

# NASD

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

*To NASD Members and Registered Representatives:*

**FREE-RIDING AND  
WITHHOLDING  
INTERPRETATION  
CHANGED**

The Board of Governors at its May meeting adopted a revised "Interpretation with Respect to Free-Riding and Withholding," which will be included in the next NASD Manual supplement. Every member and principal of a member should give special attention to this guide as well as calling it to the attention of all registered representatives.

In adopting the revised Interpretation, the Board considered in detail the recommendations of a special committee appointed to look into the problem caused if a firm were to use certain conduits such as banks to place shares of "hot" issues in accounts which normally would not be entitled to any allotment at all.

As a preventative, the Board has adopted a new section in the Interpretation which points out that in the case of sales to banks, trust companies or other accounts for undisclosed principals, a member has a responsibility to ensure that the ultimate purchaser of a "hot" issue is not within the prohibitions stated in the Interpretation. These prohibitions include a person associated with a member, or senior officers of banks, insurance companies or other institutional type accounts, or persons in the securities departments of the aforementioned groups or members of the immediate family of such persons.

Certain other minor changes were made to the previous Interpretation, such as specifically prohibiting making sales to senior officers of banks, insurance companies or other institutional type accounts unless the member can establish that a purchase is for bona fide investment, in accordance with the account's normal investment practice. The definition of "member of the immediate family" has also been enlarged to include brothers or sisters of individuals presently enumerated in the Interpretation.

The Association's Free-Riding questionnaires are being changed to reflect the language in the new Interpretation which will become effective August 1, 1966.

**NOMINATION PROCEDURE  
REVISED FOR  
COMMITTEE AND  
BOARD POSTS**

In early July, the Association will institute a revised procedure for nomination to NASD District Committees and the Board of Governors. Under the new system, the entire membership of each NASD District will receive early notification of the District Committee and Board vacancies occurring on January 15, 1967, and firms will be asked to submit names of potential candidates for consideration by the District Nominating Committee. The new plan will give the District Nominating Committee longer time to investigate and consider the qualifications of individuals who have been suggested by the various firms in the District.

As stated in the By-Laws, a Nominating Committee, composed of five persons from members in the District, who are not represented on the District Committee, shall be appointed no later than September 15 by the District Committee. After its formal appointment, the Nominating Committee has only 15 days to certify a slate of names to the District Committee which then must be sent to each member in the District within five days of its receipt. At this time, if 10% or more of the members in the District wish to propose additional candidates for posts on the District Committee or Board of Governors, they must do so within 20 days of the date of the notice of the Nominating Committee's certification. If additional candidates are proposed, an election by secret ballot will be held among all members within the District. If no additional candidates are proposed within the 20 day period, the nominees offered by the Nominating Committee shall be considered duly elected.

**BOARD STUDIES  
SEC FINANCIAL REPORT  
PROPOSAL**

In response to requests from the NASD and other securities industry organizations, the SEC, in a staff letter dated April 29, clarified its original proposal to require extensive financial reporting and operating information from all broker/dealers.

At the Association's May Board meeting, the subject of financial reporting by NASD members was carefully explored in light of the specifics outlined in the letter from Irving Pollack, Director of the Commission's Division of Trading and Markets.

While the SEC apparently still deems it imperative that some type of broker/dealer financial reporting should be instituted (see January issue of NASD News), it is prepared to recommend that such reports could be made to self-regulatory organizations rather than directly to the Commission, thus preserving the confidential nature of the information and insuring the anonymity of individual firms. In addition, the SEC agreed that there could be several categories or levels of reporting so that cost to the business might be minimized.

The Board of Governors recommended that the study of this subject and its attending technical problems should be continued in cooperation with the Commission, as well as other industry organizations such as the stock exchanges, the Investment Bankers Association and the Association of Stock Exchange Firms.

**FOREIGN ISSUER  
EXEMPTION FROM  
REGISTRATION SUPPORTED  
BY SECURITIES INDUSTRY**

The respective Foreign Committees of the Association of Stock Exchange Firms, the Investment Bankers Association and the NASD are sending to interested firms in their membership an explanation of the SEC's recent decision to extend the temporary exemption from 1964 Securities Act registration requirements for foreign issues.

Concurrently, the Commission announced its intention to ask foreign issuers to voluntarily furnish certain information on a continuing basis. This information would be supplied by foreign issuers whose securities are held by 300 or more residents of the United States, and having 500 or more shareholders and one million dollars or more total assets at the end of a fiscal year after November 30, 1965. The voluntary information would include all documents and reports which were required to be made public or filed with a stock exchange in the countries in which the corporation is domiciled.

The type of reports in which the Commission is interested are those containing significant information with respect to financial condition; results of operations; changes in business; acquisitions or disposition of assets; issuance, redemption, or acquisition of securities and changes in management or control. The SEC will prepare a list of companies which have or have not voluntarily filed the requested information for use by the broker/dealer community.

While the joint Foreign Committee of the ASEF, IBA and NASD is in basic agreement with the Commission's voluntary program, it has been made clear to the SEC that "support of this program in no sense implies that we would favor, and in fact as the Commission is aware we have consistently opposed, a compulsory program which would require the filing of such information with the Commission. Nor do we feel that the Commission would be warranted in concluding that general compliance with the voluntary program would indicate that foreign issuers would also comply if the reporting were made compulsory . . ."

The letter to the securities industry from the various Foreign Committees pointed out that putting such a program on a voluntary basis will meet the greater part of objections from foreign countries concerning attempts to impose United States regulations on non-domestic corporations. The Committees were of a view that the presently contemplated voluntary program would in practice result in obtaining much more information for U. S. investors than a compulsory program.

Broker/dealers are urged by the Committees to encourage the voluntary compliance on the part of foreign companies with the SEC's request for information. NASD members wishing copies of the Foreign Committee's advisory letter should write to the NASD Washington office, 888 - 17th Street, N.W., Washington, D. C. 20006.

**RECENT DISCIPLINARY  
ACTION ON CUSTOMER  
COMPLAINTS AND  
JOINING WITH  
NON-MEMBERS**

Two recent and rather unusual business conduct cases have again pointed up the necessity for each NASD member and all supervisory personnel to be as familiar as possible with the Association's rules and interpretations, particularly those that are new or recently amended.

In one case, a District Business Conduct Committee censured and fined a member for failure to adequately and promptly investigate a customer complaint. The customer had complained to the firm that one of its registered representatives made unauthorized transactions and recommended unsuitable stocks. In the ensuing business conduct hearing, the Committee was unable to substantiate these charges through testimony or evidence presented. However, it was found that the firm had failed to take appropriate and necessary steps to investigate the original complaint. It was further noted in the District Decision that no written memorandum was made of the fact that the customer had complained and the matter was not called to the attention of any partner of the firm until several months later.

Association regulations covering customer complaint files can be found under Section 21(c) of the Rules of Fair Practice which was amended last year in connection with the NASD's new supervisory procedures.

In the second case, a District Business Conduct Committee found that a member had participated in the distribution of ten new issues either as an underwriter or selling group member and during these distributions joined with a member who had been suspended. For these and other violations, the member was censured, fined \$1,000 and suspended for 60 days.

In its defense, the firm stated that it believed such transactions could be effected between the member and non-member, which was a customer of the firm, so long as the prices charged the non-member were the same prices as charged to the public. The firm further stated its belief that the rule in question applied only to formal rather than informal arrangements.

The Committee, in its decision, noted that Section 25 of the Rules of Fair Practice provides that no member shall join with any non-member, broker or dealer in any syndicate or group contemplating the distribution to the public of any issue of securities or any part thereof. The Committee maintained that the term "join" included any arrangement between a member and non-member whereby shares were allocated from, and deemed part of, the distribution of shares to the public.

In this case, it was quite apparent that the purpose of the accommodation was to accomplish the distribution of securities by the non-member to the public.

**ASSOCIATION PROPOSES  
SHORT COURSE FOR  
STATE EXAMINERS**

In an effort to help strengthen the broker/dealer investigative programs conducted by various States, and coordinate this work as much as possible with the Association's own member firm examination activities, the NASD has offered to set up brief indoctrination seminars for novice investigators on the staffs of State Securities Administrators.

It is planned that these seminars would be held in the Association's District offices and conditioned upon the needs of the particular State and the availability of facilities. The short course would be designed primarily for new state employees and would focus mainly on those topics which are of common concern to the Association and the States, such as capital, misuse of customers' funds and securities and fraudulent or deceptive practices. In addition, the indoctrination course would attempt to give State trainees some background in the fundamentals of the securities business and the ethical code enforced by the Association.

In making the proposal to State Administrators, the Association emphasized that the seminars would not be viewed as preparing a trainee for the full range of his duties as an investigator, but rather as a means of acquainting him with the procedures and techniques proven successful by the NASD staff through long experience in this area.

**NASD'S EXAM  
SERVICES EXPANDED**

As part of its continuing interest in encouraging comparable standards of training and supervision for securities dealers who are not members of the Association, the NASD has recently offered to prepare an examination for non-member principals to be given by state authorities as part of their own qualification requirements. This exam will be taken only by non-members of the NASD in order to meet individual state requirements.

The proposed Principal Examination would be designed to test a candidate's knowledge, in greater depth than the current state representative examination, covering those areas of the securities business that are the responsibility of officers, partners and sole proprietors of non-NASD members. The examination, approximately three hours in length, would include multiple choice, matching and, where possible, short essay or subjective questions that permitted grading within the State Administrator's office.

The Association proposes to absorb the cost of constructing and printing the examination which would be made available to each Administrator that chooses to use it on a regular basis. Revised forms of the examination would be constructed from time to time without charge to the states participating in the program.

In a related area, the Association has agreed, at the request of the Chicago Board of Trade, to make available its test center facilities across the country so that persons associated with NASD members may take a commodity test in the same manner as their Association and Exchange exams. The administration of the Board of Trade examination at the NASD's 80 examination centers adds to the continued expansion of this service for members and all securities agencies. At present, examinations are administered for the New York, American and Pacific Coast Stock Exchanges, as well as five individual states and the Federal Government SECO program.

This would be the first time in the 118-year history of the Commodity Trade Board that a written examination was required. At present, a commodity salesman is only required to pass a background check. The proposed commodity examination is expected to begin in the Fall.

**COURT ASKED TO  
REVIEW SEC DECISION  
ON BANK MUTUAL FUNDS**

On May 5, the Association filed a petition for review of SEC orders concerning the First National City Bank's proposed commingled investment plan.

The Commission, in a four-to-one decision, had previously granted the bank's request for exemptions from the Investment Company Act. The bank was permitted to set up a mutual fund administered by a committee, the majority of whom would be bank officers. The SEC exceeded its authority, the NASD said, because its decision was contrary to fundamental statutory policy.

The Association's petition, filed in the U. S. Court of Appeals, Washington, D. C., noted that the Investment Company Act "imposes restrictions on the composition of a board of directors in order to reduce the problem of conflicts of interest. The existence of potential conflicts of interest in the relationship here involved is admitted and the statutory requirements, therefore, cannot be waived by Commission order," according to the Association.

Also pending in Federal District Court is a suit against the Comptroller of the Currency by the Investment Company Institute. The suit asks for a declaration that the Comptroller illegally exceeded his authority when he put into effect a regulation permitting national banks to sponsor their own mutual funds.