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EXECUTIVE DIRECTOR REPORTS IMPROVING TREND IN MEMBERSHIP

The membership curve has leveled off in the last few months and new applications are being received with more regularity in contrast to an almost complete lack of them during most of 1942, Wallace H. Fulton, Executive Director, reported to the Board of Governors at a meeting in Chicago, May 25. "As of April 30 we had 2,221 members, a decline from the year-end of 63. The figures for the period are distorted to some extent due to the fact that they reflect cancellations of 31 memberships for non-payment of assessment. A lag of 90 days and more occurs between our October billings and cancellation of a membership for failure to pay dues assessed therein. Thus the deadwood among the membership as of October 1 was not cut loose until the first quarter of this year. There were also four expulsions this year to April 30. Thirty new members were admitted up to April 30 and on that date 9 applications for membership were pending. Without straining to make them so, analysis of recent membership statistics is very encouraging.

Examination Program

"In accordance with instructions of the Board of Governors laid down initially in May of last year, examination of members is proceeding under the plan approved by the Board in January when it reaffirmed the decision of a year ago. The plan called for examination of members this year through the means of forms to be filled out listing a stated number of transactions, these forms to be distributed by and, when returned, analyzed by the national office. It will be recalled that the initiative for this policy was, among other things, the necessity for economy in all phases of Association work. In addition, the Board selected the present examination method as the most efficient answer to demands for a uniform program of examination, as opposed to the several types of examination methods, many costly, that had previously been employed. The grow-

ing manpower problem which, of course, is more serious today than ever, also entered into the decision to conduct examinations the way we are now doing. Had we not undertaken the program being observed, I am not at all sure that we could have completed examination of all members this year. As it is we have had our share of difficulties due to the need of training inexperienced people.

"Just a few words about the mechanics. Beginning with February, a percentage of members in each District is,

each month, sent schedules to be filled out showing all details of 50 sales to customers by the member acting as a principal. Members of the Board and District Committees received schedules in the first mailing over and above the proportionate representation of the membership. We have made four mailings to date. A total of 1,078 members or about 48 per cent of the membership have received the schedules; 792 have been completed and returned; 417 have been analyzed. One member has so far apparently refused to respond and the appropriate District Committee has been notified of this. District Committees have been forwarded the schedules on which analyses were completed. When sent to District Committees, the schedules do not identify the member. Committees have requested the source of fifty-four of the schedules before them, indicating that facts disclosed in the schedules are such as to make it desirable that the Committee look further into the subjects.

"Vigorous Enforcement" Urged

The Board of Governors at its meeting last month unanimously affirmed its past policy of strict and unrelenting enforcement of the By-Laws and Rules of Fair Practice of the Association and, before adjourning, adopted a resolution calling upon the fourteen District Committees to continue their careful review of members' practices and the filing of complaints where conditions warrant such action.

Following is the resolution adopted by the Board: "Resolved, That the Board of Governors urges upon all District Committees and all District Business Conduct Committees continuation of the enforcement work of the Association in a vigorous and forceful manner and that, wherever warranted, the formal method of procedure, *i.e.*, filing of complaints, rather than informal procedure, be followed in carrying out the policy of the Board."

Complaint Picture

"As of April 30 there were 2 complaints pending against members, one in District No. 8 (Chicago) and one in District No. 14 (Boston). A year ago there were 25 complaints pending as of April 30. At the end of 1942, 7 complaints were pending. The gradual disappearance of complaints, it seems to me, is attributable to several things. Without

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ranking them in importance, one to the other, I think it fair to say that the principal factors have been:

"1. The effective educational and enforcement work done in the past two years;

"2. Increase in recent months in volume of business done by a majority of members;

"3. The tendency toward stability in number of members;

"4. Change-over in examinations from a District to a National basis;

"5. Almost complete cessation of references to the Association from the SEC.

"Disciplinary actions against members—plus the publicity given in the NASD News to the causes of such actions as well as penalties imposed, plus the word-of-mouth publicity which has followed them—have done much to cure conditions which two years ago prompted the Board to move aggressively against violators of the Rules of Fair Practice. In other words, I believe the complaint statistics recently have reflected the effects, direct and indirect, of the enforcement program begun two years ago. Not only has the fringe of the membership been materially curtailed by expulsions and other disciplinary actions but it would seem logical that those who occupied border-line positions are more conscious of the dangers of such positions. So long as the Board pursues an aggressive policy, benefits will continue to accrue. As to the influence of the change-over in examination methods, I believe this temporarily affected institution of complaint proceedings. The lag was for a period of perhaps three months. However, that is now behind us. Schedules are periodically going to District Committees in volume according to the size of their Districts. If causes for complaints exist in the facts disclosed by the schedules and Business Conduct Committees proceed in keeping with the policy of the Board, the statistics will mirror the decisions of such Committees.

"I hope I have not laid too much emphasis upon the effective work done by the Association and upon other things influencing complaint filings. Certainly there has been no relaxation in our purpose to examine members' practices according to the declared objectives of the Board. A very few months will demonstrate how many members remain on the fringe and also the number of those close to its inner borders.

"In the year to date we have had 3 references from the SEC. Numerically, the staff of the Commission has been greatly reduced and demands of the war have in many ways materially lessened their inspection activities. This means that our own examination work must be as thorough and efficient as possible if our Rules enforcement is to be as successful as during the last year.

Booklet

"The Board will recall that at the January meeting I reported that a booklet was being prepared describing the background, organization and functions of the Association. Copy was ready for the printers in April and the booklet entitled "... a symbol of self-regulation for industry ..." was distributed to members earlier this month. It has also been sent to members of Congress, Better Business Bureaus, Chambers of Commerce in larger cities, State Securities Commissioners and hundreds of individuals in industry,

banking and professional life. A notice was distributed offering 25 copies free to all members for distribution to salesmen, traders and customers. A number of members ordered 100 or more copies."

Confirmation of "When-Issued" Transactions Essential

"Each party to a transaction shall send written confirmation of same on the date of the transaction. Confirmations shall be compared upon receipt and any discrepancies shall be checked immediately; and a corrected confirmation shall be sent by the party in error."

Quoted above is Section 9 of the Uniform Practice Code of the Association and all members are bound to comply with its provisions in the interests of orderly transacting of over-the-counter trading.

Attention of members to this section of the code is particularly appropriate at this time in view of the volume of trading in "when-issued" securities. Contracts involving substantial quantities of such securities have over recent months and day after day been entered into by members, many of whom, it is reported, have failed to formally acknowledge the existence of the contract. They, by their neglect, have not only confused the other party to the contract but also may unwittingly be contributing to a possible cause for future dispute when settlements are to be made.

One member, in a letter to the Association directing attention to the problem as it bears upon "when-issued" dealings, said:

"We realize fully that today more than ever our business is faced with the problem of lack of personnel so that the important mechanics of operation cannot go forward as they should. Nevertheless we feel that it is especially important that the confirmation of any transaction should not be overlooked.

"We are especially concerned about this situation because the confirmations or whatever form a broker might use are the only medium after a trade is entered into by telephone to really confirm and bind all parties without the risk of future question as to what might have taken place some time in the past."

Weeks if not months elapse between contractual arrangements for "when-issued" securities and the settlement of such contracts. It is therefore obviously desirable that both parties to such contracts immediately undertake to establish the accuracy of their individual understanding of the terms of contracts and remove any possible cause of future dispute.

New York Transfer Tax Ruling Is Released

The Bureau of Law of the Tax Commission of the State of New York, by memorandum dated February 16, 1943, has advised all stock transfer tax examiners to make no claims for stock transfer taxes based upon a situation in

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Expulsion, One-Year Suspension Ordered in Two Conduct Cases

The Board of Governors has affirmed the expulsion of one member and increased from sixty days to one year the period of suspension ordered by a District Business Conduct Committee against a second member. Both decisions of the Board were made upon recommendations of the National Business Conduct Committee. The latter considered the cases for the Board when the members involved appealed decisions rendered by District Business Conduct Committees. The members have the right to appeal from the Board's decisions to the Securities and Exchange Commission.

The member whose expulsion was affirmed by the Board dealt in oil royalties which the District Business Conduct Committee found were sold at prices which were not fair. The complaint in this case also alleged unfair prices and mark-ups in transactions in other securities. Additionally, the District Business Conduct Committee found that the member, without written authorization, had hypothecated customers' securities to secure a loan of the firm; that the member had failed, in several instances, to give or send proper confirmations to customers disclosing the capacity in which it acted. Specifically, the DBCC and the Board found that the member had violated Sections 1, 4, 12 and 19 of Article III of the Rules of Fair Practice.

60-Day Suspension Increased

A sixty-day suspension of another member was increased to one year by the Board after the National Business Conduct Committee had considered the complaint and decision upon appeal by the member involved. This case revolved around allegations that, in a series of transactions in a trust holding landowners' royalties in mineral rights, the member had violated "just and equitable principles of trade" and sold such securities at prices which were unfair. The member initially undertook distribution of the royalties at a price of \$2 per unit through an arrangement with another dealer under which the price per unit to the member was \$1.70. Subsequently, it became known to the member that another source was prepared to sell the royalty units at a much lower price. The member negotiated a purchase of these units at \$1.05 per unit. The units as acquired were sold to the president of the member company at \$1.50 each and prior to their being sold to the public were repurchased by the member from its president at \$1.70. These were then sold to the public at \$2 or \$2.25 per unit, the higher price being charged customers when the member bought other securities from customers at a loss.

Agreement to Sell at \$2 a Unit

The member's contention was that he had an agreement with the original dealer to sell the royalty units to the public at a price of \$2. When new supplies of the royalties became known, the royalty dealer and the member felt that these should not undermine their agreement for the distribution of the units in the state wherein the member was located.

Other instances of alleged excessive prices were recited in the complaint against this member but upon consideration of the circumstances surrounding the securities and

the position of the member, the District Business Conduct Committee found no violations of the Rules had occurred. However, for taking secret profits in a single transaction, the DBCC imposed a "strong censure" upon the member in addition to the sixty-day suspension. As previously stated, this suspension was increased to one year by the National Business Conduct Committee in its recommendations to the Board, which were affirmed.

Association Expenses Cut 35% in First Half to March 31

A 35 per cent reduction in total expense of the Association for the six months ended March 31 in comparison with the same period of the previous fiscal year was reported to the Board of Governors last month by Treasurer James Parker Nolan.

Mr. Nolan added that unless extraordinary expenses are incurred in the last half of the current year, the Association will have operated within its budget and at a cost 30 per cent below expenditures of the 1941-42 fiscal year.

The Treasurer reported that total expense for the six months ended March 31, 1942, was \$146,208. In the comparable six months' period, expenses totalled \$224,894. District Committees' expenses in the first half of the current fiscal year dropped to \$59,493 from \$116,033, reflecting, largely, effects of the change in examination methods this year. (For details of the examination program see report of the Executive Director, page 1.)

Members will recall that in the February issue of the NEWS, budget and revenue figures were discussed. At that time it was pointed out that the Finance Committee estimated budget needs of the current year at \$275,000 while income was expected to approximate \$250,000. It is now indicated that final figures for the year should show these projections approximately realized.

"This means," Mr. Nolan stated to the Board, "that for the final half of the current year the Association will operate at or about the sum of its income. Unusual legal expenses or other developments largely beyond our control could upset this prospect but we are hopeful that the Association will not experience any large financial burdens beyond current obligations.

"We are continuing our efforts to effect economies wherever possible without impairment of our program."

Theis, St. Louis Board Member, Added to Executive Committee

Albert Theis, Jr., Albert Theis & Sons, Inc., St. Louis, Mo., has been elected a member of the Executive Committee of the Association. His election followed adoption by the Board of Governors of a resolution making the Chairman of the National Business Conduct Committee a member of the Executive Committee. Other members of that Committee are the Chairman of the Board, Vice-Chairmen, Treasurer, and three other members of the Board and the Executive Director who is an ex-officio member of the Committee. The Executive Committee acts for the Board during intervals between meetings of the latter.

Booklet Describing NASD Now in Third Printing

The booklet bearing the title "... a symbol of self-regulation for industry . . .", and describing the background, organizations and functions of NASD is now in its third printing. Fifteen thousand copies have been distributed throughout the country to date.

Members were notified of their right to receive free of charge up to 25 copies of the booklet for distribution to customers and to salesmen, traders, cashiers, and other employees. This offer remains open to members who have not as yet applied for their quota. Additional copies above the 25 limit will be billed the member at cost.

The Board of Governors believes that this booklet should be carefully read by every member of the Association and by all employees of members as well as by the general public who should be familiarized with the work of NASD.

To obtain your supply of this booklet address a post card or letter to National Association of Securities Dealers, Inc., 1616 Walnut Street, Philadelphia, Pa., giving the number of copies wanted. You will be sent a bill for charges on copies over 25.

Amendment to Complaint Procedure Adopted by Board

The Board of Governors has adopted an amendment to the Association's Code of Procedure for Handling Trade Practice Complaints. The amendment reads as follows:

"If a respondent or any aggrieved person, who has made application to the Board of Governors for a review of the disposition of the complaint against the respondent firm pursuant to Section 14(a), shall dismiss appeal without a determination by the Board of Governors on the merits thereof, the Board of Governors shall have an additional period of thirty days subsequent to said dismissal in which to determine whether it shall review the matter on its own motion." This amendment will become 14(b) of the Code of Procedure.

The Securities and Exchange Commission did not disapprove adoption of the amendment and permitted it to become effective July 1, 1943.

"THANK YOU . . ."

The Board of Governors wishes to express its appreciation for the fine spirit of co-operation members have given to the examination program now under way. Ever since the mailing of schedules began in February, the great majority of members have responded promptly with the information called for; and, where returns had to be delayed beyond deadlines set, these were explained and in all but a few instances were justified by personnel conditions.

If a member has not as yet received from the Executive Office forms to be filled out by him it means simply that his name has not been reached in the routine. About one-half of the membership has been covered to date.

Purpose of the amendment is indicated by its language. The Board believes it desirable that it retain control over cases decided by District Committees where a respondent first appeals a decision and then withdraws such appeal. The new amendment clearly establishes authority of the Board to retain such cases before it even though an appeal is withdrawn by the member-respondent.

Advisory Committee on R. R. Reorganizations Named

The possibility that a number of railroad reorganization plans, pending before Federal Courts, will be released over the next several months, makes it advisable that the securities business be guided by well-informed groups in order to meet satisfactorily the problems to be presented when the courts act.

As a result, the Board of Governors of NASD at its last meeting approved recommendations that an Advisory Committee be formed to advise and counsel with the National Uniform Practice Committee on these problems as they arise. Chairman Henry G. Riter, 3rd, in the name of the Board has appointed the following to serve on this special Committee:

Pierpont V. Davis, Harriman, Ripley & Co., Inc., New York, who will serve as Chairman;

Charles L. Bergmann, R. W. Pressprich & Co., New York;

George W. Bovenizer, Kuhn, Loeb & Co., New York;

Fairman R. Dick, Dick & Merle-Smith, New York;

John F. B. Mitchell, Wood, Walker & Co., New York;

Roy C. Osgood, First National Bank of Chicago;

Robert G. Rowe, Stroud & Co., Inc., Philadelphia;

Jean C. Witter, Dean Witter & Co., San Francisco;

Orrin G. Wood, Estabrook & Co., Boston.

New York Transfer Tax Ruling Is Released

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which an agreement is made outside the state with a resident of the state to sell stock to said resident and delivery is made by shipment of certificates through a bank in New York with sight draft attached.

The memorandum concludes:

"I am of the opinion, where certificates of stock are deposited in the mail or delivered to a common carrier outside the State for transmission into the State to a purchaser with a condition that payment be made before the certificates are released to the purchaser that no tax can be imposed either upon the theory of the passing of title in the State or upon the theory of a delivery in the State. With respect to the delivery theory, it should be pointed out that it is well understood that a taxable delivery is one whereby the transferor parts with title."

In issuing the memorandum, the Bureau of Law advised that the so-called Cole memorandum dated October 27, 1936, be disregarded.

Copies of the full text of the memorandum are available and will be furnished upon request to the Executive Office of NASD.