

# NASD

*News*

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NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., 1700 K STREET, N.W., WASHINGTON, D.C. 20005

*To NASD Members and Registered Representatives:*

## **NASDAQ To Be Expanded To Include Trade Reporting**

Work will soon begin on a major expansion to NASDAQ which will allow subscribing firms to report details of each securities trade to the NASDAQ central computers. This trade reporting system will apply to OTC trades where either one or both parties is a NASDAQ subscriber.

The two main benefits of the proposed trade reporting system, according to Gordon S. Macklin, NASD president, will be to provide more information to investors and to speed up the clearing and settling of trades. The proposed trade reporting system would make it possible for traders to verify each trade within minutes of its execution and to immediately detect any errors. In order to accomplish this, the Association plans to provide NASDAQ subscribers with a printed comparison or an uncomparing report within a few minutes after the trade is entered.

Another important reason for initiating a trade reporting program is that NASDAQ can provide a substantial part of the trade input for the National Clearing Corporation—the new nationwide clearing system that is being developed for the over-the-counter market. The Association plans to have trades automatically routed by NASDAQ to the National Clearing Corporation where they will be matched, compared and cleared.

This increased computerization of the OTC securities marketing chain will result in more efficient brokerage firm operation, fewer errors in trades, rapid correction of errors that do occur and rapid transmission of trade data to the clearing corporation for settlement. The result should be improved executions for customers and substantial savings in time and a reduction in cost for brokerage firms, as well as a pronounced decrease in paperwork.

Because of the modifications that must be made to NASDAQ to accommodate this new program, it will probably take about two years to put a trade reporting system into effect. The program will be developed in phases so that NASDAQ subscribers hopefully would be able to report trades for comparison purposes to the National Clearing Corporation at an earlier date.

The Association has formed a special Automation Committee to direct the implementation of the trade reporting program. The Committee is chaired by Peter C. Barnes of H. O. Peet & Co., Inc. of Kansas City, Missouri. Other members of the Committee are: Roger E. Birk, Merrill Lynch, Pierce, Fenner & Smith, Inc. in New York; J. Robert Doyle, Doyle, O'Connor & Co., Inc. in Chicago; James T. Gahan, E. F. Hutton & Company, Inc. in New York; Edward J. Kelly, Loeb, Rhoades & Co. in New York; William S. Mason, Jr., New York Hanseatic Corporation in New York; Peter R. Wilde, CG Equity Sales Company in Bloomfield, Connecticut.

**Decision in Aetna Case  
Involving NASD Rule 25  
Is Appealed by Association**

As well as studying the trade reporting program from the standpoint of reducing trade errors and providing trade information to the National Clearing Corporation, the Committee will also examine the feasibility of adopting real time reporting of trades for the negotiated market.

A Securities and Exchange Commission hearing examiner recently handed down a decision which upheld the NASD's right to establish and enforce Section 25—the Association's rule which prohibits members from participating in securities distributions with non-members. The decision also reaffirmed the Association's right to restrict members' granting to and receiving of sales concessions from non-members, dealing with non-members and dual registration of personnel.

However, the decision directed the NASD to write an exception to this section. The exception would allow NASD member affiliates of insurance brokerage firms to join in distributions involving group sales of mutual funds and variable annuities if the principal underwriters are regulated through SECO.

The decision has been appealed and will be reviewed by the full Commission. Until a final determination has been made, all NASD members are responsible for complying with Section 25 as it currently appears in the NASD Manual.

The decision was in response to a petition to eliminate Section 25(b)(2) which was submitted to the SEC by the Commission's own Division of Trading and Markets. The Aetna Life and Casualty Company later requested and was granted permission to become a party in the case.

The Association rule prohibits Aetna's subsidiary, the Participating Annuity Life Insurance Company, from distributing variable annuities through NASD members as well as prohibiting Aetna Financial Services, Inc., another Aetna subsidiary, from distributing Aetna's mutual fund through NASD members. Both Aetna subsidiaries are SECO members. All SECO regulated broker/dealers are similarly prevented from joining in such distributions.

Aetna explained that it had a close business relationship with major insurance brokerage houses, and that these firms had an interest in distributing equity products. In this case, Aetna stressed, it is not the practice of the insurance industry for a company to sell these equity products directly to its customers.

The Division of Trading and Markets' brief contended that the NASD had improperly applied Section 25 by employing economic sanctions which allegedly exceed the authority granted the Association by Congress.

The NASD, which believes that it has been applying Section 25 appropriately under the regulatory authority provided by the Maloney Act, objected strenuously to Aetna's and the Division of Trading and Markets' request to abolish the rule.

The Association contends that elimination of the rule would adversely affect the Association's ability to perform its regulatory duties. The NASD believes jurisdiction over the entire distribution team is necessary. Under the hearing examiner's decision, this would not be possible. In its brief, the NASD argued that both the staff of the SEC and the Commissioners themselves had been fully aware of the NASD rule and its application and that it had been applied since 1939 without objections being raised by the Commission.

The NASD stated that "the Securities and Exchange Commission has consistently supported the view that the Association can properly prevent its members from participating or joining with non-members in the distribution of issues of securities and that it has on a number of occasions reaffirmed this position both explicitly and implicitly."

The brief also pointed out that "the legislative history of the Maloney Act is replete with references to the necessity of specifically allowing the Association to accord members preferential business advantages not inconsistent with the public interest and that these preferences . . . make disciplinary action by the Association meaningful." In addition, the brief stressed that "the Board of Governors of the Association does not believe it would meet its responsibilities and duties under the Maloney Act . . . if it permitted its members to participate in the distribution of an issue of securities which was not subject to the same regulatory standards or which, if there was complete comparability of regulatory standards, would be subjected to an unevenness in regulation from the standpoint of investigative and disciplinary proceedings."

The decision by the SEC hearing examiner fell midway between Aetna's and the NASD's positions. As mentioned earlier, the decision stated that the NASD has the authority to apply Section 25, but cannot prevent members that are subsidiaries of insurance brokerage firms from handling group sales of mutual funds and variable annuities underwritten by underwriters subject to SECO regulation.

The decision also stated that an insurance brokerage firm should be allowed to form two separate broker/dealer subsidiaries, one an NASD member and the other SECO regulated. The Association contends that Section 25 prohibits this since the NASD member would necessarily be joining with the non-member in distributions because of their sister status.

In addition, the decision stated that parallel underwritings of distributions should be allowed where the issuer of mutual funds or variable annuities would arrange for independent broker/dealers, one a member of the NASD and one a member of SECO, to underwrite securities and then distribute them, one through NASD broker/dealers and the other through SECO broker/dealers. The Association also contends this conduct is properly prohibited by its rule.

The NASD, the SEC Division of Trading and Markets and Aetna have all asked for Commission review of the decision. The Commission is expected to take up this matter within several months.

Broker/dealer firms that continually stand ready to buy or sell OTC securities, often called market makers or wholesalers, will be required in the future to execute transactions of 100 shares of stock upon request of other firms at their prevailing quotations in the NASDAQ computer system, according to a recent policy adopted by the NASD Board.

Ever since NASDAQ began operation in February of this year, the Association has encouraged market makers to stand firm behind the quotations for securities which they enter in the NASDAQ system. In almost all cases, market makers have been diligent in this regard. However, there have been cases where a competing trader has contacted a market maker by telephone to either buy or sell a security at the price quoted on NASDAQ, and the market maker has offered different bid and ask quotations than what he was showing on the terminal screens in the system.

**NASD Tightens Control  
Over Any "Backing Away"  
By NASDAQ Market Makers**

**Rash of Disciplinary Cases  
Regarding Filing of Form Q  
Have Reached Final Stage**

In order to maintain the high credibility of the NASDAQ system for investors and the industry, the Board of Governors' policy is designed to deal with the isolated problem of not honoring quotations or "backing away". All NASDAQ subscribers will be notified by the NASD that they will be subject to possible disciplinary action for entering quotations into the system and then refusing to complete transactions at these quoted prices for at least a minimum of 100 shares.

The NASD is in the process of adjusting its regulatory procedures to provide strict enforcement in this area. According to the new NASD policy, only under extraordinary circumstances, such as a breakdown of NASDAQ equipment which prevents a firm from entering or updating quotations, will market makers be relieved from the responsibility of keeping their quotes current.

Last year, the Association inaugurated both annual and quarterly financial reporting programs which require members to report data on income and expenses to the NASD. Form 17A-10, which is required by the Securities and Exchange Commission, is a detailed form which requests information ranging from a firm's net capital computation and primary sources of income to compensation for a firm's employees. Information from Form 17A-10 is analyzed and relayed to the SEC, without any of the reporting firms being identified.

Form Q, which members are required to fill out on a quarterly basis, is a shortened version of the 17A-10 form. Developed by the NASD, Form Q is primarily being used to spot-check members for possible problems in the financial and/or back office operations areas. This quarterly reporting program began in December of 1970.

All member firms were notified at the beginning of both reporting programs that complete, accurate and timely responses on these forms were necessary, and that firms that either failed to file or which filed inaccurate information would face disciplinary action by the Association.

The first disciplinary actions stemming from firms' filing misleading and inaccurate information on Form Q have now become final. Seventy-seven firms have been penalized through censure and fines for filing information on Form Q which did not tally with financial information regarding these firms which was calculated by the Association staff.

All of the cases are being processed through the Association's summary complaint procedure, which is used in cases involving technical infractions of NASD rules.

Firms which have not filed either Form 17A-10 or Form Q by the appropriate deadline dates can also expect disciplinary action from the Association.

It is important that all financial forms be filed when requested and that the information be correct. All NASD members which have been placed in Group B for the quarterly reporting program should be aware that they are required to have their Form Q's completed and returned to the NASD by August 20th. This current filing covers the quarter ending on July 31, 1971.

**Exchange Stock Warrants  
Now Eligible for NASDAQ**

The Board of Governors has approved a change in Schedule D of the Association's By-Laws so that warrants whose underlying stock is listed on a national securities exchange will be eligible to be included on the NASDAQ system. Until this change, to be implemented shortly, only warrants for stocks in the NASDAQ system were eligible.

The basic requirements for inclusion on the NASDAQ system which pertain to warrants of NASDAQ stocks will also apply to warrants of stocks on national exchanges. These requirements state that if the underlying security is authorized, the warrants may be authorized regardless of the price. Also the number of warrants that must be publicly held (100,000) will be tabulated at the time of the initial authorization of the warrants.

**IBA Winning Essays  
Are Now Available**

The Investment Bankers Association has asked the NASD to alert members to the fact that the winning essays from the IBA's essay competition have been published and are available to NASD members.

*Financial Public Relations for the Public Company* is the title of the winning Institute of Investment Banking competition essay. The author is Judith E. Meador, assistant vice president of A. G. Edwards & Sons, Inc. St. Louis. The essay won on the basis of its depth of research and original contribution to literature in the field of investment banking.

Briefly, the essay describes why financial public relations is important to the publicly held company, who the company's audiences are and how they can be reached.

Runner-up essays in the competition were:

*Motivation of the Registered Representative-A Continuing Task*, by Theodore R. Paulson, Crowell, Weeden & Co., Laguna Hills, Calif. In his essay, Mr. Paulson mixes behavioral science theory with practicalities of sales management as it applies to the brokerage branch office to identify and solve motivation problems.

*A Common Stock Policy for Pension and Profit Sharing Plans*, by H. Vernon Winters, Wachovia Bank & Trust Co., Winston-Salem, N. C. The equity-fixed income policy for a retirement plan has usually been established on the basis of the generally accepted standards within the investment industry. Mr. Winters presents a more logical and empirical way to establish the investment policy to assure that the plan is based on previously determined specific needs and objectives.

Copies of Miss Meador's essay are \$3 each. The runner-up essays are \$2 each. They may be obtained by writing the Investment Bankers Association Publications Department, 425 Thirteenth Street, N. W., Washington, D. C. 20004.

# MANAGEMENT & SUPERVISION

# NOTES

## Financial Plan Collapses, Catches, RR, NASD Firm

A registered representative, his immediate supervisor and his firm were penalized by the NASD in the wake of the collapse of a financial plan for purchase of mutual fund shares and insurance.

The balanced financial plan which had been devised by the registered representative, was set up so that money withheld from salaries of the participants would be evenly divided between life insurance and mutual fund share purchases. In developing the mechanics of handling the money, the representative initially established a bank account for the plan. Checks were made out to the account, and he withdrew funds to pay for the mutual fund shares and insurance premiums.

When he tried to create a simpler system, he found himself in difficulty. He managed to arrange pre-authorized check agreements with the insurance company, which took money from the bank account through an automatic monthly draft. The same arrangement could not be worked out with the mutual fund company, which then had to be paid by cashier's checks. The defect of the system became apparent when money was not submitted to the bank on a consistent basis by plan participants, and there were not enough funds to cover both insurance payments and the purchase of mutual fund shares. The monthly draft by the insurance company depleted the account to the extent that there were not enough funds remaining with which to purchase mutual fund shares.

The registered representative, realizing that the system had gone awry, did his best to rectify the situation by contacting customers who had not sent in their agreed upon contributions to the plan. When this failed to generate the necessary money, he put his own funds into the plan's bank account on several occasions. He also stopped recruiting new participants for the plan.

However, he neglected to inform both his supervisor and the customers that the plan's financial arrangements were in jeopardy. The breakdown of the cashing system was not discovered until a customer attempted to liquidate mutual fund shares and discovered that the shares had never been purchased. The same situation had arisen in eighty separate accounts.

The Association, in examining the case, determined that the registered representative's supervisor was also at fault in this matter since it was his re-

sponsibility to assure that the cashing system for such a program would be properly arranged and also to check to see that the system was working correctly. He had not taken either of these steps.

## New York Transfer Tax Law Is Amended

NASD members should note that two changes in the New York State Stock Transfer Tax Law became effective on July 1, 1971.

First, the tax rate was reduced for stock sales made in New York State for individuals qualifying as nonresidents under Section 270-a(1)(a) of the law. The rates, which apply from July 1, 1971 to June 30, 1972, are:

<i>Selling Price Per Share</i>	<i>Nonresident Rate, %</i>
Less than \$5	1.0
\$5 to less than \$10	2.0
\$10 to less than \$20	3.0
\$20 or more	4.0

Second, a maximum stock transfer tax of \$750 will be applied to sales of shares on one day by one individual when the shares are the same class and are issued by the same issuer. This maximum tax will be effective between July 1, 1971 and June 30, 1972.

Under the amendment to Article 12 of the New York State Stock Transfer Tax Law, the maximum tax applies to any seller, not just to individuals qualifying as nonresidents.

### Please Note:

The NASD urges all members to carefully note the new Schedule of Examination Centers (effective on July 1, 1971) which gives information on location of the centers as well as the times examinations will be administered. The schedule, which was recently mailed to members, contains numerous time and address changes.

Any questions regarding this material should be addressed to Mr. James Mashburn, Qualification Examination Department, 1735 K Street, N.W., Washington, D.C. 20006.