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NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 888 17TH ST., N.W. WASHINGTON, D.C.

To NASD Members and Registered Representatives:

NATIONAL CLEARING ACQUIRES NOTC

The National Clearing Corporation has announced that its offer to purchase the stock of the National OTC Clearing Corporation in New York has been successful. On September 25, 1970, 98 percent of the shares outstanding when the offer was made had been tendered either for cash or for NCC notes. Approximately two-thirds of the outstanding shares, valued at \$818,294.86, were tendered for notes. David H. Morgan, NCC President, had urged stockholders to enhance NCC's financial position by accepting notes. He stated that he was gratified at the stockholders' response, which indicated support of the national clearing concept.

On August 31, 1970, the offer was made to the 94 stockholders of the NOTC to purchase all of their issued and outstanding common stock at the book value as of July 31, 1970 (\$2193.82 per share). The NCC proposed to pay the shareholders either by issuing 8½ percent subordinated notes due on July 31, 1975, or by offering cash in the same amount per share. The NCC specified that if more than \$600,000 would be tendered for cash that it reserved the right to pay each stockholder a pro-rated portion of the \$600,000 plus notes for the remainder of the shares' book value.

The NOTC, which currently operates in the New York area, was established in 1961 to aid in the reporting and clearance of OTC securities transactions in the locality. Ninety-four broker/dealers, all members of the NASD and all located in or near New York City, owned all of NOTC's issued and outstanding common stock. In addition, the NASD owns all of the NOTC limited participation voting stock.

The Boards of Directors of both the NCC and the NOTC stressed that acceptance of this offer would serve the interests of the securities industry as a whole, as well as the investing public, by aiding the NCC to develop and implement an improved system for reporting, clearing and settling OTC securities transactions on a nationwide basis.

The NCC will eventually adapt the NOTC's clearing system to fit into the continuous net settlement clearing program. The NCC's continuous net settlement system will account for, clear and settle securities transactions. A clearing member's open securities position, as well as money balance, will be brought forward daily on a perpetual basis. This system will merge daily balances and carry them forward, leaving all items in the system until settlement occurs, thus eliminating fails to receive or deliver. The system will begin with the reporting of trades by clearing members and will end with the clearance of securities delivered with a corresponding money settlement to the Clearing Center. All settlements, receipts and deliveries of securities will be made directly with the center.

The NOTC employs a "balance order" clearing system in which participating

firms report their buy and sell orders to the NOTC daily. These trades are then matched and netted daily by the NOTC. Unlike the continuous net system, the NOTC does not carry a member's net balances forward. Instead it reports each firm's position each day and settlement is then made directly between brokerage firms, not with the NOTC.

The NCC intends to maintain and operate the NOTC's present clearing operations until the transition from the balance order system to the continuous net settlement system can be effected in New York. To facilitate the transition and to introduce the new system to the New York brokerage community, several of the NOTC Board members will also serve as Directors to the NCC. In addition, the entire NOTC Board will serve as an advisory group for matters pertaining to the New York operation.

The NCC, which hopes to have at least two area clearing centers in operation during the coming year (one in New York and one on the Pacific Coast), is currently working with the Pacific Coast Stock Exchange's Clearing Corporation in designing the NCC system. The PCSE has made available computer programs and other necessary educational material used in its present "net-by-net" system.

The first clearing center will probably be on the Pacific Coast and the second in New York, and the first inter-area clearing operation will be conducted between West Coast and New York brokerage firms by expanding the present NOTC/POTC "pilot installation." As future area centers become operational, intra-area trades will be the first to be cleared. Later clearing services will be extended.

MAURICE SCHWARZ REPLACES A. B. FOX ON NASD BOARD

The National Association of Securities Dealers recently elected Maurice Schwarz, Jr., Senior Vice President of Sutro & Co., Incorporated, Los Angeles, to the organization's Board of Governors. Mr. Schwarz will fill the unexpired term of A. B. Fox, former President of Stern, Frank, Meyer & Fox in Los Angeles, who died suddenly of a heart attack on August 31, 1970. The Association regrets the loss of Mr. Fox who was a valued member of the Board and had formerly served the Association as Chairman of the NASD District Committee in District 2.

Mr. Schwarz, whose term will expire on January 1, 1973, has been active in the securities business since 1929. He began working for Anderson & Fox (later known as Slaughter, Anderson & Fox) in that year after attending Southwestern University. In 1935 he moved to Schwabacher & Co. as a registered representative and remained with the company until 1942 when he joined Sutro & Co., Incorporated. He became a general partner in the firm in 1959 and the resident partner in Los Angeles in 1961.

The focal point of Mr. Schwarz's NASD activities has been membership on the NASD Business Conduct Committee for District 2 in 1965, 1966, and in 1967 when he served as Co-Chairman of the committee. The committee is responsible for maintaining ethical standards of conduct for securities firms and employees in California, Nevada, and Hawaii.

Mr. Schwarz is also a member of the Board of Governors of the Pacific Coast Stock Exchange and of the Stock Exchange Club of Los Angeles. His main non-related work activity is membership on the Board of Directors for the Big Brothers of America. He has been active in Big Brother work on both the local and the national level and also has been engaged in related activities concerning juvenile problems and crime prevention.

CONSUMER EDUCATION PROGRAM TO REINFORCE INTRODUCTION OF NASDAQ

Start-up date for NASDAQ is only a few months away—and the NASD is mounting a national consumer education program that will follow close on its heels. The program, which will begin by heralding the advantages and consumer benefits of the new electronic stock market created by this nationwide automated quotations system, was approved by the Board of Governors in May.

Doremus & Company, the advertising agency selected by the NASD to put

this total communications effort into motion, will unveil the complete educational package before the NASD Board in late September. The campaign will utilize NASDAQ to familiarize investors and member firms alike with the latest developments in the OTC market, and, hopefully, will stimulate investor knowledge in OTC securities. It will include numerous ways of reaching the public, personnel in brokerage firms and officials of OTC companies. Some of the communications tools will be:

1. Informative full-page ads will be placed in national and financial publications, such as Life, Time, Wall Street Journal, U. S. News and World Report, Forbes, Institutional Investor and the Investment Dealers' Digest, which will dramatically call attention to NASDAQ and explain its purpose and its potential for improving the over the counter market.
2. Television commercials will be prepared for NASD member firms to use on a local level. These will be provided to program participants and will dovetail with the national program.
3. Radio commercials for member firm use will be prepared to spark interest on the local level.
4. Brochures are being designed and written on NASDAQ and the OTC market which can be used on both local and national levels along with confirmation stuffers and other customer educational material.
3. Radio commercials for member firm use will be prepared to spark interest in bringing both registered representatives and customers up-to-date.
6. An educational film called "The Electronic Stock Market" will be produced for use by groups ranging from investment clubs to educational television.
7. Other educational aids will be prepared for use by registered representatives and customers.

A film presentation is now in the preparatory stages which will explain the program's objectives and methods used to obtain them. It will include sample ads, media schedules, and other detailed program plans. This presentation will be shown to NASDAQ subscribers in various locations across the country beginning in November who will be asked to voluntarily contribute to the program.

The objective of the educational program is to strike while the NASDAQ iron is hot. The NASD believes that there will never be a more optimum time to focus public attention on the improvements and the inner workings of the OTC market. Investors need to know what NASDAQ can do for them. Registered representatives need the tools to explain the NASDAQ system to their customers. More broadly, the story of the OTC market must be told—what it is, how it works, and the place it has in the national economy and in personal financial planning.

The NASD has formed a subcommittee to study the capital requirements necessary for entering the securities business and the adequacy of present regulations in all areas of financial responsibility as applied to non-exchange member firms of the Association.

The subcommittee, which is expected to make its first report to the NASD Board in September, is chaired by Peter C. Barnes of H. O. Peet & Co. in Kansas City, Missouri. Other members are J. Robert Doyle of Doyle, O'Connor & Co., Chicago, Illinois; Preston E. Macy of Murphey Favre, Inc., Spokane, Washington; E. Richard Larson of Richards, Merrill and Peterson, Inc., Spokane, Washington; and Frank J. Kenney of M. A. Schapiro & Co., Inc., New York.

The Association has long been on record in favor of adequate capital require-

COMMITTEE WILL STUDY CAPITAL REQUIREMENTS

ments for brokerage firms, believing that a strong capital position is necessary for a firm to fulfill its financial responsibility to its customers. As early as 1942 the Association submitted an amendment to its by-laws to the membership which would have required \$5,000 minimum net capital for members dealing directly with customers and \$2,500 minimum net capital in all other instances. This amendment was not adopted because the Association did not have the power under existing law to implement such a rule.

In 1963, when Congress was studying amendments to the Securities Exchange Act of 1934, the NASD and the SEC firmly backed the amendment which was designed to strengthen requirements for those entering the business. Again, the Association stressed the importance of a minimum net capital requirements for its members. The SEC added its support to this concept.

The Securities Acts Amendments of 1964 became law in August of that year and for the first time provided a legal foundation for establishing minimum net capital standards. In 1965, the Securities and Exchange Commission amended their Rule 15c 3-1 in order to adopt minimum net capital requirements for all broker/dealers. The requirements closely followed those in the earlier rule proposed by the NASD: \$5,000 net capital for firms dealing with the public and \$2,500 for firms engaged in transactions not involving the public.

The NASD has always examined its member firms to assure that they are in compliance with minimum capital requirements of Federal Law. However, the Association, in analyzing the reasons that non-exchange firms have gone out of business, has discovered that inadequate capital is not always the primary reason. The form and content of capital, inventories of securities, firm investments, costs, and the adequacy of sophisticated operational methods all have a bearing on the ability of a brokerage firm to operate profitably in down-market situations. The new subcommittee plans to study the implications of all these factors which relate to the financial stability of non-exchange firms.

LEGISLATION IN PROGRESS

Mutual Fund Bill

The mutual fund legislation, which has undergone many changes during the past three years, may possibly be enacted into law this fall. The mutual fund bill sponsored by Harley O. Staggers (D-W. Va.) was passed by the House on September 23, 1970. The bill must now go to a House-Senate conference committee where differences in the Senate mutual fund bill (which was passed in 1969) and the House legislation must be resolved.

The four main provisions of the House bill are: (1) Buyers of front-end load plans could withdraw from such a plan within one year and receive a refund of the amount they invested plus 80 percent of the sales charge. (2) Fund managers may be sued for breach of fiduciary duty. The bill states that those who sue fund managers must present "clear and convincing" evidence. (3) Performance fees for fund managers would be regulated by a scale which would decrease fees when performance was low and increase fees when performance was high. (4) The NASD must determine criteria for a fair sales charge for a mutual fund within 18 months after the bill becomes law or abdicate its responsibility to the SEC.

The House bill is less stringent than the Senate bill which allows investors three years to recoup sales charges for a contractual plan, rather than one. In addition, the House bill omits the provision in the Senate bill which would allow banks and savings and loan associations to sponsor mutual funds.

Broker/Dealer Insurance

Anticipating the possible passage of the legislation, the Association has been developing plans to carry out the sales charge study. The Investment Companies Committee of the NASD and the Investment Companies Department have been working with the Economics Department to lay the groundwork for the study. The study will be undertaken as a joint effort between NASD staff members and outside consultants. Interviews are now being held with various economic consultant firms. The Association will make every effort to assure that the study will be carried out objectively and that the results will be fair to both investors and the industry.

In July of this year, the securities industry, the SEC, and the Treasury presented a compromise proposal to Congress which would establish an insurance corporation to safeguard an investors' free credit and equity balances in the case of failure of a brokerage firm. The proposed legislation was formulated along the lines of the Federal Deposit Insurance Corporation which protects bank customers.

Disagreements arose in Congress regarding several of the industry's proposals, and progress of the legislation was temporarily stalled. However, this month the Senate Banking Committee and the House Commerce Subcommittee both approved bills to set up such a corporation. The legislation closely parallels the industry proposal.

One of the primary areas of contention concerned the composition of the Board of Governors for the Corporation. The compromise plan had suggested a 15-man Board of Governors, with 10 representatives from major securities groups and five Presidential appointees. The Senate bill would reduce the Board to five men: the Chairman of the SEC, the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and two industry representatives appointed by the President. The House version proposes a seven-man Board with industry representatives predominating. Under the House bill, the NYSE would select two members; the NASD and the American Stock Exchange would each select one member; one member would represent all the regional exchanges; and two members would be Presidential appointees. This structure would hold firm *unless* the Corporation had to borrow money from the Treasury. Before such a loan could be made, the bill requires that four more members be appointed by the President.

Both bills provide for a non-profit corporation that would insure investors up to \$50,000. The insurance fund would be formed by assessing broker/dealers initially at the rate of $\frac{1}{8}$ of one percent of their gross revenue from the securities business. Firms would then be assessed at $\frac{1}{2}$ of one percent annually until the fund reaches \$150 million. At first, the fund would be augmented by \$65 million in bank credit. Both bills specify that the assessment rate would be reduced when the fund contained ample reserves. The House bill provides that, if the fund would drop under \$100 million, the assessment rate again would be raised to $\frac{1}{2}$ of one percent.

The fund would be backed by \$1 billion in credit from the Treasury. If the industry could not repay a Treasury loan, a transaction charge of 20 cents per thousand dollars would be levied on transactions over \$5,000 to meet industry obligations.

The Senate bill requires all broker/dealers, with the exception of firms that do not handle customers' cash or securities, to join the Corporation. The House bill would exempt only mutual funds or variable annuities. The SEC would have oversight authority over the corporation and over the financial responsibility of its members.

Variable Contracts Corner

Variable contracts offered by insurance companies are the newest securities to be covered under the NASD's regulatory program. Because of the complexities of variable contracts and the many questions raised by their very newness, the Association is devoting a column to this area. The purpose of the column, which will be included in the NEWS whenever warranted, is to keep insurance companies aware of the NASD's activities in this segment of the industry. The first column centers on the structure of the Variable Contracts Committee and the areas being studied by this group. Later articles will explore individual subjects in depth.

The Variable Contracts Committee was formed last year. Its function is to advise the NASD Board on all matters connected with variable contracts, but, in reality, its mission is greater in scope. The Committee is composed of nine members from life insurance companies marketing variable annuities, a member from the mutual fund industry and a member from the general securities industry.

Members of the full committee are: John F. Guion, Chairman, from the American Republic Assurance Co.; Arthur H. Haussermann, The Crosby Corporation; Louis A. Lanford, Hill, Crawford and Lanford, Inc.; George E. Lyman, California-Western States Life Insurance Company; Robert M. Powell, CNA Investor Services, Inc.; Ian M. Rolland, The Lincoln National Life Insurance Company; Henry O. Smith, SMA Equities, Inc.; Alan M. Thaler, The Prudential Insurance Company of America; Harry Walker, The Equitable Life Assurance Society of the United States; Peter R. Wilde, CG Equity Sales Company; and Kaye B. Wilson, American United Life Insurance Company.

- A joint sub-committee composed of several members of the Investment Companies Committee and the Variable Contracts Committee has been formed to consider mutual problems faced by the two groups. Mr. Guion and S. Whitney Bradley, Chairman of the Investment Companies Committee, are joint Chairmen of this group. One of the current problems being discussed is the SEC's proposed rule to amend Rule 22d-1 to impose more stringent requirements regarding investments in mutual funds or variable products by employees of the companies offering these products. As the rules presently stand, such employees can often purchase their company's products at a discount or without a sales load.
- A sub-committee on comparisons and illustrations is studying variable annuity sales literature and supplemental material in the light of the SEC's Statement of Policy. The areas currently being examined are: (1) literature comparing annuities offered by different companies or sponsors and (2) the possible merits of allowing the hypothetical performance of an immediate variable annuity to be illustrated in supplementary sales material. Harry Walker of The Equitable Society is Chairman of the committee, which is working on guidelines regarding comparisons and is evaluating the question of illustrations.
- The sub-committee on improper selling practices, chaired by Robert M. Powell of CNA Investor Services, Inc., is working on two problems. The first is the replacement of life insurance or annuity contracts where equities are involved. The sub-committee is concerned that such replacements should be

in the best interests of customers and that all facts involved in such a replacement should be disclosed. In the interest of coordinating the committee's activities in this area with those of the industry the Chairman recently appeared before the industry advisory committee to the National Association of Insurance Commissioners on variable contracts. The group is in the process of developing guidelines for disclosure to be used in a replacement situation and is open to suggestions from members.

The sub-committee has also been working on proposed standards to guide an insurance company concerning what can, or cannot, be included in news releases, annual reports, publicity, and media interviews relating to variable contracts and mutual funds.

A separate full committee of experts was appointed in late August by the NASD Board to study the feasibility and mechanics of publishing accumulation unit values for variable annuities among the mutual fund price list supplied to newspapers. Originally, the NASD had contemplated submitting this material in a separate list, but newspapers vetoed this suggestion because of lack of space.

The Chairman of this Committee is Francis S. McComb, Vice-Chairman of the NASD Board. Other members are: John M. Bleakie, Chairman of the Quotations Committee; Robert L. Cody, NASD Governor-At-Large representing mutual funds; and John F. Guion and Alan M. Thaler from the Variable Contracts Committee.

Comments from members are welcomed by the Variable Contracts Committee. Members should make their views known to the Chairman of the Committee or to John Taylor, Director, Variable Contracts, NASD.

MANAGEMENT & SUPERVISION

NOTES

SEC PROPOSES RULE TO CURB ABUSES BY SHELL CORPORATIONS

The Securities and Exchange Commission has, within the past two years, become increasingly concerned about promoters who buy shell companies and then make a public distribution of securities by using "spin-off" devices. The most common "spin-off" device consists of the acquisition of a shell corporation by another corporation and the spin-off of its shares to the acquiring corporation's shareholders.

When this is done for fraudulent purposes, false reports are often issued regarding the company's prospects and its assets. The resultant activity in the company's shares often results in highly inflated stock prices—a situation which is damaging both to the public and the securities industry.

To combat the problem, the SEC recently proposed a rule which would partially place the responsibility on broker/dealers of determining if a company is legitimate before they submit quotations to an inter-dealer quotation system. The proposed rule, 15c2-11, would require that a broker/dealer have available almost all the information about a company now required in a prospectus before submitting a quote to an inter-dealer quotations system for a stock that has not regularly been quoted in a similar

system within the previous 30 days. A broker dealer would be released from this requirement in the case of: (1) A new issue where the registration statement has been filed which was effective 90 days before the broker/dealer submits a quote *and* the broker/dealer has a copy of the prospectus; (2) Proper notification has been filed for a Regulation A new issue and the broker/dealer has a copy of the offering circular which is dated within 40 days before a quote is furnished; and (3) The issue is exempted under the 1933 Act.

The broker/dealer must make certain that the issuer has filed the reports required by Federal or State Law and that he has a copy of the issuer's most recent annual report as well as any reports filed after the annual report. The rule would not apply to securities listed on a national securities exchange which were traded on the exchange the same day or the day before the quote is submitted.

In all other instances, the broker/dealer must make available to any interested person and the quotation system a wealth of material about a company before submitting a quote. This material would be required to be submitted with the quote and would include information regarding the company's name; main address; state of incorporation; the nature of the business, including the product or service offered; the extent of the issuer's facilities and detailed financial information concerning the issuer; and the names of the chief executive officers and members of the Board of Directors. The broker/dealer would also have to furnish the exact title and class of the security; the number of shares or total amount of the security outstanding; and the name and address of the transfer agent.

The broker/dealer must also reveal: (1) if the quote is being furnished on behalf of any other broker/ dealer; and, if so, his name; (2) if the quote is being furnished on behalf of the issuer or its directors, officers, or anyone who is the beneficial owner of more than 10 percent of any of the outstanding equity securities of the issuer; and, if so, the names of such individuals; and (3) any other information which the broker/dealer has used in determining the price of the quote.

The NASD supports the Commission's attempt to lessen the problems created for investors and the securities industry which are caused by trading in shell companies. However, the NASD, in a written comment on the rule, stressed that "it is hoped. . . that the remedies ultimately adopted will not create unnecessary hardships for brokers or dealers, unduly hamper the financing of small businesses or the trading of their shares, or discriminate against the over-the-counter market in favor of the exchange markets."

NASD INSURANCE TRUSTEES ANNOUNCE DIVIDENDS AND INCREASE HEALTH COVERAGE

A well managed group insurance program equals better coverage at lower cost. Applying this formula, the NASD began to offer group life insurance to member firms in 1948 and added group medical insurance in 1952. The NASD plans are sponsored by the NASD and are administered by the Association's Insurance Trust.

Recently the NASD Insurance Trustees announced that \$575,000 in dividends was mailed to member firms who were participating in the Group Life and Medical plans as of April 30, 1970. Refunds based on percentages of premiums paid by each participating firm during the previous twelve months were:

- Life and Accidental Death and Dismemberment Insurance—40 percent of annual premiums.
- Comprehensive Major Medical Insurance—10 percent of annual premiums.
- Medicare Supplemental Coverage Plan — 10 percent of annual premiums.

The Trustees also announced that higher room and board options up to \$75 per day will also be available as of October first to participating members in geographical areas where these costs are higher. New benefits, which will also become effective on October first, will be offered to participating members without additional charge. They are:

- The doubling of the Major Medical maximum from \$25,000 to \$50,000 per cause. A lifetime ceiling of \$25,000 will be placed on mental or nervous disorders.
- An increase of 20 percent in the surgical and anesthesia schedule. The new surgical maximum will be \$1,200.

The life and medical insurance plans will open on October 1, 1970, on a non-medical basis to any *member firm* which desires coverage for all of its eligible employees or which desires to increase its room and board option. For further information, contact the NASD Insurance Trust, 888 17th Street, N. W., Washington, D. C., 20006.

These programs have provided over \$17.8 million in benefits for NASD members during the past 22 years and have returned over \$4.6 million in dividends. Near the end of September 1970, 742 firms were participants in the Life Insurance Plan and 439 member firms were participants in the Comprehensive Major Medical Insurance Plan. Altogether, over 13,000 individuals are insured by these plans.