



SPECIAL REPORT

NASD MEMBERS

SR-3

To: Members of the National Association of Securities Dealers, Inc.
Re: Guideline on Fair Dealing with Customers

In previous Special Reports to you and in the most recent issue of the NASD News it was stated that the Association was developing a guideline concerning Fair Dealing With Customers and also three new rules on selling practices which will be sent to the membership soon for vote.

After extensive discussions with the SEC staff over the past five months covering such topics as the Association's suitability rule and various other subjects under the broad heading of selling practices and supervision, we have prepared the Fair Dealing Guideline which follows.

Neither the guideline on Fair Dealing With Customers nor the three rules which you will be receiving shortly for vote on discretionary accounts, customer records and supervision, will change the Association's present suitability rule. However, it is felt that the guideline will be helpful in the training and continuing education of all registered representatives and other personnel.

Sincerely,

A handwritten signature in cursive script, reading 'Robert W. Haack', is written in black ink.

Robert W. Haack,
President

NOTE: The By-Laws amendments submitted to you in July, relating mainly to changes in the composition of the Board of Governors, became effective September 21, 1964.

October 9, 1964

FAIR DEALING WITH CUSTOMERS

(Ref.—Sections 1, 2 and 18 of Article III of the Rules of Fair Practice)

Implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of the Association's rules, with particular emphasis on the requirement to deal fairly with the public.

This does not mean that legitimate sales efforts in the securities business are to be discouraged by requirements which do not take into account the variety of circumstances which can enter into the member-customer relationship. It does mean, however, that sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed, rather than on the argument that they result in profits to customers.

District Business Conduct Committees and the Board of Governors have interpreted the Rules of Fair Practice, taken disciplinary action and imposed penalties in many situations where members' sales efforts have exceeded the reasonable grounds of fair dealing.

Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are set forth below, as a guide to members:

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| 1. Recommending speculative low-priced securities to customers without knowledge of or attempt to obtain information concerning the customers' other securities holdings, their financial situation and other necessary data. The principle here is that this practice, by its very nature, involves a high probability that the recommendation will not be suitable for at least some of the persons solicited. This has particular application to high pressure telephonic sales campaigns. | Recommending Speculative Low-priced Securities |
| 2. Excessive activity in a customer's account, often referred to as "churning" or "overtrading." There are no specific standards to measure excessiveness of activity in customer accounts because this must be related to the objectives and financial situation of the customer involved. | Excessive Trading Activity |
| 3. Trading in mutual fund shares, particularly on a short-term basis. It is clear that normally these securities are not proper trading vehicles and such activity on its face may raise the question of rule violation. | Trading in Mutual Fund Shares |
| 4. Numerous instances of fraudulent conduct have been acted upon by the Association and have resulted in penalties against members. Among some of these activities are: | Fraudulent Activity |
| (a) Establishment of fictitious accounts in order to execute transactions which otherwise would be prohibited, such as the purchase of hot issues, or to disguise transactions which are against firm policy. | Fictitious Accounts |

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| (b) Transactions in discretionary accounts in excess of or without actual authority from customers. | Discretionary Accounts |
| (c) Causing the execution of transactions which are unauthorized by customers or the sending of confirmations in order to cause customers to accept transactions not actually agreed upon. | Unauthorized Transactions |
| (d) Unauthorized use or borrowing of customers' funds or securities. | Misuse of Customers' Funds or Securities |
| (e) Transactions by registered representatives which are concealed from their employers or securities transactions outside registered representatives' regular employment, even if disclosed to their employers, if such transactions are in violation of Federal or State law. | Private Transactions |

In addition, other fraudulent activities, such as forgery, non-disclosure or misstatement of material facts, manipulations and various deceptions, have been found in violation of Association rules. These same activities are also subject to the civil and criminal laws and sanctions of Federal and State Governments.

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| 5. Recommending the purchase of securities or the continuing purchase of securities in amounts which are inconsistent with the reasonable expectation that the customer has the financial ability to meet such a commitment. | Recommending Purchases Beyond Customer Capability |
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While most members are fully aware of the fairness required in dealing with customers, it is anticipated that these enumerated practices, which are not all inclusive, will be of future assistance in the training and education of new personnel.

The Securities and Exchange Commission has also recognized that brokers and dealers have an obligation of fair dealing in actions under the general anti-fraud provisions of the Federal securities laws. The Commission bases this obligation on the principle that when a securities dealer opens his business he is, in effect, representing that he will deal fairly with the public. Certain of the Commission's cases on fair dealing involve practices not covered in the foregoing illustrations. Usually, any breach of the obligation of fair dealing as determined by the Commission under the anti-fraud provisions of the securities laws could be considered a violation of the Association's Rules of Fair Practice.

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October 9, 1964