

N.A.S.D. NEWS

Published by the National Association of Securities Dealers, Inc.

Volume I

Washington, D. C., June 22, 1940

Number 2

SUMNER T. PIKE REPLACES MATHEWS ON COMMISSION

**New Commissioner Has Considerable
Experience in Investment
Banking Business**

Appreciates Business Point of View

Sumner T. Pike was recently sworn in as a member of the Securities and Exchange Commission to fill the vacancy caused by the resignation of Commissioner George C. Mathews. He has had considerable experience in the investment banking business and appreciates the business point of view. He is a Republican and is also considered a liberal. At a recent press conference, he expressed the opinion, speaking generally, that "some modification" probably would be in order after any initial attempt to regulate an area which has been outside the law. Pointing to the evolution of the Interstate Commerce Commission, Mr. Pike implied that some similar development might be expected from the SEC.

Believes In Securities Laws

"It is too much to expect of a thing like this which has sprung full-grown that every comma would fit every business situation which arises," he said.

Mr. Pike also emphasized that he believed in the basic principles of the securities laws.

He was with the Department of Com-
(Turn to Page 2)

SECRETARIES COUNSEL MEET IN CLEVELAND

**Confer on Administrative Organization
—Exchange Information
on Local Problems**

A meeting of Secretaries and Local Counsel of District Committees of the Association was held recently in Cleveland, Ohio. The purpose of the meeting was to bring District Secretaries and Counsel up to date on the various activities of the Association, to perfect administrative organization, and to ex-

(Turn to Page 3)

INDEX

	Page
Certain Fraudulent Acts Il- lustrated by SEC Release	1
District Activities	4
Questions and Answers	2
Secretaries, Counsel Meet	1
Sumner T. Pike Biography	1
Typical Complaints	3
Violations of SEC Rule X- 17A-3 Revealed	1

SEC INVESTIGATIONS REVEAL RULE VIOLATIONS

**Many Members Misunderstand Regula-
tions on Keeping and Preser-
vation of Records**

It has been learned that SEC investigations reveal numerous violations by Association members of SEC Rules X-17A-3 and X-17A-4 (Keeping and Preservation of Records). These violations generally occurred among the smaller firms. This apparently results from considerable confusion as to how these rules must be physically complied with. For this reason, the Washington office of the NASD has sent to all District Chairmen certain forms prepared by Tallman, Robbins & Co., which are designed to accomplish simple and convenient compliance with the Rules.

Forms Available for Inspection

These forms are available for the inspection of any member who desires to see them. Further information concerning the forms may be obtained from Tallman, Robbins & Co., 314 West Superior St., Chicago, Ill.

Apart from physical compliance with the Rules, there also appears to be some confusion as to whom the Rules are applicable. They apply not only to certain members of national securities exchanges, but also to all brokers and dealers registered with the SEC.

The provisions of the Rules are explained in Pages E-1-13 of your MANUAL. The Rules themselves, are contained at Pages E-14-17.

SEC RELEASE ILLUSTRATES CERTAIN TYPES OF ACTS REGARDED AS FRAUDULENT

**Complaint Charges Securities Dealers
Claimed Wide Experience When
They Had Little**

Commission Reports in Injunction Case

The following release of the Securities and Exchange Commission is well worth reading as an illustration of certain broker-dealer conduct which ran afoul of certain fraud provisions of the Securities Act of 1933 and the over-the-counter provisions of the Securities and Exchange Act of 1934.

(EDITOR'S NOTE: The names of the persons actually involved in the case have been deleted by us and the letters A, B and C inserted in their stead.)

"The Securities and Exchange Commission today reported that Judge _____ of the United States District Court for the _____ had entered a final judgment enjoining Mr. A, Mr. B and Mr. C from further violating the fraud provisions of the Securities Act of 1933. The Court also enjoined Mr. A from further violating the over-the-counter market provisions of the Securities Exchange Act of 1934. The defendants consented to the entry of the judgment.

"The Commission in its complaint alleged that since January 1, 1939, the defendant A had been effecting transactions in securities and inducing their purchase and sale by means of deceptive and fraudulent devices and contrivances in violation of Section 15 (c) of the Securities and Exchange Act of 1934.

Practices Alleged by SEC

"In this connection, it was alleged that A, among other things, purported to act as a broker or agent in the purchase and sale of securities for the account of his customers, when in fact, without their knowledge, approval or consent, he acted as principal; that while purporting to act as agent in purchasing securities for his customers, he charged them an amount far in excess

(Turn to Page 3)

QUESTIONS AND ANSWERS

QUESTION: What are the obligations of a member when acting as a broker for his customer as distinguished from a member's obligations when he acts as a dealer in a transaction with a customer?

ANSWER: It is not possible in the compass of this column fully to answer all of the legal and other implications of this question but the following observations are by way of a general reply.

When a member acts as a broker for his customer, he either buys or sells securities for his customer, and for services rendered he is entitled to charge a commission. Acting in this capacity, a member is no more nor less than a simple agent of his principal, the customer whose orders he executes. As such an agent, his general obligations are well defined by the common law.

A Broker's Duties

Essentially, a broker or agent is a fiduciary and he thus stands in a position of trust or confidence with respect to his customer or principal. He must at all times, therefore, think and act as a fiduciary. He owes his customer or principal complete obedience, complete loyalty, and the exercise of his unbiased judgment. The law will not permit a broker or agent to put himself in a position where he can be influenced by any considerations other than those to the best interests of his customer or principal. Thus, when acting as a broker for his customer with respect to a transaction in Security A, he can not himself buy Security A from his customer or himself sell Security A to his customer. Nor can a member act as a broker for two customers in connection with the same transaction unless he makes full disclosure to both customers of the true nature of his position.

Secret Profits Barred

A broker may not in any way, nor in any amount, make a secret profit. For example, a broker may not, directly or indirectly, purchase or sell a security for his customer at one price and confirm the purchase or sale to his customer at a different price and retain any difference. He must confirm to his customer at the price at which he purchases or sells the security, plus, of course, his commission, if any, for services rendered, which, under the Rules of the Association must be a fair commission under all the relevant circumstances. A broker

also has the duty to get the best possible terms for his customers.

Rules Covering Brokers

The foregoing principles of the common law having to do with the obligations of a broker or agent to his customer or principal have found formal expression and amplification in certain of the Rules of Fair Practice of the Association and in certain of the so-called over-the-counter rules of the Securities and Exchange Commission, and, accordingly, to assure compliance with these formal requirements, every member (and all salesmen or employees who deal with the public) who acts as a broker for his customers should be thoroughly familiar with at least Article III, Sections 2, 3, 4, 12, 13, 14 and 15 of the Rules of Fair Practice of the Association and SEC Rules X-15C1-2, X-15C1-3, X-15C1-4, X-15C1-5, X-15C1-6 and X-15C1-7.

A Dealer's Duties

A member when acting as a dealer or principal in a transaction with a customer is acting essentially as a merchant, buying or selling securities for himself, for his own account, and, like all merchants, hoping to make a profit of the difference between the price at which he buys or has bought for himself and the price at which he sells for himself. A member when acting as a dealer or principal is thus not subject to the common law principles of agency which apply to a broker, but a dealer must at all times make it clear to his customer that he is acting as a dealer or principal, if that is the fact. He must be ever careful in such transactions not to make misrepresentations, directly or indirectly, with respect to the particular security being purchased or sold, and he must buy from or sell to his customer at a price which is fair, taking into consideration the market price, if any, market conditions, the expense involved, and all other relevant circumstances, and he should confirm to customers as dealer or principal.

Rules Covering Dealers

The foregoing principles with respect to the obligations of a dealer have also found formal expression and amplification in certain of the Rules of Fair Practice of the Association, in certain of the over-the-counter Rules of the Securities and Exchange Commission, and in certain sections of the Securities Act of 1933, so when acting as a dealer, a member (and all salesmen or employees who deal with the public) should constantly have in mind the provisions of Article III, Sections 2, 3, 4, 6, 12, 13, 14, 15 and 16 of the Rules of Fair Practice

SUMNER T. PIKE

(Continued from Page 1)

merce as an expert from 1939 until he joined the SEC and handled the Department's portions of the Temporary National Economic Committee's hearings. In the interview he expressed the opinion that the investment banking proceedings before the TNEC "did not develop the full subject" and that he didn't think the "entire proceedings were thorough."

Early Career Sketched

The following is a thumbnail sketch of Mr. Pike's earlier career:

Born: August 30, 1891, at Lubec, Maine. Education: Grade and high schools at Lubec; graduated Hebron Academy, Hebron, Maine; graduated Bowdoin College, Brunswick, Maine, class of 1913.

Employment: 1913-17, Stone and Webster, Boston, Savannah Electric Co., Savannah, Lowell Electric Light Corp., Lowell, Mass., (the latter two operated by Stone and Webster).

Army: 1917-19, various grades to Captain C. A. C. Principal duty, instructor in Officers Training Camp at Fort Monroe, Va.

Employment: 1919, Stone Webster; Eastern Texas Electric Co., Beaumont, Texas.

Employment: 1920-22, vice president of Service Station Equipment Co. and Rupert Equipment Co., Dallas, Texas, and Kansas City, Mo.

Trading in Americas

Employment: 1923, Assistant to president of G. Amsinck and Co., New York City, engaged in trading with Central and South America.

Employment: 1924-28, American Fore Group of Fire Insurance Companies, New York City; employed in, and later in charge of, investment department.

Employment: 1928-39, Vice President of Case Pomeroy and Co., New York City, a private capital investment firm. Engaged in exploration for production of oil in the United States and exploration for oil in Persia, Afghanistan, Venezuela and Santo Domingo.

Mr. Pike was appointed Business Adviser to the Secretary of Commerce on November 27, 1939.

of the Association, and Rules X-15C1-2, X-15C1-3, X-15C1-4, X-15C1-5, X-15C1-6, X-15C1-7, and X-15C1-8 of the Securities and Exchange Commission, and Sections 12(2) and 17(a) of the Securities Act of 1933, as amended.

**TYPICAL COMPLAINTS:
HOW THEY ARE HANDLED
BY CONDUCT COMMITTEES**

**Two Cases Described—One Referred
to Association by Securities and
Exchange Commission**

District Group Initiates Action

EDITOR'S NOTE: The presentation of typical complaints and how they are handled by District Business Conduct Committees is a regular feature of the NASD NEWS.

Case No. 1

The SEC turned over to the Association a complaint made to it by a customer of a member charging (1) that the member had recommended the sale of a certain utility preferred stock, the recommendation being based on "reports of the Securities and Exchange Commission," that the customer sold the stock on these recommendations at 66, and that the stock subsequently topped par, and (2) that the member sold certain bonds to the customer at prices two to three points above the prevailing asked price.

1. The District Business Conduct Committee informally investigated and found with respect to the first charge that nearly a year had elapsed between the sale of the stock and its reaching par. The committee found further that the dealer could not reasonably have foreseen this rise and that the customer had a 100 per cent profit in the stock at the time of the sale. Further, the committee noted that the customer had told the member that he desired to get into income producing securities inasmuch as there were no dividends being paid on the stock.

2. With respect to the second charge, the member made available to the committee his confirmations on the other side of all the transactions in question and they indicated, in the opinion of the committee, only a reasonable profit and that the prices charged were not out of line with prevailing prices. The committee investigated the entire account and concluded that it appeared to be "quite satisfactorily handled," that most of the items sold to the customer showed a substantial advance, and that the dealer had been meticulous in sending proper confirmation, etc.

The Committee accordingly dismissed the complaint and explained the transactions to the customer, who expressed

CLEVELAND MEETING

(Continued from Page 1)

change information and views with respect to District administrative and legal problems.

Francis A. Bonner, Chairman of the Board of Governors, Joseph C. Hostetler of Baker, Hostetler & Patterson, General Counsel, and Wallace H. Fulton, Executive Director, reviewed the Association's organization and activities and discussed various administrative and legal problems. Particular emphasis was placed upon the handling of formal and informal complaints, quotations on over-the-counter securities, and the working out of uniform business practices.

District Problems Discussed

District administrative and legal problems were gone into in detail with a view to standardizing administrative procedure and perfecting liaison between Districts and between Districts and the Washington office.

Those attending the meeting felt that it would aid them greatly in their work locally and that it would enable them better to serve their Committees and the members in their respective Districts.

his satisfaction with the final disposition of the case.

Case No. 2

A District Business Conduct Committee charged a member with proposing an exchange of bonds calculated to yield excessive profits. The member had sent a circular to holders of certain real estate bonds suggesting a par for par trade for certain utility bonds. The circular intimated that the real estate bonds were due for difficulties and that the utility bonds had good prospects of appreciation. On the date the circular was sent out, the real estate bonds were quoted about 10 points over the utility bonds.

The member admitted that the profit would have been excessive, but said that he would not have allowed the trade to be consummated under market conditions as they existed at that time. He also alleged that a subsequent letter had been sent out offering a cash difference on the trade.

The committee investigated and found there had been no transactions in the real estate bonds. The member was requested to report any transactions he had in the real estate bonds during the next three months. The member had no such transactions during that period and the case was marked closed.

SEC RELEASE

(Continued from Page 1)

of the actual price paid by him for the securities, and in selling securities for his customers, he credited them with an amount far less than the actual price received by him for the securities sold, and in each case retained a secret profit for his own use and benefit greatly in excess of the customary commissions; that he purported to exchange customers' securities for other securities having substantially an equivalent aggregate market value, when in fact he exchanged the customers' securities for other securities having at the time a substantially smaller aggregate market value.

Fraud Charged

"The complaint charged that the foregoing acts, practices and course of business operated as a fraud and deceit on A's customers.

"It further was alleged that A, in the course of effecting transactions and inducing purchases and sales obtained money and property by means of untrue statements of material facts.

"Among other things, the complaint charged that A stated that the defendants B and C previously had been associated with one of the largest financial houses in New York, that they were experts and specialists in bonds and general securities, and that customers might have the utmost confidence in their opinions and statements and could deal with them in safety.

"The complaint alleged, however, that B and C had never been associated with any financial house in New York or elsewhere and prior to their association with A had not had any experience in the bond or general security business.

Position Not Disclosed

"The complaint alleged that A was effecting transactions and inducing the purchase and sale of securities by means of other deceptive and fraudulent devices and contrivances in that he failed to give or send to his customers at or before the completion of each transaction written notification disclosing whether he was acting as a broker for his customer, as a dealer for his own account, as a broker for some other person, or as a broker for the customer and some other person."

NOTE: In connection with paragraph three of the above release, it should perhaps be noted that it is unlawful for an agent to make a secret profit, whether such profit be large or small.

DISTRICT ACTIVITIES

COMMITTEE MEETINGS, EDUCATION PROGRAMS, OTHER EVENTS REVIEWED

Chairmen Give Resumes of Work Carried on by Members in the Various Areas

The NASD NEWS is inaugurating a new feature in this issue—"District Activities"—which will appear regularly in future issues. This feature, as its name implies, will be devoted to news and happenings in the various Districts with the thought of bringing all Districts into closer touch through the medium of the News.

District No. 1

From various sections of our District there have come evidences of a lively interest, on the part of Association members, in the NASD NEWS. Reports of the meetings and doings of the Board of Governors and of the several national committees are not only found to be of particular interest, but are serving to bring the membership closer together, as a general understanding is had of the Association's problems, purposes and accomplishments.

District No. 2

Our District is continuing in its efforts to carry on its campaign to educate the industry with regard to administration of our rules. It is our feeling that this campaign should be conducted by carrying our policy to the personnel of the various member firms, sales executives and sales forces through direct contact.

In recent weeks, our Uniform Practice Committee and Quotations Committee have been particularly active. At the present time we have only one unsettled case in the District, which is in Los Angeles.

District No. 3

The Denver newspapers began printing quotations on "Local Securities" on May 6 as the result of the excellent work of our Quotations Committee. This committee supervises the collecting, compiling, disseminating and publishing of these quotations. Several issues heretofore not quoted are now included in the list.

District No. 4

Our District Committee has not met since the last meeting of the Board of Governors of the Association in Washington, D. C., April 29-30. We expect to hold a meeting very shortly.

We believe our membership is becoming more and more interested in the Association each month and at our forthcoming meeting we hope to appoint an Education Committee which will carry out this phase of our program in a more intensive way. Our Uniform Practice Committee expects to issue a bulletin shortly explaining some

of the most misunderstood practices covered in the transaction of daily business.

District No. 7

The administrative machinery has been completely installed and is now operating within our District. With the view of acquainting members and their employees with the aims, objects and rules of our Association, the Education Committee will hold meetings this month with executives and partners; cashiers and office managers; and salesmen and traders. These meetings should be very interesting and valuable to our members.

District No. 8

Recent activities in our District have included three meetings of the Full District Committee and meetings of the Quotations and Uniform Practice Committees. It was decided in March to initiate an educational campaign among the members and the Field Secretary, with the assistance of the District Chairman and Governors, has held meetings in Omaha, Milwaukee, Grand Rapids, Detroit, Davenport, Des Moines and Indianapolis.

The District Business Conduct Committee has had one formal and one informal complaint presented to it, concerning which hearings have not yet taken place, but are expected to be completed during June. The Quotations Committee also expects to complete its initial work in June and will, at that time, be prepared to offer its quotations for publication wherever desirable in the District. The Uniform Practice Committee has appointed a subcommittee to draft suggestions for the national Uniform Practice Committee.

District No. 11

Since May 1 our District has handled four cases involving business conduct and the Business Conduct Committees in both Virginia and Maryland have done excellent work in running down the facts and thus bringing together complete information in each case. This has involved considerable work and time, but we feel that the results accomplished fully justify the effort. One case was brought by a member against another member and a settlement was advised. Another case was brought by a customer against a member. In one case it was necessary to call in an outside accountant.

District No. 12

(EASTERN DIVISION)

During the past several weeks there has been very little real activity in our District. The Quotations Committee has finally succeeded in working out an agreement with the Philadelphia newspapers to include quotations furnished by the committee.

The Uniform Practice Committee held a meeting June 3rd for the purpose of drawing up a set of tentative rules which they felt would apply to

this District in order that they may submit them to Joseph T. Johnson, chairman of the national committee.

(WESTERN DIVISION)

Our District has been busy with merely routine matters. The membership shows increasing interest in NASD activities as evidenced by more questions asked of the District Committee and more requests for assistance in meeting day-to-day problems.

Quotations have been published in the newspapers for about two months now and the kinks which developed in the first few weeks have been ironed out by the Quotations Committee.

The Uniform Practice Committee has made up a tentative set of rules for the Pittsburgh District and it is planned to promulgate these rules as soon as they can be coordinated between the Eastern and Western Divisions of the District.

District No. 13

Nevil Ford, Vice Chairman of the NASD, Harry W. Beebe, District Chairman, and Major Garnet C. Williams, District Committeeman, recently attended meetings in Buffalo, Rochester and Syracuse to acquaint members with the activities and purposes of the Association.

At the meetings, Mr. Ford discussed the good relationship prevailing between the Association and the SEC and Mr. Beebe assured members that all complaints and inquiries received equal attention. Mr. Williams summarized the activities of Buffalo Business Conduct Committee of which he is the Chairman.

The Buffalo gathering on May 23 was arranged through the Buffalo Securities Dealers Association and its president, Frederick A. Terry of Schoellkopf, Hutton & Pomeroy, Inc., introduced the speakers. The Rochester meeting on May 24 was arranged by the Local Committee in that city composed of: Davis S. Rutty, Chairman; Walter H. Baumer; E. Harry Gilman; and John H. Kitchen. Edward J. Bullock, Chairman of the Syracuse Committee, arranged the meeting in that city which was held on the same day as the Rochester meeting.

In view of disturbed world conditions, the large turnout for these meetings was good evidence of the dealers' interest in the Association.

Progress is being made by the special committee drafting uniform practice rules and it is expected that they will be presented to the full Uniform Practice Committee for approval in the near future.

District No. 14

Our District has no news of special import to report for the past month. Members of various committees have continued to study and investigate the problems assigned to them and are looking forward with interest to the handing down of general policies from the various national committees.