

NASD

News
VOLUME XXVII NO. 7
SEPTEMBER, 1968

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

To NASD Members and Registered Representatives:

**REVISED MUTUAL FUND
BILL PASSED**

A revised version of the mutual fund bill, S. 3724, has received the approval of the Senate after being reported out by that body's Banking and Currency Committee. The bill has been sent to the House of Representatives where its backers, principally the administration and the Securities Exchange Commission, are pushing for a favorable vote before the end of this session of Congress.

The revised legislation reflects several major concessions from the original SEC proposals including changes in three important and controversial areas: (1) sales charges (2) management fees and (3) contractual plans.

The original SEC proposal to limit mutual funds sales charges has been dropped and replaced with language that would allow a registered national securities association (the NASD) to regulate the level of these charges. The Association had stated in response to questions by both the Senate and House committees considering the legislation, that it did not seek such powers but would accept these added responsibilities as part of its self-regulatory role with certain conditions. The most important of these was the stipulation that the reasonable level of sales charges could not be determined on the basis of information now available and a thorough, in depth study would have to be made and evaluated before any decisions could be made.

In the area of management fees the legislation now states that management fees are to be presumed to be reasonable if it has been approved by a majority of the funds independent directors. Such a presumption must be made by courts considering challenges to the level of the managements fees and the court may only overturn the decision of independent directors by the presentation of a "preponderance" of contrary evidence.

The SEC proposal to abolish front-end contractual plans was also discarded in the revision. In its place the Senate voted to allow the continuation of the contractual plans but limit commission withdrawals to 20 percent of any single year's payments and 64 percent of the total commission in the first four years.

Also included in the Senate passed bill were provisions which would allow banks to establish and sell mutual fund type shares. It has been reported that the savings and loan industry will also try to tack on comparable authorizations in the House to open up this part of the equity field to their institutions.

**LOST, MISSING OR STOLEN
CERTIFICATES**

Name: LINCOLN FIRST GROUP, INC. (The name of this corporation has been changed to LINCOLN FIRST BANKS, INC., 183 Main Street East, Post Office Box 1939, Rochester, New York 14603, and notice of this is overprinted across the certificates.)

Certificate Numbers: Serial numbers R2801 to R6000

These missing 3,200 one hundred share certificates bear the facsimile signatures of Wilmat R. Craig, President and Alexander D. Hargrave, Vice President and Secretary of Lincoln First. The certificates have been missing since May 9, 1968.

**TWO INVESTMENT BUSINESS
BILLS MADE LAW
BY PRESIDENT**

The President has signed two Congressionally passed bills, the first concerning full disclosure of corporate equity ownership and the second authorizing a study of the impact of institutional activities in the securities markets.

The full disclosure bill, S.510, amends the Securities Exchange Act of 1934 by requiring the disclosure of pertinent information when a person or group seeks to acquire a substantial block of equity securities of a corporation by a cash tender offer or through open market or privately negotiated purchases. Also disclosure must be made when a corporation repurchases its own equity securities.

The second bill authorized the Securities and Exchange Commission, in cooperation with the Financial Industry, to conduct a study of institutional activities in the securities business. The study will investigate the impact investment companies, banks, insurance companies, pension funds and other large buyers and sellers of securities have upon the depth and liquidity of markets.

**ASSOCIATION FIGHTS FOR
NON-MEMBER ACCESS
TO LISTED MARKETS**

In a recent letter to Chairman Cohen of the SEC, the Association strongly reaffirmed its previous position that NASD members should be given adequate access to the listed markets in order to partially replace the loss of income from the contemplated abolition of give-ups, which in turn should be gradually phased out over a period of time.

The NASD letter was critical of a New York Stock Exchange interim proposal concerning the commission rate structure which would have deferred consideration of the access question and called for immediate abolition of give-ups after the big Board's interim commission schedule was put into effect. The NASD termed the Exchange proposal as "a reversal of a previous position in two matters of utmost importance to Association members."

After a special Board meeting in early July, the Association strongly endorsed the exchange proposal that non-member firms be given access to the listed markets through a plan to share stock exchange commissions on listed business developed by over-the counter broker/dealers.

Although the NYSE had tentatively mentioned 33 $\frac{1}{3}$ percent as the amount of exchange commission to be shared with non-members, the NASD Board did not endorse this level since specific details of the access plan had not been released.

NASD president Walbert said that the exchange proposal for listed commission sharing should be sufficient to enable non-members to support the cost of serving customers in this area.

At that time the Association's Board also took a position regarding customer directed give-ups of a portion of exchange commissions, volume discounts and the commission rate structure itself, all of which have been under intense scrutiny in public hearings being conducted by the Securities and Exchange Commission.

Although the Association is well aware of the significant, and in some cases overriding, contribution customer directed give-ups make to the financial soundness of a large portion of the NASD membership, it was apparent that it could not continue support of a give-up system which the exchange, the SEC, other industry organizations and the Justice Department had earlier indicated could not be justified along with a minimum commission rate schedule. However, the Board pointed out that because the Federal Government and the stock exchange both had supported and allowed the give-up system to grow and flourish for thirty-four years, and the economic viability of a large segment of the securities industry had grown dependent on this source of income in order to adequately serve its customers, it would not be in the best interest of the public or the industry to suddenly abolish the give-up system without a meaningful period to allow for adjustment and change in present business practices.

The NASD position emphasized that limited access to the exchanges for non-members was not a complete substitution for the present give-up system. However, it was felt that the long sought participation in listed business on a fair and equitable basis would enable NASD members to provide even more expanded facilities to public investors.

The recent letter from the NASD to the SEC stated that, "If customer directed give-ups were to be abolished it was the NASD's understanding they would be phased out over a reasonable period of time thus giving members who would be severely effected the opportunity to assess the potential loss of income and hopefully to make plans to adjust their businesses so that this loss of income could be replaced. The stock exchange, which had originally agreed to a gradual phasing out, now proposes to abolish the give-up as soon as the new commission rates become effective."

Secondly, the Association stated that, "It expected that access for non-members to New York Stock Exchange commissions would be forthcoming promptly. This, of course, would allow for some replacement of income against that lost through the abolition of give-ups. The New York Stock Exchange now states it is willing to defer action on access to a later time. The delay and uncertainty of this action will be most harmful to NASD members."

Accordingly, the Association's letter objected to the institution of any system to supplant the current existing commission rate level and structure, including give-ups, which fails to provide full consideration and resolution of access to exchanges by non-members. The NASD said that, "To abolish this system without resolving the problems of replacing lost revenue through exchange access would be unjustified."

**OTC MARGIN
APPROVED**

President Johnson recently signed into law the Senate and House passed bill to authorize marginability for certain over-the-counter securities under regulations to be established by the Federal Reserve Board. Although the NASD supported the concept of OTC marginability in both the House and Senate hearing on the bill, it was felt that many complex and difficult problems would have to be resolved before any meaningful operation could be adopted.

The Association does not anticipate that a substantial number of NASD members will be able to begin handling margin accounts immediately after adoption of the regulations. The reasons cited for this conclusion were that most exclusively OTC firms were small and the costs involved in setting up margin accounts and the maintenance of these accounts would tend to outweigh any advantages that would accrue to the firms or their customers. Part of these increased costs would be attributable to the establishment, maintenance and continuous supervision of the complex record keeping that is required for margin accounts.

In commenting on the proposed legislation, the Association also pointed out the problems attendant to splitting the over-the-counter market into two classes of securities, marginable and non-marginable. The public will have to be educated as to the meaning and implications of margin. In cases where smaller, financially sound companies are denied margin privileges while other more actively traded corporations of equal soundness have secured the privilege, confusion could result both as to the broker/dealers, customers and the management of the issuers.

The Association is presently working closely with the Federal Reserve in developing guidelines to be used in selecting OTC securities to be afforded margin privileges.

**NASD NEGOTIATING
WITH BUNKER-RAMO
ON NASDAQ**

The NASD recently announced that it had entered into negotiations with Bunker-Ramo Corporation to design and operate its planned automated quotations system (NASDAQ) for the over-the-counter securities market. Bunker-Ramo is also the supplier designated by the National Security Traders Association to operate its interim quotations system which will continue until the installation of NASDAQ.

In announcing the decision to negotiate with Bunker-Ramo Corporation, NASD President Walbert said that the final installation of the NASDAQ system will be of inestimable benefit to both investors and Association members. Walbert noted that in addition to relieving many of the present burdens connected with supplying over-the-counter quotations information, newspaper bid and ask prices would be substantially more current, and for the first time published volume data and other information will be readily available to the public.

Walbert pointed out it is anticipated that under the terms of the proposal, Bunker-Ramo would develop, install and operate the NASDAQ system but the NASD pursuant to its regulatory responsibility would own the information contained in the network, control the selection of securities qualified for quoting, set the prices charged users for the services and establish and enforce the rules under which firms may use NASDAQ.

FAILS STILL PLAGUE BUSINESS—CUSIP MAY HELP

In the past several months, the NASD Board of Governors has taken several steps under new emergency rule procedures in an attempt to cut into the paper work logjam in member offices and the high level of fails to receive and deliver. The Association instituted Wednesday and early curtailment of trading in mid-June and has ordered these limitations continued through September.

The NASD has emphasized that during shutdown periods members are required to be fully staffed and no orders, solicited or unsolicited, can be accepted. Municipal bonds and other exempt securities outside NASD jurisdiction are not subject to the trading limitations. However, it is requested that trading in these securities be voluntarily limited in order to assist in clearing up operating backlogs.

The Association is also cooperating in industry efforts to develop more efficient handling of transactions and the subsequent reduction in the time required to process confirmations and securities certificates by clerical personnel. One such long range project is CUSIP (Committee on Uniform Securities Identification Procedures) that identifies specific security issuers and their issues—stocks, bonds, notes, etc. of corporate, municipal, state, federal and selected foreign issuers. Under the CUSIP plan a universally accepted number will be permanently assigned to each issue that identifies that single issue and no other. In addition, a numbering system will also be devised for all broker/dealer firms. CUSIP represents a foundation for the further simplification of the operations departments of the securities industry.

The CUSIP system will incorporate an eight-character number that will identify uniformly both the issuer, whether a corporation, municipal or government, and the particular issue thereof.

The CUSIP number will provide the entire industry with a common language for brokers, transfer agents, banks, etc. and others involved in clearing and settling a transaction. It is hoped that the CUSIP project can be implemented on a large percentage of transactions within two years.

Richard B. Walbert, NASD President, said that the Association plans to utilize the CUSIP system by incorporating it into a standard man-machine

readable broker confirmation now being designed. This new format will include a uniform broker identification number currently under development by the Association. Automation of the confirmation and eventually the security certificate and transfer instruction will enable the financial community to more effectively process securities transactions.

NASD MEMBERSHIP IS GROWING

For the first time in almost six years, the NASD membership totals have shown signs of reversing the steady decline in the number of Association member firms. The total NASD members as of January 1, 1968, was 3,669 but this figure increased monthly to the August 1 level of 3,790.

An analysis of the new firms joining the NASD for the first time shows that insurance companies are becoming an increasingly important participant in the securities industry. Insurance firms, whose merchandise includes a combination of mutual fund shares, variable annuities or related products, bring with them large captive sales forces. The testing of these salesmen, prior to their registration to distribute the insurance company's products, presents special problems to the Association testing centers. To handle the inflow of applicants for registration, the NASD staff has been enlarged and a traveling proctor has been retained to hold special examination sessions for the larger class of the insurance applicants.

The number of registered representatives has been increasing at the average rate of over 1,600 per month since January 1, 1968. The total registrations now active with the NASD has risen to over 113,000, the highest figure in history.

Caution in Choice of Training Material

The NASD has become increasingly aware of certain types of books and other material purported to be training tools for the Association's examinations.

The purpose of the examination program is to fairly test applicants' knowledge and comprehension of the fundamentals of the securities industry. Some of the material being promoted by publishers today includes books and other information which is of dubious value and should not be chosen by the management of firms for their preparation for Association examinations. Crash programs to pass the tests

and the material designed to satisfy the objective may very well result in new sales representatives having inadequate knowledge of the fundamentals and the regulations in the business. Such cases can result in grave problems for the supervising managements and it seems very doubtful that they can successfully or properly contribute to their firm or the industry in the long run.

The NASD urges caution in selecting training materials in order to avoid inferior references. If any questions arise in this area, it is suggested the members contact the Association for clarification and recommendation of specific references.

BROKER/DEALER FINANCIAL REPORTING

The Securities and Exchange Commission announced June 28, 1968, the adoption of SEC Rule 17a-10 under the Securities Exchange Act of 1934 requiring broker/dealers to report on income and expenses. The reporting form is divided into three parts and many of the items the NASD had specifically objected to have been deleted and these omissions should ease the cost and burden of filing.

Broker/dealers are required under the new rule to file one of the three part forms along with an introductory page. Part I applies to non-members of the New York Stock Exchange whose gross securities income was between \$20,000 and \$100,000 or had gross income of at least \$20,000, eighty (80) or more percent of which came from retail mutual fund sales, municipal bonds, fractional interests in oil, gas or other mineral rights; variable annuities, savings and loan placements, or real estate syndications.

Part II of the reporting form is required of non-NYSE members who do not qualify under Part I and whose gross securities income was between \$100,000 and \$1,000,000.

The final Part III applies to the income and expenses of broker/dealers who are members of the NYSE or do not qualify to complete Part I or II.

All firms are required to file on a calendar year basis the income and expense information. Firms with gross income of less than \$20,000 during the year will be required only to file the introductory page and not any of the forms. The first calendar year applicable under the new rule will be 1969 and forms must be filed within 90 days after December 31, 1969. A set of the forms is now in the mail to all members.

The NASD expects to soon pass a rule or interpretation requiring all Association members to file di-

rectly with the NASD. The only exception to this will be members of national stock exchanges having a reporting plan approved by the SEC. All information received by the NASD will be passed on to the Commission on an undisclosed basis without identification of particular firms.

Plans are being made for editing and checking of more than three thousand reports to be filed directly with the NASD. Hopefully with the use of computer processing, an economic analysis of certain quantitative data will be made available to NASD members so that they may compare their operation with firms of similar size and with a similar product mix.

NEW UNDERWRITING INTERPRETATION

The Board of Governors, in a notice to members July 3, 1968, announced new policy guidelines for underwriters. The new interpretation is the result of a review of filings in which the Board noted an increasing tendency of granting options, warrants and/or stock to an underwriter or persons associated with the underwriting. In many cases the options and warrants had been immediately exercisable with the underlying shares. These situations, which allowed sale of the stock or warrants after the underwriting via a post-effective amendment, give rise to possible "free-riding" violations since the aggregate number of shares offered plus the shares underlying the options or warrants and/or stock are considered to be a single offering.

In order to insure that securities acquired by an underwriter or person associated with an underwriter in connection with the offering does not violate the NASD Free-Riding Policy, the Association has issued the new interpretation. Under the new guidelines, warrants, options and/or stock received directly by the underwriter or associated persons is locked-up and cannot be sold for a period of at least one year after the offering.

Also under the interpretation, firms associated with an underwriting in an advisory capacity for the purpose of facilitating the offering and receiving compensation are considered managing underwriters if such is not designated to another broker/dealer firm. In some cases in the past, particularly in best efforts undertakings, brokers have acted in this advisory capacity without being named managing underwriters. Because of the above, firms now designated managing underwriters must adhere to the filing requirements of the Interpretation and will be subject to scrutiny as managing underwriters under the NASD rules and regulations.