

PUBLIC HEARINGS OF SEC EMPHASIZE NEED FOR REG. REP. TRAINING AND TOUGHER RULES



Testifying at the SEC Public Hearings were left to right—Ray Moulden Sec., Investment Companies Committee; Marc White, NASD General Counsel; Avery Rockefeller, Board Chairman; Wallace H. Fulton, Executive Director and John Hodges, Special Assistant. Below—Rockefeller and Fulton check an NASD publication before answering a technical question.

The public hearing phase of the SEC's study of qualifications, supervision and training in the securities business concluded May 25 after 18 days of testimony by mutual fund representatives, big Board members, officials of two major exchanges and the NASD.

Questioning by the study group's legal staff brought out the need for many changes in the methods of training, testing and supervision of salesmen as well as inadequacies of supervision over sales practices in some securities firms.

Avery Rockefeller, Chairman of the NASD's Board of Governors, and Wallace H. Fulton, Executive Director, told the hearing group on May 23, that the Association's Board had recently authorized increasing the passing score of the



new qualification examination which went into effect January 1, this year.

It is hoped that this further strengthening of requirements for entry into the business, they said, will stimulate more comprehensive training programs for potential registered representatives hired by NASD members. However, Mr.

(Continued on Page 2)

SEC STATES POLICY ON EQUITY FUNDING OFFERS

The equity funding concept will be subjected to strict government controls under a new policy action and a proposed rule of the Securities and Exchange Commission.

The SEC has ruled formally that the equity funding package—which involves the purchase of investment company shares for use as collateral against loans made to pay life insurance premiums—constitutes an investment contract which must be registered under the 1933 Securities Act.

This means that such packages
(Continued on Page 4)

BOARD OK'S NEW TEST FOR OFFICERS, PARTNERS

The development of a special subjective type examination for individuals entering the securities business for the first time as partners, officers, or sole proprietors, was authorized by the Board of Governors at its May meeting.

The essay type examination will cover particularly the responsibilities of officers of members in connection with the keeping of proper books and records, the SEC's Net Capital Rule, the SEC's Statement of Policy and regulations of the Association.

The development of a course of study to help registered representative trainees prepare for the NASD qualification examination was also authorized by the Board at the May meeting.

Board Chairman Avery Rockefeller stated that our present needs call for a training plan designed primarily for home study, but which also can be adopted for a classroom conducted course.



NEED FOR DISTRICT OF COLUMBIA "BLUE SKY" REGULATION DISCUSSED AT HEARING

Fulton stated that this action of the Board must now be reviewed by the SEC.

Mr. Rockefeller also reported on the Board of Governors' decision to develop a comprehensive essay type exam for principals, partners and officers of member firms who are new to the securities business.

In response to questioning concerning restrictions limiting entry into the securities business, Mr. Rockefeller stated that the NASD was in favor of minimum capital requirements and additional statutory bars.

In earlier testimony, Philip A. Loomis, Director of the SEC's Division of Trading and Exchanges, emphasized that under the present statutory bars to entry into the business, "even a convicted bank robber could become a securities salesman."

Much of the first week of the hearings was devoted to testimony from officials of some of the largest mutual fund sales forces, whose hiring, training, and sales practices were examined.

Supervisory problems resulting from the trend toward more and more branch offices came under the study group's scrutiny during the second week of the hearings. Specific cases of churning, free-riding, and suitability, involving branch offices of firms, were aired.

The hearings were part of the fact finding program of the SEC's overall study. No attempt was made to evaluate or judge specific actions or policies in the securities business that were brought out during the three week session.

Shortly after the public hearings concluded, Congress approved a recommendation of the House Committee on Interstate and Foreign Commerce that the original appropriation of \$750,000 for the securities market's study be increased by \$200,000 and the time for the final report to Congress be extended to April of 1962.

Recent newspaper articles and increased complaint actions in the District of Columbia have focused attention on the lack of "blue sky" laws relating to minimum capital, prior experience, and character, which has made the area attractive for unscrupulous securities dealers driven out of other states.

Testifying before a Commerce and Finance Subcommittee of the House Interstate and Foreign Commerce Committee, NASD's Executive Director, Wallace H. Fulton, pointed out the need for corrective measures, arising in part from the great increase of broker/dealers in the Washington area during the past few years.

He stated that the one feature of certain state laws that is not now covered in the District is the reg-

istration and licensing of broker/dealers and the setting of standards for entry into the business.

Mr. Fulton voiced the hope that the SEC study group, functioning under House Joint Resolution 438, will make recommendations to the Commission and Congress for National standards, and these standards would be applicable to the District of Columbia.

In summary, Mr. Fulton said, "We suggest that regulations for securities dealers who operate in the District of Columbia be adopted and administered by the Securities and Exchange Commission. We realize that this means additional work for an already hard pressed agency, but it would seem that the Commission is the ideally suited body with the existing capabilities to perform this service."

28 VIOLATIONS OF REGULATION "T" RESULTS IN SUSPENSION—\$1,000 FINE

"We were merely endeavoring to recoup some profit for certain customers who had suffered heavy losses on glamorous electronic issues sold by the firm."

This was the essence of a unique defense presented in a recent case appealed to the Board of Governors which included 28 violations of Regulation "T".

The facts in the case were not in dispute. None of the 28 customers involved ever paid for their purchases. The firm simply issued "difference checks" which represented the profits, if any, between acquisition and liquidation prices.

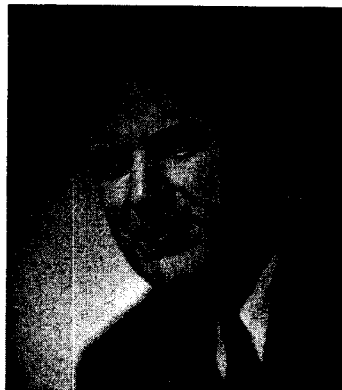
In defense, the firm also stated that the securities involved in the 28 transactions were not new issues and were sold at cost to the customer without profit to retain customer good-will.

Nor did the firm freeze these accounts for 90 days as required in the Regulation. The investigation of the case uncovered 15 other instances where the dealer had allowed customers cited in the original 28 transactions to make additional purchases within 90 days without full cash payment.

Also uncovered was the fact that in participating in the distribution of nine hot issues during a 2½ year period, the firm withheld large portions of the participations in its trading account for various periods of time before offering the securities to the public.

The Board found that these facts reflected a total disregard of Regulation "T" and the Free-riding and withholding interpretation. Result: 30 days suspension, \$1000 fine and censure.

NEW OTC CLEARING CORPORATION MAKES \$1 MILLION STOCK OFFER TO NASD MEMBERS



Carl Stolle, Chairman of the Board of Directors of the OTC Clearing Corporation, is president of G. A. Saxton & Co., in New York.

A newly organized Over-the-Counter Clearing Corporation, sponsored by the NASD, mailed prospectuses on June 5, to Association members in the New York area, covering a \$1 million private offering of the corporation's common stock at \$1,000 a share.

The Clearing Corporation will provide facilities where contracts of members can be verified, matched, and grouped, to expedite delivery and settlement of securities in the over-the-counter market.

Initially, the stock offering is being made to NASD members in the New York financial community but, ultimately it is expected that Association members throughout the nation will be able to participate. The organization was incorporated in Delaware on December 4, 1961, and under its by-laws, stock shares may only be purchased by NASD members and stock transfers are restricted to this group.

Similar clearing facilities have been in operation for some time for securities traded on the New York and American Stock Exchanges. However, increased public interest and the consequent explosive growth in the unlisted market has spotlighted the need for a central clearing house to eliminate "fails to receive and deliver" by over-the-counter dealers.



John H. Kirvin, Clearing Corp. President and also a Director, is Vice President of Glore, Forgan & Co., in New York.

Funds covering the organizational costs of the Clearing Corporation were provided by the NASD and will be repaid to the Association as soon as the Corporation is established in profitable operation. Two directors appointed by the NASD will sit on the Clearing Corporation's Board.

Although there are many more securities in the over-the-counter market than on all the exchanges combined, it is expected that the initial list of stocks to be cleared through this new corporation will be limited to active issues.

The Clearing Corporation is presently looking for facilities to house its operation in the lower Manhattan area of New York City.

The organization of the Clearing Corporation represents the culmination of work of a special committee appointed by the NASD in early 1961. Other directors of the Clearing Corporation are: Alfred B. Averell—Bache & Co.; Albert J. Eisenberg—Sutro Bros. & Co.; Thomas B. MacDonald—Blyth & Co., Inc.; Kenneth W. Martin—Merrill Lynch, Pierce, Fenner & Smith, Inc.; William R. Muller—New York Hanseatic Corporation; John D. Weeden—Weeden & Co.; Irvin J. Whitehill—Dean Witter & Co.

F.R.B. PRESENTS NEWEST REG 'T' INTERPRETATION

A check presented in payment for a prior securities purchase in a special cash account must have cleared the bank on which it was drawn and the proceeds credited to the account of the dealer before that dealer can issue his check for the sale of such securities out of the account.

This interpretation of Regulation T was recently made by the Federal Reserve Board in a case which presents important implications for all NASD members.

The case involved a customer who purchased stock in a special account with a member firm on Day 1. On Day 3, the customer sold the stock at a profit. On Day 8, (includes weekend) the customer presented his check to the dealer for the cost of the original purchase. On Day 9, the dealer mailed to the customer a check representing the proceeds from the sale.

The FRB interpretation stated that the receipt of the customer's check does not represent payment until that check has cleared the bank and the funds credited to the dealer's account. Since this process normally takes from one to two days, the dealer in the circumstances noted above should not have mailed his check until certain the customer's check had cleared the bank.

DISTRICT SECRETARIES MOVED IN FOUR AREAS

Four of NASD's District Secretary assignments have been changed in the last few months.

Edward R. Gilleran, secretary in District No. 11 has been moved to the Executive Office in Washington to take over the new position of Chief of Examiners.

Francis C. Doyle, secretary in District No. 13, has moved into Gilleran's spot in District No. 11.

William S. Clendenin, former secretary to District No. 4, has taken over Doyle's post in District 13.

The new secretary in District No. 4 is Edward J. Holoka, formerly assigned to the Executive Office.

Equity Funding

will be subject to the prospectus and other full disclosure requirements of the 1933 Act, and that advertising in public media will be limited to the "tombstone" type. The tombstone restricts statements in advertisements to identification of the security, the price and where a prospectus may be obtained.

In a companion action, the SEC has announced a proposed new Rule 15c2-5, under the Securities Exchange Act of 1934, which would bar any transaction involving the arranging of a loan for a customer to whom a security is sold, unless the broker/dealer first determines that the transaction is suitable for the customer and delivers to him a written statement setting forth certain material information.

SEC said it has reason to believe that some dealers have been offering equity funding programs without adequate consideration of their suitability for particular customers, and that broker/dealers have "failed to furnish the customer with adequate information concerning the nature and extent of his particular obligations, the specific charges which he will incur, the risks involved in the transactions, and the commissions and other remuneration which the dealer, and others in a control relationship to him, will receive in connection with the transactions."

As to the new requirements for registration of equity funding contracts, SEC warned that anti-fraud provisions of the Securities Acts are applicable to their offer or sale, and to literature, statements and representations about the equity funding concept.

Moreover, the Commission said programs of the equity funding type may result in creation of a separate investment company under the 1940 Investment Company Act and that sponsors of such programs should consider this possibility, as well as the 1933 Act registration requirements, and take immediate steps to conform with all applicable requirements of law.

EXPULSION OF SIX MEMBERS ANNOUNCED IN MAY

The expulsion of six NASD members for violations of The Rules of Fair Practice was announced in May. The members expelled and the reason for expulsion were:

Pittsburgh Hanseatic, Inc., Pittsburgh, Pennsylvania, (no relation to New York Hanseatic Corp.) for violation of the SEC Net Capital Rule, failure to maintain proper books and records and for violation of Regulation T.

Alexandria Investments and Securities, Inc., dba Vincent Associates, Ltd., New York, for failure to maintain proper books and records, violating the SEC Net Capital Rule and failure to supervise transactions of registered representatives.

Atlantic Equities Company, Washington, D. C. for violating the SEC Net Capital Rule and selling securities at prices which were not fair and reasonably related to the current market.

Fairfax Investment Corporation, Washington, D. C. for violating Regulation T and failure to maintain proper books and records.

Hiner & Company, Washington, D. C., for violation of the Net Capital Rule, Regulation T, failure to maintain proper books and records and granting a selling conces-

sion to a non-member of the Association.

Elmer K. Aagaard, Salt Lake City, Utah, for failure to register certain individuals with the Association whose duties required registration.

NEW BOOK AVAILABLE ON EQUITY FINANCING

A recent study by Professor Solomon J. Flink of Rutgers University, prepared under a grant from the Small Business Administration, presents a graphic and penetrating analysis of the problems involved in acquiring adequate equity capital—especially on first stock offerings—for small manufacturers.

Professor Flink's short but well written book entitled "EQUITY FINANCING OF SMALL MANUFACTURING COMPANIES IN NEW JERSEY" is based on an intensive series of interviews with the chief executive of more than 100 new businesses in New Jersey which have experienced rapid growth since their founding.

Copies of the publication may be purchased for \$1.50 each from the New Jersey Department of Conservation and Economic Development, Trenton, N. J.

NEW EXAMINERS COMPLETE TRAINING IN COURSE AT THE EXECUTIVE OFFICE



Richard Coster, an examiner in District 11, shows new examiner trainees how to compute capital in one of their class sessions. The trainees are undergoing a five-week course at the Executive Office before starting field training.