

June 28, 1961

STATEMENT OF THE NATIONAL ASSOCIATION OF SECURITIES
DEALERS, INC. PRESENTED TO THE COMMERCE AND FINANCE
SUBCOMMITTEE OF THE HOUSE INTERSTATE AND FOREIGN
COMMERCE COMMITTEE IN CONNECTION WITH H. J. RES. 438

Mr. Chairman and members of the Subcommittee:

I am William H. Claflin, III, of Boston, Massachusetts, Chairman of the Board of Governors of the National Association of Securities Dealers, Inc. I am accompanied today by Samuel S. Whittemore, Spokane, Washington, a member of the Board of Governors and Chairman of the Legislation Committee of the Association. Also with me are Donald H. Burns, Assistant to the Executive Director, and Marc A. White, Counsel to the Association. We regret that Mr. Wallace H. Fulton, Executive Director of the Association, is unable to be with us because of a recent illness.

We are here to discuss House Joint Resolution No. 438, which would amend Section 19 of the Securities Exchange Act of 1934 by adding a new subsection under which the Securities and Exchange Commission would be authorized and directed to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including the rules for disciplining members of these organizations for conduct inconsistent with just and equitable principles of trade.

The Association is in favor of the resolution and the amendment to Section 19 of the Securities Exchange Act of 1934. We note that the proposed amendment authorizes the Commission to make a study and investigation, and

we wish to point out that we believe a study of the rules of the various exchanges and the Association may well be beneficial in the light of the growth and increased activity in the securities markets and the fact that in the past 25 years there has not been time nor available funds and personnel for a concentrated review of the operation of these organizations and their procedures.

As to that part of the resolution which relates to the Association, we question whether this appropriation would be justified merely to investigate the Association's Rules or the Association's enforcement procedures. We cite the following reasons: The National Association of Securities Dealers, Inc. is the only organization in the country registered pursuant to Section 15A of the Securities Exchange Act of 1934. The principal work of the Association is the continuous examination and investigation of members to see that our Rules, certain rules and regulations of the Securities and Exchange Commission and certain regulations of the Board of Governors of the Federal Reserve System are being complied with by our members. The Association's Rules of Fair Practice, adopted in compliance with Section 15A of the Securities Exchange Act of 1934, constitute a code of ethics which in many areas go beyond statutes or general rules of law in the securities field. They are directed to the public interest as well as the welfare of the securities business and are designed to promote within our industry high standards of commercial honor and just and equitable principles of trade.

The Association has previously furnished the Subcommittee on Legislative Oversight of the Interstate and Foreign Commerce Committee a history of

the Association and its activities from formation through the year 1958. This history was the subject of a Subcommittee publication in 1959. This publication traces the history of efforts at self-regulation by the industry from 1934 to the passage of the Maloney Act amendment in 1938, under which Act the National Association of Securities Dealers was established.

As the aforementioned reprint indicates, the Association performs many functions in an effort to carry out the Congressional intent as expressed in the Maloney Act, but its main function is that of self-regulation of the membership by constant enforcement of its Rules and certain of the rules and regulations of both the Securities and Exchange Commission and the Federal Reserve Board.

This enforcement results in complaints, disciplinary proceedings and decisions imposing penalties of expulsion, suspension, fines or censure. These decisions are the work of the Association's 13 regional Districts or so-called District Business Conduct Committees. They are reviewed by the Board of Governors of the Association and in turn forwarded to the Securities and Exchange Commission for their review. In instances where a member or a registered representative feels aggrieved at a decision of the Association and has exhausted his remedies within the Association, he may appeal to the Securities and Exchange Commission. The Commission may by its own action call up the decisions for review. Of course, any person aggrieved by a Commission decision may appeal to the Federal courts of appeal.

In the three years since the information was compiled for the Subcommittee reprint, 23 cases have been appealed to the Securities and Exchange

Commission. Thus, the Commission has had occasion to consider specific cases involving most of our Rules and through the hearing of these cases is continuously reviewing the nature and scope of our examinations, disciplinary actions, By-Laws, Rules and interpretations.

In addition to the continuous review implicit in the disciplinary area, it should be noted that the Association has never put into effect a Rule, interpretation or policy until the Commission has considered the matter and determined that it will not disapprove. Any proposed changes in these would, of course, be subject to the same procedures.

In order not to remain static during the growth of the business and to meet problems and new techniques, we consult on a continuous basis with the staff of the Commission and the Commission itself. Our aims are similar: the protection of investors through integrity in our business. By achieving this, the public interest is served.

We are all aware of the great interest in securities which has marked recent months. Nor can we overlook the fact that this has been a cyclical development since the end of World War II. Statistics indicate the growth of the business itself in this period. In 1946, the Association had 2,514 member firms; in 1956, it had 3,634; and as of May 30, 1961, we had 4,586. In 1946, members had 849 branch offices; in 1956, there were 2,548; and as of May 30, 1961, there were 4,373. In 1946, 23,374 representatives were registered with the Association; in 1956, we had 48,566; in May, 1961, we had 93,351 registered representatives.

This rapid and constant growth has caused the Association to conduct numerous studies of its own. In the last few years, we have given consideration to and have had almost continuous discussions with the Division of Trading and Exchanges of the Commission relating to the improvement and modernization of our Rules. Prominent in these discussions have been:

1. Improving the admission standards required of registered representatives and the adoption of a more searching and difficult examination which will require a far greater knowledge of the securities business prior to admittance.
2. Changes in the Rules to provide increased monetary penalties.
3. Possibility of broadening areas of disqualification of individuals entering the business.
4. Amending and changing our methods of enforcement of the Association's policy on "free-riding and withholding," which is designed to insure that those new issues which command a premium at the time of offering are sold to the public and not to insiders or used for commercial advantage.
5. Modernization of the Association's 5% Policy, which relates to the fairness of mark-ups in dealings with customers.

We have completed some of these projects. We have also taken up many minor matters which relate to streamlining procedures when the times have indicated the necessity for change. These efforts serve to keep us well aware of the need for continuous review of problems and solutions.

For these reasons we do not believe the expenditure of money as proposed would be necessary solely to determine the adequacy or enforcement of our Rules. We hope that a study of the Rules of the Association and those of the exchanges on an over-all basis can be found to be helpful, and for this reason we are in favor of the resolution. We assume that Congress would intend that this study go beyond the mere question of adequacy of current rules and will include consideration of present-day problems in the securities markets and those which can be envisioned in the future.

There is one other area in our business where we are studying the effects of rapid growth. Assets of mutual funds have recently passed the 20 billion dollar mark, and this expansion of the investment trust business has caused us to renew the emphasis on our responsibilities and activities in this field.

Much is yet to be learned about the role of variable annuities and real estate investment trusts in the securities field. What effect will electronic equipment for handling quotations and bookkeeping have on the operation of the business and the customary methods of marketing securities, and how will this affect the Association's inspection of our members?

It is to all of these areas and those which may be inherent in the operation of the exchanges that we hope the study will be directed.

Our industry would not feel that I was fulfilling my trust if I did not emphasize the serious state of the present backlog of new issues waiting to be processed by the Securities and Exchange Commission. The long delays resulting from this condition dangerously impair the flow of new capital to

industry. Companies that have more immediate needs for capital are forced to find other ways of raising money, and these often are not to the best interests of the company or its public stockholders. We sincerely urge that every possible aid be given to the Commission to solve this problem and, if this study is instituted, to assure that the workload will not fall on present personnel and tend to aggravate this already serious condition.

Should you determine to proceed, we are ready and willing to cooperate in every way and are hopeful that this study will prove advantageous to the public and our industry.

On behalf of the National Association of Securities Dealers, Inc., I want to thank this Committee for the opportunity afforded us to comment on House Joint Resolution No. 438.