

NASD

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ENTRY STANDARDS TO BE STRENGTHENED

If the NASD membership approves a recently submitted By-Law amendment, the Association will have authority to disqualify individuals responsible for the liquidation of a broker/dealer under the auspices of the Securities Investor Protection Act (SIPA). The proposal is part of the Association's comprehensive package covering standards of entry into the securities business which was first proposed in September of last year.

The Association has long been concerned about the adequacy of industry entry standards, including those for admission to NASD membership. More recently, information generated by a study of broker/dealers that had been liquidated by the Securities Investor Protection Corporation (SIPC) gave the Association pertinent guidance on areas that needed strengthening. It was determined that many of the broker/dealers which ended in SIPC trusteeship were managed by inexperienced or incompetent personnel. Further, all too often fraudulent management activities contributed directly or indirectly to the firm's demise. Yet, many of these individuals continued to engage in the securities business. There were a few occasions in which the principal officers of firms in SIPC liquidation immediately started new firms, in some instances actually setting them up prior to the failure of the old ones. Other times, the principal officer registered immediately with an existing firm and continued in the securities business.

To curtail this business-as-usual arrangement, the NASD's suggested By-Law change would enable the Association to disqualify a person who had been an officer, director, general partner, controlling person or part of the management or supervisory personnel of a firm within three years of the firm's liquidation through a SIPA proceeding. The amendment also provides that a member employing a person so disqualified will itself be disqualified from membership. New firms will not be admitted to membership if they have any disqualified individual associated with them.

Also contained in the By-Law amendment is a set of criteria for determining disqualification. When considering whether the disqualification is in the public interest, the Association will consider: (1) circumstances surrounding the financial or operational difficulties of the broker/dealer which led to SIPA proceedings; and (2) the involvement of the individual in the activities causing these financial or operational difficulties. The proposed amendment stipulates that if there has been no involvement by the individual in the activities which resulted in a SIPA proceeding, that individual will not be disqualified.

An individual who has been declared unqualified under the proposed By-Law amendment may apply to the Association for reconsideration within thirty days, and request a hearing if he chooses. In addition, he may apply to the NASD President for a stay of the effectiveness of the disqualification. In determining whether to grant the stay, the Association President will use the same criteria used in determining the disqualification, coupled with Association records and any other information deemed pertinent. If the stay is denied, the hearing for reconsideration of disqualification must be held within 45 days of the denial. A final decision must then be reached within 60 days of the hearing.

Finally, the proposed change includes a two year "statute of limitations." The determination of disqualification must be made and sent no more than two years from the date of institution of SIPA proceedings.

Once made, the disqualification determination will remain effective until it is altered, modified or rescinded by the Board of Governors upon finding that any of these actions would not be contrary to the public interest. However, any applicant dissatisfied with the Association's action may apply to the Securities and Exchange Commission for review.

The final voting date is May 27, 1974.

NASDAQ INCLUSION FEES

The Association has adopted a plan to levy issuer fees on corporations whose securities are quoted in the NASDAQ system. In a letter, dated April 1, seeking comments from all interested parties, the Association noted that the stature of the over-the-counter market had been greatly improved by the sophisticated surveillance mechanism and growing visibility for over-the-counter securities brought about by the NASDAQ system. To date, all costs associated with the development, operation and regulation of the NASDAQ market have been borne solely by the broker/dealer members of the NASD. Now that the system has been established and the regulatory mechanism in place, the Association believes that it is reasonable to have NASDAQ companies participate to a limited extent in sharing those costs which directly relate to the operation and regulation of the NASDAQ market.

To this end, the NASD's Board has adopted the imposition of fees, to be levied annually, on the basis of 1/20 of one cent per share for each issue, with a minimum of \$250 per issue and a maximum charge to each issuer of \$2500.

Since the NASDAQ system began operations in February, 1971, its growth has raised the stature of the over-the-counter market in a number of ways. Its facilities make current quotations on NASDAQ securities available instantaneously throughout this country and much of the free world in such a way that the investor has reasonable assurance of securing the best possible execution of his OTC transaction. The development of NASDAQ has resulted in the daily publication of an increased number of quotations of OTC securities in a growing number of newspapers. Further, NASDAQ has provided volume statistics on OTC issues. Never before was there such a yardstick for measuring trading activity in the OTC market. In addition, the NASDAQ system has enabled the NASD to release comprehensive and accurate stock price indices on major groups of the OTC market. Finally, the data processing capabilities of NASDAQ have enabled the NASD's Market Surveillance Department to utilize a sophisticated regulatory mechanism to protect investors in NASDAQ securities.

The Association anticipates that annual issuer fees will average less than \$1,000 per company, with many companies paying less than \$500. Implementation of the fee schedule is pending official non-disapproval from the Securities and Exchange Commission.

EXCESS-SIPC INSURANCE COVERAGE A POSSIBILITY

The Association is encouraging the availability of a group insurance policy which would extend coverage over that offered by the Securities Investor Protection Corporation (SIPC) to customers of NASD members. While discussions have been

underway for some time with a leading insurance broker, the NASD has recently supplied them with a detailed breakdown of its examination and enforcement procedures. This document is designed to aid the insurance broker in laying the groundwork for the drafting of the excess-SIPC insurance policy.

Since the late 1970 passage of the Securities Investor Protection Act, customer accounts have been insured up to \$50,000. Protection for cash is limited to \$20,000 per account. Within the past year, several larger broker/dealers have acquired insurance to cover their customers' accounts in amounts well in excess of that supplied by SIPC. The Association believes that making similar insurance coverage available to broker/dealers of all sizes will be beneficial to investor confidence in the entire financial community.

In its discussions with insurance representatives, the NASD has pointed out that: (1) it has substantially upgraded its surveillance techniques and personnel to the point that any broker/dealer approaching financial difficulty would now be identified at a very early stage, thereby minimizing exposure to underwriting risk; (2) entry standards are about to be imposed making re-entry to the securities business extremely difficult for persons responsible for a firm's failure; (3) a program will soon be instituted restricting the activities of new firms to those areas where they can clearly demonstrate experience and competence; and (4) the recent imposition of mandatory fidelity bonding requirements for all NASD members has served to enhance the financial stability of member broker/dealers.

DUPLICATION IN REPORTING TO BE EASED

Responding to a Securities and Exchange Commission request, the Association recently sent the SEC its suggestions for the format and content of an omnibus regulatory report to be known as the Key Regulatory Report (KRR). In January, the Commission proposed the concept of a Key Regulatory Report, to replace several reports currently in use, as a step toward the reduction of duplication in broker/dealer reporting requirements.

Employing the concept of layering, the proposed report, as envisioned by the SEC, would require increasing amounts of information and detail of information as the scope and complexity of a broker/dealer's operations increased. Working with this concept, the Association has sent the SEC a detailed draft report. Basically, the Association proposes that the KRR consist of three separate sections. Each succeeding section would require more information than the one preceding it, and each broker/dealer would be required to file only one of the sections—that applicable to his type of operation. The KRR has been designed to be filed quarterly, complemented by a monthly summary financial and operational report of the Form M type currently employed by the NASD.

Part I of the Association's proposed KRR would be filed by introducing broker/dealers, special products members, insurance product members, investment company share distributors and mutual fund and/or variable contracts retailers. These firms (approximately 1200 NASD members) generally do not hold customers' funds or securities. This section of the KRR would contain a statement of financial condition, a net capital summary, an income and expense statement, an annual income reconciliation and self-regulatory assessment payment schedule, and

a series of supporting schedules. Also included would be a SIPC-3 Form (certification of exclusion from membership in SIPC) or a SIPC-6 Form (quarterly general SIPC assessment payment), as applicable.

Although based on the NASD's Form Q, Part I of the KRR would require somewhat less detail of information than is currently required for this type of member. Further, in drafting its proposed KRR, the Association has followed the recommendation of the SEC Advisory Committee Study that the supporting schedules be filed on an exception basis only. Members would be instructed to file these schedules only when specified financial or operational parameters are exceeded. The Association feels that this procedure would radically decrease the time and money spent by this segment of the industry in report preparation.

Part II of the NASD's draft KRR would be filed by all self-clearing general securities dealers who are either sole NASD members or members of national securities exchanges other than the New York (NYSE) or American (AMEX) Stock Exchanges. While the format to this section would be identical to Part I, the detail of information required would be more extensive. This is primarily due to the additional customer exposure and expanded operation of the firms which would be filing this report.

Finally, the Association has suggested that something approaching the NYSE's current Joint Regulatory Report be used as Part III of the Key Regulatory Report. This section would be filed by NYSE and AMEX members and, perhaps, by certain other NASD members whose operation, product mix and potential customer exposure require more detail than that contained in Parts I or II.

Use of the KRR, in conjunction with a monthly Form M type report as proposed by the NASD, could result in a significant reduction in the number of reports required of broker/dealers. As drafted by the Association, the KRR would replace Form Q, currently employed by the NASD for quarterly financial information. The Joint Regulatory Report, now used by the New York and American Stock Exchanges, could be replaced by Part III of the KRR. The Association also feels that appropriate use of the KRR, including certification by an independent accountant, could eliminate the need for the annual reporting forms, Form X-17A-5 (financial condition) and Form X-17A-10 (income and expenses). Incorporation of SIPC Forms into the KRR would obviate the need for separate filing of this material by broker/dealers.

NEW BOARD MEMBERS TAKE OFFICE

Nine industry leaders took office in January to serve on the Board of Governors for three-year terms. The new Governors are:

Nelson S. Burbank—Burbank and Company
Peter J. Eichler—Bateman Eichler, Hill Richards, Inc.
Wesley E. Horton—Colonial Management Associates
E. Richard Larson—Richards, Merrill & Peterson, Inc.
Alfred J. Rauschman—Reynolds Securities, Inc.
George Rinker, Jr.—The Ohio Company
Ian M. Rolland—Lincoln National Life Insurance Company
Robert W. Swinarton—Dean Witter & Company, Inc.
Richard D. Vermillion—Smith Barney & Company

Nelson S. Burbank, President of Burbank and Company in Boston, Massachusetts, has been elected to represent District #13 on the Association's Board of Governors. Burbank, who served last year as chairman of the NASD District #13, attended Brown University before entering the securities business in 1946. He established his own firm in 1953 and is a past Chairman of the Board of Governors of the Boston Stock Exchange, Burbank is a trustee for the Reading Savings Bank and Director of Health Insurance of Vermont, Inc.

Peter J. Eichler, who has served on the NASD's District Committee #2, is Executive Vice President of Bateman Eicheler, Hill Richards, Inc. in Los Angeles, California. He is a member of the Stock Exchange Club in Los Angeles and the Bond Club of Los Angeles, as well as being active in other community activities. After graduation from Claremont Men's College, he began his brokerage career with Union Securities in New York in 1950. He has been elected to represent District #2.

E. Richard Larson, Executive Vice President and Secretary with Richards, Merrill & Peterson, Inc., Spokane, Washington, has been a member of NASD District #1. A University of Idaho graduate, he began working for Richards, Merrill and Peterson, Inc. in 1947. He has been the Chairman of the Pacific Northwest Group of the Securities Industry Association as well as being a past President of the Spokane Stock & Bond Club. In addition to serving on the NASD District Committee, Larson has been a member of the NASD National Capital Standards Committee since 1970. He represents District #1.

Alfred J. Rauschman, Vice President and Director of Compliance for Reynolds Securities, Inc., New York City, was elected from the Association's District #12 region. Rauschman, who was chairman of the Association's District Committee in 1973, is a graduate of the Citadel in Charleston, South Carolina, and St. John's University School of Law. He entered the securities business in 1956 and is a member of the Bankers Clubs of America and the Catholic Lawyers Guild.

George Rinker, Jr., Executive Vice President of The Ohio Company, Columbus, Ohio, was graduated from Capital University in Columbus and began working for his current company in 1942. He was a member of the NASD District Committee #9, serving as Chairman in 1971. Rinker has been a Treasurer, Vice Chairman and Chairman of the Ohio Valley Group of the Investment Bankers Association, as well as serving on other IBA committees. He is a representative of District #9.

Robert W. Swinarton, formerly a member and Chairman of NASD District Committee #12, is Vice-Chairman of the Board and a Member of the Executive Committee of Dean Witter & Co., Incorporated. He has been active in the IBA, the SIA, served on the advisory committee for the Federal National Mortgage Association, and is a member of both the Bond Club of New York and the Municipal Club of New York as well as belonging to many other professional and community groups. He was graduated Summa Cum Laude from Washington & Lee University in 1950, the year when he also began his career with Dean Witter. Swinarton also represents District #12 on the Board.

Richard D. Vermillion, Vice President and Resident Manager of Smith Barney & Co., Milwaukee, Wisconsin, served in 1972 as Chairman of District #8. He was graduated from the University of Virginia and then began his career

in the securities business in 1946 with Ketcham & Nongard in Chicago, Illinois. President of the Milwaukee Club, Vermillion is also active in other community organizations. Vermillion has been elected to represent District #8.

In addition, the NASD has elected two governors-at-large to the Board. Wesley E. Horton, President of the Distributor Division of Colonial Management Associates, will represent the mutual fund industry on the NASD Board. Ian M. Rolland, Senior Vice President, Lincoln National Life Insurance Company, has also been elected as a governor-at-large.

Horton, whose company is located in Boston, Massachusetts, is a graduate of Northeastern University and is a Certified Public Accountant. He is a member of the Investment Companies Committee of the Securities Industry Association. He has been active in the NASD since 1969, when he became a member of District Committee #13, which he chaired in 1971. He is currently a member of the NASD Investment Companies Committee.

Rolland, who is from Fort Wayne, Indiana, is a graduate of De Pauw University and received his Master's degree from the University of Michigan. He is a member of the Board of Governors of the Society of Actuaries, the American Academy of Actuaries, the Actuaries Club of Indiana, Kentucky, and Ohio, and a member of the American Life Insurance Association's Variable Contracts Committee. He is also a member of the NASD Variable Contracts Committee since 1969.

SERVICE BUREAUS UNDER REVIEW

NASD members who rely on back office bureaus to provide recordkeeping services were cautioned recently to satisfy themselves of the financial stability and future viability of their service bureau suppliers. Last summer the Association learned that some service bureaus had been incurring steady losses because of the decline, at that time, in the transaction volume of users. In one case, the situation had become so severe that the service bureau's hardware supplier began legal action to repossess its equipment.

It is the broker/dealer's obligation to maintain current and adequate books and records even though the firm has contracted with a service bureau to perform some or all of its recordkeeping requirements. Failure by the service bureau to provide necessary records could place the broker/dealer in violation of Rules 17a-3 and -4 of the Securities Exchange Act of 1934. Conceivably, a member could be forced to cease all operations immediately if its service bureau did not perform.

Recognizing the dependency that the brokerage firm subscriber must necessarily place in a service bureau, the Association conducted a nationwide study to determine the full extent of the problem. Nearly all service bureaus in the country were contacted. Investigations covered, among other things: capital structure, cash flow, contractual commitments with suppliers, compatibility with competitive systems, and the diversification of clientele.

Study results indicated that unregulated service bureaus, particularly those exclusively geared to the brokerage community, can pose a serious threat to the continued operation of broker/dealer subscribers during periods of declining transaction volume. An abrupt cessation of a subscribing broker/dealer's operations could affect members dealing with that firm and the public as well.

The study concluded that regulation of service bureaus is essential and recommended that the Securities and Exchange Commission seek legislation to achieve that result. An interim system of regulation of service bureaus, through rules directed at members who use third party recordkeeping services, was also recommended. The development of these rules is currently in progress.

Finally, the study recommended that NASD members be notified of the hardships that could be encountered if their service bureau fails to provide the required books and records. This recommendation has been carried out. In its letter to the membership, the Association suggested that members review the background of their existing or prospective service bureaus. Members were also encouraged to request sufficient current information to properly evaluate the service bureau's current financial condition, the nature of its facilities and equipment, and arrangements for back-up facilities in the event of an interruption in service.

'73 YEAR END STATISTICS

Trading volume on NASDAQ, the automated quotations system for the over-the-counter market, averaged 6,566,656 shares per day in 1973 compared with 8,850,000 shares per day in 1972. Total aggregate volume on NASDAQ reached 1.7 billion shares in 1973, compared to 770 million shares on the American Stock Exchange and 4 billion shares on the New York Stock Exchange in 1973.

Reflecting the generally weak market conditions, all leading stock market averages had registered substantial losses in 1973. Two averages measuring performance of the over-the-counter securities markets, the NASDAQ Composite Index and the National Quotation Bureau Industrial Index, declined 31% and 25% respectively.

The Dow Jones Thirty Industrials closed 16.6% lower on the year, while the New York Stock Exchange Index and the Standard and Poor's 425 Industrial Average, both broader indices of stocks on the New York Stock Exchange, lost 19.6 and 17.4% respectively. The Amex Index declined 30% for the full year.

Statistics covering the operations of the NASDAQ system show that 2,932 securities were quoted in the system at year end 1973 compared with 3,486 issues at the end of 1972. Also, at December 31, 1973, there were nearly 500 active market makers in the system with an average of 4.8 market makers per security. Market makers are firms which continuously quote and stand ready to buy and sell a security at any time. There were 632 market makers with an average of 5.7 per security at the end of 1972. Quotes were available through over 30,000 terminals used by registered representatives and the public, institutions and large traders, and by market makers.

A full comparative quarterly table of the leading market indices as well as year end comparative data on NASDAQ statistics follows.

	Quarterly Comparison of Market Indices						Changes	
	1972	1973						
	12/29	3/30	6/29	9/28	12/31	4th Quar.	Year	
NQB Industrials	639.49	602.76	515.72	623.95	476.46	-23.7	-25.5	
NASDAQ Industrials	132.41	113.37	92.82	107.01	83.57	-22.0	-37.0	
NASDAQ Composite	133.73	117.46	100.98	111.20	92.19	-17.1	-31.1	
DJI (NYSE)	1020.02	951.01	891.71	947.10	850.86	-12.7	-16.6	
S&P 425 (NYSE)	131.87	125.00	116.72	121.58	108.95	-10.4	-17.4	
NYSE (Industrials)	70.33	65.52	60.13	64.65	56.60	-12.5	-19.6	
AMEX (Price Index)	129.05	108.94	92.62	105.41	90.33	-14.3	-30.1	

TAX SHELTER FILINGS

As the following chart indicates, the total number of tax shelter filings for the first quarter of 1974 is approximately thirty percent less than the number filed in the first quarter of 1973. The total amount of dollars registered is also off by about 30% from the same period last year.

NASD TAX SHELTER FILINGS

Product	1973 1st Quarter		1974 1st Quarter	
	Number	Dollars Registered	Number	Dollars Registered
Oil & Gas	60	\$306,543,650	35	\$266,146,460
Real Estate	29	193,824,052	31	144,888,700
Vintage & Farming	3	9,426,380	1	4,600,000
Cattle Feeding & Breeding	6	41,715,000	2	8,000,000
Miscellaneous *	6	131,700,000	4	57,900,000
Total:	104	\$683,209,082	73	\$481,535,160
REIT's	16	\$439,929,160	2	\$ 12,000,000

The following chart compares tax shelter filings from 1970 through 1973.

NASD—TAX SHELTER FILINGS

Product	1970		1971		1972		1973	
	Number	Dollars Registered	Number	Dollars Registered	Number	Dollars Registered	Number	Dollars Registered
Oil & Gas	62	\$664,337,000	155	\$740,093,579	226	\$1,027,452,045	228	\$908,615,170
Real Estate	54	\$256,485,390	139	\$523,534,085	243	\$1,910,662,045	172	\$849,436,163.80
Vintage & Farming	3	\$10,742,000	7	\$30,226,611	21	\$43,284,834	29	\$59,894,880
Cattle Feeding & Breeding	13	\$26,764,000	22	\$244,636,000	30	\$192,012,000	47	\$329,111,000
Miscellaneous *	13	\$26,336,260	11	\$29,915,620	19	\$55,256,000	28	\$205,712,000
Total:	145	\$984,664,650	334	\$1,568,405,895	539	\$3,228,666,924	504	\$2,352,769,213.80
REIT'S	Not available		71	\$2,540,358,976	63	\$1,417,466,823	51	\$1,320,457,871

* Miscellaneous includes products such as: Cable TV, Auto Racing, Mining, Computer Leasing, Theatrical Productions, Restaurants, Commodities and many others