texas in 1934 where he was associated with Dallas Rupe & Son, Inc., as a vice-president until 1946. He is one of the founders and a vice-president of First Southwest Co., Dallas.

## EXECUTIVE DIRECTOR



**Wallace Fulton**, a native Californian, joined Walker's Manual in 1924. He became president of the publishing house in 1930. From 1933 to 1935, he was Director of Compliance of the Investment Bankers Code Committee. He returned to Washington in 1936 to be Director of the Investment Bankers Conference, Inc., and when NASD was formed in 1939, became its Executive Director.

## VARIABLE ANNUITIES STATUS

The Securities and Exchange Commission presently has before it the registration statements of Variable Annuity Life Insurance Company and Equity Annuity Life Insurance Company for processing under the Securities Act of 1933 and the applications of these companies for certain exemptions from the Investment Company Act of 1940. Both applicants have urged speedy action by the Commission so that their variable annuity contracts may be sold as securities in compliance with the Federal securities laws.

In connection with the applications for exemption from certain requirements of the 1940 Act, the Association, along with the National Association of Investment Companies and the North American Securities Administrators, participated at SEC hearings, filed statements and briefs and appeared before the Commission in oral argument.

During the hearings, the applicant companies made substantial changes in their requests in order to meet the objections of the Association and other participants. Oral argument was requested and granted before the Commission so that the Association could re-emphasize its position of long standing—that these contracts, held to be securities by the Supreme Court of the United States, should be sold to the public only under the maximum protection of the Federal securities laws.

The Association has been working to this end since 1957. It participated in the litigation through the Federal courts. In its appearances before the Commission, the Association has sought to make certain that the variable annuity companies comply with the decision of the Supreme Court.

The exact form such compliance will take will be known when the registration statements of those companies are made effective by the Commission.

## ADVERTISING

### Recruiting Ads Hit

Advertising designed to recruit sales personnel must now conform to the Interpretation with Respect to Advertising as revised and expanded by the Board of Governors at its September meeting.

Under the revised Interpretation, advertisements which contain "exaggerated or sensational statements or claims of rewards and opportunities greater than can be expected by reasonable standards or implying conditions which are factually incorrect, for the purpose of recruiting sales personnel . . ." are in violation of Interpretation.

Examples of sales recruiting advertisements, reviewed by the Board of Governors, were found to offer glowing promises of income and job security far beyond that which could be reasonably expected upon entering any business. These advertisements were seen to be as damaging to the well-being of the securities business as "come on" advertisements are misleading to investors.

In expanding the scope of the Interpretation for the purpose of exercising control over recruitment advertisements, the Board pointed out that the use of advertising to inform members of the public of career opportunities within the securities business is to be encouraged.

## SPECIAL DEALS

The Board of Governors at its September meeting revised the interpretation of Section 1, Article III of the Rules of Fair Practice relating to "special deals," as follows:

"It shall be deemed conduct inconsistent with just and equitable principles of trade and in violation of Section 1 of Article III of the Rules of Fair Practice for a principal underwriter (or any of its representatives) in connection with the sale or distribution of investment company shares to give directly or indirectly to a member or to a registered representative of a member anything of material value in addition to the discounts or concessions set forth in the currently effective prospectus of the investment company."

The objective of the Board's prohibition against "special deals" is to bar the granting of special gifts or anything of material value, not disclosed in the prospectus, to dealers or their representatives as an inducement or reward for the sale of investment company shares.

## DIVIDEND GAP

The Treasury Department has reported that an estimated \$1½ billion gap exists between dividends paid by corporations and dividends reported by stockholders on income tax returns for the year 1956. Much of the failure to report dividends, the Treasury believes, occurs through carelessness or ignorance.

At conferences with the Treasury Department, attended by representatives from organizations in the securities business and from industry, it was agreed that much can be done to narrow this gap through an educational campaign stressing that dividends must be reported. The alternative might be the establishment of a withholding tax on dividends.

The Treasury Department has requested the help of corporations

## Free-Riding

*(Continued from Page 1)*

Commission pointed out that among these practices was the allotment of large blocks of shares of "hot issues" to trading houses.

Evidence of possible violations of certain phases of the Federal securities statutes and of the Association's Interpretation of Free-Riding and Withholding uncovered by the SEC has been referred to the Association for appropriate action.

---

and broker/dealers in reminding shareholders:

- 1—that all dividends, whether paid to the taxpayer or credited to his account, are reportable on the taxpayer's individual tax return
- 2—that many dividends paid to shareholders are reported by corporations to the Internal Revenue Service on Form 1099
- 3—that the taxpayer is entitled to certain exclusions and credits on dividends received
- 4—that all notices of dividends paid to the taxpayer be retained for use in preparing the individual's tax return.

The Treasury has prepared the following insert notice (document #5219) which can be requisitioned from your District Director of Internal Revenue or may be reproduced by individual corporations and broker/dealers:

### TO ALL TAXPAYERS

Interest and dividends whether paid to you or credited to your account, must be included in your U. S. income tax return. Accuracy in reporting such amounts, even if small, will benefit both the recipient and the government, and will avoid expensive enforcement action that might otherwise be necessary.

Commissioner of  
Internal Revenue

## LEGISLATION

### Progress Report

Hearings before the Senate and House Sub-committees studying the amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934 proposed by the SEC have been completed. Between the initial and final appearances before these Committees, the SEC made changes in its proposals based upon comments from the Association and other groups. In turn, the business groups modified certain of their comments after consideration of supporting memoranda prepared by the SEC. Thus, the areas of difference between the SEC and the securities business have been substantially reduced.

Congress adjourned September 15, 1959, without taking action on any of the Commission's proposals. It is expected that revised legislation, more acceptable to the securities industry, will be presented in the second session of the Congress when it convenes in January, 1960.

### Letters

*(Continued from Page 2)*

or more of a particular fund's shares in December, who desires to purchase additional shares during the following 12 months, cannot execute a "letter of intention" that would include the \$25,000 original purchase for the purpose of qualifying for additional discounts on the sales charge for new purchases.

Best means of protecting the customer's interest is to put him on notice that a "letter of intention" is available whenever a sale is made in an amount sufficient to make the next purchase eligible for a discount were a "letter" in effect. There is no penalty on the customer should he fail to buy additional shares; and he is protected in case additional investable cash becomes available to him during the next 12 months.