Finally, the Commission held that the prohibition against insider trading on the basis of confidential corporate information extended not only to the broker-dealer's own accounts but to discretionary accounts of his customers.

The basic conflicts which are highlighted by the *Cady, Roberts* case stem from the fact that a director, by virtue of his office, may have access to corporate information not contemporaneously available to the general public. A representative of a broker-dealer sitting on the broad of directors of a company may have difficulty resolving loyalties and duties to the company, his customers, and stockholders of the company who are not his customers.

In *Cady, Roberts*, violations of the antifraud provisions of the Securities Act were involved. Other instances in which the "inside" information is either less specific or less certain may pose delicate and difficult ethical problems for the persons involved. For example, the general information about the affairs and prospects of a company which a director may obtain through long and close association with it may be highly useful to a broker-dealer firm, both in it own trading and in making recommendations to customers. Several broker-dealers said that they attempt to distinguish between "hot" information and a "general feeling" about the company. The senior partner of Fulton, Reid & Co., Inc., stated:

> I should like to * * * emphasize the difference between inside information of a general note—this is, monthly earnings—which probably do not add much to the general knowledge of the market * * *. In other words, it wouldn't help you evaluate a stock normally to have monthly earnings unless there was a drastic change indicated by them * * *. The other type of information, such as imminent merger negotiations, litigation or any number of things of that nature, are the things which would cause us to withdraw from the market and to try as nearly as we can to prevent trading.

Carl M. Loeb, Rhoades & Co. also tries to distinguish secret information which it receives through members who serve as directors, from that which may be disclosed. A partner of the firm told the Special Study:

> I ascertain from management in most cases, or in all cases, if I am going to make this information available to anyone. I say, "Is this information available generally to any part of the investing public that wants to find it?"
>
> * * * If that is the situation, I do not wait 6 months until the public report comes out on the company. If this is not secret information and you are sure this is information that would be available in like manner, you do not try to jump the market but, at the same time, you do not want to stand back and look stupid.
>
> This is a very difficult area to move in. This is why we have this policy of not tying our trading department's hands with inside knowledge, because what is inside knowledge to me is already on the street in about 9 cases out of 10.
>
> That is why we get the company to release the information as soon as possible, to remove the problem.

It should also be pointed out that underwriting firms, whether or not they have a representative on a company's board of directors, often retain a special relationship which enables them to obtain information concerning the company which the general public does not have. In the first place, the requirement in an underwriting agreement of regular financial reports to the managing underwriter, as distinguished from the general body of stockholders, may give the firm a considerable advantage in the market.[432] Secondly, a firm with an under-

[432] See sec. 2, above.

writing relationship is likely to be among the first to be advised of any corporate developments. Such information may not be secret, and it may be available to any diligent analyst who bothers to inform himself about the company, but the underwriting firm may still have a very real advantage over members of the general public. An officer of William, David & Motti, Inc., a small broker-dealer firm,[433] now defunct, stated, with regard to companies whose securities the firm has underwritten:

> Most of the information we get does not come from the board of directors. * * * Any information we want we usually speak to the president on the phone and it has nothing to do with the directors. We would get that information whether we were a director or not. * * *
> Some of the information, sure, it is nonpublic information, either good or bad.

The potential conflicts are clearest where broker-dealer firms make an inter-dealer market, or they or persons connected with them otherwise trade as principals, in the stocks of companies on whose boards they have representation.[434] Even here the views and practices of the industry vary widely. A partner of Kidder, Peabody & Co., testified that, while the firm may maintain positions in securities of companies of which a member of the firm is a director, the director will not tell his partners any nonpublic information. In one case, the director-partner kept the news of an adverse development in the company to himself for 6 weeks, and the firm, which held a position in the company's stock, suffered a substantial loss.

Other firms take similar precautions in "insulate" their trading departments from confidential information. A partner of Carl M. Loeb, Rhoades & Co., testified that one method of insulation was to make it highly inconvenient to communicate advance information:

> Kelly [partner in charge of the trading department] is on the 16th floor at the end. I am on the seventh floor. To get to the 16th floor, and you cannot get him on the telephone, you have got to go out, get on the elevator to the 12th floor, change on the 12th floor and go to the 16th floor.
> If you have ever been in that office, the counterroom, I guarantee you, you cannot discuss anything in there.
> All the rest of the partners are down on the seventh floor.
> Geographically, in our firm we do not have much of a problem.

Other broker-dealers may occasionally solve the problem by withdrawing from the market when confidential information is received. The partner of Fulton, Reid & Co., Inc., whose views are quoted above, stated:

> * * * If we have information in our shop that cannot be divulged and is not generally known and that might affect the value of the stock, we have on occasion forbidden trading in the stock in our office.

Other firms regard the use of confidential information acquired through a directorship as a business prerogative. As one broker-dealer stated:

> There are probably only two alternatives. * * * You can either take the position that a public release of information is necessary before you can act on it, or you can take the position that having been the company's main underwriter

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[433] For a description of this firm, see ch. II.B.1.a(1).

[434] See ch. IX.B.5 for a discussion of the proposal to apply sec. 16(b) of the Exchange Act to over-the-counter companies, subject to exemption in particular cases or circumstances. If this proposal were adopted, short-swing profits of officers, directors, and controlling stockholders in the stock of such companies would, in the absence of exemption, be recoverable by the company, with the effect that it might be impractical for broker-dealer firms to "make markets" in securities of companies upon which they have board representation. See *Blau* v. *Lehman*, 368 U.S. 403 (1962).

and investment banker you are therefore entitled to that kind of information; that you took a risk in originally offering the stock to the public and therefore can make the best possible use of it.

The New York Stock Exchange recently disciplined a member for trading on the basis of confidential information acquired as a director of a listed company. The exchange severely censured and imposed a $1,000 fine on a general partner of a member firm, for failing to "adhere to the principles of good business practice in the conduct of his * * * business affairs." [435] The member learned from the president of the company on October 11, 1962, that a tender offer would be made to purchase shares of the company's stock at $15 a share. On the following day he placed an order to purchase 5,000 shares at an average price not to exceed 10½ for the account of his wife, and the transactions were completed. On October 15 the board of directors of the company approved the $15 offer, which was then made public. After the transactions were revealed by the exchange's stock watching program and the member was questioned about them, the purchases were canceled.

A director's use of confidential information for his own benefit (whether or not the director is a broker-dealer) is of course the problem to which section 16 of the Exchange Act is addressed. Under that section, discussed more fully in chapter IX, the director (or other "insider") of a company whose stock is listed on an exchange must publicly report all transactions in the stock and any profits realized by buying and selling within a 6 months' period are recoverable by the company at the instance of any other stockholder.

While the duty of a broker-dealer serving as a director not to use confidential corporate information for his own benefit seems clear, more complex questions are presented where his duties to his customers are involved. The exchange recently told its members:

> Every director has a fiduciary obligation not to reveal any privileged information to anyone not authorized to receive it. Not until there is full public disclosure of such data, particularly when the information might have a bearing on the market price of the securities, is the director released from the necessity of keeping information of this character to himself. *Any director of a corporation who is a partner, officer or employee of a member organization should recognize that his first responsibility in this area is to the corporation on whose board he serves.* Thus, a member firm director must meticulously avoid any disclosure of inside information to his partners, employees of the firm, his customers or his research or trading departments. [Emphasis supplied.] [436]

This directive may have been designed to insure compliance with the *Cady, Roberts* opinion. The staff of the Commission, on the other hand, has taken the position, in response to requests for interpretative opinions by members of the industry, that if a broker-dealer serving as a director has material information, the disclosure of which is necessary to prevent fraud on a customer, or in a transaction in which he participates, it must be disclosed; and that if the broker-dealer believes that he is under a duty to the corporation not to disclose the information, his only alternative is not to participate in transactions in the security until disclosure may be made.[437]

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[435] Exchange rule 401.

[436] New York Stock Exchange, M. F. Educational cir. No. 162, June 22, 1962.

[437] In *Van Alstyne, Noel & Co.*, 33 S.E.C. 311 (1952), the Commission held that where a broker-dealer with representation on the board of a company disseminates favorable information concerning the company, it may not withhold unfavorable information on the ground of a duty to the company not to disclose.

Most of the broker-dealers who were interviewed take the position that they are under no duty to disclose inside information even to customers whom they put into the stock, but that their only duty is to keep such customers "informed generally on published information." A partner of Kidder, Peabody & Co., told the Special Study that he felt no responsibility to advise even fee-paying investment advisory clients of confidential adverse information learned as a director. According to this partner, the firm actually would not have this information, since he would keep it to himself until it was made public.[438] He stated further:

> Our responsibility to them is to do a thorough research and to use the best judgment that is available to the firm.

In some circumstances, however, it may be impossible for a firm to take the position that it has no duty to inform customers of adverse developments of a company which are still confidential, since these customers may have been led to rely on the firm for this kind of information. They may have purchased stock through a firm just because they were told the firm was represented on the company's board of directors and that therefore they would be advised quickly of developments. Indeed, the fact that a broker-dealer firm is represented on the board of a company whose stock is being recommended is undoubtedly pointed out by many salesmen as an inducement to purchase the stock.[439]

Some firms believe that they have an obligation to advise their customers that they will not receive confidential information concerning the securities of companies upon whose board the firm is represented. For example, when a partner of Lehman Bros. is elected to a company's board of directors, fee-paying investment advisory clients are notified that the securities of the company will be excluded from the firm's supervision and that no further recommendations to buy or sell will be given. Nevertheless, ordinary brokerage customers of the firm are not told that they will not be advised of confidential developments. The basis upon which the firm makes this distinction between the two kinds of customers is that the firm has a contractual relationship only with its fee-paying customers. A representative of the firm stated that it does not pass on confidential information to any of its customers:

> I don't think we have any right to do it. I don't think we have any obligation. * * * [I]f we do have inside information, good or bad, on a company that has not been made public, we will direct our order room until that information is made public not to accept orders in that security, either buy or sell, except purely on an unsolicited basis.

Furthermore, Lehman Bros. takes the position that it is under no obligation to inform a customer purchasing a stock on an unsolicited basis of adverse information known about the issuer, since in such a case it is performing a strictly brokerage function.

Whatever may be the full implications and impact of the *Cady, Roberts* decision on broker-dealer views and practices in the future,

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[438] This technique of insulating confidential information possessed by a partner or officer from other members of the firm, which is also referred to above, may raise legal questions. Under the prevailing law of agency, knowledge obtained by a partner of a partnership or an officer of a corporation in the course of his duties is generally imputed to the partnership or corporation. See Uniform Partnership Act. sec. 12.

[439] See description of the selling activities in connection with the stock of U.S. Automatic Merchandising Corp. in pt. B of this chapter.

some broker-dealers apparently have felt in the past that they were entitled to use information obtained from board membership for the benefit of their customers and themselves, without regard to other stockholders and noncustomers. Morton Globus, proprietor of Globus, Inc., a small underwriting firm that brought out many new issues during the years from 1959 to 1961, testified that when he receives inside information through a directorship, he transmits this information to his salesmen for the use of the firm's customers and that this is "one of the reasons why I hope we will be a little more successful than other houses on the street." Globus also stated that in cases where salesmen solicit customers on the basis of favorable information concerning the company which he learned as a director, he feels no duty as a director to the selling stockholder who was not given the information.

Representatives of H. Hentz & Co. stated that inside information acquired through board representation is "usually" not disclosed. Nevertheless, when the firm acquired adverse information concerning a company through a directorship, that information was transmitted to customers holding the security. As a result of its underwriting a public offering of 200,000 shares of the common stock of Shore-Calnevar, Inc. on February 20, 1961, Hentz had a representative on the board of directors of the company. Shortly after the public offering this director learned that the company's net earnings had dropped from $1 per share in its 1960 fiscal year to 28 cents in fiscal 1961. This adverse financial information was transmitted to the firm's partners, registered representatives, and customers. The information was "gotten around * * * without going into print or without putting anything in black or white." When asked why the information was not conveyed in a market letter, Hentz' representatives stated that it would be "a dangerous procedure" which might open the firm to lawsuits.[440]

It would appear that, since the *Cady, Roberts* decision spotlighted the problem of potential conflicts, there has been greater sensitivity to it in the securities industry. As one partner of a large firm put it, Cady, Roberts has made it easier "for the director that had the secret information not to give it to his partners." The New York Stock Exchange has twice since Cady, Roberts warned its members about the potential difficulties to which directorships may lead.[441] In at least one instance, exchange officials have informally told a member firm that the conflicts involved between holding a directorship and firm trading in the securities of a company may make it advisable not to put any representatives of the firm on any additional boards of directors. In addition, there is evidence that some firms are disengaging from their directorships partly as a result of Cady, Roberts.

4. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

For purposes of the present discussion, there is no occasion to question the merits of broker-dealer representation on board of directors of publicly held companies. Undoubtedly the managements of many

[440] In January 1962 the Hentz representative resigned from the Shore-Calnevar board. For further discussion of the Shore-Calnevar offering, see ch. IV.B.3.b(3)(a).
[441] M. F. Educational Circulars Nos. 152 and 162 (Dec. 26, 1961, and June 22, 1962).

corporations who seek individuals in the securities business as directors value their judgment and experience, as investment bankers and otherwise. Many broker-dealers assert that the need for this kind of judgment and experience is especially great in the case of corporations which have recently made a first public offering and whose managements are inexperienced in financial matters and in fulfilling obligations to public stockholders. From the broker-dealer's point of view, representation on a corporate board can aid it in discharging what it considers its responsibilities as underwriter and at the same time may be of tangible or intangible value to the firm in other ways.

The problems here considered arise from broker-dealer representation on company boards in conjunction with other relationships and activities of the broker-dealer that may involve other obligations or interests, and therefore potential conflicts of obligation or interest. For example, if the broker-dealer represented on the board has been a managing underwriter in the flotation of a company's securities, obligations to customers in the original allotment and to fellow underwriters and their customers may be important. If the same broker-dealer is now making a market, or recommending or selling the securities to retail customers, or has investment advisory clients, additional motivations and obligations may arise and the potentiality for conflict with the director's obligation to his corporation and its stockholders inevitably widens.

The nub of the difficulty is the use of inside information. It is well established that a director is a fiduciary who may not use inside information for his private benefit, and enforcement of such fiduciary obligation of directors (and officers and controlling stockholders) of listed companies is the central purpose of section 16 of the Exchange Act. The most obvious misuse of inside information for the director's own benefit would be in transactions for the broker-dealer's own account as principal, a subject which is further considered in chapter IX.

The most subtle questions of conflict arise where transactions of customers are involved. Where a broker-dealer has inside information through a directorship, there may be a violation of obligation to the corporation and its stockholders if the information is used, and, at least in some circumstances, there may be violation of obligations to customers if it is not used, especially if the customers have been led to rely on the protection flowing from his close affiliation with the corporation. But the problem is even more complex than this, because the use of inside information for the benefit of customers may amount to fraudulent activity in respect of members of the public on the other side of customers' transactions.

Broker-dealer firms have a great variety of views and practices in this area. Some firms take the position that inside corporate information is available for their benefit and that of their customers; others attempt to maintain a wall of insulation between the individual when serving as director and the same individual in relation to his firm, its trading department and its retail customers. In the former instance, apparently no obligation to the corporation or its stockholders is recognized, or else an obligation to customers is considered dominant. In the latter, the emphasis is on obligations as director notwithstanding any obligations to the public customer. Just how sharply and consistently these theoretical distinctions are maintained

in practice is not easy to determine. Other firms avoid or prefer to avoid directorships entirely, because of the conflicts problem or for other reasons.

The regulatory and self-regulatory treatment of this subject is of rather recent origin. The New York Stock Exchange recently issued two educational circulars to its members, pointing out the many pitfalls in this area. The Commission's staff, while making no general pronouncement on the subject, has advised individual broker-dealers that the duty to disclose material information to customers may be overriding in some circumstances, so that many broker-dealers may prefer not to place themselves in a position where there is a conflict between this duty and any obligation as director of a corporation not to disclose the information. In the 1961 case of *Cady, Roberts*, the Commission held that the antifraud provisions of the securities laws had been violated where inside informations to reduction in a company's regular dividend became the basis for transactions of a partner of a broker-dealer firm for his wife's account and discretionary accounts of customers, in the absence of disclosure of the inside information to persons on the other side of the transactions. The rather distinct problems that may arise from directorships in connection with over-the-counter making of markets and retailing seem not to have received attention from the NASD, the agency with primary self-regulatory responsibility for over-the-counter markets.

The Special Study did not conduct any investigation, as such, of the effect of directorships on broker-dealer trading and retailing activities, although views and descriptions of practices were sought in interviews with several firms. It is clear from even this limited survey that broker-dealer directorships are far from being an unmixed blessing to those involved or those affected. In some circumstances the positive aspects may be so far outweighed by negative ones as to preclude the directorship; but even where this is not the case, vigilant concern for niceties of conduct is obviously called for.

Actually, the problem of directorships is part of a broader one. A striking phenomenon of the securities industry is the extent to which any one participant may engage in a variety of businesses or perform a variety of functions. A single firm with customers of many kinds and sizes, may, and often does, combine some or all of the functions of underwriter, commission house in listed securities, retailer of unlisted securities, wholesale market maker for unlisted securities, custodian of funds and securities, investment adviser to discretionary accounts, to others on a fee basis, and to one or more investment companies, and financial adviser to one or more corporations. Its principals may invest or trade for their own accounts in securities also dealt in for others. In addition, as more particularly discussed above, principals and employees of the firm may serve on boards of directors of issuers of securities which the firm has underwritten, in which it makes a wholesale market, which it recommends to its retail customers, or all three.

Since each of these functions involves its own set of obligations to particular persons or groups of persons and since the self-interest of the broker-dealer may be involved in one or more, there are multifarious possibilities of conflict of obligation or interest in matters large and small. The multitude and variety of possibilities of conflict in the

securities business make it difficult, if not dangerous, to generalize as to the problems presented or possible remedies. Total elimination of all such possibilities is obviously quite out of the question; theoretically, it would involve complete segregation of functions—a remedy often invoked or suggested where conflicts are considered. But segregation as a specific remedy for all the multifarious possibilities for conflicts in the complex securities business could not be a simple segregation in any traditional sense but would have to involve fragmentation of the business to a point where (as facetiously pointed out in a recent magazine article) each investor would have his own broker who would not be permitted to act for any other customer or for himself.

In some limited sectors, combinations of functions involving clearly conflicting roles may be excluded as a matter of business policy or public policy because the conflicts are deemed so fundamental and pervasive as to require separation; in most sectors, multiple roles are not excluded as a matter of policy, but here the conduct of broker-dealers performing them may require increased regulatory and self-regulatory vigilance. Some kinds of conduct (as in *Cady, Roberts*, for example) are so gross that they already have been, or may in the future need to become, the subject of specific decisions or regulations. For others, more capable of being handled in terms of ethics than of law, the self-regulatory agencies would seem to have an ideal milieu for performing their role of elevating and guiding conduct of their members above and beyond strictly legal requirements. The exchanges and the NASD should be charged with continuing responsibility for keeping abreast of changing forms and methods of doing business, identifying areas of frequent difficulty, and setting forth guides to the conduct of broker-dealers serving as directors and performing other roles containing potentialities of conflict.

The Special Study concludes and recommends:

1. The many facets of the securities business, including the typical combinations of broker and dealer functions, underwriting functions, quasi-banking functions, and advisory relationships with issuers of securities and with customers, involve potential conflicts of interest and obligation of many kinds and degrees. This would appear to be the kind of area in which the self-regulatory agencies, with support from governmental agencies where violations of legal duties are involved, can be instrumental in defining and effectuating higher ethical standards. With all credit to the limited efforts they have made, the self-regulatory agencies have left many important subjects virtually untouched; for example, although the NYSE has recently advised its members concerning conduct in connection with the holding of directorships, the NASD, which has special responsibilities in respect of over-the-counter markets, apparently has never addressed itself to the conflicts involved in the role of the broker-dealer who is a corporate director while engaging in interdealer and retail transactions in the corporation's securities. The self-regulatory agencies, no less than the Commission, should institute more positive, continuing programs for the study of important problems of conflict of interest in the securities business, with a view to speaking out on particular questions in the form of cautionary messages, policy statements, codes of ethics, or rules of fair practice, as circumstances may require.

APPENDIXES

APPENDIX III-A

SAMPLE FORM OF CUSTOMERS' CASH ACCOUNT AGREEMENT

Members
NEW YORK STOCK EXCHANGE
AND OTHER PRINCIPAL EXCHANGES

Investment Customer's Card

Account Number ..... Date .....

Name of Customer .....

Business Address ..... (No.) (Street) (City and State)

Residence Address ..... (No.) (Street) (City and State)

Business Telephone No. ..... Residence Telephone No. .....

Wife's or Husband's Name .....

Occupation ..... (Name of concern, nature of its business and position held)

All communications to the undersigned are to be sent to .....

Bank Reference .....

Dear Sirs:

This will confirm our understanding and agreement that every transaction or intended transaction for the account of the undersigned through or with your firm, or any firm successor thereto, shall be subject to and in accordance with the constitution, charter, certificate of incorporation, by-laws, regulations, rules, codes, rulings, directions, customs and other requirements (including all changes, amendments and additions therein and thereto which may affect such transaction or intended transaction) of the exchange, board of trade, association, institution or other body conducting the market on which such transaction is executed or is intended by you to be executed, and of the clearing corporation, clearing house or other association, institution or body performing similar functions, connected therewith, as well as of all committees, boards and other bodies, officials and authorities thereof, except in the case of over-the-counter transactions or intended transactions all of which shall be subject to and in accordance with the certificate of incorporation, by-laws, regulations, rules, codes, rulings, directions, customs and other requirements (including all charges, amendments and additions therein or thereto which may affect such transaction or intended tranactions) of the National Association of Securities Dealers, Inc. and of all committees, boards, and other bodies, officials and authorities thereof. The undersigned, if an individual, is over the age of twenty-one years.

I $\frac{\text{am}}{\text{am not}}$ a citizen of USA.

Witness. Very truly yours,

(Signature of Witness) (Signature of Customer)

Approved by: ..... (Signature of Customer)

96746 O - 63 - 30

APPENDIX III-B

SAMPLE FORM OF CONFIRMATION

TRADE DATE

PLEASE FORWARD ALL PAYMENTS TO THE OFFICE SERVICING YOUR ACCOUNT

DATE DUE*

WE CONFIRM THE FOLLOWING TRANSACTION SUBJECT TO THE AGREEMENT ON THE REVERSE SIDE HEREOF

YOUR ACCOUNT NUMBER ON OUR BOOKS	QUANTITY BOT.	QUANTITY SLD.	DESCRIPTION	Symbol	PRICE	AMOUNT	INTEREST OR STATE TAX	FEDERAL TAX	Post. and/or Reg. Fee	COMMISSION	NET AMOUNT

PLEASE INDICATE THIS NUMBER ON YOUR REMITTANCE AND OTHER CORRESPONDENCE

*IF THIS CONFIRMATION COVERS SECURITIES PURCHASED, PAYMENT IS DUE ON "DATE DUE" INDICATED ABOVE.

IF THIS CONFIRMATION COVERS SECURITIES SOLD AND NOT HELD BY US IN YOUR ACCOUNT, THEY SHOULD BE DELIVERED ON OR BEFORE "DATE DUE" INDICATED ABOVE.

SEE REVERSE SIDE FOR EXPLANATION OF OTHER SYMBOLS.

PLEASE PRESERVE THIS CONFIRMATION FOR INCOME TAX PURPOSES

SECURITY SYMBOL EXPLANATION

THE MARKET ON WHICH THIS TRANSACTION WAS MADE IS INDICATED BY ONE OF THE FOLLOWING SYMBOLS

1	NEW YORK STOCK EXCHANGE
2	AMERICAN STOCK EXCHANGE
8	OVER - THE - COUNTER
	OTHER SYMBOLS NAME OF MARKET ON REQUEST

ANY OF THE ABOVE SYMBOLS INDICATES THAT THE ABOVE TRANSACTION WAS MADE BY US AS YOUR AGENT FOR YOUR ACCOUNT AND RISK

SYMBOL 5 INDICATES WE HAVE ACTED IN THIS TRANSACTION AS AGENTS FOR ANOTHER (OVER-THE-COUNTER UNLESS OTHERWISE INDICATED)

SYMBOL 7 INDICATES WE HAVE ACTED AS PRINCIPALS (OVER-THE-COUNTER UNLESS OTHERWISE INDICATED)

IF THE NUMBER 9 APPEARS TO THE LEFT OF ANY SYMBOL, WE HAVE ACTED AS AGENTS FOR AND CHARGED LIKE COMMISSIONS TO BOTH BUYER AND SELLER

NAME OF OTHER PARTY TO TRANSACTION AND TIME OF EXECUTION WILL BE FURNISHED ON REQUEST

IT IS AGREED BETWEEN AND THE CUSTOMER

(1) THAT ALL TRANSACTIONS ARE SUBJECT TO THE CONSTITUTION, RULES, REGULATIONS, CUSTOMS, USAGES RULINGS AND INTERPRETATIONS OF THE EXCHANGE OR MARKET, AND ITS CLEARING HOUSE, IF ANY, WHERE THE TRANSACTIONS ARE EXECUTED, AND IF NOT EXECUTED ON ANY EXCHANGE, OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS INC.

(2) THAT UNLESS AND UNTIL ALL OBLIGATIONS OF THE CUSTOMER TO ARE DISCHARGED, MAY FROM TIME TO TIME AND WITHOUT NOTICE TO THE CUSTOMER PLEDGE OR REPLEDGE, HYPOTHECATE OR REHYPOTHECATE, ANY OR ALL SECURITIES NOW OR HEREAFTER HELD, PURCHASED OR CARRIED BY, FOR THE ACCOUNT OF THE CUSTOMER OR DEPOSITED TO SECURE THE SAME, EITHER SEPARATELY OR UNDER CIRCUMSTANCES WHICH WILL PERMIT THE COMMINGLING THEREOF WITH SECURITIES CARRIED FOR THE ACCOUNT OF OTHER CUSTOMERS, FOR ANY AMOUNT WHATEVER, EITHER MORE OR LESS THAN THE AMOUNT DUE THEREON, WHETHER UNDER GENERAL LOANS OF OR OTHERWISE, OR MAY LEND THE SAME, OR DELIVER THE SAME ON CONTRACTS FOR OTHER CUSTOMERS WITHOUT HAVING IN ITS POSSESSION AND CONTROL FOR DELIVERY A LIKE AMOUNT OF SIMILAR SECURITIES.

(3) WE WILL HOLD FOR YOUR ACCOUNT SECURITIES PURCHASED AND PROCEEDS OF SALES UNLESS INSTRUCTED OTHERWISE

(4) UNLESS YOU INDICATE YOUR NON-ACQUIESCENCE IN WRITING, THIS AGREEMENT SHALL ALSO INURE TO THE BENEFIT OF OUR SUCCESSORS, BY MERGER, CONSOLIDATION OR OTHERWISE, AND ASSIGNS, AND WE ARE AUTHORIZED TO TRANSFER YOUR ACCOUNT TO ANY SUCH SUCCESSORS OR ASSIGNS

NOTE: IF THIS TRANSACTION IS A SALE, AND THE SECURITIES ARE NOT ALREADY IN OUR POSSESSION AND DO NOT REPRESENT A SHORT SALE, PLEASE FORWARD THEM IMMEDIATELY, TO AVOID POSSIBLE PAYMENT OF PREMIUM ON SECURITIES BORROWED.

COMMODITY SYMBOL EXPLANATION

THE MARKET ON WHICH THIS TRANSACTION WAS MADE IS INDICATED BY ONE OF THE FOLLOWING SYMBOLS.

04	NEW YORK COTTON EXCHANGE
15	CHICAGO BOARD OF TRADE
24	NEW YORK PRODUCE EXCHANGE
25	CHICAGO MERCANTILE EXCHANGE
43	NEW ORLEANS COTTON EXCHANGE
	OTHER SYMBOLS NAME OF MARKET ON REQUEST

IT IS UNDERSTOOD THAT THE WITHIN AND ALL OTHER TRANSACTIONS MADE FOR YOUR ACCOUNT BY US CONTEMPLATE ACTUAL RECEIPT AND DELIVERY OF THE PROPERTY AND PAYMENT THEREFOR AND THAT ALL PROPERTY SOLD FOR YOUR ACCOUNT IS SOLD UPON THE REPRESENTATION THAT YOU HAVE SAME IN YOUR POSSESSION ACTUALLY OR POTENTIALLY. THESE TRANSACTIONS ARE MADE SUBJECT TO THE RULES REGULATIONS AND CUSTOMS OF THE BOARD OR EXCHANGE ON WHICH THEY ARE MADE AND SUBJECT TO ANY AND ALL FEDERAL AND/OR STATE STATUTES TO THE EXTENT THAT SAME MAY BE APPLICABLE THERETO. THE RIGHT IS RESERVED BY US TO CLOSE TRANSACTIONS WITHOUT FURTHER NOTICE WHEN, IN OUR JUDGMENT MARGINS ON DEPOSIT WITH US ARE BELOW OUR REQUIREMENTS

NAME OF OTHER PARTY TO CONTRACT FURNISHED ON REQUEST

APPENDIX III-C

ASSOCIATION OF STOCK EXCHANGE FIRMS: STANDARD FORM OF MARGIN AGREEMENT

ASEF—Form 101—Revised July, 1955

CUSTOMER'S AGREEMENT

Gentlemen:

In consideration of your accepting one or more accounts of the undersigned (whether designated by name, number or otherwise) and your agreeing to act as brokers for the undersigned in the purchase or sale of securities or commodities, the undersigned agrees as follows:

1. All transactions under this agreement shall be subject to the constitution, rules, regulations, customs and usages of the exchange or market, and its clearing house, if any, where the transactions are executed by you or your agents, and, where applicable, to the provisions of the Securities Exchange Act of 1934, the Commodities Exchange Act, and present and future acts amendatory thereof and supplemental thereto, and the rules and regulations of the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and of the Secretary of Agriculture in so far as they may be applicable.

2. Whenever any statute shall be enacted which shall affect in any manner or be inconsistent with any of the provisions hereof, or whenever any rule or regulation shall be prescribed or promulgated by the New York Stock Exchange, the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and/or the Secretary of Agriculture which shall affect in any manner or be inconsistent with any of the provisions hereof, the provisions of this agreement so affected shall be deemed modified or superseded, as the case may be, by such statute, rule or regulation, and all other provisions of the agreement and the provisions as so modified or superseded, shall in all respects continue and be in full force and effect.

3. Except as herein otherwise expressly provided, no provision of this agreement shall in any respect be waived, altered, modified or amended unless such waiver, alteration, modification or amendment be committed to writing and signed by a member of your organization.

4. All monies, securities, commodities or other property which you may at any time be carrying for the undersigned or which may at any time be in your possession for any purpose, including safekeeping, shall be subject to a general lien for the discharge of all obligations of the undersigned to you, irrespective of whether or not you have made advances in connection with such securities, commodities or other property, and irrespective of the number of accounts the undersigned may have with you.

5. All securities and commodities or any other property, now or hereafter held by you, or carried by you for the undersigned (either individually or jointly with others), or deposited to secure the same, may from time to time and without notice to me, be carried in your general loans and may be pledged, re-pledged, hypothecated or re-hypothecated, separately or in common with other securities and commodities or any other property, for the sum due to you thereon or for a greater sum and without retaining in your possession and control for delivery a like amount of similar securities or commodities.

6. Debit balances of the accounts of the undersigned shall be charged with interest, in accordance with your usual custom, and with any increases in rates caused by money market conditions, and with such other charges as you may make to cover your facilities and extra services.

7. You are hereby authorized, in your discretion, should the undersigned die or should you for any reason whatsoever deem it necessary for your protection, to sell any or all of the securities and commodities or other property which may be in your possession, or which you may be carrying for the undersigned (either individually or jointly with others), or to buy in any securities commodities or other property of which the account or accounts of the undersigned may be short, or cancel any outstanding orders in order to close out the account or accounts of the undersigned in whole or in part or in order to close out any commitment made in behalf of the undersigned. Such sale, purchase or cancellation may be made according to your judgment and may be made, at your discretion, on the exchange or other market where such business is then usually transacted, or at public auction or at private sale, without advertising the same and without notice to the undersigned or to the personal representatives of the undersigned, and without prior tender, demand or call of any kind upon the undersigned or upon the personal representatives of the undersigned, and you may purchase the whole or any part thereof free from any right of redemption, and the undersigned shall remain liable for any deficiency; it being understood that a prior tender, demand or call of any kind from you, or prior notice from you, of the time and place of such sale or purchase shall not be considered a waiver of your right to sell or buy any securities and/or commodities and/or other property held by you, or owed you by the undersigned, at any time as hereinbefore provided.

8. The undersigned will at all times maintain margins for said accounts, as required by you from time to time.

9. The undersigned undertakes, at any time upon your demand, to discharge obligations of the undersigned to you, or, in the event of a closing of any account of the undersigned in whole or in part, to pay you the deficiency, if any, and no oral agreement or instructions to the contrary shall be recognized or enforceable.

10. In case of the sale of any security, commodity, or other property by you at the direction of the undersigned and your inability to deliver the same to the purchaser by reason of failure of the undersigned to supply you therewith, then and in such event, the undersigned authorizes you to borrow any security, commodity, or other property necessary to make delivery thereof, and the undersigned hereby agrees to be responsible

for any loss which you may sustain thereby and any premiums which you may be required to pay thereon, and for any loss which you may sustain by reason of your inability to borrow the security, commodity, or other property sold.

11. At any time and from time to time, in your discretion, you may without notice to the undersigned, apply and/or transfer any or all monies, securities, commodities and/or other property of the undersigned interchangeably between any accounts of the undersigned (other than from Regulated Commodity Accounts).

12. It is understood and agreed that the undersigned, when placing with you any sell order for short account, will designate it as such and hereby authorizes you to mark such order as being "short", and when placing with you any order for long account, will designate it as such and hereby authorizes you to mark such order as being "long". Any sell order which the undersigned shall designate as being for long account as above provided, is for securities then owned by the undersigned and, if such securities are not then deliverable by you from any account of the undersigned, the placing of such order shall constitute a representation by the undersigned that it is impracticable for him then to deliver such securities to you but that he will deliver them as soon as it is possible for him to do so without undue inconvenience or expense.

13. In all transactions between you and the undersigned, the undersigned understands that you are acting as the brokers of the undersigned, except when you disclose to the undersigned in writing at or before the completion of a particular transaction that you are acting, with respect to such transaction, as dealers for your own account or as brokers for some other person.

14. Reports of the execution of orders and statements of the accounts of the undersigned shall be conclusive if not objected to in writing, the former within two days, and the latter within ten days, after forwarding by you to the undersigned by mail or otherwise.

15. Communications may be sent to the undersigned at the address of the undersigned given below, or at such other address as the undersigned may hereafter give you in writing, and all communications so sent, whether by mail, telegraph, messenger or otherwise, shall be deemed given to the undersigned personally, whether actually received or not.

16. Any controversy between you and the undersigned arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or the American Arbitration Association, or the Board of Arbitration of the New York Stock Exchange, as the undersigned may elect. If the undersigned does not make such election by registered mail addressed to you at your main office within five (5) days after receipt of notification from you requesting such election, then the undersigned authorizes you to make such election in behalf of the undersigned. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators, or of a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

17. This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous; shall cover individually and collectively all accounts which the undersigned may open or re-open with you, and shall enure to the benefit of your present organization, and any successor organization, irrespective of any change or changes at any time in the personnel thereof, for any cause whatsoever, and of the assigns of your present organization or any successor organization, and shall be binding upon the undersigned, and/or the estate, executors, administrators and assigns of the undersigned.

18. The undersigned, if an individual, represents that the undersigned is of full age, that the undersigned is not an employee of any exchange, or of any corporation of which any exchange owns a majority of the capital stock, or of a member of any exchange, or of a member firm or member corporation registered on any exchange, or of a bank, trust company, insurance company or of any corporation, firm or individual engaged in the business of dealing, either as broker or as principal, in securities, bills of exchange, acceptances or other forms or commercial paper. The undersigned further represents that no one except the undersigned has an interest in the account or accounts of the undersigned with you.

Very truly yours,

Witness, ...

Dated, ...

.....
(City) (State)

CUSTOMER'S LOAN CONSENT

Until you receive written notice of revocation from the undersigned, you are hereby authorized to lend, to yourselves as brokers or to others, any securities held by you on margin for the account of, or under the control of, the undersigned.

Dated, ...

.....
(City) (State)

Witness, ...

APPENDIX III–D

TERMINOLOGY INVOLVING HOLDING AND CONTROL OF CUSTOMERS' SECURITIES

The terminology involving holding and control of customers' securities would appear not to be uniformly understood throughout the securities industry. It would seem desirable, therefore, to explain the manner in which certain terms are used in this chapter.

The term "margin" securities is used to describe all securities which have been purchased "on margin." These are further divided into "usable margin" securities which under the rules of various exchanges and the NASD may be pledged, and "excess margin" securities which cannot be so used. "Margin" securities are differentiated from "fully paid" securities which are those securities of customers for which the entire payment has been made. It should be noted that the NYSE uses both the terms "free" securities and "fully paid" (see rule 402 and par. 2402.10 of the NYSE Guide) and it is understood that the terms are synonymous.

The term "segregation," as applied to customers' securities, is employed both to indicate the manner in which customers' securities are "identified" (i.e., how the ownership of securities is determined by the records and practices of the firm) and the location of customers' securities (i.e., the extent to which they are separated from firm securities).

The term "safekeeping" used with respect to customers' securities, is intended to indicate that such securities are held beyond settlement date other than for processing for immediate delivery. It is not intended to imply a particular standard of care.

Broker-dealers normally hold customers' securities:

In "street" name, i.e., in the name of a broker-dealer; or

In the name of the customer, either with or without stock power available or attached, or endorsed or not endorsed.

The name in which the securities are held may be dependent upon the system used by the firm to segregate securities. It should be noted that securities in "street name" are not necessarily in the street name of the broker-dealer who holds them for customers. Such securities are negotiable and may be freely transferred if they are in the name of any generally accepted broker-dealer on the "street." Normally, however, a broker-dealer holding securities in street name will cause them to be transferred into his own name, or that of his nominee, because interest and dividends will be paid to the holder of record and transfer into the name of the broker-dealer who actually holds the securities reduces the problems involved in interbroker transfer of interest and dividends.

Where securities are held in the customer's name, there is considerable variation in practice as to whether an endorsement or a stock power is obtained by the broker-dealer upon receipt of the security. Many broker-dealers encourage the practice of obtaining a stock power or endorsement on the ground that it simplifies the mechanics of transfer in the event of sale; also it may further encourage the customer to trade through the broker-dealer holding the security.

The customer's securities are made more vulnerable, absent adequate precautions by the broker-dealer, because the security is negotiable without further notice. Most broker-dealers, recognizing this, separate securities certificates and the powers so as to reduce the possibility of unauthorized transfer by those handling the securities; at least one instance is known, however, in which a large broker-dealer believes that its security precautions and personnel are sufficiently good that certificates and stock powers can be kept together.

APPENDIX III–E

LETTER TO REGISTERED BROKER-DEALERS REGARDING INVESTMENT ADVICE

(Budget Bureau approval No. 71–6205)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., March 6, 1962.

GENTLEMEN: As part of the Study of Securities Markets authorized by Public Law 87–196, we are gathering information on the subject of investment advice by broker-dealers. Your firm has been selected as one from which we would like to obtain certain data to aid us in this study. The fact that you have received this letter should not be regarded as a reflection on your firm or anyone

connected with it. Nor should the receipt of this letter indicate that particular stocks discussed in any of the communications referred to below are under investigation.

We would appreciate your furnishing us the following material:

1. A copy of each market letter, research bulletin, report, analysis, investment advisory recommendation, or other selling or advisory literature, whether or not prepared by your firm (other than recommendations based upon individual portfolio review, prospectuses relating to registered issues, or sales literature relating to mutual funds or Government or municipal bonds), which was distributed by your firm during the period from April 1, 1961 through June 30, 1961. Each document should be designated, in order of date of release, 1–1, 1–2, 1–3, etc., and should be so marked in your files for future reference.

2. With regard to each item supplied in response to item 1, indicate the date of distribution; the approximate number of copies distributed (i) free of charge and (ii) for a fee or charge, indicating the amount or basis of such fee or charge; and the name and address of the firm or individual from whom obtained, if not prepared by your firm.

3. A copy of each advertisement paid for by your firm during the period from April 1, 1961, through June 30, 1961 (excluding tombstone ads, advertisements limited to naming your firm and identifying its business, and advertisements relating to recruitment or changes of personnel), together with the names of the newspapers or periodicals in which each such advertisement appeared and the date of publication. Each advertisement should be designated, in order of date of publication, 2–1, 2–2, 2–3, etc., and should be so marked in your files for future reference.

4. A copy of each written communication (including wires and teletypes) prepared by or originating with your firm during the period from April 1, 1961, through June 30, 1961, not supplied in response to item 1, which was distributed to sales personnel or branch offices of your organization and which contained analyses or recommendations with respect to a particular security or securities (other than advice with respect to a single portfolio or account and other than material relating to mutual funds or Government or municipal bonds). Include all analyses of securities or summaries of prospectuses distributed to sales personnel or branch offices in connection with proposed or pending distributions. Each communication should be designated, in order of date of distribution, 3–1, 3–2, 3–3, etc., and should be so marked in your files for future reference.

5. List the securities discussed in any of the communications supplied in response to items 1 and 4 in which your firm "made a market" (entered a listing in the daily "sheets" of the National Quotation Bureau and/or stood ready to purchase or sell the security in limited quantity) on the date of the release of the communication.

6. Indicate the number of your registered representatives and supply an organization chart of your research department.

We would appreciate receiving the foregoing material by March 26, 1962.

Sincerely yours,

MILTON H. COHEN, *Director.*

APPENDIX III–F

LETTER TO REGISTERED INVESTMENT ADVISERS REGARDING INVESTMENT ADVICE

(Budget Bureau approval No. 71–6203)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., May 21, 1962.

GENTLEMEN: As part of the Study of Securities Markets authorized by Public Law 87–196, we are examining the subject of investment advice and have selected your company as one from which we would like to obtain relevant information. The fact that your company has been selected for study should not be construed as a reflection upon it, upon anyone connected with it, nor upon any of its prior advisory recommendations.

To facilitate such study, we would appreciate your furnishing us with the following material:

1. A copy of each market letter or report, research bulletin, analysis, investment advisory recommendations, periodic publication issued on a subscription basis, or other advisory literature, (other than recommendations based upon individual portfolio review and prospectuses relating to registered issues) which

was distributed by your company during the period April 1, 1961, through June 30, 1961. Each document should be designated, in order of date of release, 1–1, 1–2, 1–3, etc, and should be so marked in your files for future reference.

2. With regard to each item supplied in response to item 1, indicate its date of distribution, the approximate number of copies distributed (showing the approximate breakdown between broker-dealers; institutional subscribers, including banks; insurance companies and investment companies; investment advisory firms; and other recipients), and the amount or basis of the fee or charge therefor.

3. A copy of each advertisement paid for by your company during the period from April 1, 1961, through June 30, 1961 (excluding advertisements limited to naming your firm and identifying its business and advertisements relating to recruitment or changes of personnel), together with the names of the newspapers or periodicals in which each such advertisement appeared and the dates of publication. Each advertisement should be designated, in order of date of publication, 2–1, 2–2, 2–3, etc., and should be so marked in your files for future reference.

4. A copy of each direct-mail solicitation item distributed by your company during the year 1961.

5. A general organization chart of your firm and detailed organization charts of your research and investment advisory departments, indicating the classifications and approximate numbers of personnel employed in the latter departments.

6. General statistics showing comparative volume of your business as of (i) approximately 10 years ago, (ii) 1 year ago, and (iii) the present time, in terms of approximate numbers of personnel employed, types of publications or other material prepared for distribution to subscribers, numbers of subscribers thereto, and number of private investment counsel fee paying clients.

We would appreciate receiving the foregoing material by June 8, 1962.

Sincerely yours,

MILTON H. COHEN, *Director.*

APPENDIX III–G

FOLLOWUP LETTER TO REGISTERED BROKER-DEALERS REGARDING INVESTMENT ADVISORY PERSONNEL

(Budget Bureau approval No. 71–6203)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., June 13, 1962.

GENTLEMEN: In connection with our study of the subject of investment advice pursuant to Public Law 87–196, you previously cooperated with us by furnishing various materials and other relevant information. Your further assistance is requested in furnishing the following information:

1. State the number of registered representatives employed by your firm at the end of the year 1955 and the number of persons (other than clerical and secretarial) in your firm's research department at that time.

2. With respect to your firm's officers, partners, and employees (other than clerical and secretarial) performing research and investment advisory services, indicate as to each such person: (*a*) Whether he engaged in 1961 in selling securities to public customers and, if so, the number of customer accounts serviced by him in December 1961, divided between individual and institutional customers; (*b*) his salary for the year 1961 (if a partner show the tax return figures at columns 4 and 6 of schedule K to Federal Tax Form 1065), the amount of any commissions paid to him during the year 1961, and the amount and basis of any other compensation paid to him with respect to the year 1961; (*c*) a specific description of his duties both within and without your firm's research department; (*d*) his educational background, i.e., highest educational institution attended and degree received; and (*e*) his business experience during the past 5 years. In supplying the foregoing information, each such officer, partner, and employee may, at your discretion, be identified by letter symbol, such as "A," "B," etc.

Your cooperation in supplying this additional information by July 2, 1962, will be appreciated.

Sincerely yours,

MILTON H. COHEN, *Director.*

APPENDIX III–H

FOLLOWUP LETTER TO REGISTERED BROKER-DEALERS REGARDING INVESTMENT ADVISORY PERSONNEL AND A SAMPLING OF ADVISORY MATERIAL

(Budget Bureau approval No. 71–6203)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., June 15, 1962.

GENTLEMEN: In connection with our study of the subject of investment advice pursuant to Public Law 87–196, you previously cooperated with us by furnishing various materials and other relevant information. We are now doing a limited followup study and we request your further assistance in furnishing the following information:

1. State the number of registered representatives employed by your firm at the end of the year 1955 and the number of persons (other than clerical and secretarial) in your firm's research department at that time.

2. With respect to your firm's officers, partners, and employees (other than clerical and secretarial) performing research and investment advisory services, indicate as to each such person: (*a*) Whether he engaged in 1961 in selling securities to public customers and, if so, the number of customer accounts serviced by him in December 1961, divided between individual and institutional customers; (*b*) his salary for the year 1961 (if a partner show the tax return figures at columns 4 and 6 of schedule K to Federal Tax Form 1065), the amount of any other compensation paid to him with respect to the year 1961 (these items should be stated separately); (*c*) a specific description of his duties both within and without your firm's research department; (*d*) his educational background, i.e., highest educational institution attended and degree received; and (*e*) his business experience during the past 5 years. In supplying the foregoing information, each such officer, partner, and employee may, at your discretion, be identified by letter symbol, such as "A," "B," etc.

3. A list of all financial and advisory services and publications (including financial magazines, newsletters, research bulletins, etc.) to which your firm was a subscriber during May 1962.

4. A copy of each market letter, research bulletin, report, analysis, investment advisory recommendation or other selling or advisory literature, whether or not prepared by your firm (other than recommendations based upon individual portfolio review, prospectuses relating to registered issues, or sales literature relating to mutual funds or Government or municipal bonds), which was distributed by your firm during the period April 16, 1962, through June 8, 1962. Each document should be designated, in order of date of release, 4–1, 4–2, 4–3, etc., and should be so marked in your files for future reference. With respect to each item, indicate the date of distribution; the approximate number of copies distributed; and the name and address of the firm or individual from whom obtained, if not prepared by your firm.

5. A copy of each written communication (including interoffice wires and teletypes) prepared by or originating with your firm during the period from April 16, 1962, through June 8, 1962, not supplied in response to item 4, which was distributed or addressed to sales personnel or branch offices of your organization, or to correspondent firms, and which contained analyses, suggestions, comments, or recommendations with respect to particular securities or the market situation generally (other than advice with respect to a single portfolio or account and other than material relating to mutual funds or Government or municipal bonds). Each communication should be designated, in order of date of distribution, 5–1, 5–2, 5–3, etc., and should be so marked in your files for future reference.

6. List the securities discussed in any of the communications supplied in response to items 4 and 5 in which your firm "made a market" (entered a listing in the daily "sheets" of the National Quotation Bureau and/or stood ready to purchase or sell the security in limited quantity) on the date of the release of the communication.

Your cooperation in supplying this additional information by July 9, 1962, will be appreciated.

Sincerely yours,

MILTON H. COHEN, *Director.*

APPENDIX III–J

QUESTIONNAIRE FR–1. BROKER-DEALER FINANCIAL RESPONSIBILITY

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., May 24, 1962.

GENTLEMEN: Under the provisions of Public Law 87–196, approved by the President on September 5, 1961, the Securities and Exchange Commission is authorized and directed to make a study and investigation of the securities markets and rules and practices relating thereto. The Commission has adopted an order of investigation authorizing members of its staff assigned to the Special Study of Securities Markets to conduct the study and investigation pursuant to Public Law 87–196.

A questionnaire designated "form FR–1," which you are requested to answer and return, is enclosed. The purpose of the questionnaire is to develop information as to certain practices within the securities industry relating to safeguards for assets of customers; handling of margin accounts; nonregulated sources of credit; hypothecation and lending of customers' securities; and bonding of broker-dealers and their employees.

This questionnaire is being distributed to approximately 250 broker-dealers registered with the Commission. Since its purpose is primarily to develop information as to practices within the securities industry, the fact that it is being sent to you is not intended to be a reflection upon your methods of operation or to indicate that the Commission considers that you have in any way violated a Federal or State law or any rule or regulation of the Commission.

Your full cooperation would be appreciated.

Very truly yours,

MILTON H. COHEN, *Director.*

Enclosure: Form FR–1.

Form FR-1

Budget Bureau Approval
No. 71-6209

SPECIAL STUDY OF SECURITIES MARKETS

Securities and Exchange Commission
Washington 25, D. C.

QUESTIONNAIRE

Firm Name _____

Address of Main Office _____

INSTRUCTIONS

Please read this questionnaire in its entirety before attempting to answer any questions. The questions are intended to apply to your entire firm, including branch offices. If your answer to any question requires additional explanation to be complete or if there are significant variations in the practices of your several offices, please supply the explanation or report the variations in the practices in space provided in the questionnaire or on a separate rider. Please show the number of the question as to which additional information is being supplied on each page of each rider. Where a question requests that copies of forms used by you be supplied, please show the number of the question on the first page of each form supplied.

Where all or a part of a question is clearly not applicable to your firm you should insert the symbol "NA" where appropriate.

In a number of questions you are asked to "specify" or are given similar instructions. You are urged to give such additional information where requested in order to make your answers as complete as possible.

Where estimates or approximations are requested, it is not expected that you will make a detailed count or inventory. Your estimates or approximations, however, should have a reasonable basis, e.g. a spot check or sampling or detailed knowledge of a responsible member of your organization.

You are requested to write the name of your firm in the place provided therefor on each page of this questionnaire.

Your attention is directed to the provisions of Title 18, U. S. Code, Section 1001, which makes it a criminal offense to submit false information to an agency of the Federal Government.

Return of the questionnaire and inquiries concerning it should be directed to Herbert G. Schick, Room 137, or James E. Bacon, Room 134B, Special Study of Securities Markets, at the above address. Mr. Schick's telephone number in Washington, D. C. is 202-WO 2-3320; that of Mr. Bacon

is 202-WO 3-7950. All questionnaires should be received no later than June 25, 1962. Requests for extensions of time will be considered in unusual circumstances, but such requests must be received no later than June 25, 1962.

DEFINITIONS

Special Cash Account: An account in which customer transactions are effected with the understanding that they will be settled promptly (Reference: Federal Reserve Board, Regulation T, Section 220.4(c)).

General Account: An account which includes all financial relations between a broker-dealer and a customer except those special accounts (including special cash and commodities accounts) which are provided for by Regulation T, Section 220.4. A general account specifically includes a margin account. (Reference: Regulation T, Section 220.3)

Customers' Securities Held for Safekeeping: Customers' securities deposited or left with or held by broker-dealers which are fully-paid and of which the customer has the right to immediate possession, but excluding securities held by broker-dealers during processing for immediate delivery.

Name of Firm_____

General Information with Respect to the Firm

1. State below the approximate number of your employees (including partners, officers or stockholders employed by the firm) as of April 30, 1962, who were:

   a. Principally salesmen: _____

   b. "Back office" employees: _____

2. a. State the approximate number of open customers' securities accounts of any type with your firm as of the date of your April 1962 trial balance taken under Rule 17a-3(a)(11) or within 30 days prior thereto (specify date:_____).

   _____

   b. State the approximate number of open customers' securities margin accounts with your firm as of the date of your April 1962 trial balance taken under Rule 17a-3(a)(11) or within 30 days prior thereto (specify date:_____).

   _____

Customers' Agreements and Statements of Account

3. a. Do you request that customers sign an agreement with you upon opening a

		Yes	No
i.	general account? *	[ ]	[ ]
ii.	special cash account? *	[ ]	[ ]
iii.	any other kind of securities account?	[ ]	[ ]

   b. Attach one copy of each form of all such agreements used by you.

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* See definitions, page ii.

Name of Firm_____

4. a. Indicate by checking appropriate boxes if, in the absence of specific instructions, it is your practice to send statements of account, irrespective of activity, to:

	Customers having General Accounts	Customers having Special Cash Accounts
i. Monthly?	[ ]	[ ]
ii. Quarterly?	[ ]	[ ]
iii. Other regular periods?	[ ]	[ ]
iv. Irregularly? (State the occasions on which such statements are sent)	[ ]	[ ]

b. If, in the absence of specific instructions, you send statements of account only for periods in which accounts are active, is the accounting period:

	General Accounts	Special Cash Accounts
i. Monthly?	[ ]	[ ]
ii. Quarterly?	[ ]	[ ]
iii. Other (specify)?	[ ]	[ ]

5. a. Do your statements of account to customers usually show:

(Check appropriate boxes)

	Monthly	Quarterly	Regularly at other intervals (Specify below)	Irregularly (Specify circum-stances below)
i. debit and credit balances at beginning and ending of statement period?	[ ]	[ ]	[ ]	[ ]
ii. long positions in each security?	[ ]	[ ]	[ ]	[ ]
iii. short positions in each security?	[ ]	[ ]	[ ]	[ ]
iv. each security transaction during the statement period?	[ ]	[ ]	[ ]	[ ]
v. interest and dividends received during the statement period on securities held?	[ ]	[ ]	[ ]	[ ]
vi. rights received during the statement period with respect to securities held?	[ ]	[ ]	[ ]	[ ]

b. Please attach one actual representative example (omitting customer identification) of each type of statement which you send to customers.

Name of Firm _____

Customers' Free Credit Balances

6. a. Do you maintain a segregated bank account for the benefit of your customers and keep in it:

(Check appropriate boxes)

i. an amount at least equal to their aggregate free credit balances? [ ]

ii. an amount at least equal to a specified percentage of their aggregate free credit balances (specify the percentage: _____%)? [ ]

b. Do you as a matter of policy maintain in your general bank balances:

i. an amount at least equal to the aggregate free credit balances of all of your customers? [ ]

ii. an amount at least equal to a specified percentage of the aggregate free credit balances of all of your customers (specify the percentage: ____%)? [ ]

7. a. Do you determine the aggregate amount of customers' free credit balances held by you:

(Check appropriate box)

i. daily? [ ]

ii. weekly? [ ]

iii. monthly? [ ]

iv. quarterly? [ ]

v. other fixed period (specify)? [ ]

vi. irregularly (state approximately how often)? [ ]

Name of Firm _____

b. If you employ one of the methods referred to in question 6 to safeguard customers' free credit balances, do you make appropriate adjustments in the account balances:

(Check appropriate box)

i. immediately following determination of the aggregate amount of customers' free credit balances in accordance with your answer to 7a above? [ ]

ii. at some other time (specify)? [ ]

8. a. Do you customarily solicit instructions from your customers which specify the time when the proceeds of their securities sold by you are to be remitted?

Yes	No
[ ]	[ ]

b. Do you customarily solicit such instructions:

(Check appropriate box or boxes)

i. when an account is opened? [ ]

ii. when an order to sell is received by you? [ ]

iii. at some other time (specify)? [ ]

(If you have checked more than one box, explain.)

Name of Firm _____

c. When customers sell securities through you and no prior specific instructions have been received, do you customarily remit the proceeds:

(Check appropriate box)

i. promptly following settlement date? [ ]

ii. upon request of customer? [ ]

iii. with next statement to customer? [ ]

iv. at some other time (specify)? [ ]

9. a. Do you customarily solicit instructions from your customers which specify the time when dividends and interest received by you on such customers' securities held by you are to be remitted?

Yes	No
[ ]	[ ]

b. Do you customarily solicit such instructions:

(Check appropriate box or boxes)

i. when an account is opened? [ ]

ii. at some other time (specify)? [ ]

(If you have checked more than one box, explain.)

Name of Firm _____

c. When you receive dividends and interest on customers' securities, and no prior specific instructions have been received from such customers, do you customarily remit such dividends and interest:

(Check appropriate box)

i. promptly following receipt? [ ]

ii. upon request of customer? [ ]

iii. with next statement to customer? [ ]

iv. at some other time (specify)? [ ]

10. a. Do you customarily solicit instructions from your customers as to disposition of rights received by you with respect to securities of such customers held by you?

Yes	No
[ ]	[ ]

b. Do you customarily solicit such instructions:

(Check appropriate box)

i. when an account is opened? [ ]

ii. after rights are received? [ ]

c. If you do not solicit, or are unable to obtain, instructions with respect to the disposition of such rights, do you customarily:

i. sell the rights on the customer's behalf? [ ]

ii. exercise the rights on the customer's behalf? [ ]

iii. allow the rights to expire? [ ]

Name of Firm _____

11. a. Do you ever pay interest to customers on their free credit balances?

Yes	No
[ ]	[ ]

b. If your answer to 11a above is "Yes," state:

i. The rate of interest you are now paying on such balances.

_____%

ii. The minimum dollar amount, if any, of such balances on which you pay interest. $_____

iii. The maximum dollar amount, if any, of such balances on which you pay interest. $_____

iv. The length of time such balances must be retained by you before interest is paid.

_____

c. State briefly the considerations governing the selection of customers who receive interest on free credit balances.

Securities of Customers

12. a. Do you ever hold fully-paid securities of customers for safekeeping?*

Yes	No
[ ]	[ ]

b. As of the date of your April 1962 trial balance, taken under Rule 17a-3(a)(11) or within 30 days prior thereto (specify date: _____), for approximately what percentage of your customers' open accounts did you hold securities for safekeeping?

_____%

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* See definition, page ii.

Name of Firm_____

13. a. Do you carry, either directly or with a correspondent, margin accounts of your customers?

	Yes	No
	[ ]	[ ]

b. If so, do you segregate margin securities in your customers' accounts from other securities of customers which are:

		Yes	No
i.	excess margin?	[ ]	[ ]
ii.	fully-paid in street name?	[ ]	[ ]
iii.	fully-paid in customers' names endorsed or accompanied by stock power?	[ ]	[ ]
iv.	fully-paid in customers' names unendorsed and not accompanied by stock power?	[ ]	[ ]

14. a. Do you hold customers' excess margin and fully-paid securities in street name by bulk method?*

	Yes	No
	[ ]	[ ]

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* A method whereby excess margin and fully-paid securities in street name (other than callable bonds) are placed together by name and class of issue, with a record of the ownership of such securities maintained on requisition ("in"), removal ("out") and summary cards and the ownership of each certificate not being specifically identified.

Name of Firm _____

b. Do you hold customers' excess margin and fully-paid securities in street name not held by bulk method, and/or fully-paid securities in customers' names:

		Yes	No
i.	in a separate envelope for each customer?	[ ]	[ ]
ii.	by name and class of issue, the ownership of each certificate being specifically identified by name or account number?	[ ]	[ ]
iii.	other? (describe):	[ ]	[ ]

c. i. Are there any differences in the manner in which you hold customers' fully-paid securities in customers' names which are endorsed or accompanied by a stock power and those which are unendorsed and not accompanied by a stock power? [ ] [ ]

ii. If so, describe:

15. Do you segregate the following classes of customers' securities from securities in your firm investment and trading accounts:

		Yes	No
a.	margin?	[ ]	[ ]
b.	excess margin and fully-paid in street name?	[ ]	[ ]
c.	fully-paid in customers' names endorsed or accompanied by stock power?	[ ]	[ ]
d.	fully-paid in customers' names unendorsed and not accompanied by stock power?	[ ]	[ ]

Name of Firm_____

Margin Accounts

(If you never carry customers' margin accounts, leave all answers to questions 16, 17, 18 and 19 blank.)

16. Do you require that margin customers maintain minimum margin:

(Check appropriate boxes)

a. equal to a certain percentage of the market value of securities long (state the percentage: _____%)? [ ]

b. equal to a certain percentage of the market value of securities short or, for low-priced securities, a certain dollar value per share, whichever is higher (describe and state the percentage or dollar value)? [ ]

c. equal to a certain percentage of the debit balance (state the percentage: _____%)? [ ]

d. of a certain dollar amount (state the amount: $_____)? [ ]

e. calculated in some manner other than described in a through d above (describe)? [ ]

Name of Firm _____

17. Do you review margin accounts to determine the extent to which additional margin is required or the extent to which accounts have excess margin:

(Check appropriate box)

a. daily? [ ]

b. weekly? [ ]

c. monthly? [ ]

d. some other regular period (specify?) [ ]

e. irregularly (state approximately how often)? [ ]

18. a. Do you have a policy of permitting your customers to purchase on margin only those securities in specified categories or on a selected list?

Yes	No
[ ]	[ ]

b. If so, describe briefly such categories or the basis for selection of such securities by you.

Name of Firm _____

19. a. Describe briefly any safeguards employed by your firm to prevent the overall long or short position in a particular security held in one or more customers' margin accounts from being excessive.*

b. Describe any standards used to determine:

i. Whether any single customer's position is excessive.

ii. Whether the overall position of all customers of your firm is excessive.

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* The term excessive has reference to the customer or firm position in relation to: (1) the number of shares outstanding in the issue, (2) the amount of "floating supply" and (3) the average daily trading volume.

Name of Firm _____

Firm Indebtedness

20. a. As of the date of your April 1962 trial balance, taken under Rule 17a-3(a)(ii) or within 30 days prior thereto (specify date: _____), state the total of your firm's outstanding indebtedness collateralized by securities. *

$_____

b. State the percentage of indebtedness reported in 20a, above, owed to each of the types of lenders listed below:

Source of Credit	
Domestic bank	_____%
Foreign bank having no domestic branch	_____%
**Other financial institution	_____%
Other (specify)	_____%
Total	100%

c. State the approximate aggregate market value of all unlisted securities*** used to secure the indebtedness stated in 20a, above:

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* Exclude securities lent and "fails to receive."

** Includes savings and loan associations, finance corporations, factors and insurance companies.

*** Corporate securities not registered on a national securities exchange and not entitled to unlisted trading privileges on such an exchange.

Name of Firm _____

Non-Purpose Loans

21. During the year ended April 30, 1962, did your firm at any time extend credit to a customer for a purpose other than the purchase or carrying of commodities or listed securities?

Yes	No
[ ]	[ ]

If your answer is affirmative, state the total of such loans as of the date of your April 1962 trial balance, taken under Rule 17a-3(a)(11) or within 30 days prior thereto (specify date: _____), and attach a copy of the form of non-purpose loan agreement used by your firm.

Name of Firm _____

Hypothecation and Lending of Securities

22. a. Do agreements signed by your customers, in connection with the opening or administration of the following types of accounts, give consent to the hypothecation of their securities held by you whether or not you have a lien against such securities?

	Yes	No
i. special cash accounts?*	[ ]	[ ]
ii. general accounts?*	[ ]	[ ]

23. a. How often do you hypothecate excess margin securities of your customers:

(Check appropriate box)

i. never?	[ ]
ii. occasionally?	[ ]
iii. regularly?	[ ]

b. How often do you hypothecate fully-paid securities of your customers:

i. never?	[ ]
ii. occasionally?	[ ]
iii. regularly?	[ ]

c. Do you customarily segregate equivalent securities or withdraw from hypothecation securities of customers against which you had a lien when the amount of the lien has been paid?

Yes	No
[ ]	[ ]

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* See definitions, page ii.

Name of Firm _____

24. a. Do you ever lend to others, and/or borrow for your own use, securities of your customers which are:

	Yes	No
i. excess margin?	[ ]	[ ]
ii. fully-paid?	[ ]	[ ]

b. If so, do you customarily:

i. obtain written consent as to each block of securities?	[ ]
ii. obtain written consent as to each transaction?	[ ]
iii. obtain written general authority for such transactions at the time customers' accounts are opened?	[ ]
iv. obtain written consent at any other time (describe)?	[ ]

Name of Firm_____

c. As of the date of your April 1962 trial balance, taken under Rule 17a-3(a)(11), or within 30 days prior thereto, approximately what percentage (in terms of market value) of such excess margin and fully-paid securities, referred to in 24a above, was:

i. lent to other broker-dealers? _____%

ii. used for the purpose of:

(a) effecting good delivery on long sales of securities by other customers? _____%

(b) effecting short sales by other customers? _____%

(c) effecting short sales for your own account? _____%

(d) Other (describe)? _____%

d. If your answer to 24a i and/or ii above is "yes," do you, for the benefit of such customers, segregate cash received from the borrower from funds in your firm's accounts?

Yes	No
[ ]	[ ]

Name of Firm _____

25. When you hypothecate or lend and/or borrow customers' excess margin or fully-paid securities, do you give them notice:

	Securities hypothecated		Securities lent and/or borrowed	
	Yes	No	Yes	No
a. at or prior to the time of each transaction?	[ ]	[ ]	[ ]	[ ]
b. in the next statement to customers?	[ ]	[ ]	[ ]	[ ]
c. at any other time (specify below)?	[ ]	[ ]	[ ]	[ ]

Bonding

26. a. If your firm is a partnership, do you carry a bond or insurance against fraudulent or dishonest acts of general partners?

Yes	No
[ ]	[ ]

b. If so, what is its maximum coverage?

$_____

Name of Firm _____

27. a. Do you carry brokers' blanket bond coverage?

Yes	No
[ ]	[ ]

b. If so, what is the maximum coverage?

$_____

c. If the maximum coverage with respect to losses arising from one or more of the causes listed below differs from your answer to 27b, above, enter the differing maximum amount or amounts on the appropriate line or lines:

i. Misplacement of property. $_____

ii. Check forgery. $_____

iii. Securities forgery. $_____

iv. Fraudulent trading. $_____

d. If any individuals or classes of employees* are excluded from your blanket bond coverage, specify below.

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* The term "employee" includes officers and any directors who are also officers or are employed by the firm in some other capacity.

Name of Firm _____

e. If you do not carry brokers' blanket bond coverage, state the type and amount of any other bond or insurance coverage which you carry to protect against loss arising from fraudulent, dishonest or criminal acts of employees, theft, misplacement or mysterious disappearance of money, checks, securities or other property, forgery or alteration of securities, checks or other documents, or fraudulent trading.

This is to certify that the information contained herein is true and correct to the best of our knowledge and belief.

Date: _____

_____
(Authorized firm signature)

By: _____
(Name of Partner or Officer)

Title: _____

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