



NASD

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NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 1700 K STREET, N.W., WASHINGTON, D.C.

To NASD Members and Registered Representatives:

**SEC MAY REQUIRE
MORE FINANCIAL
INFORMATION
FROM DEALERS**

SEC Chairman Manuel F. Cohen in a speech at the November IBA meeting in Florida, publicly indicated for the first time that the Commission was considering requiring greatly expanded and more detailed financial statements from broker/dealers.

In describing this increased financial information proposal, Chairman Cohen said, "the new statements would be in sufficient detail to enable the SEC to evaluate the relative contributions of various types of revenue-producing activities of broker/dealers." "It is important," he said, "to know the total capital invested in the securities business and how it is employed, the revenues of the business and related costs of operations by major sources." Mr. Cohen emphasized that when the SEC had solved some of the difficult cost allocation questions inherent in this undertaking, it will represent a long step toward achieving full knowledge of the securities business as it presently exists.

Mr. Cohen pointed out that the Commission has, for many years, required broker/dealers to file certain balance sheet figures. "However, up to this time," he said, "the only revenue information received has been the reports filed by some New York Stock Exchange members, designed to break out on a somewhat arbitrary basis certain income and expenses relating solely to NYSE commission business."

The reports now contemplated by the Commission, according to Mr. Cohen, would go well beyond the limited nature of the present NYSE reports. First, they would be on a mandatory basis for all broker/dealers and investment advisers. Secondly, they would cover all phases of the securities business. And thirdly, they would provide a tie-in of profit and loss information with balance sheet data.

It is the SEC's position that many inter-related and interlocking questions, such as commission schedules, markup policies, off-board trading, volume discounts, reciprocal business, concessions to non-exchange members, among others, cannot be satisfactorily resolved without the income and expense data presently being sought.

The NASD is presently examining the proposed reporting from the standpoints of regulatory need, costs and burden to the industry, and will discuss alternatives, if necessary, with the Commission.

**NASD FIGHTS
BANK MUTUAL
FUND APPLICATION**

Supported by other securities industry organizations, the NASD, in arguments before the SEC on January 18, strongly opposed the pending application of First National City Bank of New York to establish a mutual fund under the 1940 Investment Companies Act and, at the same time, to be exempt from certain important investor protection and conflict of interest provisions in this statute.

Previously, the Association, along with the Investment Company Institute and the Association of Mutual Fund Plan Sponsors, had submitted original and counter briefs for the Commission's consideration which detailed the industry opposition and legal exceptions to the bank's application. Other organizations, such as the Investment Bankers Association and the Association of Stock Exchange Firms, have also indicated to the SEC their support of the Association's position.

On the opposing side in this important case involving a basic interpretation of existing law is, of course, First National City Bank which has also submitted extensive briefs supporting its position. In addition, other banks and non-financial institutions appear to be waiting in the wings ready to follow City Bank's lead if the present application and requested exemptions are approved. The SEC's Division of Corporate Regulation has submitted its own brief in support of the bank's application.

Comptroller of Currency James J. Saxon has also issued a statement approving from his agency's point of view the bank's proposed plan for this commingled investment fund, even though he noted that the bank's proposal did not fully meet all of his current regulations concerning trust accounts. Mr. Saxon indicated that his agency would consider changing these regulations to comply with First National City Bank's needs if its application was approved by the Commission.

The subject of bank-operated mutual funds has been a long-standing controversy in financial circles. In the past, banking officials took the view that they should not have to register with the SEC in order to operate a commingled investment fund. A bill to this effect was introduced in both the last and present sessions of Congress at the urging of the American Bankers Association.

The First National City Bank's subsequent decision to apply for registration under the Investment Companies Act seemed a concession to the SEC, but this would be substantially offset by the requested exemptions from important protective provisions of the law, according to the NASD.

First National City Bank proposes to establish a commingled investment account with a minimum \$10,000 initial participation and subsequent participation in \$1,000 units. The bank's proposed fund will have no underwriter. The bank instead, acting as agent, will arrange that the funds of customers signing the investment agreement are placed in the pooled account. Administrative supervision of the fund will be handled by a committee consisting of bank officers and only one individual independent of the bank.

It is proposed that the bank itself will manage and make all buy and sell decisions in the investment portfolio. This would be handled under a formal agreement with this administrative committee that is made up primarily of bank officers. Participants in the fund will have an opportunity to approve the agreement

annually and select members of the administrative committee. The bank's fee for its management services will be one-half of 1 per cent annually based on the average net asset value of the fund on each valuation date. The fund will be valued once a week or when a participant wishes to terminate his interest in the fund. No sales fee will be charged.

The main thrust of the NASD's opposition to this arrangement is that the bank is asking for exemptions from Section 10 of the Investment Companies Act which was clearly intended to insure that directors of an investment company do not possess affiliations involving potential conflicts of interest, and that such directors do not constitute a majority of persons who are bank officers.

In addition, the Association pointed out in its argument before the SEC that the bank's application should not even be considered by the Commission because no reference is made as to whether or not investors in the fund will be granted the voting rights prescribed by the Act. The Association contended that since the bank itself will have sole responsibility for investment decisions, participants in the fund will not have an opportunity to actually select the individuals making these investment decisions as called for by law. Under the bank's proposed application, investors will only vote for the administrative committee supervising the fund operation.

Further, the NASD argued that in order for the bank to obtain approval for its proposed plan from the Federal Reserve Board it purposely made no differentiation between the bank and the administrative committee. Now, so as to comply with the Investment Companies Act, the bank states that the administrative committee is, in fact, independent from the bank. Thus, it is the NASD's contention that the administrative committee described in the bank's application is in fact dominated and controlled by the bank itself and responsive to the bank's will regarding investment decisions and management.

On January 14, Representative Wright Patman, Chairman of the House Banking and Currency Committee, sent a letter to SEC Chairman Manuel F. Cohen requesting that any Commission decision regarding City Bank's application be held up until Mr. Patman could conduct an investigative hearing into the legality of the proposed activity under the Federal banking laws. In his letter, Mr. Patman called the Federal Reserve Board's approval of First National City Bank's plan "a gross misinterpretation of law." There is no indication when the SEC will issue an opinion on First National City Bank's application.

**NEW OFFICERS,
GOVERNORS AND
DISTRICT COMMITTEE
CHAIRMEN CHOSEN**

Four new Association officers will officially assume their duties during the NASD Board Meeting January 24-26.

Allan C. Eustis, Jr. will be Chairman of the Board. Mr. Eustis, who has been an Association Governor since 1963 and served last year as Chairman of the National Business Conduct Committee, is a Partner in the New York firm of Spencer Trask & Co. He has been associated with Spencer Trask since 1925, is a graduate of Yale University and served in the Air Force during World War II, attaining the rank of Lt. Colonel.

Vice Chairmen of the Board in 1966 will be W. James Price and Julian A. Kiser. Mr. Price is a Partner in Alex. Brown & Sons, Baltimore, Md. Also a graduate of Yale, he has been with Alex. Brown since 1952. Mr. Kiser is Chairman of the Board of Kiser, Cohn & Shumaker, Inc., Indianapolis, Inc. He is a graduate of the University of Chicago.

Julian L. Gumbiner, Executive Vice President of Stern Brothers & Co. in Kansas City, Mo., will be Chairman of the Association's Finance Committee which is responsible for all financial and budgetary decisions. Mr. Gumbiner attended the University of Chicago and has been in the securities business since 1929. He has been with Stern Brothers & Co. since 1944.

Seven new Governors have been elected to serve three year terms on the Board. Ralph E. Phillips, a Partner in Dean Witter & Co. Los Angeles, will replace Van S. Trefethen of Shuman, Agnew & Co., San Francisco, as Governor from District No. 2.

Charles E. Crary, a Vice President of E. F. Hutton & Company, Tucson, Arizona, will replace Malcolm F. Roberts, Hornblower & Weeks-Hemphill, Noyes as Governor from District No. 3.

Arthur Stansel, Manager of the Birmingham, Alabama, office of Courts & Co., will replace G. Shelby Friedrichs, Howard, Weil, Labouisse, Friedrichs and Company, as Governor from District No. 5.

Phil E. Pearce, President of G. W. Crawford Co., Inc., Columbia, South Carolina, will replace Gus G. Halliburton, Equitable Securities Corporation, Nashville, as Governor from District No. 7.

Robert V. H. Harned, President of Warren W. York & Co., Allentown, Pennsylvania, will replace Norman B. Ward, Jr., Singer, Deane and Scribner, Pittsburgh, as Governor from District No. 11.

Herbert R. Anderson, Chairman and chief executive officer of Group Securities, Inc., New York, N. Y., and Joseph D. Krasowich, a Partner in Gregory & Sons, New York, were elected Governors in District 12. They will replace John W. Callaghan, Goldman, Sachs & Co., and W. Scott Cluett, Harriman Ripley & Co., Inc.

In addition, the following men were installed on January 15 as District Committee Chairmen.

District No. 1—Kurt H. Olsen of Harris, Upham & Co., Inc. Portland, Oregon.

District No. 2—Peter J. Eichler of Bateman, Eichler & Bingham, Incorporated, Los Angeles, and Kenneth H. Sayre of Irving Lundborg & Co., San Francisco, as Co-Chairmen.

District No. 3—Robert L. Mitton of Robert L. Mitton Investments, Denver, Colorado.

District No. 4—Glenn L. Milburn of Milburn, Cochran & Company, Inc., Wichita, Kansas.

District No. 5—Vernon J. Giss of Stephens, Inc., Little Rock, Arkansas.

District No. 6—W. Lewis Hart of Funk, Hobbs, Hart & White, Inc., San Antonio, Texas.

District No. 7—J. Coleman Budd of The Robinson-Humphrey Company, Inc., Atlanta, Georgia.

District No. 8—J. Robert Doyle of Doyle, O'Connor & Co., Inc., Chicago, Illinois.

District No. 9—Jack R. Staples of Fulton, Reid & Co., Inc., Cleveland, Ohio.

District No. 10—John S. R. Schoenfeld of Ferris & Company, Washington, D. C.

District No. 11—J. Mabon Childs of Chaplin, McGuiness & Co., Pittsburgh, Pennsylvania, and Samuel K. McConnell, Jr., Woodcock, Moyer, Fricke & French, Inc., Philadelphia, as Co-Chairmen.

District No. 12—John Brick of Paine, Webber, Jackson & Curtis, New York, New York.

District No. 13—Joseph Gannon of May & Gannon, Inc., Boston, Massachusetts.

**BOOZ, ALLEN
STUDY MAY BE
FINISHED IN
SPRING**

The study of NASD dealer organizational procedures, expenses, profitability, quotations and trading activities, currently being conducted by the management consulting firm of Booz, Allen and Hamilton has progressed to the point where information contained on the first questionnaire sent to all members in October is now being programmed onto computers for detailed analysis.

According to Booz Allen officials, the study is slightly behind schedule due to the fact that some few Association members did not promptly complete and return the first questionnaire form. However, NASD President Haack recently stated that he is still hopeful of having the completed study report by Spring for early discussion with the SEC.

As part of the over-all study a selected group of OTC broker/dealer firms, banks and trust companies and large wire houses have also been individually interviewed by Booz Allen staff representatives in such cities as Portland, Maine, Boston, Mass., New York City, Washington, D. C., Nashville, Tenn., Des Moines, Iowa, Denver, Colorado and Seattle, Washington. In addition, Booz Allen had conducted interviews with a number of mutual fund underwriters and corporate stock issuers.

A second questionnaire to a selected list of approximately 100 NASD member firms will also be sent out by the management consultant, probably in February.

In a recent letter to members, Haack emphasized that all data submitted by individual members on the questionnaires will be held in strictest confidence by Booz, Allen and Hamilton and will not be made available to NASD personnel. Although data in replies will be analyzed and utilized in preparation of the study report, complete anonymity of the individual firm will be maintained.

**STUDY OF AUTOMATED
QUOTATIONS SYSTEM
MAKES HEADWAY**

With the endorsement of the Board of Governors, the Association's special eight-man Automation Committee has been proceeding carefully and deliberately in the development of broad guidelines and criteria for an automated quotations and information retrieval system, along with a communications system, for the OTC market.

During the past several months, the Committee has met with major electronic equipment manufacturers, SEC staff representatives and a group of large market making firms in an effort to explore all facets of the many problems connected with automation before proceeding with a program of implementation.

Previously, the Committee had adopted the basic premise that any contemplated system of automated quotations, first, would maintain and support the negotiated character of the OTC market, secondly, would provide safeguards to protect the important functions of market makers, and finally, would definitely not involve any electronic crossing or matching of orders in a machine thereby executing contracts and removing the essential function of negotiation. The Association's Board of Governors, at its September meeting, wholeheartedly supported this Committee approach to automation.

Recently the Committee again met with equipment manufacturers to present its tentative requirements covering the structure of any proposed system. NASD Governor Robert M. Gardiner of Reynolds & Co., Committee Chairman, told the equipment manufacturers that it would appear that the OTC market was susceptible to only a single system, rather than competing systems sponsored by different suppliers. Any proposed system, he said, ideally would be compatible with equipment now in use to obtain listed quotes. NASD control would be exercised through the adoption and enforcement of rules under which members could participate in the automated system.

In a projected description of such a system, Gardiner stated that the Committee had tentatively agreed to the following five points:

1. Initially a selected or limited number of actively traded securities should be quoted in the system.
2. The system should be used to gather price and volume data on a daily basis for prompt dissemination to newspapers.
3. The system should be designed to accommodate two-way communication so that retail dealers could use the equipment to contact the market maker of their choice.
4. It will be necessary for the Association to establish obligations and standards that define qualified market makers allowed to participate in the automated system by supplying quotations on a particular security.
5. Regardless of geographic location, there should be a flat cost to all subscribers using the system to retrieve prevailing inter-dealer quotations.

On this last requirement Gardiner pointed out to the equipment manufacturers that the supplier of the hardware used in the contemplated automation system would be directly responsible to the Association so that administrative costs could be kept at a minimum and to insure that location of broker/dealers would not be a determining cost factor but rather the type of equipment used.

In summing up the Committee's position and previous work, NASD President Robert W. Haack re-emphasized that the complex nature of the over-the-counter market and the diversity of interests and needs of Association members, when coupled with the equally difficult technical and philosophical problems presented by the subject of automation, would preclude a quick or easy answer to the overall problem.