



*To NASD Members and Registered Representatives*

**NEW MEMBERSHIP  
STANDARDS PROPOSED**

In September, the Association issued for comment several proposed rules designed to combat the problems of inexperience and questionable business management in some new broker/dealers. One of the rules, a proposed amendment to the Association's By-Laws, would bar an officer, director, general partner or controlling person of a firm in liquidation by the Securities Investor Protection Corporation (SIPC) from the securities business. The Board of Governors could approve exceptions to this rule if they find that employment of such a person would not be contrary to the public interest. The remaining rule proposals would impose a strict pre-admission and qualification procedure for potential members of the Association.

Recent SIPC statistics point out the problem of inexperience in some new broker/dealers. For example, of the firms placed in SIPC liquidation as of June of this year, 77% were in business less than five years; 65% less than four years; and 53% less than three years. To a large extent, the failure of these new firms was due to inadequate experience and poor management. Many of these firms were simply ignorant of brokerage accounting and regulatory rules. However, it was also found that principal officers of a few firms in SIPC liquidation were immediately starting new firms, occasionally setting up the new firm prior to the failure of the old one.

Under the proposed entry standards, each new applicant firm must have at least two officers or partners who have qualified to become registered principals. In addition, at least two officers or partners must have had at least three years' prior experience within the preceding five years, with a broker/dealer in a managerial or supervisory capacity. A waiver of this experience requirement may be obtained in exceptional cases—for example, if the individual's general business experience and background merit it, and such a waiver is in the public interest.

All new member applicants would be required to attend a formal pre-membership interview to demonstrate their ability and qualifications. The information generated by the interview would enable the NASD to determine that the applicant's business activities are consistent with and restricted to his abilities.

The criteria evaluated by the NASD in determining the permitted business activities of an applicant would, under the proposals, include among other things: (1) overall knowledge and facilities for running a profitable broker/dealer operation; (2) ability to compute all capital and reserve requirements; (3) thorough understanding of record keeping requirements; (4) satisfactory written supervisory procedures; (5) a flexible plan of operation allowing the applicant firm to deal with changes in capital, personnel and office space requirements during the first year of operations.

The pre-membership interview and review of the membership acceptance criteria would be undertaken by the NASD staff. These recommendations would be reviewed by the District Committee on each of the Association's thirteen geographical districts. Each applicant would have the right to appeal to the Association's Board of Governors. Subsequent appeals could be made to the Securities and Exchange Commission, and then finally the courts.

The proposed entry standards program is not designed to deny Association membership to interested firms. Rather, its purpose is to restrict a firm's operations to the capabilities of the individuals which make up the management and staff of the applicant firm. Thus a firm could conceivably be limited, because of the background and experience of its management team, to the distribution of mutual fund shares only. Or the qualifications of the individuals associated with the applicant may indicate the firm is not qualified for membership in the Association at all.

It is anticipated that these new rules will become effective early in 1974.

## **NCC IMPLEMENTS FREE ACCOUNT MODIFICATION**

The National Clearing Corporation has recently implemented a major modification to its continuous net settlement system to provide for a more complete accounting service to its Clearing Members. Known as the free account net settlement system (FANS), this modification is an important step towards a depository interface.

Previously NCC had physically delivered securities, as they were received, to Clearing Members to whom these securities were owed. Under the free account modification, NCC allocates securities received to a Clearing Member's free account by bookkeeping entry. The actual certificates are retained by NCC, eliminating any unnecessary physical movement of certificates not needed by Clearing Members. If certificates are needed, they can be ordered out of the free account by the Clearing Members. Those Clearing Members who desire to continue to receive all securities allocated to them have been provided with an "automatic" order out option.

Market makers and large retail firms will have the option to have NCC automatically apply securities in the Member's free account to cover short positions—in essence, automatic delivery by bookkeeping entry.

Another option available permits a Clearing Member to apply its free account securities to cover short positions on a selective or journal basis. The Clearing Member can, of course, elect to cover its short positions through physical delivery and maintain any free account security balances.

Clearing Members receive daily reports detailing the allocations and bookkeeping entries. Computer output (in the form of punch cards or magnetic tape) is also available upon request detailing the securities in a Member's free account.

The free account modification represents a major step toward the further immobilization of securities. In order to further this important industry goal, and at the request of its Clearing Members who are also members of the Depository Trust Company (DTC), NCC has established a pilot interface through use of NCC's membership at DTC. This interface is now being expanded and a joint NCC/DTC automated development project is under way.

This development project will accomplish the following:

- Allow deliveries through DTC versus a Clearing Member's CNS account.
- Allow deliveries through NCC versus a DTC Member's account.
- Allow a Member of both NCC and DTC to maintain a Free Account in any cleared security either at DTC, at NCC, or at both.
- Allow NCC Clearing Members who are not DTC participants to deliver or receive securities free or valued to the total DTC membership. This option will also be available to any DTC member who is not a member of NCC.
- Allow NCC to deposit at DTC all securities not required for current order out requests when such securities are eligible at DTC.

The planned implementation date for this interface is May, 1974.

While these important system modifications are being made, NCC is con-

tinuing its national expansion. The NCC clearing network was expanded in September with the addition of another regional clearing center in Dallas, Texas. The nine NCC clearing centers (the other are: New York, Boston, Philadelphia, Chicago, Atlanta, Milwaukee, St. Louis, and Washington, D.C.) currently serve nearly 300 Clearing Members. In addition, broker/dealers in cities that are not yet part of the network, also participate through a variety of agency and correspondent arrangements through other Clearing Members. In the future, NCC plans further expansion of its clearing network. Minneapolis is the next scheduled center which is expected to be operational in January, 1974.

## **SURVEY RE CUSTOMER PROTECTION RULE**

In an effort to assist the Securities and Exchange Commission, the Association is requesting comments from its members on the effectiveness and workability of the SEC's Rule 15c3-3, which has been in effect for approximately eleven months. The SEC's stated objective in instituting Rule 15c3-3 was "the elimination of the use by broker/dealers of customer funds and securities to finance firm overhead and such firm activities as trading and underwriting." To achieve this goal, the Commission, working with the industry, designed two basic provisions to the rule. The first deals with a broker/dealer's obligation to promptly obtain possession or control of customers' fully-paid and excess margin securities. The second is a requirement that broker/dealers maintain a Special Reserve Bank Account in an amount equal to the total of all funds which have customers' assets as their source (i.e. customers' credit balances held by the firm or cash realized through the utilization of customers' securities) minus customer-related debits.

In announcing the adoption of the rule, which became effective on January 15, 1973, the Commission stated "The operation of Rule 15c3-3 will be carefully monitored by the Commission to determine whether there will be need in the public interest for the protection of investors to tighten or relax any of the restraints and time frames embodied in the rule." To assist the Commission in fulfilling its objective, the NASD is conducting a survey of all members to obtain comments and suggestions pertaining to the requirements of the rule. More specifically, the Association requested the submission of comments covering, at a minimum, the following areas:

1. Provisions of the rule which are considered either inadequate or unnecessary for the protection of customers' funds or securities; an explanation of such and alternative suggestions, if any;
2. Requirements of the rule which are believed to be unduly burdensome in relation to the level of customer protection achieved; and,
3. Provisions of the rule or interpretations thereof which have been found to be either ambiguous or questionable as to application and/or intent.

Comments and alternative suggestions regarding all aspects of the rule are welcomed.

A summation of the views and comments as expressed by the membership will be forwarded to the Commission at the conclusion of this survey. To determine the true impact of the rule and to insure that the rule functions in a manner consistent with its intended purpose, total participation and cooperation from the membership is necessary.

Comments should be mailed by December 20, 1973 to:

National Association of Securities Dealers, Inc.  
Department of Regulatory Policy and Procedures  
1735 K Street, N.W.  
Washington, D.C. 20006

## BONDING RULE ADOPTED

The Association has recently announced the adoption of a new rule concerning mandatory fidelity bonding for NASD members, which was approved by the membership and submitted to the Securities and Exchange Commission earlier this year. When announcing that it did not disapprove of the rule, the SEC stipulated that the Association develop and adopt by March 1, 1974 a plan to ensure that no member subject to the rule will be excluded from the securities business merely because it cannot obtain a fidelity bond at reasonable cost. The Association has already taken steps to develop a plan acceptable to the Commission; therefore, the rule will be declared effective as of March 15, 1974.

Under the rule, those members who are required to join the Securities Investor Protection Corporation, are subject to the SEC net capital rule, and have employees will be required to carry a blanket fidelity bond. This bond, covering officers and employees, is to provide against loss in the following areas: (1) Fidelity; (2) On Premises; (3) In Transit; (4) Misplacement; (5) Forgery and Alteration, including check forgery; (6) Securities Loss, including securities forgery; and (7) Fraudulent Trading.

Coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration together must be 120 percent of the member's required net capital up to \$600,000. The highest required net capital during the twelve months immediately preceding issuance of the bond will be the basis for determining the amount of the bond. If a member's required net capital is in excess of \$600,000, coverage for these five areas will be determined by the following table:

<i>Net Capital Requirement under Rule 15-c3-1</i>	<i>Minimum Coverage</i>
\$ 600,001- 1,000,000	\$ 750,000
1,000,001- 2,000,000	1,000,000
2,000,001- 3,000,000	1,500,000
3,000,001- 4,000,000	2,000,000
4,000,001- 6,000,000	3,000,000
6,000,001-12,000,000	4,000,000
12,000,001-and above	5,000,000

The bond for these five areas must be at least \$25,000.

Fraudulent Trading coverage must be at least \$25,000 or fifty percent of the requirement for the first five categories, whichever is greater, up to a maximum of \$500,000. Coverage for Securities Forgery must be at least \$25,000 or twenty-five percent of the coverage required for the first five categories, whichever is greater, up to a maximum of \$250,000.

The bond may include a deductible provision of \$5,000 or ten percent of the minimum bond requirement, whichever is greater.

The Association is currently working with the insurance industry to develop a plan to cover those members of the Association who cannot obtain bonds through the normal commercial channels.

Following are definitions of the seven areas of coverage:

Fidelity: Loss through any dishonest or fraudulent act of an employee.

On Premises, In Transit, Misplacement: Loss of any covered property through robbery, burglary, theft, hold-up, damage or mysterious or unexplained disappearance while the property is within a member's office or other offices; and any loss of or damage, except by fire, to any of a member's offices, furnishings, fixtures and equipment, losses of insured classes of property while in transit.

Forgery and Alteration: Loss through forgery or alteration of checks, drafts, or other written promises or through losses caused by impersonation.

Securities Loss: Losses caused by a member in good faith dealing in counterfeit, forged, or stolen securities or currency or through guaranteeing or witnessing signatures that are forged or altered.

Fraudulent Trading: Losses due to fraudulent trading in a customer's account.

## OFFICERS FOR '74

The Association's Board of Governors has nominated David R. Murphey, III, President of Pierce, Wulbern, Murphey, Inc., Tampa, Florida, as Chairman of the NASD Board for 1974.

Other officers nominated for 1974 are: Junius W. Peake, Vice President—Policy Planning, Pershing & Co., Inc., New York City—Vice Chairman; Joseph P. Short, Managing Partner of Arthurs, Lestrangle & Short, Pittsburgh, Pennsylvania—Vice Chairman; and Bernard Weissman, Chairman of the Board and Secretary-Treasurer of Gold, Weissman & Frankel, Inc., New York as Chairman of the NASD Finance Committee. The new officers will formally assume their duties in January of 1974.

David Murphey, a member of the NASD Board, has served the Association this year as Chairman of the National Business Conduct Committee. Formerly, he served on the Association's District Committee #7, of which he was Chairman. District #7 encompasses Florida, Georgia, South Carolina, part of Tennessee, Puerto Rico, the Canal Zone and the Virgin Islands.

Murphey has also served on the Association's Free-Riding Interpretation Committee, and is currently a member of the NASD's Executive Committee and the Chairman of the Municipal Securities Committee. He is active in numerous civic and business organizations.

Junius (Jay) Peake is currently on the National Clearing Corporation's Board of Directors (NCC is a wholly-owned subsidiary of the NASD and is engaged in clearing OTC transactions) as well as having been on the NASD Board. He serves on the Executive Committees of both organizations. He has been a member of the NASD's District #12 Committee (New York City and surrounding area) and the National Business Conduct Committee. In addition, he has served on the National Uniform Practice Committee, the Automation Committee, the Advisory Panel of the National Clearing Corporation, the Committee on Entry Standards, the Arbitration Committee, and the Municipal Securities Committee. He has also been active in affairs of the American Stock Exchange, the American Bankers' Association, the Securities Industry Association, and is a member of the Bond Club of New York. He has testified before both Houses of Congress and the Securities and Exchange Commission regarding operational problems in the securities industry.

Peake, who lives in Tenafly, New Jersey, is a member of the Englewood Field Club, a former Chairman of the Tenafly Community Chest and a Trustee of Englewood Hospital in Englewood, New Jersey.

Joseph P. Short became a member of the NASD's District Committee #11 (Delaware, Pennsylvania, West Virginia, New Jersey) in 1969 and served as Co-Chairman of that Committee in 1971. He has been a member of the National Business Conduct Committee, serving this year as Vice Chairman. Short is also a member of the Bonding Coverage Committee, the Finance Committee, and the Committee on New Issues.

Short is a member of the Bond Club of Pittsburgh, the Duquesne Club, and the Fox Chapel Racquet Club.

Bernard Weissman, who resides in Hastings-on-Hudson, New York, has served the Association in numerous capacities. He was a member, later Vice-Chairman, of the Association's District #12 Committee. In addition, he has been a member of the NASD Board, the National Business Conduct Committee, the Committee on Entry Standards, the NASDAQ Committee, the Financial Reporting Committee and the Association's Sub-Committee on the Securities Investor Protection Corporation.

Weissman's main area of expertise is trading, and he is a member of the National Security Traders Association and the Security Traders Association of New York, serving as President of the latter group in 1968. He is also a member of the American Stock Exchange Arbitration Panel.

In his community, he is on the Planning Board and Treasurer of the Institute of Society, Ethics and the Life Sciences.

## **WHEAT ELECTED GOVERNOR AT-LARGE**

Francis M. Wheat, partner in the Los Angeles law firm of Gibson, Dunn & Crutcher and former member of the Securities and Exchange Commission, has been elected Governor-at-Large of the Association. The Board of Governors elected him unanimously to fill the unexpired term of A.A. Sommer, Jr., who had resigned to become an SEC Commissioner. Wheat, therefore, will serve as Governor until January 1976.

Wheat joined Gibson, Dunn & Crutcher in 1948 upon graduating cum laude from Harvard Law School. In 1964 he left the firm to serve a five year tour of duty as an SEC Commissioner. Upon leaving the Commission in 1969, he returned to the Los Angeles law firm.

A distinguished lawyer, Wheat has a solid background in corporation, business and securities law, including the registration of securities for public offering under the Securities Act of 1933. He is the author of the "Wheat Report," an appraisal of federal administrative policies under the '33 and '34 Securities Acts, as well as articles on various aspects of the securities business and its regulation, both under federal and state law.

Currently he is a member of the American Law Institute, the American Judicature Society, the American Bar Association, and the California State Bar Association. He is Vice President of the Los Angeles County Bar Association, and a member of the Advisory Council of Financial Accountings Standards Board.

Wheat also serves as Vice Chairman of the Board of Trustees, Pomona College; Member, Committee of Visitors, Harvard Law School; and Director, Greater Los Angeles Urban Coalition.

"The NASD is fortunate to have Frank Wheat on its Board," commented NASD President Macklin. "He has a proven inclination for public service and will be a helpful and constructive contributor to NASD policy."

## **GROUP INSURANCE EXPANDED**

The Insurance Trust is currently embarked on a major program to acquaint the NASD membership with its new, up-graded life and health plans. For this purpose members may now request quotations to compare the new rates and new benefits against their own plans.

### **NEW UNLIMITED MAJOR MEDICAL MAXIMUMS**

Greatly improved group health plans with *unlimited* major medical maximums and a "Stop-Loss" provision (which puts a ceiling on the amount of out-of-pocket expense borne by the individual) have been added. Substantial savings in costs may also be possible, depending on the plan selected.

Variations in medical costs between geographic areas are automatically taken into consideration in both benefits and premium rates, making the new plans especially suitable for firms with multiple locations. If desired, the plans can be tailored to supplement local Blue Cross and Blue Shield plans.

### **LIFE MAXIMUM RAISED TO \$100,000**

In the Group Life Insurance Program, a firm with 35 or more employees may now be covered under a new schedule which offers a benefit equal to two times annual earnings up to a maximum of \$100,000, state law permitting. For firms with 10 to 34 employees, the maximum is \$50,000; for firms with under 10 employees, it is \$25,000. All schedules include matching Accidental Death & Dismemberment coverage.

In the 25 years that the NASD has sponsored low-cost group insurance to its membership, its programs have paid more than \$27,000,000 in benefits and returned over \$6,000 in dividends to participating firms. To obtain descriptive literature or a quotation, write or telephone:

NASD Insurance Trust  
Group Administrative Office  
2021 K Street, N.W.  
Washington, D.C. 20006  
(202) 822-1884