

NASD

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

To NASD Members and Registered Representatives:

NASD TESTIFIES AT SECURITIES INDUSTRY HEARINGS

This year the Securities and Exchange Commission as well as panels in both the U. S. Senate and House of Representatives have been conducting extensive hearings, delving into the problems of the securities industry and various possible solutions. This careful scrutiny began in August when the House Subcommittee on Commerce and Finance, chaired by Congressman John Moss (D.-Calif.), began taking testimony on the industry's operational problems. These hearings will continue with inquiries into such areas as the role of the stock certificate; brokerage activity in connection with money management; commission rates; and the market place of the future.

On the other side of the Capitol, a subcommittee on securities of the Senate Committee on Banking, Housing and Urban Affairs, chaired by Harrison Williams (D.-N. J.), began exploring related areas in the securities business this fall. In speeches and interviews, Senator Williams has expressed his concern that there be adequate competition in the securities market of the future.

Recently concluded were hearings on the securities industry before the SEC. The Commission sought industry response to such questions as: How should the securities markets of the future be structured? What is the best way to regulate these markets? What organizations should be allowed to either become members or have access to the exchanges? What role should competition play in the market place? The question of disclosure of prices, volume and quotations in all markets was also under study.

The answers to the questions raised by these three groups are expected to eventually shape the future direction of the industry. Various industry securities organizations and individuals affiliated with the industry, including the NASD, are cooperating with these governmental groups in seeking solutions for the industry's problems and in voicing their thoughts about the securities industry to come.

Responding to the requests of Congress and the Commission, the NASD has testified before both the Senate and the House Subcommittees, as well as before the Commission.

Operations

The NASD has informed the Commission and Congressional units of the steps it has taken to correct operational problems among NASD members. The Association's emergency program, designed to monitor the paperwork problem, was outlined. This program was begun during the paperwork crisis of two years ago. It was pointed out that, in attempting to reduce the paperwork flow, the NASD had designed procedures to simplify and coordinate the handling of securities transactions.

Noting that emergency measures cannot provide a final solution, Gordon S. Macklin, NASD president, reported to the various panels on the progress of the Association in establishing a nationwide OTC clearing system—the National Clearing Corporation—which is expected to significantly reduce the number of failures to deliver and receive stock certificates. He commented on the differences between the daily balance order system, which has been used to clear OTC transactions in

New York, and the continuous net clearing system which has been developed by the National Clearing Corporation for use in the OTC market on a nationwide basis. (The continuous net system was placed in operation on a pilot basis in New York early last month.)

Mr. Macklin noted that the advantages of the continuous net system, where all clearing members settle transactions directly with the clearing center, were stressed by both the Rand Corporation and the Arthur D. Little Corporation—two management consulting groups that had carried out studies regarding operational problems under NASD sponsorship.

It was pointed out that the continuous net system is expected to reduce 60 percent of actual deliveries from the system, as opposed to the 25 to 30 percent reduction under the daily balance order system. In addition, the NASD president stated that the Rand Corporation has estimated that the industry would save \$50 million annually when the continuous net system is fully implemented.

Looking toward the future Mr. Macklin told the government study groups that the Association is studying methods by which NASDAQ can be used as an interface with the National Clearing Corporation so that actual transactions may be uniformly reported, compared and cleared. This actual trade reporting system, he emphasized, would provide regulatory and operational benefits for the firms involved.

Financial Stability of Broker/Dealers

In order to help protect the public from financial problems among NASD firms, the NASD explained that it had increased its staff to allow more frequent inspections of members' books and records, instituted an early warning system as part of financial reporting, and imposed restrictions on firms with financial problems. Most importantly, the NASD discussed the capital rules which have been proposed for NASD members. (These rules, incidentally, were sent to the membership for comment early this month.)

Noting that the proposed capital rule is designed to improve the liquidity and quality of capital of broker/dealers, the NASD outlined the basic provisions of the new rule which include: an increased minimum net capital; an initial net capital requirement for new members of 120 percent of the required amount; a separate minimum net capital requirement for market makers; a minimum equity requirement of 25 percent of total capital; and new regulations covering subordinated capital.

Regulation of the Securities Industry

The NASD reaffirmed its belief in the concept of self-regulation. "We view the existing market structure," stated President Macklin, "—encompassing exchange markets, third market, NASDAQ and the rest of the OTC market—as a viable structure that generally has performed well and can and will meet the challenges of the future."

As basic principles for the entire regulatory framework, he emphasized: equality of regulatory standards among all organizations; elimination of duplication in surveillance activities and disciplinary proceedings; and membership qualification standards which assure high professional standards without unfairly or arbitrarily restricting access to the broker/dealer community.

NASDAQ

President Macklin stated that fuller use of the NASDAQ facilities for reporting of the quotations and transactions of the various markets could stimulate competition which is in the public interest. He voiced the Association's belief in the desir-

ability of fully exploring and implementing the potential of the NASDAQ system including expansion of its quotations capacity to all markets and implementing its potential for trade reporting.

Other portions of NASD testimony clarified the Association's positions on a number of central industry questions, in particular stressing the advantages of competition within the securities markets. Among the things that he mentioned as having healthy competitive potential were: access by non-member broker/dealers to the exchanges through a commission rate discount of at least 50 percent, and the introduction of a composite tape for reporting all transactions in the various markets.

As the self-regulatory body for the OTC market, the Association will continue to participate in any Congressional and Commission hearings, cooperating whenever possible in resolving the major issues which currently face the industry.

TASK FORCE TO REVAMP QUALIFICATIONS PROGRAM

The NASD has embarked on a program to implement certain recommendations of its Board of Governors with respect to the qualifications of securities industry personnel. This program, which includes participants from other regulatory bodies and member firms of the Association, is intended to result in a significantly improved qualification system for the NASD, one that will rest on two major innovations. The first of these will allow for the creation of different classes of registration in line with job functions that exist in the securities business. Initially, the Association will concentrate on establishing standards for operations principals, OTC traders, general securities salesmen and mutual fund-variable annuity salesmen. The second innovation will be the development of an enforceable system of standards for member training programs. In this connection, the Association will not only assume the right to review and evaluate the training programs and procedures of members, but will also assume the responsibility of providing member firms a set of objective standards for use in creating their programs. In its final form this new qualifications and training standards program will mean that an individual will no longer automatically become a registered representative by merely passing the traditional qualification examination, but he will be required in addition to have successfully completed an approved training program within his firm.

The NASD has sought the help of its member firms and other securities industry organizations in providing experienced and qualified personnel to work on various aspects of the problem. Discussions have been held with representatives of the New York and American Stock Exchanges, Investment Bankers Association, National Security Traders Association, Wall Street Training Directors Association, Association of Stock Exchange Firms, as well as numerous member firms. Listed below are the names of the people and firms that are represented in the task force which will establish the required standards. These volunteers will devote six weeks of their time to the project, which began with a three day workshop on November 29th held at the New York Institute of Finance in New York City.

In the first part of this project the task force will have as its goals the development of exhaustive job descriptions for each class of registration, the establishment of training performance objectives which training programs must meet in order to produce individuals capable of performing their jobs and the ordering of these training performance objectives in an hierarchical sequence describing a learning process that proceeds from simple to complex knowledge and skills.

At the operational level, there will be separate groups developing standards for each class of registration, working under the supervision of Dr. Peter Esseff of Educational System for the Future, consultants in educational technology. The

methodology to be employed will be the "systems approach" to education and training, a scientific method for defining both the structure and outcomes of training courses. This is the first time that the systems approach to training will be used in the securities business, although it has been used extensively in the military, in industry and in academic education. While this approach in its entirety will consume approximately six months, the Association has for reasons of cost control, divided it into four distinct phases, thus allowing all concerned to periodically judge the effectiveness of this approach and the advisability of continuing into subsequent phases.

Inasmuch as the results of this project will affect not only the NASD and the training programs of its members, but the qualification programs of the New York and American Stock Exchanges as well, it has become an industry wide effort to upgrade the level of training for personnel in the securities business. In this sense, it is a truly self-regulatory action by the industry.

This project will continue to need industry volunteers. Those interested should contact Mr. Frank J. McAuliffe at the NASD Executive Office (202)833-7394. Volunteers should have broad experience in their respective areas and must be prepared to devote a major portion of their time for five to seven weeks. The volunteer must be able to travel to and spend some days in the New York area.

PROJECT TASK FORCE MEMBERS

Name	Firm
A. Raymond Brummett	NASD, Inc.
John Buehler	Eastman, Dillon, Union Securities & Co., Inc.
Ron Buesinger	A. G. Edwards & Sons, Inc.
Donald Carfagno	Keefe, Bruyette & Woods, Inc.
Alan Citron	NASD, Inc.
Jerome C. Cuppia	Merrill Lynch, Pierce, Fenner & Smith, Inc.
Glenn Givens	Reynolds Securities Inc.
Richard A. Greves	New York Stock Exchange
Dave Hall	NASD, Inc.
Dave Huntoon	New York Stock Exchange
Ray Jacobs	Phoenix Equity Planning Corporation
Charles D. Lowenstein	ADL Investment Company, Inc.
Leonard Mayer	Mayer & Schweitzer, Inc.
James McCormack	Metropolitan Life Ins. Co.
Vincent Monterosso	Metropolitan Life Ins. Co.
James G. Mundy	Suplee-Mosley, Inc.
Robert L. Pagel	Loewi & Company
Junius W. Peake	Shields & Company
Jerry Pilpel	NASD, Inc.
Wayne Randall	New York Stock Exchange
Edward Ross	First Investors Corporation
John W. Ross	MONY Sales, Inc.
Warren Shore	CBWL-Hayden, Stone Inc.
John E. Skillman, III	Reynolds Securities Inc.
Dale E. Smith	Singer, Deane & Scribner
Lynn Szerlip	CBWL-Hayden, Stone Inc.
A. John Taylor	NASD, Inc.

John Wall
Theodore T. Wdowiak
Bernard Weissman
Robert Wickersham
Robert A. Woeber
James Yore

NASD, Inc.
Merrill Lynch, Pierce, Fenner & Smith, Inc.
Gold, Weissman & Frankel, Inc.
National Clearing Corp.
Arthurs, Lestrangle & Short
NASD, Inc.

**NEW GOVERNORS
TO TAKE
OFFICE IN '72**

Seven men, representing six districts, have been elected to the NASD Board of Governors for three-year terms to begin in January of 1972. As Governors, these men will aid in directing Association activities and formulating Association policy.

The members in District 2 have elected B. P. Lester, Jr., General Partner of Hornblower & Weeks-Hemphill, Noyes in Los Angeles, to represent them on the Board. Mr. Lester has previously served on the District Business Conduct Committee for District 2 and was Chairman of that committee in 1968.

James P. Fellows, General Partner of Boettcher and Company in Denver, Colorado, has been elected to represent District 3. He was a member of the District 3 Business Conduct Committee from 1968 to 1970, serving as Chairman in 1970.

District 5 members have chosen Vernon J. Giss as their Board representative. Mr. Giss is Vice President & Secretary-Treasurer of Stephens, Inc., Little Rock, Arkansas. He has served the Association as a member and then Chairman of the District 5 Business Conduct Committee.

The new Governor representing District 7 will be David R. Murphey, III, President of Pierce, Wulbern, Murphey, Inc., in Tampa, Florida. From 1968 to 1971 he was a member of the District 7 Business Conduct Committee, serving as Chairman in 1970.

Joseph P. Short, Executive Managing Partner of Arthurs, Lestrangle & Short, Pittsburgh, Pennsylvania, will represent District 11. His previous Association service includes: member, District 11 Business Conduct Committee and Chairman, DBCC for District 11 in 1971.

District 12 will have two new Governors—Edward B. deSelding, Senior Vice President of Spencer Trask & Co. Incorporated of New York City, and Junius W. Peake, Partner in Charge of Administration & Operations for Shields & Company, also in New York City. Mr. deSelding has been a member of the District 12 Business Conduct Committee—Chairman in 1971. Mr. Peake, in addition to serving on the District 12 Business Conduct Committee, has been a member of the NASD's Automation Committee, National Uniform Practice Committee, and the Advisory Panel of the National Clearing Corporation.

**NASDAQ VOLUME
RELEASED TO
WIRE SERVICES**

On November 1st, NASDAQ volume figures were released to the press for the first time. This information on trading activity carried out through the OTC market's new automated quotations system has been eagerly anticipated by investors and the industry since NASDAQ began operation.

The volume figures, which exclude warrants, debentures and units, are released via the NASDAQ central computers to the wire services, which are disseminating these figures to the press.

On a daily basis, the following volume information is available on almost 2,900 NASDAQ stocks: volume figures for individual NASDAQ securities; aggregate

volume figures for NASDAQ securities; and a list of the ten most actively traded NASDAQ stocks. In addition, the wire services are being supplied with daily, weekly, monthly and yearly market summaries which, for the first time, provide a comprehensive view of trading in a substantial portion of the OTC market.

NASD studies completed before release of the volume figures, indicated that the volume reported for the OTC market through NASDAQ would normally exceed the cumulative volume on all of the registered stock exchanges in the country, with the exception of the New York Stock Exchange. On a weekly basis, NASDAQ volume is expected to be about half of the New York Stock Exchange volume.

The first weekly NASDAQ volume figures have supported these predictions. As can be seen from the chart below, NASDAQ volume doubled that of the American Stock Exchange and totaled about half the New York Stock Exchange volume.

	NASDAQ	AMEX	NYSE	ALL OTHERS
November 1, 1971	6,200,800	2,840,000	10,960,000	2,143,229
2	6,249,000	3,390,000	13,330,000	2,045,256
3	7,571,600	3,670,000	14,590,000	2,423,887
4	7,266,400	4,100,000	15,750,000	2,898,592
5	6,021,500	2,560,000	10,780,000	2,013,432
Weekly Total	33,309,300	16,560,000	65,410,000	11,524,396
Daily Average	6,661,860	3,312,000	13,082,000	2,304,879

The Association considers volume information of great significance to the industry and investors, and has accordingly devoted considerable effort to insuring the accuracy of these figures before releasing them to the public—an effort which has focused on educating NASDAQ firms regarding the proper reporting of volume and also has included regulatory safeguards to assure that reporting is accurate.

Since July, NASDAQ subscribers have been on notice that failure to correctly report volume can result in disciplinary action by the Association. In order to check market maker compliance, the NASD examining staff has been comparing firms' order tickets against the volume reports generated by the NASDAQ computers to make sure that the two are equal. This double-check is now part of all routine examinations of NASD members.

In addition, a management tool has been added to the NASDAQ system which allows a trading department manager to query the system at the end of each day and have listed on his terminal screen all of the stocks in which his firm has

entered no volume for that day. This enables him to discover if the firm has complied with required NASDAQ volume entry procedures.

The basic concept which underlies the reporting of NASDAQ volume is the publication of volume figures which will inform the public of the number of shares of an issue that changed ownership during a business day. In order to accurately reflect this change of ownership, the NASD and the SEC jointly have developed the method for computing NASDAQ volume.

In the NASDAQ system, there are only two ways in which shares can change ownership: (1) If there is a difference between the number of shares in a market maker's inventory at the beginning of a business day and at the close of business that day, that difference reflects a change in ownership; (2) if shares are *both* purchased and sold by a market maker during the day (i.e. flow through his inventory), these shares are also counted as having changed ownership. By adding the net change in inventory to the number of shares of that security which the firm both bought and sold during the day, the NASDAQ system computes the firm's volume figure for that security.

For example, a market maker opens the day with an inventory of 3,000 shares of XYZ, Inc. During the day he purchases 2,000 additional shares and sells 4,000 shares, leaving a closing inventory of 1,000 shares. The difference between his opening and closing inventory is 2,000 shares. These 2,000 shares are considered as having changed ownership. An additional 2,000 shares flowed through the market maker's inventory—that is, they can be counted as having been both purchased and sold. The 2,000 share net change in inventory is added to the 2,000 shares that flowed through the inventory, resulting in a total volume of 4,000 shares in XYZ, Inc. for that market maker.

The same process is repeated by the NASDAQ computers for each market maker in the security so that a single volume figure for the security will be released for publication by the NASDAQ system shortly after 4:30 p.m. Eastern Time.

This technique will capture volume in cases where the NASDAQ market maker acted as principal (trading for his own account) or acted as an agent in crossing securities orders between two public customers. Trades between investors and non-NASDAQ market makers obviously cannot be reflected in the volume figures.

5 NASD EXECS BECOME VP's

The NASD Board recently appointed five key staff executives to the position of vice president. The new vice presidents are: George Bergen, District Director of the Association's New York regulatory region; Ralph E. Burgess, Chief Economist; V. Reed Manning, Technical Consultant on NASDAQ; A. John Taylor, Director of the Variable Contracts Department; and George E. Warner, Director of the Corporate Finance Department.

George Bergen's long service with the NASD, dating back to 1950, includes positions as Assistant Secretary and Secretary of the Uniform Practice Committee, Assistant Secretary of the Investment Companies Committee and Secretary for the Ohio District regulatory office. Since 1957, he has been the Director of District 12, the NASD's largest regional office which includes the states of New York, Connecticut and northern New Jersey.

As Chief Economist for the NASD, Ralph Burgess was given the primary responsibility for the supervision of various Association studies involving economic and statistical analysis. Important among these is the current mutual fund study. In addition, Burgess has been supervising the study of the impact of the inclusion of listed securities on NASDAQ.

Prior to joining the NASD in 1967, he served as Chief of Economic Policy

Research for the Securities and Exchange Commission. He is a Fellow of the American Statistical Association and a Fellow and Executive-Treasurer of the National Association of Business Economists.

Since December of 1970, Reed Manning has been advising the NASD staff on the technical aspects of the operation of NASDAQ. As chief communications advisor for Arthur D. Little, Inc., which was assigned the task of developing a system for automating the OTC market, he was instrumental in conceiving the NASDAQ system. In his new position as vice president, he will continue to work with the technical end of NASDAQ, including the development of additional services. Manning is a Senior Member of the Institute of Electrical and Electronics Engineers.

John Taylor joined the NASD staff in 1969 as Director of the newly established Variable Contracts Department, which was formed to aid the Association in regulating the insurance industry's marketing of equity products. Taylor had previously been Assistant Vice President of the Participating Annuity Life Insurance Company, a subsidiary of Aetna Life and Casualty. In the past few years he has been a featured speaker at the 1971 convention of the National Association of Life Underwriters, the 1971 American Life Convention Legal Seminar, the 1969 convention of the Legal Seminar, and the 1969 convention of the Life Insurance Agency Management Association.

In the nine years that he has been with the NASD, George Warner has served as Assistant in the Underwriting Department, Assistant Treasurer, and most recently, Director of Corporate Financing. As Vice President of Corporate Financing, he will continue to supervise the Association's review of arrangements of member firms for the underwriting and distribution of securities issues. These reviews are conducted to determine if the underwriting arrangements adhere to the Association's Rules of Fair Practice.

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