

NEW YORK STOCK EXCHANGE PROGRAM

The following is a general summary of a program which has been worked out with a view to affording additional protection to the members of the public in their brokerage dealings with Member Firms of the New York Stock Exchange.

(I) Capital Requirements and Segregation of Capital Employed in Firms and Partners Underwriting, Security and Commodity Positions and Commitments. A review of past failures of member firms indicates that the over-extension of security and commodity positions for firm and partners' account has been an important factor. In order to lessen the importance of this factor, it is now proposed to revise the regulations relating to capital requirements of member firms and to encourage member firms to organize separate companies, to be known as affiliated companies, for the purpose of carrying underwriting, security and commodity positions for the company's own account and for the account of the member firm's general partners.

Revised Capital Requirements

Effective April 1, 1939, no member or member firm, doing a general business with the public, except those subject to supervision by State or Federal Banking authorities, shall permit, in the ordinary course of business as a broker his or its aggregate indebtedness to all other persons, to exceed 1500 percentum of the member's or firm's working capital. In

computing the aggregate indebtedness of such members and member firms there shall be included at least the following:

- (a) All money borrowed, except borrowings subordinated to the claims of general creditors of the member or firm;
- (b) Customers' unsegregated free credit balances, and
- (c) All other obligations for the payment of money except obligations in connection with purchase commitments for securities or commodities.

In computing the working capital of members and member firms, there shall be excluded at least the following:

- (a) The value of any securities (other than United States Government securities) or commodities carried for any account in which such firm or a general partner therein has an interest;
- (b) The value of any securities (other than United States Government securities) or commodities carried for any customer's account (other than a "cash" account) which is in deficit;
- (c) The amount of any net purchase commitment for securities (other than United States Government securities) or commodities for any account in which such firm or a general partner therein has an interest, or for any customer's account (other than a "cash" account) which is in deficit;
- (d) Memberships in Exchanges;
- (e) Furniture and fixtures;
- (f) Fixed or slow assets;
- (g) Amounts owing to the member or member firm by any of his or its affiliated companies; and
- (h) Unsecured accounts receivable and deficits in accounts.

The Committee on Member Firms may, by general rule or in specific instances, make exceptions to these requirements.

### Affiliated Companies

With the prior written approval of the Committee on Member Firms members and member firms may form affiliated companies, with limited stockholders liability, for the purpose of carrying underwriting, security and commodity commitments and positions for the company's own account and for accounts in which general partners of the firm with which the Company is affiliated are interested.

The following general conditions are stated only as an indication of the general principles to be observed in the formation of an affiliated company:

(1) Form and Place of Organization – An affiliated company may be an incorporated company, a joint stock association, or a business trust, the liability of whose stockholders is limited, and it may be organized under the laws of any state of the United States of America.

(2) Name – An affiliated company may bear the name of the member or member firm with which it is affiliated with the addition of distinctive words sufficient to prevent confusion between the company and the member or firm, or it may have a name entirely different from the name of the member or firm.

(3) Classes of Stock – The affiliated company may have one or more classes of stock. Except where specifically required by law, sole voting control must under all circumstances be vested in the holders of the common stock.

(4) Stockholders – All common stock must be owned either by the member or member firm with which the company is affiliated or by the general partners of such firm in the general proportion of their profit and loss interest in the member firm. Preferred stock, non-voting under all circumstances, except where otherwise specifically required by law, may be owned by limited partners of the firm, or by persons or organizations approved by the Committee on Member Firms. If the common stock of the affiliated company is owned by the individual general partners of the member firm with which it is affiliated, such partners shall by agreement provide that the common stock holdings of a retired or deceased general partner shall be transferred to the surviving or succeeding general partners of such member firm within a reasonable time after such retirement or death.

(5) Directors and Officers – The affiliated company may have as directors or trustees and as officers only persons approved by the Committee on Member Firms.

(6) Changes in Capital or Ownership – No change may be made in the capital structure of the affiliated company or in the ownership of its stock without the prior written approval of the Committee on Member Firms.

(7) Indebtedness of Affiliated Firm – The affiliated company may borrow from or carry a debit balance with the member or member firm with which it is affiliated.

The affiliated company may not carry a short position with the member firm with which it is affiliated except in case of bona fide international arbitrage transactions in identical securities, provided the margin on any short positions is maintained.

(8) Endorsement or Guarantee – No member, firm, or any general partner therein shall endorse or guarantee any obligations of the firm's affiliated company or voluntarily assume directly or indirectly any of the liabilities of such affiliated company.

(9) Banking Commitments – The affiliated company's banking and other commitments, loans and obligations shall be kept separate and distinct from those of the member or member firm with which it is affiliated, and all agreements of the affiliated company in connection therewith shall have provisions clearly setting forth that neither the member, member firm, nor any of its partners is liable thereon in any respect.

(10) Customers' Positions – The affiliated company may not hold or carry any securities, commodities, moneys, balances, equities or commitments for customers other than the general partners in the firm with which it is affiliated, or joint accounts in which the company or one or more of the general partners in such firm is interested, and other

than items pending consummation. All accounts carried by the affiliated company shall be handled in conformity with the regulations of public authorities and the Exchange.

(11) Books and Records – The affiliated company shall keep books and records separate and distinct from those of the member or member firm with which it is affiliated and such books and records shall be made available to inspection by the Exchange.

(12) Advertising – The affiliated company will be subject to the same control of its advertising as member firms.

(13) Firm as Broker – The affiliated company may have brokerage transactions effected for its account by members or member firms but shall be charged full non-member commissions.

(14) Quarters and Personnel – The affiliated company may occupy the same quarters as the member or member firm with which it is affiliated and may use the same facilities and personnel provided a reasonable distinction is made to avoid confusion in the mind of the public as to the relationship between the two.

(15) Conditions to be complied with after organization of affiliated company, but prior to commencement of business. No affiliated company shall transact any business after its organization without the prior written approval of the Committee on Member Firms. Before giving such approval there shall be submitted to the Committee

on Member Firms an opinion of legal counsel, in form and substance satisfactory to the Committee, stating that the affiliated company is duly organized and existing, and that the restrictions hereinabove set forth with respect to voting control, change in capital structure and transfer of stock have been made legally effective

Provisions Applicable to Members and  
Member Firms Having Affiliated Companies

I. New Issues – The provisions of Section 11 (d) (1) of the Securities Exchange Act of 1934, which make unlawful the extension or maintenance of credit for a period of six months in connection with new issues, will apply to transactions by the member or member firm in new issues in the distribution of which his or its affiliated company participated with the same force and to the same extent as if the member or member firm itself had participated in the distribution of such new issues.

II. Disclosure – In connection with any transactions which the member or member firm may have with his or its customers, or any recommendation which the member or member firm may make to his or its customers involving securities underwritten, distributed or issued by his or its affiliated company full disclosure shall be made by the member or firm to his or its customers of the interest of the affiliated company in such securities at that time.

III. Severance of connection with affiliated company – The Committee on Member Firms may at any time direct that the member firm and the partners therein sever all connection with the affiliated company, and after such severance may require the member firm to change its name if the Committee finds that the name of such company may be confused with the name of such firm.



### General

The proposed amendment to the Constitution of the Exchange and the proposed new Rules of the Board of Governors are attached as Schedules A and B. The conditions relating to the formation of affiliated companies, set forth above, will be adopted as a Rule of the Committee on Member Firms. These conditions are supplemental to Section 6 of Article III of the Constitution of the Exchange, as the same will be amended, and to the proposed Rules of the Board of Governors, and in organizing affiliated companies it must be borne in mind that changes may be made in the Constitution, the Rules of the Board of Governors, or the Rules of the Committee on Member Firms relating to affiliated companies and, in such event, adjustments may have to be made in the capital structure of affiliated companies, in the activities of such companies, or in the relationship between such companies and members or member firms or the partners thereof.

## II. Prohibited Loans.

Without the prior written approval of the Committee on Member Firms, no governor, person serving on a Committee, officer or employee of the Exchange shall make any loan of money or securities to or obtain any such loan from any member, member firm, non-member partner of a member firm, or affiliated company, unless such loan be (a) fully secured by readily marketable collateral, or (b) made by a governor or committee member to or obtained by a governor or committee member from the member firm of which he is a partner, an affiliated company of such member firm, or to or from a partner of such member firm.

The proposed new Rule of the Board of Governors is attached as Schedule C.

## III. Disqualification of Governors and Committee Members.

No governor or member of any committee of the Exchange shall participate in the investigation or consideration of any matter relating to any member or member firm which is indebted to such governor or committee member, or to any of his partners or to the firm of which he is a partner, or to which he, his firm or any of his general partners is indebted.

The proposed new Rule of the Board of Governors is attached as Schedule D.

(IV) Financial Statements.

The Committee on Member Firms will call for at least the following financial statements from all members who do any securities business with others than members or member firms, from all member firms, and from all affiliated companies:

- (a) An answer to a “long form” questionnaire at least once in each year. This “long form” questionnaire will be in substantially the form heretofore used by member firms carrying margin accounts and the answer to the questionnaire will call for a detailed financial statement.
- (b) An answer to a special “short form” questionnaire at approximately quarterly intervals between the calls for answers to “long form” questionnaires.

Rule 531 of the Board of Governors as the same will be amended is attached as Schedule E.

(V) Independent Audits.

The Exchange will require members and member firms doing any securities business with others than members or member firms and affiliated companies of members and member firms to have an audit of their books, records and accounts made by independent public accountants at least once in each year. The scope of the audit is now the subject of a study being made by the Exchange in conjunction with committees representing the American Institute of Accountants and the New York State Society of Certified Public Accountants.

Rule 532, as the same will be amended, is attached as Schedule F. The Committee on Member Firms will prescribe audit regulations pursuant to said Rule 532 when the scope of the audit has been decided upon.

(VI) Exchange Auditing.

The number of supervisory audits, examinations and inspections made of members' and member firms' offices will be increased and will cover affiliated companies. The audits, examinations, and inspections are being made at irregular intervals and without prior warning and include a test or spot check of safekeeping securities and segregated securities representing excess margin.

No additional rules of the Board of Governors are required to cover this item.

(VII) Report of Member Borrowings.

Every member, member firm, general partner of a member firm and affiliated company will be required to report forthwith to the Exchange the following:

- (a) Each loan (whether of cash or securities) obtained in the amount of \$2500. or more;
- (b) Each loan (whether of cash or securities) made to any member, member firm, general partner of a member firm or affiliated company;

except:

- (1) All loans of cash or indebtedness fully secured by readily marketable collateral;
- (2) All loans of securities made by the borrower for the purpose of effecting delivery against sales where money payment equivalent to the market value of the securities is made to the lender and such contracts are marked approximately to the market;
- (3) All loans on life insurance policies which are not in excess of the cash surrender value of such policies;
- (4) All loans obtained from banks, trust companies, monied corporations, or fiduciaries on the security of real estate;

- (5) All loan transactions between general partners of the same firm.

Rule 534 of the Board of Governors, as the same will be amended, is attached as Schedule G, and a proposed new Rule to be numbered 535 is attached as Schedule H.

(VIII) Partners' Accounts.

No member or member firm shall carry an account for a general partner of another member firm without the prior written consent of such partners' other general partners. Duplicate reports and monthly statements shall be sent to a general partner of the firm (other than the general partner for whom the account is carried) designated in such consent.

All securities cleared for a general partner of another member firm shall be reported to a general partner in said firm who has no interest in such securities.

(IX) Partners' Trading

The Exchange will investigate the advisability of prohibiting general partners of member firms from trading in individual margin accounts, whether such accounts are carried with their own firm or its affiliated company, or with any other member firm or affiliated company.

(X) Qualifications of Personnel.

Steps will be taken to provide for a more intensive control and supervision of persons now in or hereafter entering the business of Exchange members.

A draft of Rule 8, as the same will be amended, is attached as Schedule I.

(XI) Enforcement

The business practices of member firms and their affiliated companies are being more strictly supervised.