

## Regulation T

### NASD given authority by Federal Reserve to pass on requests for extensions by members

A recent amendment to Regulation T of the Board of Governors of the Federal Reserve System gives NASD authority, heretofore granted exclusively to Stock Exchanges, to receive applications in respect to the following:

1. A request for an extension of the period within which a transaction in a SPECIAL CASH ACCOUNT must be completed;
2. A request to authorize the transfer of a transaction from a SPECIAL CASH ACCOUNT to a general account or special omnibus account; and,
3. A request to authorize the disregarding of the prohibition in Section 4(c) (8) and effect a transaction in a SPECIAL CASH ACCOUNT.

Requests for the extension of the period in which required MARGIN REQUIREMENTS must be deposited in general accounts are NOT to be made of the NASD—but to stock exchanges as heretofore.

### District Administration

Members not familiar with provisions of Regulation T and recent amendments should acquaint themselves with these if they intend to have recourse to the privileges extended.

Consideration is being given by the NASD to the administrative machinery necessary to handle the applications relative to requests outlined above. Stock Exchanges have co-operated by supplying forms in use for several years as well as reviews of their experiences. As soon as possible, members in various parts of the country will be notified by their District Committees of procedures to be employed in their own districts as these become prepared to undertake the service. Dealers who are also members of an exchange should continue to address their requests to such exchanges. Until NASD Committees are prepared to

## CONFIRMATIONS

See pages 3 and 4 for sample forms fulfilling minimum requirements of NASD and SEC rules

establish District service of this kind, members who have employed stock exchange facilities for Regulation T extensions should continue to do so.

It is pertinent to point out that Regulation T is applicable "... to every member of a national securities exchange and to every broker or dealer who transacts a business in securities through the medium of any such member." Accordingly, any member thus affected should, if he has not already done so, obtain from a Federal Reserve Bank a copy of Regulation T and the amendments thereto.

## ARBITRATION METHODS STUDIED

Suggestions have been made from time to time that the Association develop formal machinery for the arbitration of disputes between members. At present, the only method by which the Association can deal with such matters is by complaint procedures or informally.

Accordingly, the Board made an extensive study of the machinery by which members' disputes might be quickly and fairly settled. The program as finally presented provided for arbitration boards in all districts to which all such disputes could be referred. After careful consideration of the program by the various District Committees, and on the basis of recommendations made by these, the Board decided that the plan is not feasible at this time and tabled consideration of the matter.

However, it is pointed out that members' disputes can continue to be arbitrated informally by the Association when both sides request such assistance.

## "Yes" on Registry

### New amendments making individuals subject to Association rules voted by 1,022 to 605

The amendments to the Association's by-laws proposed at the June Board meeting which, in effect, will make partners, officers, salesmen, traders and certain other employees of member firms equally responsible with the firms themselves for the observance of the Code of Fair Practice, have been passed by a substantial majority.

The vote was 1,022 in favor, 605 against. Counting of the returns was completed on July 25, affording a five-day interval after the deadline for posting the ballots for mail to reach Philadelphia from the most distant districts. Members were notified by letter of the outcome of the voting.

### Next Step SEC Filing

The Association's next step was to file an amendment to its registration statement with SEC, incorporating the new provisions which have just been passed by vote of the members. This was done on July 30. Unless SEC disapproves, the amendments become effective 30 days from date of filing. Forms for the registration of individuals will be forwarded to members as soon as possible and registration of these will be completed by about October 1.

### Balloting Secret

Every measure was taken to safeguard the secrecy of the ballots. In order to make sure that only those casting ballots were authorized to speak for member firms, a signed statement was mailed with the ballot, but sealed separately. In those few instances where instructions were disregarded and the statement was obviously enclosed with the ballot, the envelope was opened by two disinterested observers not connected with the securities business who were appointed for the purpose.

(Continued on page 2, column 3)

## Questionnaires

### Board concludes they are only currently available means to carry on mem- bership examination

Some day someone may perfect a questionnaire which those who must will enjoy filling out. But that day is not yet on the horizon. Meantime, if a vote were taken it would be found that no one, certainly no "back office" employee of a securities firm, wanted ever to see another questionnaire.

Fully aware of these sentiments, Governors of the Association and the fourteen District Chairmen at their meeting in June reviewed at length this most sensitive topic. Historically, the facts are as follows:

NASD examination work started in 1941. At the start, staff examiners were used. Several hundred members were examined in this manner with fairly satisfactory results and altogether favorable member reaction. After several months this process had to be discontinued on a membership-wide basis because the cost became burdensome and the war brought about a disappearance of men available to do this work.

### Question of Manpower

A few districts began experimenting with questionnaires, and in 1943 a questionnaire was adopted for use on a national basis. Early in 1944 and again in January of this year, the Board studied the problem of member examination. Each time it was concluded that the questionnaire, in view of conditions existing and the future outlook, afforded the only means of conducting this essential activity.

Wallace H. Fulton, Executive Director, in his report to the Board, had this to say on the subject:

"When manpower is again available, it has been my hope that we would be able to carry on personal examinations by staff people throughout the membership and on a continuing basis. When that time arrives, it would seem that the Board properly should examine into the whole question of the use of questionnaires and examinations by staff examiners and decide which of these methods is the most satisfactory, most efficient and most useful, considering member preferences and ultimate ends sought through the examination process.

"Sight should not be lost, at this juncture, of the valuable amount of information that has been accumulated

during the last three years through our use of questionnaires. [See page 6.] This Board is fully aware of the considerable amount of statistical and factual information that has been extracted from questionnaires—information that had never before been compiled and to which we may often have recourse as time goes on for the purpose of meeting problems and of refuting uninformed charges against the over-the-counter business. In this field alone, the questionnaires have proven their worth."

By way of final report, it can be said that the last 500 questionnaires on 1945 transactions are in the mails, completing this year's inquiry.

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## YOUR 1945 CERTIFICATE



All members of the Association are entitled to a Membership Certificate, to be displayed in their offices. Write to the Executive Office for your copy.

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## "RED HERRING" USE NOW LIMITED

During the highly active underwriting month of July certain new issues were handled in which "red herring" prospectuses could be distributed to underwriters only. This resulted from the fact that three months ago the SEC made a "general policy" announcement regarding requests for acceleration of effective dates of registration statements. This announcement said that in cases where "red herring" prospectuses do not meet the standards of disclosure required by the Securities Act, the SEC would not order acceleration until it had received satisfactory assurances that by appropriate means the nature of material amendments to the registration statement had been communicated to persons receiving "red herrings."

The effect of this policy pronouncement was severely to restrict under-

writers' use and circulation of "red herrings" and consequently to deprive participating dealers—especially those remote from large financial centers—of sources of information on forthcoming issues.

Underwriters and dealers, guided by advice of their own counsel, have been endeavoring to comply with the Commission's statement and at the same time preserve as far as possible a vital instrument in the successful distribution of securities.

The subject has been reviewed at length by the Board of Governors and suggestions that have been received for surmounting the difficulties have been carefully studied. While it is believed that any permanent solution to be worked out necessarily must start with some relief from the law, a committee is studying practical phases of the problem. The Committee:

Clement A. Evans, Irving D. Fish, S. Davidson Herron, June S. Jones, Robert S. Morris, James Parker Nolan, John J. Quail, John B. Shober and J. Robert Shuman.

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## "Yes" on Registry

*(Continued from page 1)*

The same two representatives did the actual counting of the votes, comparing their scores to make sure that the tally was correct.

Of the total membership qualified to vote, 71½ per cent cast ballots during June and July. While it was hoped that the secret voting procedure would bring out a larger proportion of the "electorate," the showing was almost exactly the same as in the voting on amendments three years ago, when 73 per cent of those qualified voted; 37 per cent voted "no" in this year's voting as compared with 38 per cent three years ago.

A 71½ per cent vote may be considered above the average. It is estimated that only 63 per cent of the national electorate voted last November and 65 per cent in the 1940 national presidential elections.

## Member Responsibilities Same

The responsibility for upholding the standards of business practice for which the Association was formed rests in the long run upon individuals, and the new amendments make this responsibility specific. The relations of member firms and the Association is not changed by the new measures.

The registration of individuals, which it is hoped will be completed by October 1, supplements the existing registration of firms.

# Confirmations That Conform

Sample legends, reprinted herewith, for confirming broker-dealer transactions with customers, embody minimum information required by NASD and SEC rules

The following article, together with the specimen confirmation forms satisfying the minimum requirements of NASD and SEC rules, is reprinted from an earlier issue of *NASD News*. Since the Association has gained many new members since this information last appeared, it has been thought advisable to make it once more available.

The pages should be preserved for continuing reference.

A study by the NASD of confirmations in use in various sections of the country discloses the fact that improper legends are at times employed to inform customers of the position of the member in the transaction. To clarify requirements of the NASD and the SEC on this matter, sample legends have been drafted containing the *minimum* disclosure to be made under given sets of circumstances.

These sample legends are set forth on the next page, and cover all types of broker-dealer transactions—those in which the member buys or sells as principal, or acts as broker for purchaser or seller, or acts as broker where some other person is involved. The following discussion reviews the rules and interpretations which form the background for the sample confirmations there presented.

Requirements with respect to confirmations are covered in Section 12 of NASD's Rules of Fair Practice. The Section reads:

**12. A member at or before the completion of each transaction with a customer shall give or send to such customer written notification disclosing (1) whether such member is acting as a broker for such customer, as a dealer for his own account, as a broker for some other person, or as a broker for both such customer and some other person; and (2) in any case in which such member is acting as a broker for such customer or for both such customer and some other person, either the name of the person from whom the security was purchased or to whom it was sold for such**

**customer and the date and time when such transaction took place or the fact that such information will be furnished upon the request of such customer, and the source and amount of any commission or other remuneration received or to be received by such member in connection with the transaction.**

This Section is substantially identical with SEC Rule X-15C1-4. Therefore, compliance with NASD Section 12 will automatically constitute compliance with the SEC Rule.

## Definition of "Customer"

It is to be noted that prescribed disclosures are to be made by a member only to his "customer." The term "customer" does not include a broker or dealer. Hence, a member trading for or with another broker or dealer need not impart the information called for by Section 12. With this exception, any person for or with whom a member trades is entitled to the required information. Failure to supply the required information constitutes a violation of NASD and SEC Rules.

## When to Confirm

With respect to the time when disclosure must be made, Section 12 makes provision for the giving or sending of written notification at or before the completion of the transaction. (The phrase "the completion of the transaction" is expressly defined in Section 1(j) of Article II of the Rules of Fair Practice.)

In the normal situation, where a customer buys a security, the completion of the transaction occurs when the customer, subsequent to the time of purchase, makes payment to the member of any part of the purchase price. Similarly, where a customer sells a security, the completion of the transaction normally occurs when the customer, subsequent to the time of sale, delivers the security to the member. Thus, the required disclosure should ordinarily be transmitted to the customer before he makes payment for the security he is buying or makes delivery of the security he is selling.

If, before the transaction, the mem-

ber already has custody of his customer's funds or securities, a different situation is presented. In such case, the completion of the transaction does not depend upon any act of the customer but is at the will of the member. Hence, the time of completion is defined as the moment when the member makes a bookkeeping entry of the payment of the purchase price by the customer-purchaser or the member transfers the security from the account of the customer-seller.

## Contingency Due to Customer

A further contingency is provided for: where a customer, after the transaction is effected, anticipates payment or delivers the security to the member in advance of the time when he is requested to do so. In such cases, if the customer is a buyer, the completion of the transaction occurs when the member delivers the security to the customer or into his account; and if the customer is a seller, when the member makes payment to or into the account of the customer. By this provision a member is protected against the risk of a technical violation occasioned by the act of the customer in mailing the security or the check for payment after the transaction has been effected, but before the delivery date and before the member in the normal course of business would have dispatched the confirmation bearing the required disclosures.

## All Data on Members' Capacity

Turning now, in more detail, to the nature of the disclosure to be made, Section 12 requires that, at or before the completion of each transaction involving a customer, the member notify the customer in writing of the capacity in which he is acting in the transaction. He must specify not only whether he is acting as dealer or as broker, but whether he is acting exclusively as broker for the customer, exclusively as broker for some other person, or as broker for both parties.

A further requirement in Section 12 is applicable only as between a broker and the customer for whom he is acting as agent. At or before the completion of each such transaction, a broker

must disclose in writing to his customer the name of the other party to the transaction and the date and time of the transaction, or the fact that this information is available to the customer upon request, which request *need not be in writing*. The source and amount of any commission or other remuneration received by the broker in the transaction must also be revealed. The requirement for disclosing the name of the other party to the transaction is satisfied (if the other party acts through his own broker) by disclosing the name of such other broker.

#### **No "Blanket" Disclosures**

It is important to note that the disclosures prescribed in Section 12 must be made in each transaction and that a general or "blanket" disclosure with respect to all future transactions with a particular customer is not sufficient.

The information should be furnished in language that is clear and unequivocal. The use of terms which have acquired a special significance to persons engaged in the securities business should be avoided if the same meaning would not be attributed to those terms by the average customer.

#### **Instructions to Salesmen**

Although the time fixed for the disclosure of the capacity in which a member acts is "at or before the completion of the transaction," it has always been in accord with sound practice and with fundamental concepts of law that the customer and the member have a clear understanding at the earliest possible moment as to whether their relation is to be that of principal, agent or otherwise. Wherever feasible, the customer should be informed on this point before any contract is made with him or on his behalf.

Some members already have made appreciable progress in this direction by instructing their salesmen to inform each customer in advance of a transaction that the firm is selling its own securities or buying the customer's securities for its own account. In connection with sales, particularly, these firms have evolved an effective method of enforcing compliance with this policy. If it is not certain that a salesman has clearly explained to a customer the firm's capacity in the transaction, the firm executes the order on a brokerage basis with the result that the proportionate share of commission received by the salesman is considerably diminished.

#### **WHERE MEMBER BUYS AS PRINCIPAL**

As Dealer (Principal) and for our own account, we confirm Purchase from you of—(the securities described):

#### **WHERE MEMBER SELLS AS PRINCIPAL**

As Dealer (Principal) and for our own account, we confirm Sale to you of—(the securities described):

#### **WHERE MEMBER ACTS AS BROKER FOR PURCHASER**

As your Broker (Agent) we have Bought for your account and risk—(the securities described):

Upon request we will furnish the name of the person from whom the within named securities were purchased and the date and time when such transaction took place.

Commission . . . . . [See Note A]

#### **WHERE MEMBER ACTS AS BROKER FOR SELLER**

As your Broker (Agent) we have Sold for your account and risk—(the securities described):

Upon request we will furnish the name of the person to whom the within named securities were sold and the date and time when such transaction took place.

Commission . . . . . [See Note A]

#### **WHERE MEMBER ACTS AS A BROKER FOR BOTH CUSTOMER AND SOME OTHER PERSON**

As your Broker (Agent) we have Bought for your account and risk—(the securities described):

Upon request we will furnish the name of the person from whom the within named securities were purchased and the date and time when such transaction took place. In this transaction we are acting as Brokers (Agents) for both buyer and seller.

Commission . . (from buyer) (Total in Dollars and Cents) . . [See Note B]  
Commission from seller . . . . . (Total in Dollars and Cents) . . [See Note B]

#### **WHERE MEMBER ACTS AS A BROKER FOR BOTH CUSTOMER AND SOME OTHER PERSON**

As your Broker (Agent) we have Sold for your account and risk—(the securities described):

Upon request we will furnish the name of the person to whom the within named securities were sold and the date and time when such transaction took place. In this transaction we are acting as Brokers (Agents) for both buyer and seller.

Commission . . (from seller) (Total in Dollars and Cents) . . [See Note B]  
Commission from buyer . . . . . (Total in Dollars and Cents) . . [See Note B]

#### **WHERE MEMBER ACTS AS BROKER FOR SOME OTHER PERSON AND SELLS**

As Broker (Agent) for the seller (another) we confirm Sale to you of—(the securities described):

#### **WHERE MEMBER ACTS AS BROKER FOR SOME OTHER PERSON AND BUYS**

As Broker (Agent) for the purchaser (another) we confirm Purchase from you of—(the securities described):

[NOTE A—*The total amount of commission must be disclosed in dollars and cents to the customer to whom confirmation is sent. If any other commission or remuneration is received or is to be received in connection with the transaction from any source other than the customer who is to receive the confirmation, both the source and the amount should be disclosed.*]

[NOTE B—*If any other commission or remuneration is received or is to be received by the member from any source other than the customers (buyer and seller) in connection with the transaction, both the source and the amount should be indicated to both customers.*]

# ASSOCIATION DEVELOPMENTS

## NASD CHAIRMAN AT COAST MEETINGS

Since the Board meeting in June, the chairman of NASD's Board of Governors, Ralph E. Phillips, has made a brief tour of West Coast cities where he appeared as the principal guest at a series of meetings with NASD members and District Committees. He was accompanied by Wallace H. Fulton, Executive Director. Mr. Phillips is the first Californian among the seven Board chairmen which NASD has had since its formation. All parts of the country have contributed to NASD leadership. The list of chairmen of the Board of Governors to date is as follows:

1939—B. Howell Griswold, Jr., Baltimore.

1940—Francis A. Bonner, Chicago.

1941—Robert W. Baird, Milwaukee.

1942—H. H. Dewar, San Antonio.

1943—Henry G. Riter, 3rd, New York.

1944—Ralph Chapman, Chicago.

1945—Ralph E. Phillips, Los Angeles.

The itinerary of Mr. Phillips and Mr. Fulton on the Coast included Los Angeles, San Francisco, Portland and Seattle; a meeting scheduled for Spokane had to be cancelled because of transportation difficulties. The West Coast trip was preceded by a visit of the Chairman to New York, where he addressed District No. 13 members at a mid-June meeting

## PSI CASES

The Board of Governors having decided not to appeal a decision of the SEC denying that NASD had authority to enforce price maintenance agreements in underwriting of securities, the Association is preparing to refund fines collected from members found to have violated underwriting and selling group agreements in a public offering of Public Service Company of Indiana bonds in December, 1939.

Seventy-one members were fined varying amounts. The amount collected, \$6,700, was placed in a reserve account. These funds are now to be turned back to those from whom they were collected. The process, with respect to fined members who are *still*

members, is simple and is under way. However, several organizations that were members and participated in the PSI distribution have been dissolved or been absorbed by or merged with other members in the interval. Careful inquiry is being made to ascertain means by which fines collected from such former members may be returned.

Decision not to appeal the findings of the SEC in the prolonged review of NASD's PSI actions was based upon the limited nature of the Commission's opinion. "We emphasize," the opinion said, "that all we are holding is that the NASD erroneously construed its rules as authorization for the disciplining of members for violating price-maintenance agreements."

The Executive Committee and Counsel, with the Board concurring, concluded that the opinion dealt with a phase of NASD disciplinary authority that was of minor importance in relation to the broad purposes of the Association and raised no issues in respect to enforcement of other statutory powers. Under the circumstances, and considering that an appeal would be a long and costly undertaking, it was unanimously agreed among members of the Board that no appeal be made of the SEC decision.

## Member Suspended

### NASD disciplinary action upheld by SEC

In the first test of an NASD decision involving violations of the Fair Practice rule dealing with recommendations made to customers, a one-year suspension of a member ordered by a Business Conduct Committee has been upheld by the SEC on appeal by the member.

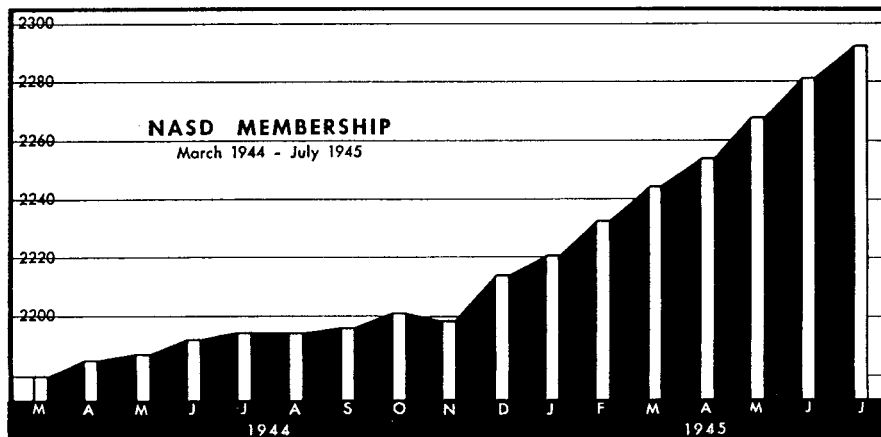
The complaint arose out of transactions effected by the member in shares of open-end investment trusts. The member was found, after investigation and hearings, to have withheld from customers the facts about transactions recommended and that recommendations were made without the member having reasonable grounds for believing them suitable for the customers.

NASD's Business Conduct Committee found that the member failed to explain to customers the manner in which prices of such shares are computed, effect of dividend payments on redemption prices or the selling "load" included in the price.

## NASD MEMBERSHIP CLIMBS

A steady flow of applications for membership in NASD testifies to the return of many people to the business who left it in recent years to enter military service or engage in war work. The increase noticeable since March, 1944, has greatly accelerated in recent

months. As of the end of July, 1945, NASD membership had mounted to 2,293. It is noteworthy that many admitted in the last six months had been previously engaged in the municipals business. The new members are well distributed geographically.



## "Mark-Ups"

Reprinted from the June number of the periodical issued by and for State securities officials

Much has been written and much more said about the subject of mark-ups by brokers dealing in over-the-counter securities, usually of a local market nature. A discussion of this question really resolves itself into a separation of the sheep from the goats in the securities industry. Hundreds of firms, scattered from coast to coast and border to border, in business in many instances for many years or even decades, enjoying reputations of business integrity, have been penalized for the sins of other firms of the fly-by-night variety. The established house, which from the very fact of its establishment must be doing a legitimate business at a reasonable mark-up, suffers serious impairment of its standing in the public eye from publicity which critically questions its conduct when the criticism should be more explicit and be directed against the here-today-and-gone-tomorrow type of firm whose interest is usually in one sale to a customer, and that a quick one.

It is true that firms do organize for the sole purpose of getting the customer's money and give nothing of great value therefor, but it is grossly unfair to publicize surveys and research efforts of organizations which tell the truth, to be sure about a certain class of dealers who may be evildoers without giving due credit to the established firms of good repute who continue in business year after year with satisfied clients and an ever-expanding clientele.

The National Association of Securities Dealers in 1943 conducted a questionnaire examination of its 2,300 members. The questionnaire called for facts revealing the prices charged customers in relation to cost and in relation to prevailing market. Over 60,000 principal transactions were reported via the questionnaires. NASD's study of these transactions revealed that 47 per cent were made at a mark-up of 3 per cent or less and 71 per cent at a mark-up of 5 per cent or less. In October, 1943, the Board of Governors of NASD sent a letter to the membership advising it of these findings, coupling this information with a statement that Business Conduct Committees had been advised to enforce

the rules of fair practice (the two principal ones being, first, that members observe high standards of commercial honor and just and equitable principles of trade and, second, that prices charged customers in principal transactions be "fair"), keeping in mind the mark-up practice guiding members in the vast majority of these transactions, as indicated by the studies of pricing practice revealed in the questionnaire.

In 1944 NASD conducted a similar questionnaire examination. When studies of the 1944 pricing practices were completed, they showed that on approximately 65,000 transactions reported on questionnaires, 51 per cent were made at mark-ups of 3 per cent or less, while 82 per cent were made at mark-ups of 5 per cent or less.

The principal transactions covered by the NASD studies of the last two years involved all types of securities (except municipal and other exemptions)—bonds, preferred and common stocks. They covered securities of all kinds—industrial, bank, insurance, railroad, etc. These securities sold in all price ranges—low-priced, medium-priced and high-priced. Every section of the country was represented, every type of dealer from the smallest one-man shop to the largest underwriting and trading organizations in the business. In contrast to some sweeping allegations that very large profits and mark-ups are made by dealers in over-the-counter securities, the NASD studies showed that only about 2 per cent of transactions analyzed in 1944 were at mark-ups of 10 per cent and more and as the individual securities involved

in these transactions were examined, it was found that many of the issues were in the lowest-priced brackets and many of the transactions themselves involved relatively small amounts of money. In any consideration of the fairness of the percentage of a dealer's profit in a given transaction, certainly the amount of money involved is a factor. On this score, it is interesting to find from a representative sampling of NASD's members' transactions in 1944 that about one-third of them involved less than \$500 per transaction.

Instances have been found in the past where a dealer has taken exorbitant profits or mark-ups running to 25 per cent and sometimes more, but the NASD and SEC, to say nothing of the effective surveillance applied by State Securities Commissions, have succeeded in making such instances more and more rare.

A great deal more in the way of factual material on the business practice of NASD members has been compiled from the questionnaire programs of the last two years, but for the immediate purpose, the facts recited above would seem to be conclusive: first, that established and reputable dealers in securities operate, on an average, at modest rather than exorbitant profit margins, and, secondly, that a 5 per cent guide has been supplied the business, which obviously is being applied, unless circumstances surrounding the individual transaction would seem to justify realizing a higher percentage and where that is done, the transaction is subject to study by the appropriate Business Conduct Committee of NASD.

