for example, to firms making markets in over-the-counter securities or to other special activities or differences in customer relationships. The NASD, in its 1942 attempt to adopt a minimum net capital rule, recognized the principle that capital needs of broker-dealers and risks to the public might be greater where firms were holding customers' funds and securities. The New York Stock Exchange and certain other exchanges similarly differentiate among specialists, floor traders, "introducing" firms not holding customers' funds, and securities and other member firms. The minimum capital or bonding requirements of some States also take into account the activities of the firms affected.

No single net capital standard at a reasonable level can take care of all these variables. Exceptions and refinements for different types of business and different relations with customers may have to be worked out, but the general pattern should at least take account of size, with all firms being subject to some "minimum minimum" and larger firms—in terms of numbers of salesmen and branch offices—being subject to an appropriately scaled up minimum.

C. Qualifications of Salesmen

1. THE SALESMAN'S ROLE IN THE INDUSTRY

a. His duties

Securities salesmen represent their firms to the public. They often serve investors as investment advisers, and sometimes even enter the field of "financial" or "estate" planning, which involves counseling the investor on his entire financial situation, including, at times, such elements as life insurance, real estate, savings accounts, and trust arrangements.

Industry representatives speak of the work of the securities salesman as a "profession," either as a present status or as one to be aspired to, depending on the position and outlook of the speaker. "Professionalism," for most persons who use the term in connection with the securities industry, implies, first, the meeting of certain initial qualification standards of competence and integrity—salesmen must be "knowledgeable and ethical," in the words of the NYSE [105]—and, second, the continued adherence to certain fiduciary or ethical standards subsequent to becoming a salesman. While problems of compliance with ethical and legal standards by securities salesmen in their day-to-day conduct is discussed in part B of chapter III, the manner in which salesmen are selected and prepared for the performance of their duties in the securities business is analyzed here.

What are the duties for which a salesman is selected and trained? A recent advertisement of Merrill Lynch, Pierce, Fenner & Smith, entitled "Hat Trick," explained the virtues of its salesmen (or "account executives," as it refers to them) in this manner:

> Every day of his working life, he [the Merrill Lynch salesman] is called on to wear a variety of hats. * * * For his customers, he answers questions, gets quotations, obtains information, and executes orders in listed and unlisted securities, government and municipal bonds, and commodities. He opens monthly investment plans and arranges for gifts to minors.

[105] NYSE Department of Member Firms Liaison, "Ethical Conduct, a Study Guide for Registered Representative Trainees of New York Stock Exchange Member Firms," p. 1 (1962).

And of course he does some recordkeeping of his own, watches the daily market action on the board and Translux in his office, and somehow manages in addition to absorb vast amounts of news that come to him over the Dow, Jones and Merrill Lynch news wires and from our research department.

He often wishes he were twins or even triplets. But somehow the Merrill Lynch account executive manages as just one busy man with many different hats.

To perform these functions, a representative from Merrill Lynch testified, his firm "basically" looks for "men of good, stable backgrounds, of highest moral caliber, men who have drives that would be desirable in our type of business, and men who show a keen sense of stewardship, because in the ultimate they are going to be handling other people's interests."

In contrast to this picture, a retired member of the NYSE who has spent over 60 years in the securities business, presented a more jaundiced view of NYSE salesmen generally:

These whiz kids of finance, these account executives—customers' men, we used to call them—they're attracted to this business of ours first of all because of the hours, and secondly [because of] the tremendous remuneration they get after they have had their 6 months' training. Now think of it: in 6 months a guy who plugs along and passes the examination is authorized to advise people on their investments. I have seen them: I walk into different offices * * * and watch these geniuses. They sit around and read the market letter of the firm they work for * * * in the morning, and the telephones begin to operate * * * They call up Joe Somebody and tell him that's it. You see? And Joe Somebody, who is in the clothing business, has got his mind full. He says, "Buy me 200 shares." So the firm gets $80 and this guy immediately gets not less than a third * * * and at half past 3 he's on his way uptown.

An experienced investor, in writing to the Commission, described the salesmen who have served him in the following manner:

My definition of a good broker [salesman] is a broker with a fairly thorough knowledge of securities analysis * * * and a fair background in economics. He must be willing to discuss with his customers only those stocks of which he has a thorough knowledge * * * . [T]his is most important, he must continue to follow the situation he has recommended and be prepared to intelligently review the company's progress, both marketwise and fundamentally, every 6 months or so * * * . In addition to the foregoing, a good broker must have a thorough knowledge of the objectives of his clients and must tailor his recommendations to meet their objectives. Unfortunately, the number of brokers who fit into this category are few and far between. * * *

As an individual who does his own investing (I was formerly a security analyst), I am a bit more aware than many of the shortcomings of these salesmen. From time to time, they call me, and I am appalled at their lack of knowledge of the situation they are trying to sell * * * . This, I feel, is one of the most dangerous aspects of the business.

* * * * * * *

* * * I do feel that the training and regulation of the security salesman is the key to safeguarding the public from 90 percent of the evils of the securities business.

The applicability of any of these descriptions to individual salesmen, of course, varies. Differences in the scope of a salesman's activities and the diligence with which he serves his customers depend to a large extent on the care with which he has been selected and trained by his employers.

b. Statistical picture of salesmen's backgrounds

The ranks of securities salesmen have been swollen in recent years by the entry into the industry of new, inexperienced personnel. The NASD's total number of registered representatives increased from

69,345 at the end of 1958 to 102,305 3 years later, and then declined to 94,444 at the end of 1962, the market-break year (table II–6). In 1962 member firms hired 29,314 registered representatives, either from other firms or from outside the securities industry, while 37,175 persons severed their connections with these firms, resulting in a net loss of 7,861 salesmen. Of the new applicants, 16,186, or about 51 percent, had to take the NASD examination because they lacked a year's prior experience in the securities industry, as salesmen or proprietors[106] (table II–7). Unless many of those inexperienced persons who passed the examination left the securities industry during the same year, roughly one-seventh of all NASD registered representatives on December 31, 1962, had less than a year's experience in the securities business. During 1961, when a bull market swelled the total NASD registered representative population to 102,305, nearly 30,000 inexperienced persons, or over a quarter of all those registered, were required to pass the examination because of their lack of experience.

The percentage of inexperienced newcomers in member firms of the NYSE, whose 32,555 salesmen (as of December 31, 1962) were almost all registered as representatives with the NASD as well, was approximately the same, amounting to somewhat more than half of the 8,400 persons registering with the exchange in 1962.

The incidence of inexperience is particularly high among mutual fund salesmen. From the responses to questionnaires STS–1 and STS–2, it appears that 95 percent of the salesmen hired by large firms specializing in mutual funds had no securities experience prior to joining their firms in 1961 (table II–8). On the other hand, 49 percent of the salesmen hired by general securities firms of similar size were inexperienced.

Persons attracted into securities selling come from a broad range of occupational backgrounds, according to data gathered by the NASD from a sampling of registered representative applications filed during 1960 by salesmen without prior securities experience. The NASD's figures show that of the applicants, 20 percent came from selling insurance or tangibles, such as automobiles, shoes, food, or clothing. Fourteen percent came from such professional categories as accountants, teachers, engineers, or lawyers. Approximately 33 percent had business or supervisory experience as executives, foremen, or other supervisors, were self-employed or had had experience in such relatively skilled occupations as public relations, traffic management, department-store buying, and the like. Ten percent indicated that they had previously been students or members of the Armed Forces. Nineteen percent gave such heterogeneous previous occupations as clerk-typist, secretary, housewife, machinist, chef, fireman, laborer, or baseball player. On the other hand, 4 percent had worked as credit or financial analysts, bookkeepers, or cashiers.

The age of persons applying to be registered representatives has declined in recent years. A statistical review of a sample of registered representative applications which became effective from July 1946 to July 1956 reveals that only 10 percent of the individuals had been 20 to 35 years of age when they applied. Similar surveys of applications filed in 1959 and 1961 show large increases in the number of applicants

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[106] NASD bylaws, art. 1, sec. 2(b). For more on the NASD qualification examination program, see sec. 3.b.2, below.

in that age bracket, rising to 46 percent for 1959 and 54 percent for 1961.

The level of education attained by salesmen entering the securities business appears to be somewhat higher than that for the Nation as a whole. Ninety-nine percent of a sample of incoming NASD representatives in 1961 had attended high school and 68 percent had spent some time at college, according to a sample of NASD applications. These figures compare favorably with statistics as of 1960 for persons over the age of 25 throughout the Nation, of whom 60 percent had attended high school and only 16 percent had completed 1 or more years of college.[107]

These statistics, though indicating that the educational level of the securities industry generally is high, tend to obscure the wide educational range among firms of different types and within firms. As might be expected, educational levels are usually high among the larger, nationally known houses, which have little trouble in recruiting college graduates. One of the largest claims that 80 percent of its salesmen are college graduates and that all but one of the rest have had some college experience. Among the large mutual fund selling organizations the level is lower. One large distributing organization's sales force, numbering in the thousands, is comprised of only 38 percent high school graduates, and includes 10 percent who never even attended high school. The diversity within firms is illustrated by an over-the-counter firm which at its peak activity employed approximately 65 salesmen, including a number of part-time salesmen. Its roster included one doctor and several lawyers and engineers at the top of the ladder, and at the bottom a number of persons who had not graduated from high school and listed such occupations as mechanic, ironworker, butcher, driver, waiter, maintenance man, and laborer.

c. Turnover—An industry problem

As the NASD statistics discussed above indicate, in recent years there has been a sizable movement of persons into the securities industry from unrelated occupations. There were also many leaving the industry: In 1961, when 29,701 inexperienced persons began as registered representatives for NASD firms, 21,224 were leaving; and in 1962, when 13,939 began, 21,800 left. Moreover, there has also been much movement of personnel from firm to firm within the industry. In 1961, representatives switching from one firm to another (not required to take the examination) amounted to 10,889 of the 40,590 persons registering with NASD during that year,[108] or about 11 percent of the total number of persons registered as of the end of the year (table II–7). For 1962, the comparable figures were 15,375 of 29,314, or about 16 percent of the total registered representative population at year's end.

Although the overall industry turnover rate is high, the most rapid turnover appears to take place in firms specializing in the sale of mutual funds. In 1961, about 43 percent of the mutual fund firms analyzed in the STS survey hired over 50 percent of their sales forces,

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[107] U.S. Bureau of the Census, Statistical Abstract of the United States: 1962, p. 117.

[108] The rules of the NASD require, as do the rules of the various exchanges and most States, that a salesman reregister each time he changes firms. Thus, figures on persons registering include both individuals joining securities firms for the first time and persons switching from one firm to another.

while only 21 percent of nonspecializing firms hired as great a percentage (table II–9). During the same year 14 percent of all mutual fund firms had over half of their sales force leaving, while only 6 percent of firms engaged primarily in the sale of other securities had as large a number leaving (table II–10).

The effect of rapid turnover can be seen more clearly in the figures for individual firms. As of April 1, 1962, Waddell & Reed, Inc., a large mutual fund selling organization based in Kansas City, Mo., employed 4,711 salesmen, 2,194 of whom had been hired during 1961. First Investors Corp., a New York mutual fund firm, took on more registered representatives during 1960 alone (1,097) than it had previously had effective registrations for (1,033). In contrast, Hornblower & Weeks, which does a general brokerage business, added during 1961 a net of only 47 salesmen to a previous registered representative total of about 350, and Paine, Webber, Jackson & Curtis employed 84 new salesmen during that year, to make a total of 659 in the firm in early 1962.

Hugh L. Jamieson, the president of King, Merritt & Co., Inc., a large mutual fund selling firm with 50 percent annual turnover in its sales force, indicated that most mutual fund salesmen who leave his firm do so because they have not made enough money selling securities. In his view, the public is in no danger from sales by a group of such transitory representatives because, he said, their failure in the business does not lie in "the quality of the sales they did make or the amount of selling they have done. Usually, they just won't make the calls necessary to accomplish the job."

Firms selling mutual funds, it should be pointed out, are not the only ones with a high rate of turnover. Nat Berger Associates, Inc., a broker-dealer specializing in real estate syndication participations, as of early 1962, commanded a sales force numbering 130 salesmen; during the previous year, the firm had gained 60 salesmen while losing 45. A. G. Edwards & Sons, a St. Louis-based NYSE firm, hired 111 salesmen during 1961, while having 57 leave; as of the spring of 1962, the firm employed 291 salesmen.

Wallace Fulton, the executive director of the NASD, commented upon the phenomenon of high turnover of securities salesmen in the following manner, in the Special Study's public hearings:

> Q. Would you say this (turnover) was a sort of easy-come, easy-go, problem as far as getting in and out of the securities business?
>
> A. I should think so. They place their money and take their chances and they are out.

Where inexperienced salesmen are concerned, it may be the public as well as the salesmen who "place their money and take their chances." Certainly one cause of turnover seems to lie in the lack of financial support during the training and early selling periods. The importance of financial support to the neophyte salesman can be seen by comparing the high number of arrivals and departures from Bache & Co.'s "investors service centers" (primarily devoted to the sale of mutual funds) to similar turnover data for the remainder of that firm's sales staff. The mutual fund salesmen, whose compensation is limited to commissions after they leave their 4 to 6 weeks of training, forsook their jobs with considerable frequency, while for Bache's other salesmen, who were usually trained for 6 months and given financial subsidies for at least 2 months more, turnover was considerably lower. Generally, a correlation is to be found, in the responses to STS questionnaires, between low or nonexistent compensation during salesmen's training periods and high turnover of sales personnel. A similar correlation may be discerned between a high turnover and a large proportion of part-time salesmen.

Perhaps the most troublesome aspect of the turnover problem involves the movement from firm to firm of salesmen who have records of employment by firms against which the Commission or the NASD has taken disciplinary action for fraud in the sale of securities. Because of the short lives of many "boiler rooms," and because firms which specialize in hard-sell underwritings of new issues or in pushing over-the-counter issues in which they have a particular interest may not always have sufficient "merchandise" for their salesmen to sell, these veteran salesmen drift from one hard-sell type firm to another, occasionally changing their names with their employment. Often referred to as "floaters," these salesmen typically do not remain at any one firm a long time—usually no more than a year or two.

An extreme example of multiple "boiler-room" associations is the career of one salesman which began in 1950 and, as of the end of February 1963, had involved 30 different registrations with 27 different firms, 14 of which firms had either been revoked by the Commission or expelled from membership in the NASD. Another person, Harold Rooff, who had associations—both registered and unregistered—with 18 firms in the 9 years since he entered the business in 1954, was asked by the Special Study staff why he changed employment so frequently. He replied:

> Well, again I say, there were certain situations that I guess sort of petered out after awhile, and earnings became very. very low so it was at these points when I left.

Of the 18 firms he was with—sometimes for as brief a period as a few weeks—6 ceased operations at one time or other as a result of decisions in regulatory proceedings; however, only one collapsed while Rooff was still there. Around the time that he was employed by his 11th firm, in 1959, Rooff said that he began to have the growing realization—

> that I was building nothing, and it had gotten to the point where most of these cases had become a drawback to me, and I was determined at about [that] time * * * that I would rather go for a long time without working, rather than sell what I began to feel were questionable securities.
>
> * * * * * * *
>
> [T]he subsequent investigations and the subsequent poor markets of these situations made me realize that maybe there was something amiss and it was at that point * * * that I went for a period of about 4 months without working anywhere until I finally went to work for [another firm].

In spite of his changing to a firm which was operating on what he considered "a very high level," Rooff moved again, and has since been associated with six more firms, two of which he served simultaneously during June 1962.

The generally rapid inflow and outflow of sales personnel intensifies the problems of securities firms in recruiting, checking, and training their salesmen. How the process of hiring and training actually works for various kinds of firms, and the extent to which problems inherent in turnover apply to them, are described below.

2. INDUSTRY STANDARDS AND PRACTICES

a. Hiring and screening of salemen

Public investors and the broker-dealer firms with which they deal share a considerable identity of interest in high standards of competency and integrity on the part of securities salesmen. Individuals of high character, good educational background, and thorough training are both an asset to a firm and an assurance to investors. However, the identity of interest is not complete, since the firms are selecting and training persons who can sell and not merely those who give good advice. Thus, many of the screening and evaluation procedures and much of the training are devoted to the selection and development of persons who can win the confidence of customers and persuade them to execute securities transactions through the particular firm.

(1) *Recruiting practices*

The diverse methods used by securities firms to attract salesmen vary with the firm, the securities it sells, and its desire for experienced or inexperienced persons. At a recent conference on "the management function in the investment banking industry," the training director for E. F. Hutton & Co., one of the largest NYSE member firms, outlined the major sources of "worthwhile candidates" for sales positions: Newspaper advertisements (excellent for "trainee-applicants"); employment agencies ("the most used and most misused source of applicants"); college placement offices ("you should not be bashful about asking the alumni placement office to publicize your opportunity"); and referrals ("one of the most productive sources of prospective employees"). These sources are used, to a greater or lesser extent, by almost all firms.

The policies and attitudes of firms soliciting sales employees can best be seen in the recruiting advertisements they use. Since the quickest way to expand a firm is to acquire producing salesmen with established customer followings, a high proportion of such advertising is aimed at experienced salesmen. Advertisements often are intended to appeal to certain groups, such as life insurance salesmen, mutual fund salesmen, persons over 40 or about to retire (one advertisement stated: "Many retired policemen, firemen, letter carriers, etc., are making big money selling high-grade securities"), or persons in specific occupations (such as accounting, advertising, or public relations). Favorite targets of NYSE member firms desiring to improve their mutual fund production are fund salesmen from nonmember firms. They are offered the increased prestige of being NYSE "registered representatives" and the possibility of augmenting their income through handling transactions in a wider variety of securities. Other appeals in recruitment advertising focus on the assistance provided by the employing firm in generating business. Large firms have relatively little difficulty in recruiting. Their compensated training programs constitute an understandable recruiting advantage for inexperienced salesmen, and often they will have several applicants for each opening. Smaller firms needing fewer salesmen naturally tend to use more informal methods of finding them.

A firm which is not overly selective may be able to draw from the ready pool of experienced salesmen described above as "floaters." The head of one firm, who was building up his firm's sales force in late

1959 and early 1960, said he did not have to advertise for salesmen: "[In] those days they were floating around by the thousands * * *. [T]hey just kept knocking your door down to go to work."

(2) *Screening and selection of potential salesmen*

The New York Stock Exchange, in its 1962 pamphlet for the guidance of its member firms on "Recruiting and Selecting Registered Representatives," lists the following as characteristics of the most desirable candidate for a sales position: (1) Skill in obtaining and servicing customer accounts; (2) knowledge of rules, regulations, and procedures; (3) analytical ability; (4) specialized investment knowledge; and (5) knowledge in related fields. The most desirable background for the development of these qualities, according to the exchange, is "successful experience as a registered representative with another member firm." Successful experience "with a nonmember firm or mutual fund dealer" or with a "service-type company" is considered next best. Also considered valuable are a notable degree of gregariousness and personal magnetism and an educational record which emphasizes business, law, or finance.

Many firms have similar criteria for persons whom they prefer to hire as sales employees. Overall, however, few firms impose particularly high requirements of education or experience upon persons they hire. About 50 percent of the firms analyzed in the STS survey stated that they had no particular educational standards for would-be securities salesmen. More than 75 percent indicated that they had no requirements of previous experience in the securities industry.

Firms imposing education requirements are principally broker-dealers with a large, general securities business, who can afford to be selective, but their educational standards are generally flexible enough to permit the substitution of experience for education. The usual minimum education requirement is well below the NYSE's ideal; most often, only a high school education or its equivalent is demanded. Few firms make experience in the securities business one of their prerequisites for employment, though it is generally viewed as an asset, and its nature and quality are usually taken into account. Those which do make experience a prerequisite are usually the ones which have no training facilities.

Some mutual fund sales organizations, however, have indicated that they prefer not to hire experienced securities salesmen. Walter Benedick, president of Investors Planning Corp. of America, stated that his firm prefers persons who have had no prior experience in the securities business because, in his view, "the securities business generally is as different from the mutual fund business as day differs from night." The firm emphasizes in its frequent recruiting advertisements that no selling experience is needed. The firm also eschews salesmen for other mutual fund firms "for the * * * reason that we do not try to take men away from other organizations." Hamilton Management Corp., another large mutual fund distributor, does not hire as salesmen either persons who have sold mutual funds for other organizations or individuals who are registered representatives in the general securities business. Some mutual fund sales firms have found it desirable to establish policies forbidding the hiring of part-time sales personnel with certain occupational backgrounds which they regard as unsuitable. A Hamilton Management Corp. policy bulletin, "Hiring Representatives," prohibits the employment of any person who is—

> * * * a bartender, barber, waiter, mechanic, cook, counterman, bellhop, busdriver, truckdriver, taxi driver, used-car salesman, parking-lot attendant, elevator operator, janitor, or who has a similar occupation. No person will be hired who is in any way engaged in manual labor.

Anthony Tyrone, the director of sales for Hamilton, explained the policy on the ground that he had been "haunted" by stories of elevator men and cabdrivers who turn out to be part-time mutual fund salesmen.

As is exemplified by the case of Albion Securities, Inc.,[109] certain firms have not been averse to knowingly hiring salesmen previously employed by firms which have been put out of business as a result of Commission or NASD action. Another small over-the-counter firm with a tolerant attitude toward the employment of former "boiler-room" salesmen is Street & Co., a New York City over-the-counter house. The firm hired salesmen with records of association with revoked or expelled firms, including one man who had been enjoined and also named a cause in a Commission revocation order and who was thus ineligible for employment by a registered broker-dealer. The firm's president explained his relaxed attitude toward his salesmen's pasts as an effort to rehabilitate them—to give them "another chance" if they fell in line with the way he "started to feel about the business." His investigation of the background of a new salesman was the essence of simplicity. He testified that he was able to certify to a man's good character by talking to him for awhile and "seeing what makes him tick * * *."

In contrast, broker-dealers who are more selective in their hiring practices use many techniques and devices to assure themselves that the backgrounds of persons they intend to hire are free of any evidence of relevant character defects. The NYSE recruiting and selection manual recommends procedures for screening, testing, evaluating, and investigating, involving several defined stages. First, candidates are required to fill out application forms, undergo preliminary interviews, and sometimes take aptitude tests,[110] to eliminate those persons whom the firms would consider clearly unsuitable. The second stage consists of a searching interview with the applicant. The final decision to hire is, in some firms, dependent on the outcome of a background investigation by an outside investigating agency.

Many firms place considerable emphasis on aptitude and other tests as screening devices. The battery of tests used by Shearson, Hammill & Co. includes the Strong vocational interest test, the California test of mental maturity, the Guilford-Zimmerman temperament survey, and the Psychological Services of Los Angeles examination. Bache & Co., on the other hand, limits its testing to the 12-minute Wonderlic test, which measures verbal and numerical facility. King Merritt & Co., Inc., measures the personality traits of its candidates through the "AVA test," which is administered in the field by managers. The test, according to King Merritt officials, is commonly used by life insurance companies to assess aptitude for selling intangibles. Some

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[109] See pt. B.1.a(4), above.

[110] A selection test being developed by the NYSE will provide member firms with a relatively inexpensive examination oriented to the particular needs of securities firms.

firms, such as W. H. Babbitt & Co., Inc., of Pittsburgh, subject persons in whom they have a serious interest to psychological interviews conducted by outside consultants. In contrast, Hodgdon & Co., Inc., a small firm dealing in a variety of "investment securities" in the Washington, D.C., area, employs what its principal partner describes as a "deep psychological interview" conducted by one of its partners:

Q. What do you mean by "deep psychological interview," Mr. Hodgdon?
A. I ask him about his relationships with his parents and his brothers and sisters, previous employers; an amateur psychiatric approach.

* * * * * * *

Q. How long does this last?
A. I would say between half an hour or an hour.

For further investigation the firm communicates with the individual's last employer, as required by the NASD, and relies on character reference letters required by the State of Virginia and any check the State may make with his previous employers, and on the "credit investigation" conducted by the firm's bonding company.

The large mutual fund sales firms, which have great numbers of salesmen, uniformly devote far less effort to their selection than do the large NYSE member firms. King Merritt & Co., Inc., which employs 2,200 salesmen, uses a combination recruiting, screening, and selection technique which concentrates on contractual plan purchasers as a likely source of recruits for salesmen. According to the firm's president, H. L. Jamieson, the local manager who attempts to sell a prospective customer a contractual plan "has a chance to decide whether he would be the type of person he [the manager] would like working with him." The manager also visits the candidate's home and meets his wife to determine whether she will object to the evening calls which are so much a part of the contractual plan salesman's life. Otherwise, the firm does little to investigate the prospective salesman's background beyond compliance with the minimal state and NASD requirements.

Many firms, particularly those not affiliated with one of the larger exchanges, rely, at least in part, on their bonding companies to assume the responsibility of investigating a prospective employee's background. Under a standard policy in widespread use throughout the securities industry, known as the fidelity bond or brokers blanket bond, the broker-dealer is protected against losses incurred as a result of the wrongdoing of employees. Firms relying upon thir bonding companies to look into the backgrounds of their sales employees usually do no more than have their salesmen fill out whatever forms the bonding companies require. For example, Investors Planning Corp., with 4,700 salesmen, forwards a candidate's application form to its bonding company and to the NASD. In accordance with NASD requirements,[111] the firm contacts the applicant's last employer and also writes to his prior business contacts. IPC's president stated that the bonding company conducts "a very extensive investigation." Unfortunately, statements of officials of insurance companies writing blanket bonds are not such as give comfort to members of firms which rely on their investigations, but rather indicate that broker's blanket bond coverage seldom entails more than a cursory check—often on a spot-check basis—of references provided by the salesman-applicant.

[111] See sec. 3.b(1), below.

The Aetna Casualty & Surety Co. has stated that it makes no investigation of individual employees *before* writing a bond (other than a check on the firm and its principals), and that its later investigation is limited to a "reference check of new employees who are to occupy key positions." The company added: "Where experience on a given broker-dealer has been unsatisfactory, or the insured requests it, we secure individual applications on all employees, review and make reference checks accordingly." Another company, the Insurance Co. of North America, has each new employee of the insured firm fill out an individual application form covering references and the employee's business history for the previous 10 years, after which it sends out reference blanks to "certain of the former employers and personal references."

An official of one of the main insurance firms dealing in stockbrokers' bonds has indicated that the reference-check method of investigation as practiced by most bonding companies has definite limiations. He stated that "the great majority" of reference blanks are ignored and that this type of investigation has "seldom caught a crook" since "a real crook will phony up" his references and the candor of the replies received is limited by a fear of defamation suits. Thus, it appears that the investigations conducted by bonding companies cannot be considered a substitute for the broker-dealers' expending the effort or expense necessary to investigate the backgrounds of their sales employees.

b. Training of salesmen

Whatever degree of integrity, intelligence, and selling aptitude may be present in persons hired by a particular firm, new recruits need training before they can assume duties as salesmen. In the complex business of merchandising securities, a salesman cannot function without some familiarity with the merchandise he sells and also with the mechanics of the market. Securities salesmen usually enter the field with little or no prior training, relying on their employers to provide them with the technical knowledge necessary for the work they will do. Although broker-dealer firms may not, in some instances, do the actual training of their salesmen, preferring instead to provide outside courses, the economic burden and responsibility for the competency of salesmen they employ remain theirs.

Industry expansion and rapid turnover of personnel have combined to increase the burden of preparing inexperienced recruits for their sales jobs. As noted above, over half of the salesmen hired by all NASD firms in 1962 and roughly the same proportion of those hired by New York Stock Exchange firms had, at most, less than 1 year's experience as securities salesmen.[112] According to a recent estimate, New York Stock Exchange member firms are currently training about 5,000 prospective registered representatives each year. Thousands more are being taught the business by nonmember firms.

The training given by most firms uses one or more of the following methods: Classroom instruction by the employing firm; lectures and correspondence courses by universities and other educational institutions; on-the-job training; and what the New York Stock Exchange refers to as "self-study," or the reading of pertinent literature on one's

[112] See sec. 1.b., above.

own. The use of the different methods varies from firm to firm, but, probably for economic reasons, the most widely used is on-the-job training, often supplemented by outside lectures or correspondence courses.

By and large, the content and extent of a firm's training program are determined by the firm's size and by the nature of its business. The amount of training given by a firm appears to be directly related to its size: the larger a firm's gross income, the greater number of training hours it is likely to provide. The STS survey shows that large firms doing a general securities business provide their trainees with more than 500 hours of on-the-job training over a period lasting about half a year. Small firms engaged in similar activities provide less than half as much training, on the average (table II–11).

A similar pattern is found in the STS data on classroom training programs, a type of training primarily confined to a few large, general business firms and some mutual fund dealers. The large, general firms provide an average of about 260 hours of classroom training over a period of approximately 26 weeks. Large mutual fund firms which give classroom training, on the other hand, average around 35 hours over a period of about 5½ weeks (table II–12).

The emphasis of the training given also shows changes corresponding to the differences in the size of the firms. Large, general securities firms devote a greater proportion of the their greater number of training hours to such classroom subjects as accounting, securities, and market analysis, and to such aspects of on-the-job training as research and portfolio analysis than do smaller firms not specializing in mutual funds. The smaller firms place more emphasis on on-the-job experience in their trading departments (reflecting the greater importance of over-the-counter activity to them) than do large firms. To the critical aspects of training relating to the securities laws and the rules of the NASD and the NYSE concerned with salesmen's conduct, the large, general securities firms devote greater numbers of classroom hours than do small firms engaged in similar activities. The time spent by the smaller firms is, however, a larger proportion of their total classroom hours (tables II–11 and II–12).

The training given by firms whose activities are limited almost exclusively to the sale of mutual funds, which range in size from some of the largest broker-dealers in the country to the smallest, is generally far less extensive both in terms of number of hours and breadth of subject matter, than that provided by nonspecializing firms of equivalent size.[113]

(1) *Training by NYSE member firms*

Probably the most significant impetus toward the development of training programs for securities salesmen is the requirement of the New York Stock Exchange, adopted in the mid-1930's, that all candidates for full registration without previous actual experience as securities salesmen receive 6 months' training. Under exchange rules each trainee during this period is expected to "undertake actual 'on-the-job' training in appropriate departments of the firm, supplemented by organized study to prepare for his registered assignment."[114]

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[113] Discussion of the general nature of the training given by mutual fund firms is contained in sec. 2.c(2), below. A more extended treatment of individual firms' programs and their relation to the practices by which mutual funds are sold may be found in ch. XI.

[114] NYSE Guide, par. No. 2345.15 (1962).

The exchange places full responsibility for the entire training program on the member firm employer, though it permits firms to assign trainees to an approved university or institute course for the formal study part of its training program.

The necessary consequence of the 6-month minimum training requirement and its prohibition of part-time employment is that, apart from the limited registration provision discussed below,[115] a member firm cannot permit an inexperienced person to engage in selling for a period of 6 months. In its review of training practices, the Special Study gave particular attention to the programs of 26 large member firms whose employees include over 40 percent of all representatives registered with the exchange.

Training programs are expensive, though of course some types are more expensive than others. A basic element of cost is 6 months' compensation for each salesman trainee, while he is nonproductive. Other elements may include, apart from the value of the time spent by firm members and employees serving as instructors, sums for bringing trainees to a central location for several months, sending trainees to outside courses or subscribing for them to correspondence courses, paying employees or outside lecturers to teach courses, or buying equipment. One firm with an elaborate program which included its own classroom training estimated that its total cost was about $10,000 per trainee. It is not surprising that only about a dozen large member firms have established training programs incorporating their own classes, which cover a range of subject matter and are held with sufficient regularity to warrant the use of the term "school."[116]

One of these firms is Merrill Lynch, whose training school is the oldest of its kind and the model for the program of many other firms. Under its program persons hired by the firm to be salesmen spend 13 weeks in the branch offices in which they will be employed, studying correspondence courses and acquiring certain background knowledge and experience, and then move to the home office in New York for another 14 weeks of intensive classroom training. After this, the Merrill Lynch trainee returns to his branch office for a final 4 to 8 weeks of preparation before beginning to handle accounts and solicit customers. While in New York, the Merrill Lynch trainee spends about 30 hours a week in the classroom (420 hours), attending classes on a broad range of subjects including back-office procedures, corporation finance, laws of the securities business, rules of the New York Stock Exchange, commodities, security analysis, effective speaking, sales techniques, and institutional sales. The Merrill Lynch school, during its 18 years of operation, has trained approximately two-thirds of the more than 2,000 salesmen now registered with the firm. Substantially all of the inexperienced persons now hired by the firm as salesmen attend the classes in New York.

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[115] See sec. 3.c(2)c, below.
[116] NYSE department of member firms liaison, "Trainer's Manual," p. 1 (1962).

Several other large firms with training schools follow a similar pattern, and is shown below:

TABLE II–a.—*Training program of selected broker-dealer firms*

Name of firm	Length of program in weeks	Approximate number of total classroom hours in training program
Bache & Co	17	450
Goodbody & Co	14	420
Reynolds & Co	13	440
Shearson, Hammill & Co	15	450
Hemphill, Noyes & Co	6	240
J. A. Hogle & Co	16	500
Francis I. du Pont & Co	16	320

NOTE.—Clearly, many of the firms have included study periods, field trips, interviews, discussion periods, and other nonclassroom activities in their totals of classroom hours.

Source: Questionnaire STS–1, and, for Bache & Co. and J. A. Hogle & Co., material supplied to the Special Study by those firms.

For all of these firms, classroom training comes after a period varying in length from 12 weeks at Goodbody & Co., to 6 weeks at Bache & Co., during which the prospective salesman is given on-the-job training at the branch to which he will later be assigned. While these firms use their classroom training programs for most of the persons they hire as salesmen, for various reasons of practicality and expediency not all new salesmen are included and lesser substitutes are used. Bache & Co., for example, trained about 60 salesmen in its branch offices in 1961, while giving some 105 trainees classroom training at its home office. In addition, the firm gave an abbreviated 4-week classroom course to approximately 35 men who were to specialize in the sale of mutual funds in the New York City area.

Some firms using classroom training, such as Dean Witter & Co. and Hayden, Stone & Co., have integrated it with on-the-job training programs conducted at the firms' home offices. The Dean Witter training lasts the entire mandatory 26-week period, while Hayden, Stone's program is 20 weeks in duration. Only when training is completed are neophyte salesmen for these firms sent to the branch offices to which they are permanently assigned. Other firms—for example, Walston & Co. and Dempsey-Tegeler & Co., Inc.[117]—provide combination classroom and on-the-job programs in regional training centers for salesmen from nearby areas. The classroom training of two firms—A. G. Edwards & Sons and Thomson & McKinnon—is given to conveniently located trainees, but is made available in correspondence form to the prospective salesmen who are receiving their training in the branch offices.

Most member firms, large as well as small, do not use classroom training, but instead employ "on-the-job training," usually in some combination with correspondence courses or courses given by local universities or institutes. "On-the-job training" is a term loosely used

[117] While E. F. Hutton & Co. falls primarily into the category having home or firm office training programs, it does have a certain number of persons (23 in 1961) who are trained in a combination on-the-job and classroom program conducted in the firm's Los Angeles regional office. Paine, Webber, Jackson & Curtis, although primarily relying on on-the-job training, provides limited 2-hours-a-week classroom training in its Los Angeles and Minneapolis offices for local trainees.

to describe a wide range of activities of a trainee not enrolled in a classroom program while fulfilling his 6-month period of compulsory apprenticeship. It includes on occasion such activities of limited educational value as service as clerks and runners. It appears that the appeal of on-the-job training lies, for most firms, in the considerable savings in training costs it affords, since no special instructors or equipment are needed.

A major limitation of on-the-job training is the danger that the trainee may do little more than sit around the office until such time as he is able to sell. The "Trainer's Manual" of the New York Stock Exchange warns:

> The "doing" part of the training plan for every trainee cannot be overemphasized. Immeasurably more benefit is gained when the trainee is an active doer rather than sitting around observing others and probably feeling that he is in the way. * * * Firms may be pleasantly surprised at the amount of work that most trainees can turn out, *provided that time and thought are given to instructing them properly.* [Emphasis in original.]

A trainee who has his on-the-job training at the home office of a firm which does its own clearing and has its own research department is likely to learn something about all the most important departments of the firm. In Dean Witter & Co., for example, the trainee spends the morning hours (usually 9 a.m to 12) of 1 or 2 weeks in each of the firm's nine departments.[118] Kidder, Peabody trainees spend as long as 42 weeks in the firm's research and portfolio analysis department, an arrangement which permits the firm to get a useful, supervised performance from the trainee, while he in turn receives training in an area of considerable importance to him as a salesman. Unfortunately, much of the on-the-job training provided by member firms is given in branch offices, which may have little for a new salesman to become acquainted with but a cashier's cage, an order desk (through which orders are transmitted and received), and possibly a margin clerk and an over-the-counter trading desk. Branch office training is thus susceptible to the danger that it will amount to doing clerical work and studying for the forthcoming examination, often through correspondence courses. Thus, one firm acknowledges that—

> The trainee is also used, depending on the local branch, to help in the clerical duties such as mailing confirmations, etc.

The training programs of most large member firms, except those that have developed their own "schools," include classrooms or correspondence courses in basic securities and stock exchange subjects given by outside institutions. The most popular courses are those given by the New York Institute of Finance, which was originally organized by the exchange as its training school but is no longer formally affiliated with it. The school gives two correspondence courses "designed primarily for individuals interested professionally in investment analysis" or for those who are "employed in or preparing to enter the investment business." The same courses are given in classrooms in New York, along with an advanced course in investment and security analysis. Classroom programs similar to that of the New York Institute of Finance have been established through the cooperation of the stock exchange with local universities in eight large cities

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[118] The departments are new accounts, cashiers, margin, accounting, trading, institutional, municipal, commodity, and portfolio analysis.

in various parts of the country. The Investment Bankers Association sponsors courses on the fundamentals of investment banking, including a correspondence course given through the Home-Study Department of the University of Chicago, a 17-week classroom course at Northwestern University and a concentrated 4-week summer residence program, also at Northwestern.

According to the president of the exchange, "over 20 percent of member firm trainees" are enrolled in the classroom courses arranged by the exchange, and "most trainees not included in internal member firm training programs or university courses are included in one of the three major correspondence courses especially designed for training registered representatives." Firms with no central training, which use instead on-the-job training in the branch offices, depend far more heavily on the correspondence courses than do other firms, since their trainees otherwise have little contact with many of the aspects of the securities business treated in the courses.

Other outside training aids used by many large firms are lectures given by the two principal odd-lot houses on their work and special courses given by broker-dealer firms in the mutual fund field, either on a correspondence basis or in classrooms. Many firms use the visits of representatives of mutual fund underwriters as a means of acquainting their new salesmen with mutual funds.[119]

For smaller firms, the stock exchange in the spring of 1962 published a "Study Plan" and a "Trainer's Manual" for the salesmen-trainees preparing for the stock exchange's examination and for the guidance of persons responsible for training. The "Trainer's Manual" assumes that most of the firms using it provide neither classroom training nor formal training of any other type. A major problem in small firms' training, as the exchange manual implicitly recognizes, is the remoteness of many of their offices from places where the technical functions in the securities business are carried out. Many firms have a main office far from the financial centers of the country; others whose principal offices are centrally located are not able to train new men there but must place them in branch offices immediately, leaving them to the relatively inadequate training available there. Many small NYSE firms do not have back-office facilities in which salesmen can profitably perform on-the-job training, since approximately half of the 500 member firms which do business with the public have their clearing done for them by larger houses or those specializing in rendering such services.

The training practices of small- and medium-sized NYSE member firms were examined through responses to the study's questionnaires sent to 31 such firms, employing from 5 to 75 salesmen. Six firms in the group avoided the training problem, apart from limited informal orientation to their firms, by taking on only persons with prior securities experience. One firm had whatever training it needed carried on by its correspondent firm, in its offices in New York. The 24 firms with their own programs used classroom training sparingly. The five largest all provided for home office stays for trainees, four of them giving classroom training, while the rest provided on-the-job training,

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[119] Other firms have devised special programs to train their salesmen in the handling of mutual funds. These programs, as well as the special mutual fund training courses mentioned above, are discussed in ch. XI below.

with particular emphasis on the research and portfolio analysis and mutual fund departments. Of the remaining 19 firms, 4 provided classroom training combined with on-the-job training, with 20, 25, 60, and 360 hours of classroom training, respectively. Characteristic of many smaller firms was the statement of the firm with the 60 hours of classroom training that the "majority of [the] classroom training [is] devoted to prospecting, sales techniques, sales presentations, and mutual funds."

(2) *Training by firms not members of the NYSE*

While a few large broker-dealer firms dealing with the public are not members of the New York Stock Exchange,[120] most nonmember firms other than certain mutual fund selling organizations tend to be smaller, with relatively few salesmen and branch offices. Salesmen whose firms are members of the National Association of Securities Dealers, as most are, must pass its examination before they can begin to sell. Many States also have examinations for salesmen. However, there are no specific restrictions imposed by any authorities other than the NYSE and the Amex on the time a trainee need spend in the business before passing his examination and soliciting members of the public as customers. Absent the 6-month training requirements of the NYSE and the American Stock Exchange the training given by these firms, as might be expected, is generally though not universally less expensive than that given by member firms, and is even more predominantly oriented to selling. Here again, the largest firms, with their more substantial customers and variety of sources of income, are those which provide the best training.

Firms which are not NYSE members were found by the study to use one or more of the following approaches to training: (1) They give some on-the-job training, sometimes supplemented by lecturing or tutoring sessions; (2) they give afterhours coaching sessions on certain reading material which they provide to their prospective salesmen; (3) they give reading material to the men, processing their applications for registration whenever the men consider themselves ready; (4) they provide little or no literature, but allow neophytes to listen to other salemen conduct business with their customers; or (5) they hire only men with prior experience as salesmen. Since the only prescribed training curriculum for nonmember firms is whatever will prepare one for the examinations which must be passed, the content of the training depends on the character of the particular firm, and covers a broad range.

At one end of the spectrum is the training program of Blyth & Co., one of the strongest of the firms that do business with the public but are not members of the NYSE. This firm, which hires only recent college graduates, has a training program considerably more extensive than that given by most NYSE firms. Trainees are given up to a year's on-the-job training, while being paid an average salary of $450 a month. Considerable amounts of time are spent in the research and portfolio analysis department, the underwriting and syndicate department, and the municipal and Government bond department as well as the "sales service desk."

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[120] See, e.g., Blyth & Co.

A very different training program is provided by Hodgdon & Co., a Washington, D.C., firm with about 60 salesmen. The firm has a classroom training program of about 55 to 60 hours of lecture time. It does not, however, support prospective salesmen on a full-time basis, and therefore it schedules training classes in the evenings from 4 to 6 p.m. to enable the trainees to continue in their previous jobs. Since the firm has specialized in mutual funds, real estate syndications, oil lease interests, and, to a lesser extent, over-the-counter securities, the training involves considerable discussion of these securities, as well as lectures on selling techniques. Other subjects are related to what the firm advertises as its "financial planning," and include life insurance, about which the salesmen hear talks by a life insurance agent.

It is characteristic of the training programs of most firms that they make little or no effort to train their salesmen in aspects of the securities business not directly related to the securities which they emphasize. Since a large number of non-NYSE member firms, especially those that are not members of regional exchanges, are heavily engaged in the sale of mutual funds, particular emphasis in training is given to these securities. Firms whose income is predominantly derived from mutual funds spend over 90 percent of their on-the-job training and classroom programs on mutual funds, according to the STS survey. Even firms which do not specialize in mutual funds devote about 40 percent of their training time, almost all of which is on the job, rather than in classrooms, to the study of mutual funds. Mutual fund firms generally do not, however, devote as many hours to this subject as do general securities firms, since the mutual fund firms devote substantially fewer hours to on-the-job training—a little more than an average of 30 hours, as against a little over 100 hours for the nonmember general securities firms.

The sales orientation characteristic of the training programs of many firms specializing in mutual funds is shown in the program followed by Renyx, Field & Co., Inc., a large retailer of funds which employed 333 salesmen as of April 1, 1962, 70 of whom worked full time. The firm's training program which, its manual states, enables a manager to give "the finest possible training that it is practical to give," consists of four steps, preceded by an introduction to the company and to mutual funds. The first step consists of a demonstration by the manager of the way in which a fund sale is made. He then passes out a fund sales kit, a "presentation to be studied and learned by heart by all reps" and a "memory jogger to be filled out and returned by all reps." The memory jogger asks for names in answer to such questions as: "Who sold you your dog?" "Who are your buddies in the American Legion?" "Who is your best friend?" These assignments are to be completed before step 2, in which the manager listens to the trainee's memorized presentation and goes over the "memory jogger" list with the trainee "to determine whether names listed would make qualified prospects." During the remainder of step 2 the manager "explains [the] NASD and the laws and regulations covering mutual funds."

In the third step, the recruits' applications to become NASD registered representatives are turned in to the manager and a written examination on the NASD's rules is given. The trainee is then asked to choose one "simulated prospect" from his memory-jogger list—

"a person who has every earmark of a qualified prospect"—in whose imaginary presence he then gives a "dress rehearsal presentation." Thereupon, "two prospects are singled out for field-training calls," which are "the critical point in the training cycle of the new trainee." After the first of these training calls, the trainees' applications are submitted to the NASD and the firm's bonding company for approval. The final step in the training is "a thorough review and critique * * * of the field training calls" and a "final checkout." The manager is partially compensated for giving the 35 hours of training by having each trainee give him "two leads to close," on which he retains the commissions.

Inadequacies apparent in training programs are not confined to mutual fund firms. Over 60 percent of nonmember firms doing a general business allow only approximately 20 hours a week for their on-the-job training programs which, for the average firm of this type, last about 7 weeks. Over 50 percent of nonmember firms not specializing in mutual funds give no on-the-job training at all.[121] A substantial number of firms provide no more training for their salesmen than is necessary to enable them to pass the NASD examination and to become acquainted with the way the firm does business.

As discussed below, the NASD examination program was not introduced until 1956 and had only nominal effect until 1962. Many salesmen entering the securities business before 1962 were required only to know enough about securities to satisfy their employers of their ability to discuss the current merchandise of the firm with some self-assurance. According to the testimony of Harold Rooff[122] when he began his first job as a securities salesman in 1955, he was unable to interpret financial figures for his customers, since he had had no courses in finance and had read no books on financial subjects at all. Instead, he had been given "certain figures and understandings of the company" whose securities were then being sold by his employer.

Another salesman, who like Rooff later became a manager, described the training he received from his first employer in the securities business—a firm which is under three separate indictments for alleged violations of the registration and antifraud provisions of the Securities Act—as follows:

> The training I received * * * was nothing more than to sit around and be guided, to understand the business, and this is about it. When I thought I had some knowledge of the business at that particular time [October 1955], I asked if I could sell, sir.

Until recently there has been no objective way in which the effectiveness of individual firms' training programs could be evaluated, inasmuch as so few persons failed the NASD and NYSE registered representative examinations. Since November 1962, the NASD examination has become a more effective screening device, under which approximately one-third of the persons taking it have failed.[123] One result shown by the scores received thus far is a marked disparity between the training given by large mutual fund firms and large general securities firms. The table which follows compares the NASD

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[121] Some of these firms hire only experienced salesmen or give their inexperienced recruits some other kind of training.

[122] See sec. 1.c, above. Also see the account of D. Richard Engel's introduction to the securities business in pt B.1.a(4), above.

[123] The NASD's qualification examinations are discussed in sec. 3.b(2), below.

examination records of applicants from certain large mutual fund organizations with those of persons from certain large NYSE firms:

TABLE II-b. *Results on NASD qualification examination received by trainees from selected broker-dealer firms, Nov. 1, 1962–Feb. 28, 1963*

Name of firm	Number of persons		Percentage failing
	Passing	Failing	
Mutual fund firms, total	393	349	47.0
First Investors Corp	114	79	40.9
Investors Planning Corp. of America	105	101	49.0
Renyx, Field & Co., Inc	3	7	70.0
Waddell & Reed, Inc	171	162	48.6
Other firms, total	390	17	4.2
Bache & Co	32	3	8.6
Dempsey-Tegeler & Co., Inc	12	3	20.0
Francis I. du Pont & Co	28	1	3.4
Goodbody & Co	10		
Hayden, Stone & Co	11		
J. A. Hogle & Co	13		
E. F. Hutton & Co	18		
Kidder, Peabody & Co	45	1	2.2
Merrill Lynch, Pierce, Fenner & Smith, Inc	97	7	6.7
Paine, Webber, Jackson & Curtis	12	1	7.7
Shearson, Hammill & Co	24	1	4.0
Dean Witter & Co	27		
Walston & Co	61		

NOTE.—Firms selected are those whose training is discussed in this section and which had 10 or more trainees take the examination during the 4-month period, in addition to the 3 NASD member firms employing the largest numbers of mutual fund salesmen.

While these results reflect the less intensive training most mutual fund salesmen receive, they may also indicate that mutual fund firms have not prepared their salesmen in many of the subjects covered by the NASD exam on the assumption that these salesmen will not have occasion to make use of such knowledge. The subject of specialized examinations is considered below, in part F.3.

c. The part-time salesman

Among persons engaged in the sale of securities are a substantial number for whom the activity is neither their main source of income nor their sole occupation. During 1961, of the 40,950 persons registering as salesmen with the NASD, 20,990 indicated that their securities activities were going to be on a part-time basis. Statistics gathered through the STS survey reveal a similar ratio of part- to full-time salesmen, as of April 1962.

While part-time salesmen are common in several areas of the securities industry, there can be no doubt of their concentration in mutual fund sales forces. Responses to STS–1 and STS–2 indicate that the firms specializing in the sale of mutual funds employ the greatest numbers and the highest proportions of part-time salesmen. Their sales forces, in the aggregate, are composed of about 66 percent part-time salesmen, as contrasted with 12 percent part-time salesmen working for nonspecializing firms (table II–13). The larger firms in each category tend to employ proportionately fewer part-timers than do smaller firms. Still, there is a sharp contrast between the two types of firms, even among those of larger size. Large firms specializing in mutual funds have sales forces composed of 61 percent part-time salesmen, while the other large firms have only 2 percent part-timers. Another area of the securities industry which apparently has a high incidence of part-time salesmen is the real estate syndication business.[124]

The significance of this phenomenon of the part-time sale of securities has been the subject of much discussion and controversy in recent years. The problem was noted by Commission Chairman William L. Cary in his testimony at the House subcommittee hearings on the authorization of the Special Study, when he mentioned "further difficulties flowing from the fact that many salemen work part-time." [125] A rule of the New York Stock Exchange,[126] like those of almost all other national securities exchanges, requires every registered representative to "devote his entire time during business hours to the business of the member or member organization employing him," and forbids his employment by any other corporation, firm, or individual. Commenting on this rule, Exchange President Funston testified at the study's public hearings:

> We believe employment of securities salesmen on a full-time basis is necessary to exercise proper control and to best serve the public.

Many members of the exchange appear to agree with Funston that part-time salesmen represent a danger to the investing public. The senior partner of one NYSE firm wrote to the Special Study in this vein:

> I believe that permitting persons who have other lines of business to devote a portion of their time to selling securities represents a very great hazard to the investing public today.
>
> * * * * * * *
>
> [It] is discouraging to have to face competition from people in all walks of life who can spare a few hours of their time for selling securities * * *. [The] small amount of investment knowledge which they have and the limited experience on which they might draw for the purpose of advising clients would fall far short of qualifying them for the serious rule which they have assumed. The aggressiveness with which many of these part-time salesmen pursue their avocation makes them, in my opinion, a distinct menace to the type of investor, of whom there are so many, who may be influenced by an aggressively persuasive approach.
>
> I do not believe that we can ever hope to raise the standard of ethics in the investment business to the level at which the overwhelmingly largest number of our associates would like to see it until we remove this glaring defect in the system.

These views typify the criticism voiced by those who object to part-time salesmen. The complaints of these critics usually are directed to the inadequate training of part-time salesmen in the intricacies of the securities industry, their overly aggressive sales tactics, and their lack of supervision.

Generally, the study's findings confirmed the existence of these conditions among mutual fund retail sales organizations,[127] most of which rely heavily on part-time salesmen. Furthermore, those smaller firms not specializing in the sale of mutual funds employed substantial per-

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[124] For a discussion of selling practices in the area of real estate syndication, see ch. IV.E, below.

[125] Hearings of subcommittee of the House Committee on Interstate and Foreign Commerce, 87th Cong., 1st sess., on H.J. Res. 438, p. 10.

[126] Rule 346.

[127] For a fuller discussion of the recruiting, selection, training, and selling practices of these firms, see sec. 2.c, above, and ch. XI, below.

centages of part-timers and revealed inadequate training and screening practices.

On the other hand, the study findings do not support a conclusion that in firms where patterns of inadequate training or improper selling do exist, their incidence is any higher among part-time salesmen than among full-time salesmen. Whatever the inadequacies of training and supervision of mutual fund retail organizations, they apply to full- and part-time salesmen alike. While recruits to the ranks of part-timers come from varying backgrounds, there is no evidence that their prior experience makes them less suited to the securities industry than trainees for full-time jobs. As to improper selling practices, the study found them no more common among part-time salesmen than among full-time salesmen. Interviews with enforcement officers, such as various State securities administrators, produced no evidence of a higher level of complaints relating to part-time salesmen than full-time salesmen.

It is clear that, insofar as the mutual fund industry is concerned, the prevalence of part-time salesmen results from the economics of most firms' recruiting and training policies, and much of the industry's justification of the institution of part-time salesmen reflects this fact. Industry representatives defend part-time salesmen on the grounds that working part time is the best way for both the prospective full-time salesman and his firm to know whether he will be able to become a successful securities salesman. Many part-time salesmen, according to representatives of the Hamilton Management Corp., are persons who are about to retire from their civil service or military jobs and who want to "prepare themselves for a future." Walter Benedick, president of Investors Planning Corp., said that his organization encourages recruits to start on a part-time basis because, "We don't want them to give up something they now have before they know that they will make a success in our business." Most of the successful salesmen in his organization, he testified, started out on a part-time basis. He also pointed out that a part-time salesman is under less financial pressure to make unsuitable sales to his customers, because he does not depend entirely on the sale of securities for his livelihood. He voiced the opinions of many persons who employ part-time mutual fund salesmen:

> [T]here is no difference in the quality of understanding and knowledge between men who devote a few hours a week and/or many hours a week to our work. There is only a difference between poorly trained men and well-trained men. There is only a difference between men who are irresponsible and men who are responsible. A man who is a so-called full-time man may be irresponsible. A man who devotes only a few times [sic] a week to this work in order to buy more things and better things of life for his family may be a very responsible person.

Benedick also stated that if a rule were to be adopted by the Commission or the NASD forbidding the employment of part-time salesmen, the effect on his firm would be "pretty catastrophic." The structure of Hamilton Management Corp., with its 7,000 or more salesmen, would also be severely shaken if the part-timers among its present salesmen, most of whom average only a week's selling in a year, were forced to choose between working full time and not selling for Hamilton.

The NASD, with approximately half of all its incoming registered representatives working part time, does not believe that special measures need be taken to eliminate or cut down on the activities of part-time salesmen. Over the years, the NASD has created several committees for the purpose of studying the problem of the part-time salesman. William H. Claflin III, a former chairman of the board of governors of the NASD, testified in the following manner before a subcommittee of the House Interstate and Foreign Commerce Committee in June 1961:

> Today, we have had none of these committees find any justification for the position that the number of hours that a man works is a criterion as to his ability and value to the industry.
>
> We continuously come up with the conclusion that the proper approach to this problem is one through further education, [and] better training of personnel * * *.[128]

The Special Study has been unable to reach any different conclusion.

3. CONTROLS OVER SALESMEN'S QUALIFICATIONS

Those in the best position to control the qualifications of persons entering the business of selling securities are the broker-dealer firms by which the salesmen are employed. As is shown above, many firms, through choice, necessity, or indifference, impose no conditions of character or competence upon employment as a salesman. The qualifications of salesmen have therefore become a matter of concern for the Commission, the NASD, the exchanges, and the State governments.

a. Federal controls

Although there is an extensive network of Federal controls over the securities industry, there is no direct control over the qualifications of persons employed as securities salesmen. There is, however, an indirect control of limited scope through the Commission's power to deny or revoke the registration of any broker or dealer where "any person directly or indirectly * * * controlled by such broker or dealer, whether prior to or subsequent to becoming such" has engaged in, been convicted of, or been enjoined from engaging in, certain specific illegal activities relating to securities.[129] The facts which would thus disqualify a potential salesman are the same as those which would bar a broker-dealer, and include the filing of false information with the Commission, conviction of a felony or misdemeanor relating to securities transactions, injunctions relating to conduct or practices in connection with purchase or sale of securities, and willful violation of the provisions of the securities laws or rules.[130]

Aside from this indirect control the Commission has no power to prevent or place conditions upon the entry of salesmen into the securities business. To a large extent, the Exchange Act, as amended in 1938 by the Maloney Act, has placed the most direct controls over salesmen in the hands of the NASD, which acts as the keeper of the records on "registered representatives." The Commission keeps no records of its own of salesmen as a group. It does not even maintain separate files on the persons—other than those named as violators or causes—who are connected with broker-dealer firms involved in disciplinary proceedings, but keeps all information on such individuals in the files of

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[128] Hearings of subcommittee of the House Committee on Interstate and Foreign Commerce, 87th Cong., 1st sess., on H.J. Res. 438, p. 65.
[129] Exchange Act, sec. 15(b).
[130] See pt. B.2.a, above, for a fuller discussion of the statutory bars.

the broker-dealers with whose cases they are related. Concerning salesman employed by the approximately 1,000 firms—some with sizable sales forces—which are not members of the NASD, the Commission has no immediate accessible records. However, Commission rule 17a-3(a)(12), adopted in 1962, now requires broker-dealers to keep individual questionnaire-type forms on all persons handling funds or securities or soliciting transactions or accounts, so that Commission investigators may obtain background information on persons connected with particular firms from the firms themselves. The rule also serves the important purpose of placing upon registered broker-dealers a greater duty of inquiry into the backgrounds of their salesmen and other employees.

b. The NASD

Although the NASD assumed its role as a regulatory body in 1939, it was not until 1946, when its program for registering representatives (active principals, managers, and salesmen) became effective,[131] that it began to exercise direct control over the employment of sales personnel of member firms. By the end of 1962, the persons subject to the NASD's jurisdiction as registered representatives numbered 94,444, and probably included over 80 percent of the salesmen in the securities industry. At first, registration of salesmen (and other persons required to be registered) was accomplished simply by their employers' filing a one-page registration form. The information required by the first registration form was limited mostly to matters relating to the disqualifying facts under the Exchange Act. Later versions requested more information, such as data concerning previous employment, education, and involvements in activities that do not constitute disqualifying bars.

By 1951, information concerning the qualifications of new salesmen, as shown by their previous business experience stated on the registration forms, was causing concern to the NASD. The NASD News quoted one Governor, Albert W. Tweedy, of Boston, Mass., as stating:

> "I have been looking over some recent applications," he said recently, "the first I have here shows the applicant's last 10 years' business experience was in the wholesale butcher business; next is a 'freelance writer, Turkish newspaper'; another sold cemetery lots; another ran a grocery store; another was a chief of police; another a district court clerk. * * *
>
> "Our committee [a committee of the board of governors assigned to study 'tests or standards for people coming into the securities business'] started out with the idea of a written examination for applicants for positions in the business, but the task, we could see, would be tremendous and would require a staff of people."

As a result, according to the article in the News—

> the committee * * * decided that the only practical avenue of approach to a solution of the problem was the adoption of a requirement that members certify that registered representatives have adequate training and experience. The import would be to impress on members the wisdom of qualifying people for selling securities and of the member's obligation of determining that by character and repute an individual could be certified for a position.[132]

The committee recommendation resulted in a 1952 amendment to the "Rules of Fair Practice" to provide that a member who employs a salesman, or other "person requiring registration * * * shall have reason to believe, upon the exercise of reasonable care, the person is

[131] See pt. B.2.b, above.
[132] NASD News, September 1951, p. 3.

of good character and of good business repute and is or will be qualified by training or experience" to perform his duties.[133] Qualifications for registered representatives were raised again by the 1956 amendment to the bylaws which had the effect of barring from employment with association firms any person whose registration with an exchange or the NASD had been suspended for conduct inconsistent with just and equitable principles of trade, or who had been convicted of a felony or misdemeanor arising out of securities transactions or related to embezzlement or misappropriation of funds.[134]

(1) *NASD controls over salesmen's character*

Aside from its disqualifying bars, the NASD control over the character and integrity of salesmen is accomplished only indirectly, through its supervisory power over its members. The section of the "Rules of Fair Practice" (sec. 27(c) of art. III) requiring that a member hiring a salesman shall have reason to believe that the person is of good character and business repute makes "[t]he determination of the character [and] good business repute * * * the *complete* responsibility of the member." [Emphasis in original.] It further makes "improper or unwarranted certification" a ground for discipline as "conduct contrary to high standards of commercial honor."

In relying on the determination of good character by members, the association requires that a responsible partner, an officer, or branch office manager sign a certification "based upon an investigation made by me of the applicant's background and other information available." [135] Until 1962, the impression among some NASD members was that the certification imposed no greater duty than contacting the prospective salesmen's previous employer, an impression perhaps fostered by the application form itself. In August 1962, however, the Commission upheld a decision of the association's board of governors in the case of *Matter of Vickers, Christy & Co., Inc.*,[136] in an opinion which made clear that the responsibility of the employer is not so limited. The member's certification is expected to result from a reasonably diligent investigation of the candidate's character and reputation. If it is discovered that a member has not been sufficiently diligent in uncovering unfavorable aspects of a prospective registrant's past that may not be serious enough to constitute statutory bars, the member may nevertheless be subject to disciplinary action. This is so even though the association cannot deny registration to a saleman with a prior history indicating poor character or business but no disqualifying offenses.

Since the NASD relies upon the diligence of member firms in certifying to the good character of new registered employees, it makes no independent determination of their integrity. The association makes no investigation to determine whether the facts as stated on the application are true, other than by checking its own files.

To some extent its limited action may stem from the sheer volume of applications: over 31,000 applications from registered representa-

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[133] NASD Rules of Fair Practice," art. III, sec. 27(c).
[134] NASD bylaws, art. I, sec. 2(a) ; these provisions are discussed in pt. B.2.b, above.
[135] NASD form R–100–K, application for registration as a registered representative.
[136] Securities Exchange Act release No. 6872 (Aug. 8, 1962).

tives flowed into the NASD during 1962—a substantial number, but considerably fewer than the more than 41,000 received in 1961.

Salesman applications from all 50 States are handled by the association's office in Washington. No use is made, through channeling applications through NASD local district offices,[137] of the knowledge of local persons and industry conditions, which might be helpful in processing applications. Moreover, the districts receive no notice from the national office of the persons in their jurisdictions who are entering or leaving the ranks of registered representatives.

While none of the 14 district offices maintains independent files on securities salesmen employed in its area, the Washington office keeps files on all individual registered representatives containing their past and present broker-dealer affiliations. These records were seldom used in enforcement until recently, when the NASD and the Commission jointly initiated a program of gathering data on the current employment of persons at one time connected with firms known to the Commission as "boiler rooms." Information obtain under this program has been made available to the NASD's district offices and to members of the Commission's enforcement staff, including its regional offices, for use in scheduling inspections and otherwise maintaining surveillance over firms.

(2) *NASD controls over salesmen's competence*

To establish standards of experience and knowledge, whether for qualification as a proprietor or salesman, the association in 1955 approved an amendment to its bylaws, which, after the Commission approved, became effective the following year.[138] The amended bylaw in effect prohibits any broker-dealer from employing a salesman who lacks 1 year's experience as a registered representative unless such salesman "shall, by passing a written examination prescribed by the board of governors, demonstrate to the association that he has the technical proficiency and knowledge of the securities business necessary to conduct such a business or to perform [the] duties or functions" of a registered representative. The board of governors is given the authority to prescribe "the nature and scope of such examination, the manner in which it shall be marked, the passing grade, and the time, intervals, and places at which it shall be held." [139]

The NASD prescribes no minimum period of training like that required by the New York Stock Exchange,[140] nor does it examine or approve training programs conducted by its members. Its entire effort to raise qualification standards and screen out salesmen lacking "the technical proficiency and knowledge of the securities business," therefore, rests on the adequacy of its examination as a testing device.

Officers of the association concede that the examination program in its early stages was of little value in eliminating the incompetent. The first examinations consisted of 100 questions drawn from a limited pool of 344 questions, later increased to 441, which were published along with the correct answers in a booklet distributed to can-

[137] But cf. pt. B.2.b, above.
[138] NASD bylaws, art. I, sec. 2(b). Other aspects of these bylaw amendments are described in pt. B.2.b, above.
[139] Ibid.
[140] See secs. 2.b(2), above, and 3.c(2)(b), below

didates for registration. This test, taken in the offices of members, at times convenient to the persons examined, consisted mostly of true-or-false or yes-or-no questions, with a few multiple-choice questions. Coming as it did from a book of questions and answers similar to that provided to applicants for drivers' licenses in certain jurisdictions, the first examination was, in the words of the association's executive director, "to be very frank * * * in my opinion a memory test. If [the applicant] had a good memory, there was no difficulty in passing the examination." Its ineffectiveness as a screening device is suggested by the low rate of failure among those taking it. For the first 4 years of the 6 in which the examination was used, the rate of applicants failing was less than 2 percent, while the highest rate for a single year was only somewhat over 4 percent (table II–7).

The increases in the number of failures shown by the table can be attributed to a gradual increase in the percentage score needed to pass,[141] and to the fact that in 1958 examinations began to be given in special examination centers under the supervision of outside monitors.[142] NASD statistics indicate that the failure rate at examination centers, while not a high percentage of the number of tests taken, was nevertheless four to five times greater than that for exams taken in member-firm offices.

The large percentage of persons passing the examination, NASD officials ascribe not to a high level of preparation or knowledge on the part of the persons examined, but rather to the ease in which the examination might be passed. As the chairman of the board of governors testified:

> Most applicants, of course, read only the pool of 440 questions and answers which were published in a booklet. As a result, the test failed to provide the incentive for intensive study of the securities business, which was the sole purpose of the examination.

On January 2, 1962, after extensive discussions with the Commission, the association introduced a completely new examination, developed at a cost of almost $25,000 by the Psychological Corp., along the same lines followed by that firm in its preparation of the NYSE's examination.[143] The new exam, actually three different tests of 125 questions each, is designed to be substantially more difficult than its predecessor and to require considerably more preparation and study. In place of a complete catalog of questions and answers, the candidate for registration receives a "study outline" listing the topics on which questions will be asked and containing a bibliography of pertinent books and pamphlets. While persons failing the old examination could be reexamined as soon as they wished, the present examination may not be taken again until 30 days have elapsed; and there is a 60-day interval after a second failure and 90 days after each subsequent failure. In the year since the examination's introduction, the association has raised the passing grade twice, both times after its failure ratio rapidly declined, a tendency, Executive Director Wallace H. Fulton observed, which "seems to be typical, and seems to occur even though no great change has been ascertained in training

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[141] The passing grade on June 1, 1956 (the first day the examination was used) was 65 percent; on June 1, 1957, it was raised to 70 percent; and on Oct. 1, 1959, it was increased to 80 percent.

[142] It was not until 1962 that all examinations were given in such centers.

[143] See sec. 3.c(2)(a).

programs." Over the first year of its use, however, a considerably higher percentage of applicants failed the new examination than the old. Whereas somewhat over 3 percent of the 30,790 examinations scored in 1961 resulted in failure, the 1962 failure rate was about 14 percent of 16,186 examinations. As a result of a recent increase in the passing grade, the failure rate has risen again, climbing to 34.1 percent of the 3,518 examinations taken in the period November 1, 1962, through February 28, 1963.[144]

The NASD is planning further refinements and developments in its controls over salesmen's competency. The executive director has proposed, but thus far without the concurrence of the board of governors, that the association authorize separate registrations of mutual fund salesmen and salesmen of other securities. As he told the board of governors in September 1962:

> In principle, all securities salesmen should have a broad, general knowledge of the entire business. But this just doesn't seem to be practical. I believe it would be more sensible to require members who concentrate exclusively on the sale of mutual funds to declare their intention and register them and their salesmen for this purpose only.

During 1962, the NASD entered into discussions with the New York Stock Exchange and the National Association of Securities Administrators to develop joint or coordinated examination programs, with a view to making it possible for an individual wishing to be registered with the NASD, the NYSE, and a State to take only one examination. As a result of these discussions, a single combined examination will be given, starting on July 1, 1963, to salesmen from the NASD, NYSE, and Amex. Salesmen from non-exchange-member firms will be required to answer 2 hours of questions on general securities subjects and the rules of the NASD, while exchange member-firm salesmen will have an additional hour of more specialized questions. The NASD hopes that the States which give examinations will, in the near future, require salesmen of NASD firms under their jurisdiction to pass the NASD-member portion of the examination, along with a coordinated half-hour test on State law. The association is also preparing a training guide for use in firm training programs, as well as in home study courses. "When completed," according to Fulton, "the study guide will be of particular help to the small firm that cannot now support a formal training program of its own."

c. The New York Stock Exchange

The rules, practices, and policies of the New York Stock Exchange relating to qualifications of salesmen are of major importance to the public and the securities industry, in that salesmen of member firms handle a high percentage of all securities transactions executed by the public. The exchange has become the acknowledged pace setter in the field of qualifications for salesmen.

The fundamental concept under which the exchange controls salesmen is the same as that of the NASD—the registration of "registered representatives" by the member firms employing them. The rules define the term "registered representatives" to include all—

> employee[s] engaged in the solicitation or handling of listed or unlisted business in securities * * * or in the trading * * * for the account of or as a representa-

[144] Performances by salesmen from particular firms on the most recent examination are cited in sec. 2.b(2), above.

tive of his employer; or in the sale of listed or unlisted securities on a dealer or principal basis for his employer; or in handling international securities arbitrage operations of his employer; or in the solicitation of subscriptions to investment advisory or to investment management service furnished on a fee basis by his employer; or one to whom has been delegated general supervision over the foreign business of his employer.[145]

Exchange requirements that certain employees of member firms be registered with it antedate the adoption of the Federal securities laws by many years. Branch managers were registered prior to 1900, and registration of customers' men and salesmen has been conducted at least since the 1920's.[146] No doubt in reaction to the 1929 market crash and in response to complaints about the unethical selling practices which had theretofore been prevalent, in 1930 the exchange undertook a more comprehensive program for registration of all producers, and introduced the first version of the present RE–1 application form, with its agreement not to engage in certain prohibited practices.[147] Shortly thereafter, a subcommittee of the committee on quotations and commissions was set up to approve the employment of all sales employees, and began to apply flexible experience standards in passing on applicants.

In 1936 the exchange set up a standing committee on customers' men and instituted a requirement that salesmen pass an examination given by the affiliated New York Stock Exchange Institute (now the independent New York Institute of Finance). Then, as now, the institute offered courses in stock exchange and brokerage office procedure as well as investment analysis. In 1936, too, a recordkeeping system for all registered employees was established, and the minimum training period was set at 6 months. Three years later salesmen and customers' men, theretofore treated as separate categories, were included in a uniform system of registration.

In the last two decades or more there has been little change in the formal exchange requirements for member firms' salesmen, except with respect to limited registration, discussed separately below.[148] At present a candidate for full registration, which entitles him to handle any and every type of securities business on behalf of his employer, must be at least 21 years old and, if lacking previous actual experience as a salesman, he must be given 6 months' training, although that period may be reduced or waived by the exchange for candidates with some previous actual experience in the securities business or closely allied work such as that of a bank trust officer.[149]

In addition, in determining his acceptability for registration, the exchange looks for evidence of "integrity" and a "record of high standards of business conduct," of "potential ability to perform creditably the duties of a registered representative," and of "preparation in the areas of knowledge necessary for a registered representative.[150]

[145] NYSE rule 10.

[146] Classically, persons now embraced within the definition of "registered representatives" were referred to either as "customers' men" when they handled the public's orders for securities transactions in which their firms acted as agents, or "salesmen" when they worked for firms selling securities to the public as principals, such as bond houses or investment banking firms. Ironically, in 1940, in "Where Are the Customers' Yachts?" Fred Schwed, Jr., commented that—

"A new name is being sought for 'customers' man. As this is being written, 'registered representative' is being considered, but I do not think that it will be retained simply because 'registered representative' is too much of a mouthful" (p. 34, footnote).

[147] NYSE Guide, par. No. 2345.17.

[148] See sec. 3.c(2)(c), below.

[149] NYSE Guide, par. No. 2345.15.

[150] Ibid.

Evidence of the first qualification is obtainable by the exchange through its investigation of the information contained in the application form, form RE-1. The second qualification is satisfied by the requisite training period with a member firm, and the third by the exchange examination for registered representatives.

(1) *Controls relating to salesmen's character and integrity*

The exchange's method of checking the honesty and integrity of would-be registered representatives was first put into use in the 1920's, although the investigation conducted has increased in scope and depth. The investigations division and the member offices and personnel division of the exchange's department of member firms are responsible for processing registered representative applications, and a staff of approximately 21 devotes a substantial portion of its time to these duties. When applications for registration are received, they are given a preliminary screening into categories for processing. Files on candidates recently registered with other member firms are checked for any derogatory information which may have been recorded since their initial registration. These files contain the RE-4 forms which each member firm is required to file on the termination of employment of any registered representative, setting forth the reason for termination and an expression of whether the terminating firm would recommend employment by another firm. Ordinarily no investigation other than this, called a "check only," is conducted, unless "the candidate left his previous employer under unfavorable circumstances." Slightly more extensive is the "staff investigation," conducted by members of the exchange staff for previously unregistered candidates who have relatively simple histories, such as persons newly graduated from college. These investigations are made by letter or telephone call and only rarely involve personal visits. Prospective registrants with more complicated pasts are referred to outside investigating agencies, which, for an average cost of about $11 per name, look into the individual's background. The scope of the agency's investigation depends largely on the complexity of the candidate's past, and varies from asking persons in his neighborhood about his behavior, to checking any police and civil litigation records, and to interviewing prior employers and associates. If the candidate has been a principal in a nonmember firm, the exchange requires one of its examiners to study the financial records of that firm to see if the manner in which its business was conducted reflects adversely upon the prospective registrant. The figures set out in the table below show the classification of the exchange's investigatory workload in recent years:

TABLE II-c.—*Type of NYSE investigation of applicants for positions as registered representatives*

Year	Total	Outside investigation [1]	Staff investigation [2]	Staff check only [2]
1959	6,116	4,011	755	1,350
1960	7,508	4,890	713	1,905
1961	8,680	5,994	674	2,012
1962	9,742	5,651	1,045	3,046

[1] The number of investigations for which bills were received.
[2] The number of investigations started.

The exchange's screening program operates, to a large extent, in an informal manner. When the staff check discloses incorrect information on the application or derogatory information is obtained through independent investigation, the exchange often suggests to sponsoring firms that they make "further depth investigation of their own" into matters which the exchange considers reflect adversely upon the candidate. Upon such a suggestion, the sponsoring firm usually withdraws its application. The exchange staff has estimated that there were 10 applications withdrawn under this informal procedure in the second half of 1961.

If an application on which there is a serious question is not withdrawn, the evidence collected in the salesman's file is summarized in a memorandum and, under a procedural change made contemporaneously with a January 1963 amendment to the exchange's rules,[151] the individual "will be invited to submit a memorandum of comment to be considered in determination of possible violations and penalties by decisionmaking members of our staff." Under the new rule, the prospective employee "may require a review by the board of governors of any determination made under this rule by filing * * * a written demand therefor * * *."[152]

The exchange staff sometimes imposes the stringent penalty of formal disapproval upon an application involving a salesman who previously escaped a stock exchange penalty in a disciplinary proceeding by resigning from his employment before a disciplinary proceeding could be completed. Almost all of the seven disapproval actions taken in 1961 appear to have been of this type, since most were related, according to records furnished by the exchange, to incidents which occurred in prior periods of employment as salesmen.

While the exchange's approach to passing on the integrity of prospective salesmen seems generally quite effective, some questions do arise concerning the use of the RE–4 form, which is filed by firms for each of their departing registered representatives and requires a statement of the reasons for the termination and the reasons, if any, why the man should not be employed as a registered representative by any other member firm. Many firms appear reluctant to put reasons for discharge in writing even though each salesman, upon signing his application form, authorizes the furnishing of such information and releases the employer from liability for doing so. For example, in the study's public hearing a branch manager of Bache & Co. admitted that he filed a form showing "record clear" for a registered representative whom he had discharged for violations of regulation T.[153]

While the exchange staff will advise prospective employers when derogatory information concerning an applicant has official documentation, such as a prior suspension by a State of the applicant's license to sell securities, it is reluctant to pass on less formalized information. Thus, the exchange checks the employment record of all registered representatives against a confidential Commission list of firms and individuals involved in securities violations, but advises

[151] NYSE rule 345, as amended.

[152] Under the exchange's recently discarded practice, a proposed salesman was informed of the exchange's attitude toward his application through his firm or in interviews with staff members. Appeal of an adverse decision to the board of governors was available to the applicant only through his firm.

[153] For a more detailed discussion of the background of this incident, see ch. III.B.5.b on the Bache & Co. Seattle branch office.

member firms that a former employer was on this list only if the applicant himself was named a "cause" of the disciplinary order. Since administrative considerations, including limitations of time and manpower, frequently prevent the Commission's explicitly naming as causes all salesmen involved in a "boiler-room" operation,[154] this reluctance on the part of the exchange has resulted in the fact that at least 12 former "boiler-room" employees are now employed as registered representatives by member firms.[155]

(2) *Requirements and exchange activities relating to salesmen's competence*

During the years since 1950, as the number of the exchange's registered representatives has more than tripled,[156] exchange spokesmen on several occasions have emphasized the importance of its requirements of knowledge and proficiency for salesmen. In 1955, a committee of members assessing the rules and practices of the exchange, known as the "Vilas committee," made the following general comment on the importance of qualifications standards:

> Training requirements, investigation procedures, and qualifying examinations for registered representatives are essential to the development of a professional status for employees of member firms who deal with the public.

Five years later, Exchange President Funston, speaking to the National Association of Investment Companies,[157] spoke of a major effort by the exchange to raise its qualification standards. Funston spoke of three directions in which the exchange's accelerated program was heading: (1) "new, tougher examinations" for registered representatives, to be ready for use by January 1, 1961, were to be administered "through a nationwide network of testing centers," rather than in the offices of member firms where the previous examination had long been given; (2) member firms were going to be given assistance to "broaden their individual training efforts," including the greater availability of exchange-sponsored training courses given at local universities, and (3) "conference programs and refresher courses for partners and registered representatives" were to be used, and new training materials were to be prepared which would share the training techniques used by firms all over the country. In the few years since this speech, these projected developments have taken place as well as further steps on the part of the exchange to raise the standards of salesmen's competence.[158]

(*a*) *Examinations.*—The exchange's examination program in the years 1936 to 1961 used a test requiring brief written answers which was given to candidates for registration in the offices of their employers by an officer or partner of the member firm concerned, and then mailed to the exchange for grading. Only about 2 percent failed the examination and most persons scored in the 90's.

The exchange now uses a 150-question, 3-hour, multiple-choice examination prepared by the Psychological Corp., a personnel consult-

[154] See *N. Sims Organ*, Securities Exchange Act release No. 6798 (May 4, 1962).
[155] Boiler-room salesmen are described in pt. B.1.a(4) and sec. 1.c, above.
[156] The number of exchange-registered representatives increased from 10,608 at the start of 1950 to 24,898 at the start of 1960, and to 32,555 at the start of 1963.
[157] The organization is now known as the Investment Company Institute.
[158] According to a member of the exchange staff, the additional steps, which would have been taken in any event, were accelerated as much as 2 years as a result of the Commission's increasing emphasis on the subject of salesman's qualifications and the publicity engendered by the Special Study's public hearings, which emphasized this subject.

ing firm. The new test is given to groups of trainees, meeting for the purpose in school auditoriums and other public places. As a result of the test's new format, the conditions under which it has been given and the passing grade set by the exchange staff, the failure rate was close to 10 percent during 1962.

The three principal subject areas covered in the examination are, in the order of their importance (1) Securities marketing procedures, including the operation of the exchanges and of the over-the-counter market and the marketing of mutual funds, Government bonds, and new issues; (2) securities and their analysis, including evaluation of corporate securities, mutual funds, and Government bonds; and (3) elements of finance, including corporation finance and accounting, investment companies and Government securities, the money market, national economic trends, and taxation. Considerably less emphasis is placed on the application of securities knowledge to specific investment needs and desires, or investment advice. Also receiving less emphasis are the securities laws and regulations governing the conduct of salesmen—the "NYSE Constitution and Rules," the "NASD Bylaws and Rules of Fair Practice," the Federal statutes, and the law of agency.

At one time, the exchange provided a choice of six examinations for registered representatives—"General Stock," "Municipal Bond," "General Corporate Bond," "U.S. Government Bond," "Public Utility Stock," and "Bank and Insurance Stocks"—but granted full registration, with the right to handle transactions in all securities, to a salesman passing any of the tests. Today, the "General Stock" examination is taken by almost every candidate for registration, although some trainees also take the limited registration examination discussed below. For persons intending to specialize in municipal bonds (in 1962 about 2 percent of persons taking full registration examinations) a substitute examination is still available.

Until recently the successful completion of the two exchange-sponsored courses at the New York Institute of Finance or certain other schools could be substituted for passing the exchange examination. The exchange will now waive the examination only for persons who have started one of the approved courses prior to January 1, 1962, and who complete both parts of the program before December 31, 1963. This rule change reflects the exchange's commitment to examinations as the sole measure of the efficacy of training.

In recent years it has become standard procedure for the exchange staff to use its examination as a disciplinary instrument, requiring that it be taken by a salesman who has been suspended or otherwise disciplined by the exchange. Although the examination has less than 10 percent of its questions devoted to securities regulations and ethical standards, the staff believes that taking the examination will make the salesman more fully aware of his responsibilities and proper sphere of activity. The exchange has not yet had to face the problem of what to do with a disciplinary examinee who fails.

(*b*) *Training requirements.*—As a result of its current concern with training standards for registered representatives, the exchange in 1962 published and distributed to member firms a study plan for a 26-week training program to be used as preparation for registration as a representative of a member firm, together with a "Trainer's Manual" for use with the study plan. However, while the study plan establishes the standards considered appropriate for member firms, the exchange does not (except with respect to limited registration programs discussed below) undertake to pass on programs established by any firm, nor does it attempt to review or inspect the manner in which existing programs are carried on.

The exchange in 1962 also tightened its administrative policy on the rule permitting reduction or waiver of the 6-month training period for persons with certain types of prior experience. Formerly the exchange staff accepted without question a member's statement, on a request for waiver or reduction, that the trainee concerned had the qualifications required under the rule. Now, however, a form letter is sent in reply to all such requests, stating the qualifications which are considered acceptable and asking whether the particular candidate meets the standards. This letter has had the effect, according to a member of the exchange's staff, of sharply reducing the number of requests. When a request is granted, the staff requires a grade of C or better on its examination before the candidate is allowed to register.

(*c*) *Limited registration.*—As "a device for carefully controlled on-the-job training in securities customer service," the exchange provides a status of limited registration for salesmen who are permitted to sell only mutual fund shares or stock selected by the salesman's firm under the exchange's monthly investment plan (MIP).[159] Limited registration is a temporary status, for which prospective salesmen may not apply until they have completed 3 months of training and in which they may not remain for longer than 7 months, after which time they must be fully registered if they are to sell any securities at all. After becoming limited registrants, salesmen may conduct sales activities for no more than half of their business hours, and must use the remainder in preparing for full registration. The earliest time at which limited registrants are eligible for full registration is 8 months after employment. Firms wishing to use trainees for selling are required to secure exchange approval of their training programs to insure that they meet the standards described in an exchange pamphlet entitled "Limited Registration Study Plan and Outline."

Limited registration came into being as a result of the rapid growth in sales of mutual fund shares in the years after World War II. During 1948 certain member firms sought a relaxation of the registration rules in order to permit the employment of mutual fund salesmen under less stringent standards. In January 1949 the board of governors of the exchange approved "on a trial basis" an arrangement under which fund salesmen, after completing 1 month's training and passing a special examination, were allowed to remain in a "limited registration" status indefinitely.

In 1952, after reviewing its experience with the operation of limited registration, the staff of the exchange expressed concern about its effect on the exchange community's reputation for highly trained and experienced salesmen. The staff noted that turnover of limited registrants was high, indicating improper screening of prospective salesmen, that "[t]he caliber of limited registrants * * * has been far

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[159] Under the monthly investment plan an investor may accumulate shares of a particular NYSE-listed stock, by purchasing periodically whatever number of shares (including fractional amounts) his dollar payment, less commissions, will buy.

below that of fully registered representatives, and that" [t]raining frequently is haphazard and, in many cases, is devoted almost entirely to sales technique, with very little emphasis on the basic rules, policies, and practices of the business." The staff was also concerned over the efforts of certain firms to "use the 'limited registration' as a device to circumvent the normal 6-month training requirements for fully registered representatives."

The staff proposed that limited registrants be required ultimately to attain full registration. Firms opposing the proposal made arguments relating primarily to economic considerations. They stated that the requirements for full registration placed member firms in an unfavorable competitive position as against nonmember firms, which were not restricted to hiring only full-time salesmen and whose prospective salesmen did not need to go through a prescribed training period or pass an examination as difficult as the exchange's. The board of governors nevertheless changed the requirements so that, instead of permitting limited registration of indefinite duration, the status could last no longer than 9 months, after which time the salesman had to satisfy the requirements for full registration if he wished to continue selling. In September 1954, shortly after the institution of the monthly investment plan, limited registrants were allowed to solicit MIP orders, upon condition that solicitation of MIP "contracts" be confined to those involving stocks on a list prepared by the firm.

In January 1962 the exchange, through letters to member firms employing limited registrants during 1961, again undertook to survey and evaluate the program. The survey revealed that member organizations doing business with the public had 1,911 prospective salesmen take the limited registration examination in 1961, while the number who took the general stock examination or became registered through completing correspondence courses was estimated at 3,500. Many applicants for full registration had earlier taken the limited registration examination. The time spent in training before taking the limited registration examination generally exceeded the minimum 1-month requirement: 30 percent of the applicants surveyed received from 5 to 8 weeks' training, 34 percent were given more than 2 months, and 36 percent, more than 3 months. Of the 139 firms which replied to the exchange's inquiry, 80 stated that they favored continuing limited registration, 48 favored abolition, and 11 took no clear stand.

The firms favoring the continuation of limited registration were all firms where mutual fund selling comprised an important percentage of total income. Economic considerations played an important role in shaping firms' attitudes. The majority of these did not have organized training programs for their limited registrants, and used the minimum required training period of 1 month. In favor of limited registration, it was argued that it benefited small firms which could not afford to support their trainees in the same manner as large firms, it was an important inducement in luring good producers away from nonmember firms, and it afforded the trainee and his firm an opportunity to assess his aptitude for selling. Many firms indicated that trainees become restless while waiting for the time before their full registration to elapse, while limited registration, as one firm put it, "* * * perhaps satisfies their ego to the extent that they are doing something besides studying." Another firm made the point that a limited registrant "sells something in which he could hardly go astray, even with his limited experience."

The firms opposing limited registration used it primarily as a training device, and generally gave 3 to 5 months of training before allowing selling as limited registrants. Some of these firms also used it to keep busy salesmen who had transferred from nonmember firms, and to meet competition from nonmember firms. The arguments against limited registration emphasized its danger to the "member firm of the New York Stock Exchange" catchet. This attitude was typified by the suggestion of a partner of one firm that the abolition of limited registration "would set us further apart from nonmembers and, actully, I believe that much more should be done to set us even further apart." Another stated: "Our business requires a degree of professionalism which precludes limited registration." Many firms expressed concern over the lack of training given limited registrants (presumably not their own), in one case comparing the limited registrant's knowledge to a "carpenter's tool kit which contains only one nail and a screwdriver." Even firms supporting the retention of limited registration indicated that it was difficult to prevent the apprentice from discussing securities other than mutual funds or the monthly investment plan. Other firms regarded the 1-month minimum training period as an inadequate time in which to acquire competence in the mutual fund field, which, they indicated, is quite complex.

The exchange staff concluded that more than 1 month should be required for limited registrants to be adequately prepared for the selling of funds and MIP securities, and noted that "some firms do appear to be abusing the privilege of limited registration by relying on trial sales as their principal selection device and by failing to train limited registrants for full registration." As a result, the exchange adopted its present requirement that limited registrants be required to spend at least half of their business time in preparation for full registration and, recognizing that a limited registrant has half as much time to study as the ordinary candidate for full registration, provided that a limited registrant could not become fully licensed sooner than 8 months from beginning his employment.[160]

Since the new provision took effect on July 1, 1962, member-firm interest in limited registration has markedly decreased, a change which is probably attributable to the fact that few if any savings in training expenses can now be effected through its use. While the ratio of persons taking the limited examination to those taking the general stock examination was better than 1 to 2 in 1961, this ratio decline to less than 1 to 10 in the last few months of 1962. The fact that after July 1, 1963, the limited examination will be part of the combined NASD-NYSE-Amex test[161] and will have 2 hours of questions in common with the "General Stock" examination indicates that limited registration can no longer be considered to involve a potential danger to the public.

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[160] In order to make the maximum time spent by a prospective registered representative no longer overall than it was previously, the maximum selling period for a limited registrant was changed from 9 months to 7.

[161] See sec. 3.b(2), above.

(*d*) *Service activities of the exchange in the area of qualifications.*—Much of the work done by the exchange's department of member firms liaison, which handles most of the details relating to the regitstration of salesmen, is concerned not with regulation but with educational and other service efforts directed to member firms. In the last 2 years this department assisted member firms considerably in developing their training programs. As already noted,[162] a pamphlet describing a model low-cost training program, together with a training handbook for use by salesmen, was sent in 1962 to all persons in charge of training for member firms. The exchange also published booklets for use by salesmen in their training, such as "The NYSE Constitution and Rules" and "Ethical Conduct" and a study guide to elementary accounting, as well as a booklet for member firm personnel departments entitled "Recruiting and Selecting Registered Representatives."

In addition the exchange sponsored a conference of member firms' training supervisors, attended by about 200 persons in New York City in May 1962, on "Selection and Training of Registered Representatives," and has set up monthly 8-hour "trainee conferences" in which prospective registrants hear lectures by the exchange staff and are shown the operation of the exchange floor. Similar conferences lasting half a day are held every month for already registered salesmen, most of whom come from outside New York City. The exchange has announced that it expects to make available to member firms an aptitude test "based on experimental testing of actual registered representatives at different points in their careers, correlated with their production," to assist in selecting salesmen. The test will be designed, according to the exchange, to "establish whether the candidate is likely to survive the training period and qualifying examination, and having qualified, whether he is likely to become a successful producer."

Finally, as is noted below,[163] the exchange has had considerable impact on the examinations given salesmen by various State administrators.

d. The other exchanges

The registered national securities exchanges, apart from the New York Stock Exchange, play a minor role in connection with qualifications for salesmen.[164] Although most of them impose some restrictions on salesmen hired by member firms, they generally also provide some form of blanket exemptions for salesmen already registered with the New York Stock Exchange, and occasionally for other salesmen. Since the preponderance of firms which are members of the American and most regional stock exchanges and which employ substantial numbers of salesmen are also NYSE members, the broad exemptions leave these other exchanges with little scope for regulatory activities affecting salesmen and with few salesmen's applications to process. The Boston Stock Exchange, for example, with 67 member firms of which approximately 32 are also members of the NYSE, processes

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[162] Secs. 2.b(1) and 3.c(2)(b), above.
[163] See sec. 3.e, below.
[164] Because of the limited number of salesmen involved in some of the minor exchanges, this section concentrates on the rules and practices of the American Stock Exchange, the Midwest Stock Exchange, the Boston Stock Exchange, the Pacific Coast Stock Exchange, and the Philadelphia-Baltimore-Washington Stock Exchange.

about 2 applications a week. The Midwest Exchange, the largest of the regional exchanges in terms of dollar volume of shares traded, had 2,013 salesmen[165] registered as of March 27, 1963, and processed applications for 509 new registrations in 1962. In sum, fewer than 1,000 new salesmen are registered by all exchanges other than the NYSE in a given year, whereas the New York Stock Exchange registered approximately 8,400 in 1962 and the NASD handled some 30,000 applications.

For registered representatives not also registered with the NYSE, many of the exchanges emulate the NYSE and make some independent investigation of the backgrounds of candidates for registration. The American Stock Exchange has an outside agency do a background investigation report on every prospective registered representative who has not been approved by the NYSE, and the Midwest Exchange occasionally requires an individual report from an outside agency for candidates whose applications contain information which raises questions. On the other hand, the Boston and Pacific Coast Stock Exchanges make no efforts to go beyond a sponsoring firm's assurance that to the best of its knowledge and belief the candidate is fully qualified and (for Pacific Coast Exchange firms) that it has made a check to verify the statements made in the application form.

Most of the country's exchanges other than the NYSE make wide use of examinations for checking the competency of their registered representatives, but few require minimum training periods or give approval to training courses. The American Stock Exchange's competency requirements are a slightly fuzzy carbon copy of the New York Stock Exchange's standards. As does the New York, the American Exchange requires 6 months' experience before its examination can be taken. It has used a short-answer test, taken at a time convenient to the candidate in the offices of his sponsoring member firm, but has a new examination, similar in format to the new NYSE and NASD exams, going into use on July 1, 1963. Other exchanges such as the Boston and the Pacific Coast employ their own short-answer examinations, given by member firms to their salesmen-trainees and then mailed back to the exchanges for grading. Since 1962, the Midwest Exchange has required all new non-NYSE salesmen to pass a 90-minute, multiple-choice examination patterned on the new NASD and NYSE examinations, administered in the offices of member firms and taken by the trainee whenever he is ready. The exchange provides a "study guide" which outlines "material which the exchange considers each registered representative applicant should cover prior to taking the * * * examination." "As soon as economically and administratively feasible," however, probably by the end of 1963, the exchange staff hopes to introduce a new examination, of the same type as that given by the NYSE and the NASD.

Although the American Stock Exchange is the only exchange other than the NYSE to have established a minimum training period, President James E. Day, of the Midwest Stock Exchange, testified that his exchange as a general rule "likes to see" salesmen receive 6 months' training. The Philadelphia-Baltimore-Washington Stock Exchange has a totally different approach to controls over salesmen's

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[165] This figure does not include salesmen for Midwest member firms which are also members of the NYSE.

competence. Rather than using an examination, this exchange concentrates on its member firms' training programs, although it does not set a fixed minimum period. The exchange requests a letter outlining the training programs which its member firms intend to use, and treats these letters as applications, looking into such aspects as the text materials used and the supervision provided. The exchange's field examiner is expected to see whether the firms are conducting their training properly when he makes his periodic inspections.

All of the exchanges studied now prohibit the employment of part-time salesmen, although for some of the exchanges the prohibition is fairly recent. The Philadelphia-Baltimore-Washington Stock Exchange's rule dates from February 1, 1962, and the Midwest Stock Exchange in October 1961 abandoned a program which it had set up 9 years earlier for qualifying persons as part-time salesmen under a "limited registration" period of a maximum of 2 years. The American Stock Exchange, while prohibiting part-time salesmen, allows limited registration of mutual fund salesmen after 1 month's training (in contrast to the NYSE's recently imposed 3-month requirement) and a special examination, but allows limited registrants to continue selling for 6 months, almost the same length as the NYSE's maximum period of 7 months.

As they lack any substantial number of salesmen not subject to NYSE qualification standards, the various other exchanges pay relatively little attention to the qualifications of salesmen; insofar as they do, they follow the NYSE's lead on qualification standards. The small number of securities salesmen who are registered only on an exchange other than the NYSE does not warrant tremendous concern on the part of the public. Indeed, if the strengthening of standards referred to in paragraph 4 of the conclusions and recommendations at the end of this chapter is effected, much of the registration work now done by these exchanges may come to be regarded as supererogatory.

e. The States

As is the case with controls over new broker-dealers, State controls over salesmen entering the securities industry range from strict to nonexistent. Two States and the District of Columbia have no securities laws.[166] The other 48 all require separate registration of persons who desire to act as salesmen, but the registration requirements vary. At the minimum, registration consists of the submission of certain basic background facts to the securities administrator; in its most elaborate form, it involves investigations and evaluations of salesmen's character, examinations of competence, and bonding. All State statutes make the effectiveness of an agent's registration dependent on his employment by a registered broker-dealer or issuer. In some States, the salesmen's registration expires when such employment ceases; in most, his registration becomes ineffective upon severance until such time as he is hired by another broked-dealer. Most salesmen registrations must be renewed every year.

New York, which instituted its registration of salesmen in 1959, is an example of a State with minimum standards. Its Martin Act requires only that every salesman file a "salesman's statement" containing information on his business history over the preceding 5 years,

[166] See pt. B.2.e, above.

any criminal record he might have, and his educational background.[167] Aside from supplemental filings required to keep this information up to date, there are no other registration or qualification provisions under New York law. As in the case of broker-dealers,[168] there is not even authority to deny, revoke, or suspend registration.

Most States require a fuller description of salesmen-applicants' past associations and activities, and provide bases upon which applications may be denied. For example, Texas requires that salesmen registered under its securities acts provide considerable background data on their previous employment (specifying exact dates, nature of work done, and reasons for leaving), any prior involvements with securities violations and other crimes, and answers to such questions as whether the applicant has any unsatisfied judgments outstanding against him or whether he has ever been discharged by or had other difficulties with a former employer. The employing broker-dealer must certify to the salesman's honesty, good character, and qualifications, and to having made an investigation of the applicant. The Texas statute provides for denial of registration upon finding of previous conviction of a felony, "any misdemeanor of which fraud is an essential element," or a violation of any provision of the statute itself. Registration may also be denied if the applicant "has engaged in any inequitable practice in the sale of securities or in any fraudulent business practice. * * *" [169]

The licensing staff of the Texas Securities Board, with occasional help from the board's investigators, conducts whatever additional investigation is needed in addition to routine processing. The usual approach involves a check of the office's own records, information on out-of-State violations circulated by the SEC, FBI records, and the records of other States where the applicant has been registered. Texas also requires letters of recommendation, although, according to William M. King, the State's securities commissioner, they "do not produce very much."

A State's effectiveness in maintaining high standards of integrity among its salesmen-registrants depends, in large part, on the size of its investigative and enforcement staff. Ohio, whose controls over salesmen's character are perhaps more stringent than those of Texas, has had a few former "boilerroom" salesmen attempt to register because of the State's reputation for the close scrutiny it gives applicants, according to its supervisor of securities. Its division of securities has 10 of its approximately 30 employees policing the qualifications of the 575 broker-dealers and some 3,500 salesmen registered in the State. Texas' staff has 18 employees for 360 dealers and approximately 4,000 salesmen. Washington State, on the other hand, has a staff of only 4 persons besides the administrator, with an industry population of 2,400 salesmen—some 500 of whom enter and leave each year—and 235 dealers.

Although examinations were seldom given salesmen by the States until fairly recently, their use as a qualification device has become increasingly widespread in the last few years, despite doubts expressed in the past by some administrators as to their authority to give ex-

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[167] N.Y. Gen. Bus. Law, art. 23A, sec. 359–e(3)(b).
[168] See pt. B.2.e, above.
[169] Texas L. 1957, ch. 269, sec. 14.

aminations and as to the adequacy of their staffs to handle the additional work.[170] A September 1962 count revealed that some 27 State administrators gave examinations, 11 of them acting in accordance with authority granted under the Uniform Securities Act, which gives the administrator discretion in the use of examinations.[171] The increased popularity of examinations reflects both the wider acceptance of the Uniform Securities Act and the NYSE's development of an examination on general securities matters expressly for use by the States. Since the exchange offered the examination to the States in August 1961, 18 States had either used the examination or begun preparations for its use as of November 1962.

Those States which do not use examinations are likely to be in the position of Texas, whose securities commissioner stated: "We have no way of determining the qualifications of the applicant with regard to his skills in the sales and presentation of the securities." [172] On the other hand, Ohio, which requires no examination, secures a commitment from the sponsoring broker-dealer that the proposed salesman will be given adequate training.

Another requirement which must be met in a few States is the securing of surety bonds for all of a firm's salesmen. These bonds, like those for broker-dealers which are described above,[173] provide a sum ranging from $500 to $2,000 for the benefit of persons suffering losses as a result of violations of the State's securities law by the individual salesman for whom the bond is written. States which require such bonds invariably provide that appropriate deposit of cash or securities will be accepted in lieu of any bond required. Oklahoma, which adopted the Uniform Act in 1959, initially had difficulty in finding insurance companies willing to write the bonds for which the act makes provision. Apparently Oklahoma's experience is not unique, and the few insurance companies writing these bonds are, because of plaintiffs' usual success in suits on the bonds, reluctant to write them except for persons who are also insured under brokers' blanket bond (fidelity) coverage.[174]

D. Qualifications of Supervisors

1. THE PLACE OF SUPERVISORS IN THE SECURITIES INDUSTRY

Traditionally, the responsibility for overseeing salesmen in the conduct of their customers' accounts was entrusted to partners or other principals of the salesmen's firms. In recent years the extensive growth in the number of securities salesmen and branch offices has added another category—that of employee-supervisors. These groups, both considered as "supervisors," exercise the industry's most direct controls over the methods of handling the firms' relations with the public. The following section examines the qualifications of per-

[170] Draftsmen's commentary to sec. 204(b), clause 6, Uniform Securities Act, in Loss & Cowett, "Blue Sky Law," p. 279 (1958).
[171] Uniform Securities Act, sec. 204(b).
[172] The commissioner stated in May 1962 that an amendment adding a dealer-salesman examination to the Texas statute had been drafted and would be presented to the session of the legislature which was to convene in January 1963.
[173] See pt. B.3.a(5), above.
[174] Brokers blanket bonds, as they affect firms' background investigations of salesmen, are discussed above in sec. 2.a(2).

sons possessing supervisory responsibility, with particular emphasis on employee-supervisors.[175]

Supervisors vary in the scope of their activities and in the titles under which they operate. Thus, persons with supervisory responsibility include managing partners and high-ranking officers, regional managers, district managers, sales managers, branch office managers, and assistant, associate, and comanagers, among others.

The single most significant item of information concerning supervisors which was developed through analysis of the STS questionnaires was the great extent to which supervisors engaged in selling to their own customers. Over 90 percent of all supervisors (including partners, directors, and officers with specific responsibility for overseeing the conduct of salesmen) were engaged in some selling activities. Of all firms, only 24 percent had any supervisors who were not engaged in servicing their own customers' accounts.

The position primarily associated with the function of supervision in the securities industry is that of the branch office manager, who has been characterized as the "first home base" for a firm's supervision and control. The importance of the branch manager results from the geographical separation of his office from the firm's management headquarters, so that he has authority and responsibility almost equivalent to that of a sole proprietor. In spite of the fact that many firms with branch offices have elaborate accounting and recordkeeping surveillance facilities to check branch activities, no substitute has been developed for the on-the-spot supervision and direction provided by the branch manager.

As the director of a semiautonomous securities selling unit, the branch manager has a wide variety of responsibilities and duties. The NYSE has described the role of the branch manager in this manner:

> The branch office manager undoubtedly holds one of the most important jobs in the securities business. His first task is to see that his branch's customers are receiving appropriate service and investment advice in keeping with their objectives while at the same time seeing that his firm and men are protected from unscrupulous customers. Upon a manager's shoulders falls not only the necessity of operating his branch at a profit, but also the responsibility for seeing that the regulations of the New York Stock Exchange and other exchanges, the NASD, the Federal Government, and the States in which he is doing business are complied with.[176]

At Merrill, Lynch, Pierce, Fenner & Smith, where "as a general policy, * * * office managers are not permitted to service customers' accounts," it is the manager's particular administrative and supervisory duty and responsibility to do, among other things, these: (1) "To train and maintain a staff of capable employees," (2) "to coordinate and supervise the activities of * * * personnel of the office," (3) "to develop those people with ability for promotion," (4) "to interpret, explain, to put into effect, to support and enforce the policy and procedures of the company * * *," (5) "to approve the

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[175] Pt. B of this chapter discusses the qualifications of principals of broker-dealer firms, but concentrates on the qualities and background needed by persons who control the policies of a firm, as well as on the financial qualifications of the firm as a whole. The present part focuses on many of the same individuals as those treated in pt. B, but is limited to aspects of the qualifications problem which relate to the overseeing of sales and other activities. See also ch. III.B.6.a, in which the supervisory policies and procedures employed by securities firms are analyzed.

[176] NYSE Department of Member Firms, "Supervision and Management of Registered Representatives and Customer Accounts," p. 4 (1962).

opening of each new account * * *," (6) "to make careful periodic analysis of all open accounts * * *," (7) "to make personal calls on customers * * *," and (8) "to engage in public relations activities * * *." In addition, the branch manager is supposed to engage generally in developing his office's business and reputation in the territory assigned him. Other firms with less elaborate operations impose fewer supervisory duties and responsibilities upon branch managers, and most of them expect managers to have their own customers.

The extent of the responsibilities borne by branch managers in addition to their selling activities can be seen in the numbers of salesmen they are called upon to supervise. Among the larger firms, where branch managers are concentrated, the average manager supervises 12 salesmen, but in some cases the ratio of salesmen to branch managers is somewhat higher. Sutro & Co., of San Francisco, for instance, employed 5 managers, who, along with 2 partners supervised 7 branch offices with 129 salesmen. Firms specializing in the sale of mutual funds had strikingly high salesmen-to-supervisor ratios. Triangle Investors Corp., of New York City, had a total of 3 officers, 1 manager, and 1 assistant manager to supervise the activities of 495 salesmen.

The average supervisor is better paid than the salesman whose activities he oversees, although some salesmen earn incomes from handling their customers' transactions which may exceed their supervisors' compensation. The average annual income of a large non-mutual-fund firm branch manager, as revealed by the STS survey, was over $28,000, as contrasted with an average of some $14,000 a year for salesmen of firms in this category. Managers of large fund firms examined in the STS survey averaged $10,500 a year, while supervisors in small fund firms earned only $8,100 a year. The average salesmen employed by mutual fund firms, a substantial majority of whom are part-time salesmen, earned about $2,600 a year.

2. THE SELECTION OF SUPERVISORS

In selecting sales supervisors, most firms turn first to their own salesmen. Firms lacking what they regard as adequate material to fill the role of supervisor obviously must recruit persons from other firms or occupations. The firms which find it necessary to advertise for branch managers and other supervisors are generally small securities firms doing a general business, larger general-business firms engaged in aggressive expansion programs and mutual fund sales organizations. Much recruiting is done through newspaper and magazine advertisements, which give some clue to the qualities the recruiters consider desirable.

Qualities emphasized by general securities firms in their recruiting ads are much the same: Experience as a salesman, a following of customers, ambition, an ability to lead, and occasionally a following of salesmen. Few if any ads acknowledge the importance of familiarity with other operational aspects of the business. An advertisement of one NYSE firm, as proposed to the NYSE for its approval, set out these prerequisites for employment as a branch manager:

> New York and American Stock Exchange member firm needs an ambitious, experienced, successful producer to manage the Philadelphia office, possibly with a following of several high-grade registered representatives * * *.

(The final clause was eliminated before the publication of the advertisement.) The inducements offered often include a chance to become a partner and the privilege of retaining one's present customer accounts. One advertisement, directed toward "former brokerage firm partners, retired representatives, or mature customers' men," offered as a special inducement the opportunity to manage "a small luxurious brokerage office * * * [to] be located in the fashionable sixties in New York City."

Mutual fund salesmen have been especially sought after as managers, both to work for mutual fund organizations and to establish new mutual fund offices or departments for NYSE member firms. For mutual fund sales organizations, however, experience in selling often outweighs in importance experience in the securities business. King Merritt & Co., a large mutual fund retailer, approved for use by its hiring staff an advertisement directed to persons able to "hire, train, and administer a sales organization," which offered opportunities regardless of a lack of previous securities experience to become a "division manager" and to "* * * build a steady, profitable, satisfying business in a prestige field." However, despite the absence of a formal requirement of securities experience for division managers, only 3 out of 169 King Merritt & Co. division managers, as of June 1962, had no experience in the securities business before becoming managers for the firm. Each of the three had previously been engaged in selling fire and casualty insurance.

The emphasis on a sales background for branch managers is also illustrated by the approach of Sutro Bros. & Co. to expansion of its branch offices. As one of the partners explained:

> [W]e have never opened up branch offices and then waited for the men to come in. Usually an entrepreneur type of customers' man approaches us.
>
> * * * * * * *
>
> He says, "I think this is a good site over here; there is a spot available here; we think it would make a good branch office; I think certain men will come along with me * * *."
>
> We negotiate with the guy and if we think he has a reasonably good record and there is nothing wrong with the fellow, and if we are in an expansive mood, * * * we would open up an office and try to build it up.

According to responses to the STS questionnaires, most firms conducting an ordinary business in securities require a supervisor to have 3 or more years' sales experience in the securities business, although some require as little as 1 year and many have flexible requirements. Smaller firms not specializing in mutual fund sales have fewer occasions to hire supervisory personnel and are less likely to have established standards of experience. Of those firms which stated that they had educational requirements for supervisors, almost all indicated that they established no higher standards for supervisors than for ordinary salesmen.[177]

Firms which derive income primarily from the retail sale of mutual funds generally have lower standards of experience and education for supervisors than do other firms. Although some supervisors are hired from outside, most persons charged with supervising mutual fund salesmen start as salesmen themselves, and are promoted to supervisory positions on the basis of their relatively high sales pro-

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[177] Firms' standards of experience and education as they relate to salesmen are discussed in pt. C.2.b(2), above.

duction. In these firms promotion to such positions is not conditioned on any particular experience, education, or training requirements; the primary criterion is the ability to sell.

Typical of the way in which mutual fund selling organizations select supervisors is the approach used by Renyx, Field & Co., Inc., which in 1962 supervised its salesmen through 27 offices. A Renyx, Field salesman reaches the ranks of supervisors by selling a specified amount of mutual funds. His share of the firm's sales charge, which was limited while he was a salesman to 40 or 45 percent on his own sales, becomes 55 percent and includes an extra commission on his supervisees' sales (an override) when he reaches "management level." As stated by William G. Damroth, the firm's president:

> So a man is moved up who shows the initiative of being a manager and being full time, and staying with the firm, you know, et cetera. So a salesman evolves into a manager.

The first rung of the Renyx, field managerial ladder is the "district manager," for which position in most cases a salesman must have had at least 1 year's experience. After the new supervisor acquires more experience in recruiting and supervising, and if he has "done an adequate amount of business," he is "moved up to the next higher range," regional manager, with overrides on business produced by salesmen working for his district managers. The firm has no minimum educational requirements.

Another such firm, Investors Planning Corp., gives automatic promotion to persons who make mutual fund sales totaling $625,000 represented by at least 100 sales to the status of "career senior," at which point the salesman "begins to recruit other men and * * * to guide the men whom he recruits in their selling practices and conduct." No tests or critaria other than that of sales are used to determine the persons who reach this supervisory level. In fact, the "investment solicitor agreement," which each IPC salesman signs, gives the right to be a career senior upon fulfillment of the above-mentioned requirements, regardless of the views of the employer as to the salesman's qualifications. The firm's next step on its supervisory ladder, with the title of "supervisor," is also automatically available to career seniors who sell or have persons operating under them sell, a specified amount of mutual funds and recruit 10 new salesmen for the firm, 6 of whom must sell enough to reach the "advanced" salesman's compensation rate.

In contradistinction to the practices of these mutual fund firms is the NYSE's warning that "a manager or an assistant manager should never be selected for his sales talents alone. * * * In fact, it is quite a misconception in many industries that because a salesman is a good producer he will be a good manager. * * * [I]t takes an exceptional man both to produce and manage at the same time."

As has been indicated, a small minority of broker-dealer firms subscribe to the NYSE policy to the point of exclusion of producing supervisors. One such firm is Merrill Lynch, which does not generally allow its supervisors to sell to their own customers. Internal promotions provide the managers of its large branches from among the managers of its smaller offices, and the managers for its small offices from among the firm's salesmen, upon the recommendation of branch managers and senior officers.[178] Before assuming his duties at a branch office, a prospective branch manager is brought to New York for a preparatory period of about a year with the firm's sales liaison branch, a 10-man unit which sends persons out to the various branches "to see how other managers are doing and to report back * * * what is going on in those offices." Most of these men are over 40 and have approximately 10 or more years' experience in securities.

Bache & Co. says it is switching from producing managers to supervising managers. It usually considers 5 to 10 years' experience sufficient, including a period spent as an assistant branch manager, and it promotes persons to the position of branch manager at the age of 28 to 35. Of 13 Bache & Co. branch managers whose personnel files were examined by the study, only 4 had had less than 5 years' experience, and the average was 9 years in the securities business, before assuming their duties as branch managers. The average educational level attained by the group, which included advanced degrees in law and economics, was slightly less than a full, 4-year college education.

Supervisors at the other end of the qualification spectrum also came to the attention of the study. One such was Morris Chaitowitz, the former proprietor of two retail shops—a general store and a "ladies' shop"—and a part-time salesman of mutual funds, who was made the manager of a branch office of William, David & Motti almost immediately after he went to work for the firm. As he later explained:

> * * * [W]hen I met them [the partners of William, David & Motti] they told me I could go right out and open up an office, which I did. I just rented an office immediately.

Another firm gave the title of "sales manager" to a 24-year-old whose experience had consisted of "4 or 5 months" as a salesman with another over-the-counter firm, during which time he had earned a total of $1,500 in commission. His education had been 3 years at New York City Food Trades High School, where he prepared to be a butcher, which was later his occupation for 3 years. When asked to explain how this background qualified him as a sales manager, he replied:

> Well, I thought that I had a general knowledge of the market, trend of the market, and I just thought I was qualified. That is plain commonsense, the market. I thought I had the commonsense.

The firm's top salesman, when asked whether this young sales manager had sufficient background in the securities business for the position he held, replied that the young man "certainly knew a lot of people."

3. CONTROLS

While supervisors constitute a distinct and identifiable category of persons engaged in the securities business, the regulation of their qualifications is, by and large, carried out indirectly. Most rules of the various regulatory authorities do not refer to "supervisors" or "branch managers" as such, but focus their regulation of qualification standards on broker-dealers, salesmen, and investment advisers. Supervisors may fall within the definition of salesman contained in various statutes and rules, and be required to meet the minimum quali-

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[178] For the last 10 years no manager has been hired from outside the firm.

fications for salesmen, or, on the other hand, those supervisors who are principals of broker-dealer firms are often included within the requirements to which the partners, officers, and other principals of broker-dealer firms are subject. Recently, regulatory attention has begun to focus upon the qualifications of supervisors as such.

a. Federal controls

Federal law, requiring registration only of broker-dealers and investment advisers, has no separate standards for supervisors. However, supervisors are included within the general statutory bars relating to past violations of securities laws, since the provisions authorizing the denial or revocation of broker-dealers' registration expressly provide for the imposition of those sanctions where the stated statutory bars apply to "any partner, officer, director, or branch manager," or to any individual "controlled by" a broker-dealer.[179]

At one time, the Commission kept records on the branch offices of all registered broker-dealers and their managers, derived from broker-dealer application forms and supplementary forms. At the present time, however, the Commission keeps no such records. Under the Commission's rule 17a–3(12), registered broker-dealers are required to maintain in their files in up-to-date form, the applications for employment for a wide range of persons connected with the firms, containing background information on such matters as previous employment, education, and criminal record. These "associated persons" about whom information is required include partners, officers, and managers, as well as employees handling funds or securities or soliciting transactions or accounts. Thus, this information is available in the firms, though not on file with the Commission, for almost all persons engaged in supervising salesmen.[180]

b. The NASD

The term "registered representative" as defined in the NASD bylaws[181] takes in almost every member of a broker-dealer firm who has any connection with transactions in securities. Thus, branch managers and other supervisors are covered by the NASD's regulatory pattern, but until recently they were not dealt with separately. In May 1962, the board of governors authorized the development, with the aid of the Psychological Corp. of a new examination to be given to partners, officers, and sole proprietors entering the securities business for the first time, in place of the examination given registered representatives with less than a year's experience in the industry.[182] The examination will be required of all new proprietors, regardless of the particular duties within their firms which they will assume. It will last approximately 3 hours, and will presumably come into use during 1963. Representatives of the association have stated that the new examination will be considerably more difficult than the present registered representative examination. The association's staff also hopes to give another version of the new examination to employees who, in the words of Avery Rockefeller, Jr., the association's chairman in 1962, "are promoted to areas of supervision such as branch office managers, etc."

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[179] Exchange Act, sec. 15.
[180] See also pt. C.3.a, above.
[181] Art. XV, sec. 1.
[182] See pt. B.2.b., above.

These projected competency requirements represent the NASD's efforts to establish qualification standards peculiarly applicable to supervisors. Although the association keeps current records of the location of branch offices, no complete records are kept of the names of qualifications of the persons in charge of particular offices, and no attempt is made to pass on the integrity of supervisors apart from the minimal controls now applicable to registered representatives generally.

c. The New York Stock Exchange

The New York Stock Exchange, whose members include most of the largest firms in the securities business, with the greatest problems of supervision has for some years required that its consent be obtained before a member firm opens a branch office.[183] The rule also states that "each such office must be in charge of a qualified person acceptable to the exchange." Approval of branch managers is required whenever a new man takes over the supervision of an office, as well as upon the initial establishment of the office.

It has only been within the past year, however, that the exchange has given its consent to the formation of branch offices, and to the men who supervise them, in anything other than a perfunctory manner. While no requests for exchange approval of branch offices or managers have been refused, letters granting approval have for the first time contained exhortations, admonitions, and even conditions, along with consent to the opening of the branch office and to the man who would run it. Furthermore, the exchange revealed in a statement submitted on May 25, 1962, at the Special Study's public hearings, that earlier in the year it had established certain standards for the guidance of the NYSE staff in passing on prospective branch managers. The president of the exchange stated that a person would be approved as a branch manager only if he (*a*) had been a registered representative with a member firm for at least 3 years, up to a recent date; (*b*) had been with a member organization in an "operational, supervisory or administrative capacity" for at least 5 years, up to a recent date; (*c*) had been a principal of a nonmember broker-dealer doing a general securities business for at least 5 years; or (*d*) had been a general office partner or voting stockholder of a member organization for at least 1 year, up to a recent date. Prior to the adoption of these standards, the exchange had only required that the applicant be qualified as a registered representative.

A factor in the exchange's new program for approving branch offices was the publicity given in January 1962 to the testimony at a Commission hearing concerning the background of Russell Siebach, a former branch manager for Sutro Bros. & Co.[184] Siebach had been appointed manager of the Huntington, Long Island, branch office of Sutro Bros. & Co. in September 1960, and exchange approval of the appointment had become effective on September 30. Siebach's experience was limited to the 6-month NYSE compulsory training period and 5 months as a fully registered representative. Before entering the securities business, he had been a used-car salesman, pro-

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[183] NYSE rule 342.

[184] The Commission instituted proceedings against Sutro Bros. & Co. involving alleged violations of regulation T of the Federal Reserve, in the reference of customers to known factoring firms, and named Siebach, who had been discharged by Sutro Bros., as a possible cause. The decision on this matter has not yet been rendered.

prietor of a cocktail lounge, and most recently, the manager of a Vic Tanny health studio. The standards of experience for branch managers which the NYSE adopted shortly thereafter contrast sharply with those which were applied at that time.

The exchange places much emphasis on educational, hortatory, and directory passages which have become "boilerplate" in the letters of approval sent to the applicant firms. It "suggests" that a newly appointed manager "review exchange, NASD, and SEC rules in the light of his new responsibilities." A firm opening a one-man branch office to be operated by a man with only 6 months' experience as a fully registered representative was told the NYSE's approval was "with the proviso that he visit your main office at frequent intervals for personal contact with the partner supervising his accounts." A firm merging with a nonmember firm with several branch offices of its own was warned that "as your firm will be doubling the number of offices falling under the supervisory responsibility of your management, you will doubtless find problems of supervision and control not previously experienced." The exchange's letter then went on to offer suggestions and assistance for the prevention of supervisory difficulties.

As of January 18, 1963, those new members and new allied members who plan to confine their activities to their offices are required to take the "Office Member and Allied Member" examination, which has a section on proprietors' responsibilities and another on supervision. A similar examination will be given to all new managers and comanagers of branch offices and will have to be passed before they may assume their duties. The exchange staff has indicated that any examination of other superivsors, such as regional managers or assistant managers, will have to await the development of a recordkeeping "method for keeping track of them."

d. The other exchanges

The American and the Midwest Exchanges are the only ones apart from the NYSE which impose special requirements upon persons wishing to become supervisors. The American Exchange, whose rules are, in this regard, substantially the same as those of the NYSE, has indicated that it is thinking about following the NYSE's lead in giving examinations to members and allied members. The Midwest Exchange requires that branch managers are to be registered "on application in such form as the exchange may require." The form actually required by the exchange is identical to that used by salesmen-applicants. The applications, many of which are for managers of sales outlets in shopping centers and other locations close to home offices, are evaluated through the use of flexible and "subjective" standards. Under this approach, the MSE staff's knowledge of the operations of the local firms and their offices and personnel is utilized in determining whether a particular individual is qualified to run a particular branch office.

The MSE imposes no particular training or experience requirements and conducts no investigation of the applicants' backgrounds other than that used in processing salesmen's applications. Whatever the effectiveness of that screening, few if any applications of the 12 to 15 submitted every year are rejected.[185]

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[185] John Weithers, secretary of the MSE, stated that he could not recall the exchange's having "turned anyone down."

e. The States

State laws concerning qualifications of persons in the securities industry are generally directed toward broker-dealers or principals of broker-dealer firms and salesmen. Since the great bulk of all supervisors are principals in their firms or engage in their own selling activities, or both, they will be required to meet the minimum State requirements of one category or the other, though a much smaller number of nonselling supervisors are not subject to any State registration requirements, and none are subject to qualification standards for supervisors as such. The effect of such a qualification scheme is to impose standards of competence and integrity upon salesmen, but to require nothing more or different of those who supervise them.

Under the Uniform Securities Act, the broker-dealer application form may, in the administrator's discretion, ask for information on the qualifications and business history of "any partner, officer, or director, [or] any person occupying a similar status or performing similar functions," including supervisors within the scope of the last phrase. Information obtained from the application form and elsewhere may be used to deny registration to a firm employing supervisors with records of past securities violations or other enumerated evidences of bad character.[186] However, if a nonselling supervisor lacks training, experience, and knowledge, the firm cannot be disqualified, since only "agents" must satisfy competency standards, and an "agent" is defined as a person who "represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities," thus excluding supervisors unless they act also as salesmen.[187] States other than the 15 which have adopted the Uniform Securities Act similarly treat supervisors or branch managers as a category of individuals whose qualifications are of little significance.

E. Qualifications of Persons Providing Investment Advice

1. THE PLACE OF ADVISERS IN THE INDUSTRY

If the supervisor of salesmen occupies a critical position from the point of view of the broker-dealer firm, for the investor the most significant figure in the securities industry may well be the person responsible for selecting the stocks to be recommended for purchase or sale. In many cases this person is the salesman with whom the investor deals, whose qualifications have been discussed in part C, above. In many other cases, however, the salesman may merely act as a conduit for recommendations formulated by someone else who, in firms with a research department, is usually known as an analyst. In still other situations the customer may prefer to seek guidance from a registered investment adviser outside of his brokerage firm. In the larger investment adviser firms the advice is also formulated by analysts, while in the one-man and other small firms this may be done by the adviser. Entry standards—or, more accurately, the lack of entry standards—for persons acting as analysts of all types are discussed in this part. An extensive discussion of the research and advisory practices of broker-dealers and investment advisers is found in

[186] The specific offenses and facts which bring about denial of registration to broker-dealers are discussed in pt. B.2.e, above.
[187] Uniform Securities Act, sec. 401(b).