NASD News

PUBLISHED BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Volume V | Philadelphia, December, 1944 | Number 2

SEC HOLDS ASSOCIATION DID NOT IMPOSE 5% RULE, OFFERED "CRITERION"

The Securities and Exchange Commission has held that the Board of Governors of the Association did *not* impose upon members a rule that they must limit mark-ups or spreads on transactions with customers to 5%. The Commission found that the Board offered members a "flexible criterion" to be used as one factor in determining if prices charged bear a reasonable relationship to current markets. The finding pointed out that the Association has consistently held that percentage of mark-up or spread is but one of the determining factors in measuring fair prices.

Interpretation Passed on by SEC

The SEC has passed on the Board's action of October 25, 1943, in adopting the following interpretation of Section 1, Article III, of the Rules of Fair Practice:

"It shall be deemed conduct inconsistent with just and equitable principles of trade for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security."

In the letter containing this interpretation the Board reported that analysis of members' questionnaires in 1943 showed that 47% of transactions studied were effected at a spread or mark-up of not over 3% and 71% at not over 5%. The letter added that District Business Conduct Committees were to enforce Section 1, and the interpretation thereof, having in mind the percentage charged in 71% of the transactions studied.

Members should carefully digest the Commission decision.

This decision of the SEC was the result of petitions filed last June, in which it was alleged that the Board in a letter to members October 25, 1943, and the Chairman and Executive Director in a letter to Business Conduct Committees November 9, 1943, imposed "on the membership a rule or something having the practical force and effect of a rule." In denying that a rule had been promulgated, the Commission said the Board had acted "well within the sphere of interpretation."

The decision of the Commission, it is understood, will be mailed to all members as soon as it can be processed. It should be read in its entirety and members might find it advisable to keep the decision on file for reference purposes. Meanwhile, the NEWS reprints below the major passages of the decision:

"The 5% figure is not designated in the letters as an established maximum spread. A member taking a greater spread might or might not be held to have violated a Rule of Fair Practice, but he could not properly be disciplined on the ground that he had violated a 5% limitation 'rule.' There is no such rule, and we do not think the letters in question purport to impose one. This is clear from the following language in the letter of October 25:

" 'The Board has the strongest possible conviction that it would be impracticable and unwise, if not impossible, to write a rule which would attempt to define specifically what constitutes a fair spread or fair profit, or to say, in exact percentage or dollars, what would result, in each and every transaction, in a price to the customer which bears a reasonable relationship to the current market. It does believe, however, that each member is entitled to know what is the practice of the membership, as indicated by the analysis of the questionnaires, and that the District Business Conduct Committees have been instructed to enforce Section 1 of Article III of the Rules of Fair Practice as above interpreted, having in mind the percentage of profit [5%] on which 71 per cent of the transactions above referred to were effected. In the case of certain low-priced securities, such as those selling below $10, a somewhat higher percentage may sometimes be justified. On the other hand, 5 per cent or even a lower rate is by no means always justified.'

"Moreover, the following statement is contained in the letter of November 9 from the Chairman of the Board of Governors and the Executive Director to the District Business Conduct Committees:

" 'The elements which have entered into disposition of business conduct cases by District bodies in the past are not in any way affected. The price to the customer in any given transaction will still be considered in the light of all relevant circumstances and particularly these elements: the percentage of mark-up over cost or over the representative market, whichever controls; whether the security is a bond or stock with an active or inactive market; the price range, whether low, medium, or high, and the amount of money involved. The question of amount of money involved is particularly relevant to application of the Board's view in respect to per-

(*Continued on page 7, column 1*)

REPORT OF EXECUTIVE DIRECTOR TO BOARD OF GOVERNORS

Following are extracts from the report of the Executive Director, Wallace H. Fulton, to the meeting of the Board of Governors and Advisory Council, October 2-3, 1944:

Membership

The Association had 2,193 members on September 15—the same as on December 31, 1943. Membership has held fairly stable this year around 2,200. Before the war, the peak in membership was 2,900.

Advertising

One hundred seventy members have been supplied Certificates of Membership. The majority of these indicated that they would, in various ways, advertise or publicize the fact of their membership. Certificates supplied to members expire December 31, when certificates for 1945 will be distributed.

Appeal of Disciplinary Decision

An NASD disciplinary decision has been appealed to the Securities and Exchange Commission. The appeal is from a one-year suspension ordered by a District Committee and sustained by the Board of Governors on appeal by the member.

Meetings with Members

The Chairman and I have resumed the series of meetings with District Committees and with members of the Association in the various districts. I recently met with members in Portland, Maine. The Chairman and I have just come from a meeting with the District Committee in St. Louis and numerous members of the Association in that city. Mr. Chapman and I in the next few weeks will attend meetings in Spokane, Seattle, Portland, San Francisco and Los Angeles. After these meetings have been held, the Chairman and I will have attended meetings in seventeen cities this year. Other meetings have been arranged for later in the year.

Department of Justice

Reports have several times appeared in print to the effect that the Department of Justice is preparing suit against investment bankers and the Association, alleging violation of the Anti-Trust Laws. The Department has admitted that it was studying and accumulating facts bearing on the subject. The Association and the business were given a sharp warning of the Department's attitude toward the traditional method of underwriting and distribution of securities when it intervened in the PSI proceedings at the end of last year. The Department was represented at oral argument before the Commission closing the PSI record and at that time made clearer than ever the degree of its interest in the question of whether underwriting and selling group agreements may be in violation of the Anti-Trust Laws.

San Francisco Stock Exchange

In July, the San Francisco Stock Exchange adopted preferential rates of commissions to be charged non-members of the Exchange who are members of other stock exchanges or the NASD. Such non-members successfully applying for extension to them of preferential rates are charged seventy-five per cent of the Exchange's minimum commission rate and must, in turn, charge the customer not less than an additional twenty-five per cent of the minimum commission rates of the Exchange. In applying for the preferential rate, the non-member agrees that all transactions executed under such terms would be in accordance with the rules and regulations of the San Francisco Stock Exchange. The S. F. Mining Exchange has extended to members of NASD special preferential rates that have been in effect for Pacific Coast members of exchanges.

Complaint Picture

Up to August 31, 15 complaints had been filed against members of the Association, including 5 which did not involve questions of pricing practices of members. Statistically, the complaint picture is brighter. As against the 15 complaints filed in the first eight months of 1944, 25 had been filed up to August 31, 1943. A total of 50 were filed in 1943, against 57 in 1942, and 120 in 1941. It does not seem probable that complaints filed in all of 1944 will approach the figures of the last few years.

Unlisted Applications

In July of 1943, the New York Curb Exchange filed applications with the Securities and Exchange Commission to extend unlisted trading privileges to six common stock issues, five of which had theretofore been traded exclusively in the over-the-counter market. In keeping with the policy of the Board, these applications were opposed by NASD. A few weeks ago, the trial examiner's report was submitted to the Commission, the trial examiner finding that for purposes of the applications the vicinity of the New York Curb Exchange was Massachusetts, Rhode Island, Connecticut, New York, Pennsylvania and Ohio, and that within this vicinity there was sufficient public interest and trading in the issues to warrant granting of the Curb's applications to extend unlisted trading privileges to them; however, the examiner concluded his report with the statement that the record failed to show that one requirement of the statute would be satisfied, namely, that the officers, directors and 10 per cent owners would be subject to duties substantially the same as if the securities were registered under the Exchange Act. In other words, although the trial examiner upheld the applications on two scores—namely, the vicinity claimed for the Curb and the claim that there was sufficient distribution and trading activity therein to warrant granting the applications—nevertheless, he felt the record did not contain complete proof required by the statute, leaving it to

(*Continued on page 4, column 1*)

NOMINATING COMMITTEES CHOOSE BOARD, DISTRICT CANDIDATES

"Nominating Committees perform perhaps the most important function of any group which participates in NASD work."

Upon receipt of a message from Chairman Ralph Chapman, of which the above-quoted is an extract, Nominating Committees early this month began selection of candidates to fill vacancies on the Board of Governors and 14 District Committees. At this writing such committees have practically completed their slates. Seven vacancies on the Board and 36 on District Committees are to be filled.

Under the By-Laws, Nominating Committees are appointed by the District Committees. Their choices become the "regular" candidates. Ten per cent of the members in any District may nominate additional candidates according to provisions of Section 6 (b) and Section 12 (b) of Article IV. Candidates elected take office January 15, 1945, for three-year terms on District Committees and the Board.

Following is a list of Nominating Committees of the various Districts and their nominees where these had been chosen:

District No. 1
(Idaho, Oregon, Washington)

William J. Collins, Portland, Chairman; R. M. Williams, Spokane; Beardslee Merrill, Spokane; Al Hughbanks, Seattle; Edmund F. Maxwell, Seattle. Candidates for vacancies on District Committee: Frederic J. Blanchett, Seattle, to succeed Waldo Hemphill, Seattle; Charles A. King, Spokane, to succeed George R. Yancey, Spokane.

District No. 2
(California, Nevada)

Roy L. Shurtleff, San Francisco, Chairman; Nelson Douglass, Stephen C. Turner, Los Angeles; Alexander McAndrew, J. R. Postlethwaite, San Francisco. Candidates: J. Robt. Shuman to succeed Mark C. Elworthy, San Francisco, on Board of Governors; for the District Committee: Revel Miller, J. Lester Erickson, Mark Davids, to succeed H. R. Baker, Willis H. Durst and Charles F. Sill, all Los Angeles; Irving P. Jacobs to succeed Spencer Brush, San Francisco.

District No. 3
(Arizona, Colorado, New Mexico, Utah, Wyoming)

Burdick Simons, Chairman; William E. McCabe, Charles J. Rice, G. B. Hazlehurst, J. H. Myers, all Denver. Candidate for Board of Governors: Burdick Simons to succeed E. Warren Willard; for District Committee: John J. Sullivan and John T. Webb to succeed Charles W. Webb and Edward B. Coughlin, all Denver.

District No. 4
(Minnesota, Montana, North Dakota, South Dakota)

W. S. Macfadden, Chairman; James P. Arms, Lester B. Elwood, Minneapolis; Leo L. Quist, Bert A. Turner, St. Paul. Candidates for District Committee: T. Frank McGuire to succeed Sidney S. Henderson, St. Paul; I. D. Owen, Rollin G. Andrews to succeed Charles A. Fuller and Wilber W. Wittenberg, Minneapolis.

District No. 5
(Kansas, Oklahoma, Western Missouri)

Eugene L. Young, Kansas City, Chairman; Paulen E. Burke, Arthur I. Webster, Eldridge Robinson, Kansas City, and Carl Meyer, Topeka. Candidates nominated: W. C. Sylvester, Kansas City, and Carl A. Meyer, Topeka, to succeed George K. Baum and Walter I. Cole on District Committee.

District No. 6
(Texas)

J. Wesley Hickman, Dallas, Chairman; Jesse A. Sanders, Dallas; Earl G. Fridley, Houston; B. F. Pitman, San Antonio; J. Marvin Moreland, Galveston. Candidates for District Committee: W. Perry McPherson to succeed Jack P. Brown, Dallas; Arthur C. Cooper to succeed Lawrence Davis, Houston.

District No. 7
(Arkansas, Eastern Missouri, Western Kentucky)

John R. Longmire, St. Louis, Chairman; Gordon Scherck, Julius Reinholdt, John Kerwin, J. Mountford Aull, St. Louis. Candidate for vacancy on Board: Firmin D. Fusz, Jr., to succeed Albert Theis, Jr. Candidates for District Committee: John A. Aid, to succeed A. B. Tilghman; Oscar H. Wibbing to succeed Mr. Fusz.

District No. 8
(Illinois, Indiana, Iowa, Michigan, Nebraska, Wisconsin)

Walter E. Kistner, Chicago, Chairman; Edward C. George, William C. Gibson, Chicago; Roy Falvey, Indianapolis; Laurence M. McCague, Omaha. Candidates for District Committee: Duncan M. Rowles and Paul E. Alm to succeed L. Raymond Billett and Augustus Knight, Chicago; James F. McCloud, Omaha, to succeed Bennett S. Martin, Lincoln; Cecil W. Weathers, Indianapolis, to succeed William W. Miller.

District No. 10
(Ohio, Eastern Kentucky)

Willis E. Doll, Cincinnati, Chairman; William O. Alden, Louisville; Herman Engler, Columbus; Oliver Goshin, Toledo; Alvin Stiver, Cleveland. Candidates for District Committee: Joseph M. Vercoe, Columbus, to succeed Edward M. Battin; Berwyn T. Moore, Louisville, to succeed Thomas Graham; J. Allison Dryden, Cincinnati, to succeed Neil Ransick.

District No. 11
(District of Columbia, Maryland, North Carolina, Virginia, West Virginia)

James M. Johnston, Washington, D. C., Chairman; Howard E. Demuth, Baltimore; William W. Mackall, Washing-

(*Continued on page 4, column 2*)

Finance Committee Reports Assessment Bases in Effect for Current Year

By HARRY W. BEEBE, *Chairman, Finance Committee*
(Following report submitted at October 2, 1944, meeting of Board of Governors)

At this time each year, the Chairman of the Finance Committee is called upon to give the Board a progress report on performance of the Committee's most vital function. That function, of course, is to provide the means whereby the money can be raised to carry on the work of the Association.

The Finance Committee met two months ago to consider and solve this annual problem. It had before it budgets of the fourteen District Committees for the fiscal year beginning today and ending September 30, 1945, as well as the budget of the Executive Office. The total expenditure forecast by those budgets for the current fiscal year was $390,000, approximately. During the last fiscal year, the Association's expenditures approximated $300,000. As you know, the Association may, during the course of the new fiscal year, be called upon to defend itself in an anti-trust proceeding and, of course, we have not yet had the SEC decision in the PSI cases, which decision may also result in court action.

Several formulas for raising the revenue needed to carry on our work this year were considered by the Finance Committee. It finally adopted the same formula as was in use last year, since that formula assured an income approximating the $390,000 that may be spent. The formula provides for a basic membership fee of $45, personnel assessment of $4.50 per unit and an underwritings assessment at the rate of 1¾ one-hundredths of 1 per cent.

One adjustment in the assessment formula, you will recall, was adopted by the Board in June. As a result, underwriters of so-called investment trust issues are being assessed on 50 per cent of their sales.

Membership this year is about the same as it was in 1943 —2,200. Personnel employed by members this year is about 42,500. Last year it was about 2,000 less.

In conclusion, you may recall that the forms sent to members this year called for a report of selling group participations of the member. This was the first time such figures were gathered. The Finance Committee voted not to provide for assessment of selling group participations for the present term. However, it decided that the subject should be fully explored in considering the assessment basis for the fiscal year beginning next October.

Executive Director's Report

(Continued from page 2)

the Commission to decide if it would resort to its discretionary powers and waive full compliance with the provisions of the statute. Counsel has prepared and submitted appropriate briefs for the Association, oral argument has been had, and a decision of the Commission is now awaited.

When-Issued Contracts

As the Board has periodically been informed, almost continuous conferences have been held over the past several months among representatives of the NASD, the New York Stock Exchange, the Curb Exchange, and the staff of the SEC on the subject of when-issued contracts. On all sides, the objective sought has been a method of surrounding such contracts with protective devices assuring prompt and efficient settlement of them at the minimum danger of disputes. The need for such arrangements has long been apparent. As a result of these conferences, tentative proposals have been advanced on the part of NASD, the Stock Exchanges and the SEC. It is the belief of the conferees that practical recommendations have been advanced, although differences remain to be negotiated.

Conclusion

In closing this interim report to the Board and Advisory Council, I feel that the time may be opportune to call attention, particularly of the Advisory Council, to a provision in the By-Laws to which District Committees might well, during the next several months, be giving thought and attention. I refer to Section 19, Article IV of the By-Laws, a portion of which reads as follows: "District Committees shall consider the practical operation of all provisions of the Certificate of Incorporation, By-Laws, Rules of Fair Practice and the Code of Procedure of the Corporation and shall report to the Secretary any which do not work satisfactorily in their respective Districts."

It is my own belief that certain of the By-Laws, and more particularly the Rules of Fair Practice, are in need of refinement, perhaps elaboration and extension in the interest of clarity and to meet new problems.

Nominating Committees

(Continued from page 3)

ton; Allen C. Ewing, Wilmington; L. Gordon Miller, Richmond. Candidates: George D. List, of Baltimore, and James H. Lemon, Washington, to succeed Harry R. Piet, Jr., Harold C. Patterson on District Committee.

District No. 12
(Delaware, Pennsylvania)

Robert G. Rowe, Philadelphia, Chairman; Arthur Burgess, Walter A. Schmidt, Philadelphia; Ernest O. Dorbritz, Robert C. Schmertz, Pittsburgh. Candidates: William K. Barclay, Jr., Philadelphia, to succeed Samuel K. Cunningham, Pittsburgh, on Board of Governors; S. Davidson Heron, Pittsburgh, to succeed himself, and Wallace M. McCurdy, Clyde L. Paul, Philadelphia, to succeed Mr. Barclay and David S. Soliday on District Committee.

District No. 13
(Connecticut, New Jersey, New York)

George W. Bovenizer, Chairman; Gail Golliday, Lee M. Limbert, Frederick J. Rabe, Walter F. Saunders, New York City.

District No. 14
(Maine, Massachusetts, New Hampshire, Rhode Island, Vermont)

Horace W. Frost, Boston, Chairman; Henry Lewis, Portland; Harold G. Meadows, William H. Potter, Jr., Boston; Harry G. Fraser, Providence. Candidates for District Committee: Carrell K. Pierce to succeed Virgil C. McGorrill, Portland; John R. Chapin to succeed Thomas A. West, Boston.

Quotations of NASD to Be Actual Retail Prices Supplied by Members

(*See page 6 for discussion of background of NASD quotations activities*)

Based on the fundamental principle that there is a wholesale and retail market for over-the-counter securities and that retail merchandisers of such securities have a right to make fair and reasonable profits in transactions with public investors, the Association on January 1 inaugurates a new method for gathering and distributing quotations.

Called a "sound and practical" solution to the problem by the National Quotations Committee, the objective is to supply the public with actual prices at which members of the Association would trade with the general public—in other words, RETAIL quotations.

Wallace H. Fulton, Executive Director, and Clarence E. Unterberg, Chairman of the NQC, are currently communicating with District and Local Quotations Committees throughout the country outlining the basic principles of the program, its purposes and how it will work.

Mr. Fulton reports that at its last meeting the Board of Governors adopted the following recommendations of the NQC:

1. All newspaper quotations sponsored by the Association be actual prices at which members will trade with the general public.
2. National Quotations Committee to counsel with District and Local Quotations Committees to the end that this recommendation be continuously in force.

Quotations based on any other method will not, after January 1, 1945, be sponsored by NASD.

Mr. Unterberg in his letter to District and Quotations Committees said the new program will result in improved quotations for the public and "protect the fundamental principle upon which our business functions—the existence of both a wholesale and retail market for over-the-counter securities."

Securities Business "Stays in High" for War Loan Drive

"Stay in high!" was the slogan for the securities business as it took its place in the Sixth War Loan drive. Having succeeded in distributing to public investors a record-breaking volume of corporate issues in the period just prior to the opening of the drive, investment bankers and securities dealers were resolved to keep up the pace throughout the war loan campaign when no new issues of securities that might detract from the drive will be publicly offered.

The current war loan drive is to run from November 20 to December 16. The goal is $14,000,000,000. The fifth drive raised $20,600,000,000 with a goal of $16,000,000,000.

An even $5 billion is to be raised through individual subscriptions. Banks are again excluded from direct participation in the current money-raising campaign.

A full kit of issues has been assembled. In addition to the standard E's, F's and G's, the current offering includes: 1¼ per cent notes due in 1947; 2½'s due in 1971 and callable in 1966; 2's due in 1954 and first callable in 1952; and one-year ⅞ per cent certificates of indebtedness.

Uniform Practice Code Amended in Respect to Stamp Tax Requirements

By HENRY B. RISING, *Chairman, National Uniform Practice Committee*

When the Uniform Practice Code was originally drafted, Section 14, relating to stamp tax requirements to effect good delivery, did not clearly state these requirements. It provided:

> *"Each delivery of a security subject to stamp tax shall be accompanied by a properly stamped bill."*

Difficulties and misunderstandings have arisen because of the inadequacy of this paragraph and there has been a definite need for clarification.

Upon the recommendation of the National Uniform Practice Committee, the Board of Governors has adopted a new Section 14 for the Code, *effective January 1, 1945*. Members have already received a letter from the Executive Office containing the new Section. Cashiers and delivery departments of members should promptly acquaint themselves with the provisions of this new Section, which are as follows:

> Section 14. (a) The seller shall furnish to the buyer at the time of delivery a sale memorandum ticket to which shall be attached and cancelled sufficient Federal transfer or documentary stamps and such State transfer stamps as are required by the State in which the sale occurs.
>
> (b) If any stamps in addition to those required by paragraph (a) hereof are desired by the buyer, the furnishing of such additional stamps by the seller may be made a part of the transaction by so specifying in accordance with Section 1 of the Code.
>
> (c) If the buyer has requested the additional State stamps, provided by paragraph (b) and at the time of delivery of the security the seller does not furnish or has not made adequate provision for such stamps, the buyer may furnish and cancel such additional State transfer stamps and deduct the cost thereof from the purchase price.

The following interpretation of Section 14 was adopted by National Uniform Practice Committee:

> *"The seller shall be entitled to assume under Section 14 of the Uniform Practice Code that the sale occurs in the State in which the seller is located and that the seller shall only be liable for the transfer tax stamps required by the laws of that State unless the buyer has at the time of the sale requested transfer tax stamps of some additional State, or unless the buyer has requested that the sale be made in the State in which the buyer is located."*

Subsection (a) of the new Section 14 merely requires the affixing of Federal tax stamps and such State transfer stamps as may be required by the State in which the sale occurs. Subsection (b) gives the buyer the right to request, at the time the transaction is made, that the seller shall furnish such additional State transfer stamps as the buyer may desire under the provisions of Section 1 of the Uniform Practice Code, which gives the parties a right to agree upon different

(*Continued on page 6, column 2*)

BACKGROUND FOR ASSOCIATION'S DECISION ON QUOTATIONS

Shortly after NASD was formed, the Securities and Exchange Commission appealed to the Association to take over the gathering and distributing of newspaper quotations for over-the-counter securities. For many years, these quotations had been obtained by newspapers from various sources in their own communities, although in New York City a central and reliable source for most quotations had developed. It was generally recognized that conditions prevailing the country over were unsatisfactory. NASD acquiesced in the Commission's request.

From the start, NASD endeavored to discharge this public service to the best of its ability—at considerable cost. It sought on the one hand to get to the public nominal quotations on over-the-counter securities which, while indicative of prices the public might receive or be charged, were not represented to be "markets" or prices at which dealers traded among themselves; and NASD sought, on the other hand, to protect rights of members of the Association whose livelihood depended upon their supply of securities in the "wholesale" market. The retailer of securities is not unlike any other merchant—to exist he has to be able to buy in a wholesale market and sell at retail. Newspaper quotations supplied by NASD were intended to indicate prevailing RETAIL prices. Results were not always above criticism but NASD's motives and objectives were beyond questioning. At no time has any newspaper ever complained about quotations received through NASD channels.

At regular intervals conferences were held with the staff and Commissioners of the SEC. These conferences could not be satisfactorily concluded from the standpoint of either side since spokesmen for the Commission contended for "inside" quotations, or prices in "actual transactions" in over-the-counter securities, *or* disclosure of current markets on confirmations. NASD consistently said it would not go into the business of publishing "inside" markets; it could not undertake the monumental task of creating machinery for recording actual transactions and it forcefully rejected demands for "disclosure." Meanwhile, the Association continued to do its best with an assignment that, more and more, became a difficult and a thankless one, considering that the staff of the Commission carried on a vigorous attack against over-the-counter quotations in court as well as in Commission proceedings.

Early this year, the Commission asked for a complete report of how quotations were gathered and computed. This report was submitted promptly. A short time later, in April, the Commission sent a letter to the Association in which it stated that in its opinion, quotations supplied by the Association were "fictitious," within the meaning of Section 15 (c) (2) of the Securities Exchange Act. The letter went on to say that the Commission recognized the efforts that had been made by NASD to improve the publication of over-the-counter quotations "for the benefit of the public," adding its conviction that the Association had "at all times acted in good faith."

The National Quotations Committee, upon receipt of this letter by the Association, met to discuss action to be taken under the circumstances. It remained firm, as it always had, on fundamental differences as between what the SEC ultimately sought and what NASD would agree to. The National Committee communicated with District and Local Quotations Committees throughout the country. Out of its meetings and contacts with these committees, the National Quotations Committee arrived at a solution to the question presented and recommended this solution to the Board of Governors for adoption. On October 2, 1944, the Board approved the recommendations of the National Quotations Committee. (These recommendations are contained in an accompanying article.) The Commission, on October 13, 1944, was informed of this action of the Board.

Uniform Practice Code Amended

(*Continued from page 5*)

terms and conditions. Subsection (c) gives the buyer the right, if the parties have agreed at the time of the transaction, upon furnishing the transfer stamps of an additional State, to deduct the cost of such additional State transfer stamps from the purchase price if the seller has not furnished or made adequate provision for the furnishing of such additional stamps.

The interpretation of the new Section 14 provides that the seller shall be entitled to assume that the sale occurs in the State in which the seller is located; that the seller shall only be liable for the transfer tax stamps required by the laws of that State unless the buyer at the time of the sale has requested transfer tax stamps of some additional State or the sale has been made in the State in which the buyer is located.

It is believed that the various practices which have been in use in many parts of the country in handling transfer taxes can readily be accommodated to the simple requirements of this new Section.

The National Uniform Practice Committee has also ruled that the use of stock clearing corporation facilities for the purchase of stamps and the use of a rubber stamp as provided thereby will meet the requirements of this Section.

Candidates of New York Committee

Irving D. Fish and B. Winthrop Pizzini have been nominated for places on the Board of Governors of the Association representing District No. 13 (New York, New Jersey and Connecticut) to succeed James Coggeshall, Jr., and Clarence E. Unterberg, both New York City. The following were nominated for the District Committee: T. Jerrold Bryce, Philip L. Carret and George J. Leness to succeed Mr. Fish, Frank Dunne and Charles F. Hazelwood, all New York City; also Roy W. Doolittle, Buffalo, to succeed David S. Rutty, Rochester.

(*See page 3 for other news on nominations*)

SEC Holds Association Did Not Impose 5% Rule, Offered "Criterion"

(*Continued from page 1*)

centage of spread or mark-up on securities selling below $10.'

"The Board of Governors denies that the objective of the letters was to limit all spreads to 5 per cent. In a letter dated June 6, 1944, from the Chairman of the Board of Governors to the Chairman of District Committee No. 13, in answer to an inquiry whether the Committee was correct in understanding the Board's policy—'as constituting a desirable objective or yardstick to be considered by the District Business Conduct Committee in applying the Rules of Fair Practice in the light of the circumstances surrounding the particular transaction under examination'—the Chairman of the Board replied as follows: 'you are correct in your understanding that the policy announced by the Board in its letter of October 25 and the subsequent letter of November 9, 1943, is not a rule, but should be considered by District Business Conduct Committees as a desirable objective or yardstick, neither more nor less, and be employed by them in the light of the circumstances surrounding each transaction which may be the subject of examination or review under the Rules of Fair Practice.'

"The main basis of petitioners' apprehension that the policy announced in the letters foreshadows a practice of limiting mark-ups over current market prices to 5 per cent is the following two paragraphs in the letter of November 9 to the District Business Conduct Committees:

" 'The general import of this statement and the construction that should be placed upon it is that when transactions show a mark-up of over 5% on the part of a member, it raises the question as to whether there is a violation of the Rule and interpretation. In such a situation, a duty is imposed upon the member to show to the satisfaction of the Business Conduct Committee that no violation has occurred.

" 'In the final analysis, the Business Conduct Committee must be impelled to act where a member sells securities at a price which bears no reasonable relationship to the current market. Isolated transactions, where the spread or mark-up is in excess of 5%, may warrant only informal inquiry or a precautionary letter, but where *practice* is established, formal complaint procedure is the recommended course.'

"It is argued that the Board's action purports to require the local committees to file complaints where more than 5% spreads are taken as a matter of practice, and purports to shift the burden of proof in such a case from the local committee to the accused member. Concededly, the announcement of the 5% figure as the basis of the Board of Governors' spread philosophy touches upon the following three aspects of disciplinary proceedings:

"(1) The circumstances under which the local committees are advised to institute proceedings; (2) The burden of furnishing an explanation of prices questioned in such proceedings, and (3) The decision as to what spreads or mark-ups are to be deemed violations of just and equitable principles of trade.

"As we have already noted, there are two procedures provided in the rules for the institution of trade practice complaints, both prescribed by Article IV of the Rules of Fair Practice. . . . Nothing is said to indicate whether the Board of Governors may or may not file such a complaint on its own motion, but whether it could do so or not in a specific case, plainly it has no authority to direct such action in the abstract. Thus, even if its language had been in terms of command rather than the 'recommended course,' the Board's action would not have the force or effect of a rule. The institution of formal proceedings against members is a local matter, and the committees are free to apply their own judgment for determining when to bring disciplinary proceedings.

"We do not interpret the Board's letters to read otherwise. They specifically state that all other factors are to be considered in determining when to bring proceedings. As we interpret the Board's action, it constitutes not a rule but notice to the membership of what the current trade practice is found to be and of what procedure the Board advises the committees to follow in trade practice cases. . . .

"Under this heading ("Burden of Proof") falls the statement contained in the letter of November 9, to the effect that when transactions show a mark-up of over 5% on the part of a member 'a duty is imposed upon the member to show to the satisfaction of the District Business Conduct Committee that no violation has occurred.' This statement purports to be an explanation of statements contained in the letter of October 25.

"To speak of formal burdens of proof in the context of a disciplinary proceeding held before a committee of the NASD may appear somewhat over-technical, since the proceeding is heard by the accused member's fellow businessmen, who are supposed to bring their knowledge of trade practices to bear upon the case and make their determination in the light of their experience as technicians in the securities markets rather than as lay jurors or legalized judges. Nevertheless, we think a substantial question of justice and fair dealing is raised by this part of the correspondence.

"If the above statement in the letter of November 9 is taken literally, it means that in any trade practice case mark-ups of over 5% are presumptively violative of Section 1 of Article III of the Rules of Fair Practice, and the burden is on the accused member to furnish evidence which will 'show to the satisfaction of' the committee 'that no violation has occurred.' In other words, the complainant would only have to show mark-ups of more than 5% over current market to establish a *prima facie* case against a member, at which point the member has the burden of introducing evidence that will persuade the committee that such transactions, in the light of all the circumstances, were consistent with just and equitable principles of trade.

"In our opinion, such an interpretation is inconsistent with the purport of the letters of October 25, 1943, and June 6, 1944, as well as with statements in the letter of November 9 itself, which expressly recognize that pertinent circumstances other than the percentage of mark-up must be taken into account and that a reasonable mark-up may sometimes be less and sometimes more than 5%. We, therefore, think the statement on this point in the letter of November 9 is erroneous, and believe that, if a trade practice case were decided on the basis of the presumption stated, it would be our duty to set aside the determination upon review. But this means only that the officers responsible for the letter of November 9 were in error in their interpretation of the Board's letter of October 25. The letter of November 9 was not distributed among NASD members but was sent to the

(*Continued on next page*)

(*Continued from page 7*)

various District Business Conduct Committees, over the signatures of the Board's Chairman and the Association's Executive Director. The Board, it will be noted, does not appear to have authorized or voted upon the statement in question.

"Our conclusion on this point is that there is at present no rule on which we may act. However, it may be appropriate for the Board or its officers to notify the District Business Conduct Committees that mark-ups in each case are to be viewed in the light of all pertinent circumstances, that no presumption of a violation arises solely on the basis of a spread in excess of 5% and that no accused member has a burden of proving his innocence merely because his spreads have exceeded that percentage. Determinations by the committees and by the Board on review must be based on a consideration of all the pertinent factors, of which the percentage of mark-up is only one.

"The third aspect of the letters is that they set forth a flexible criterion to be used in determining what prices, inclusive of spreads or mark-ups, bear a 'reasonable relationship' to current market. As we have already noted, the percentage of spread or mark-up is only one of the factors pertinent to such a determination. Others include consideration of the dollar amounts involved, market conditions in the particular security, the relationship between the member and his customer, and any unusual circumstances incident to the particular transaction. The Board also recognizes that the Association is 'devoted to the principle that its members are entitled to make a profit,' as stated in the letter of October 25. The same principle is embodied in Section 4, Article III, of the Rules of Fair Practice.

"The Board emphasizes that 'it would be impracticable and unwise, if not impossible, to write a rule which would attempt to define specifically what constitutes a fair spread or profit, or to say, in exact percentage of dollars, what would result in each and every transaction, in a price to the customer which bears a reasonable relationship to the current market.' What the Board did was to serve notice on the membership that Section 1 of Article III of the Rules of Fair Practice would be enforced 'having in mind the percentage of profit [5%] on which 71 per cent of the transactions above referred to were effected.'

"We have pointed out above that trade practice cases within the NASD are heard by the accused member's fellow businessmen, who are supposed to approach each case as experienced members of the trade, familiar with its problems and practices. In this setting it appears eminently proper that investigations of fact conducted by the Association to determine what the practices of the membership are in particular respects should be reported to the members and considered in the application and enforcement of standards of conduct.

"True, the Board was under no duty to notify the membership of its decisional policies. It could take up trade practice cases one by one and in rendering its decisions inform the members of what they might expect by way of pricing policies. Often the case by case method of making policy is necessary. Sometimes, on the other hand, advance notice can be given. The Board here determined that giving advance notice was the fairer method, and we see no reason for criticizing its determination or doubting its good faith.

"The giving of such notice does not establish a rule. The only rules that can be held to have been violated by a member in such cases are duly constituted rules of the Association, such as the Rules of Fair Practice, as interpreted and applied by the committees and the Board.

"We do not now pass upon the merits of the proposed interpretation or policy to be applied, for this may be done only upon review of an individual trade practice case where the pertinent facts are in evidence and the issue is whether, upon the whole record, the acts or practices complained of are inconsistent with just and equitable principles of trade.

"Having examined the correspondence as it relates to the different aspects of disciplinary action, we conclude that it falls short of establishing a rule. It is still too early to judge how the Board's announced policy will be applied in specific cases. While over a year has passed since the policy was announced, no appeal from disciplinary action has been brought to us in which it was contended that the policy was used as a rule in the proceeding. We think it is only fair that the Board and officers of the Association be given credit for good faith with respect to their statements in the letters and in their brief, that the announcement of the policy does not relieve the committees or the Board from examining all the facts, and that the policy is by no means an inflexible limitation on spreads.

"It appears that most of the fears expressed by the petitioners that the policy will have the effect of a rule are based on a lack of understanding of the powers and limitations on the powers of the Board of Governors and committees under the By-Laws and the Act itself. The procedures in the Act, in our opinion, offer adequate safeguards against the use of the policy as a rigid limitation on spreads. We are satisfied that the Board's action here was well within the sphere of interpretation, and under the circumstances the ultimate insurance against the dangers feared by the petitioners is the right to appeal from the decisions of the Association to this Commission and to the courts. The contentions they present here are premature.

"We conclude, therefore, that the policies announced in the letters of October 25 and November 9, 1943, do not comprise a rule and do not and cannot have the effect of a rule. . . . By the Commission (Chairman Purcell and Commissioners Healy, Pike, O'Brien and McConnaughey)."

NASD NEWS

Published periodically by National Association of Securities Dealers, Inc., under the supervision of the Board of Governors.

Ralph Chapman, *Chairman*

Vice-Chairmen

James Coggeshall, Jr. — Hermann F. Clarke

Albert Theis, Jr., *Treasurer* — Wallace H. Fulton, *Executive Director*

James P. Conway, *Editor*

Salesmen, traders, cashiers as well as partners and officers of members should read the NEWS regularly.

For your supply of extra copies write Wallace H. Fulton, Executive Director, 1616 Walnut St., Philadelphia 3, Pa.