NASD News

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., 1735 K ST., N.W., WASHINGTON, D.C.

To NASD Members and Registered Representatives:

NASD SPEAKS AT "HOT ISSUE" HEARINGS

Confronted with the present strong resurgence in almost all areas of the securities markets and remembering the excesses of hot issue speculation in similar boom markets in the early and late 60's, the Securities and Exchange Commission initiated hearings in late February with a view toward curbing speculative problems before they develop or preventing entirely practices that encourage unwarranted demand for new offerings of questionable quality. Representing the NASD at these hearings was J. Logan Burke, accompanied by various industry and staff members. Mr. Burke, an officer of W. E. Hutton, Inc., is a member of the Board of Governors and Chairman of the Association's Corporate Financing and National Business Conduct Committees.

Mr. Burke urged the Commission, in its review, to distinguish between the legitimate and the questionable forces that spur immediate price increases for some new offerings, noting that an immediate increase in price is not necessarily improper by itself. Turning to the questionable practices of stimulating immediate price increases, which he described as generally stimulating demand and restricting supply, Burke outlined past action by the Association to deal with this problem, including Corporate Financing Guidelines, new rules covering "best efforts" underwriting and the NASD's "Free-riding and Withholding" Interpretation. He also criticized the suggestion of instituting a trading moratorium on all new issues.

Since 1962, the Association has been reviewing public offerings of securities through member firms to determine the fairness of the underwriting and distribution terms. Originally including only federally registered securities, the list of offerings required to be submitted to Association review was expanded in 1963 to include intrastate offerings and further in 1970 to include all issuer offerings which entertain the use of the Association's members as underwriters or as direct participants.

Included in the Corporate Financing Guidelines are provisions which: (1) set definitive standards for compensation and underwriting arrangements; (2) limit the amount of warrants, options and cheap stock received by underwriters to a percentage of the total shares offered and include the value of these warrants, options and stock when computing underwriting compensation; (3) lock-up all non-cash items (warrants, etc.) of compensation to underwriters and related parties for a period of one year; and (4) limit the amount of issuer-directed stock to no more than 10% of the total offering and require that the recipient be related to the conduct of the issuing company's business. The Guidelines were designed to insure the fair and orderly distribution of all new issues with review and application administered on a case-by-case basis.

Burke reviewed a proposal, recently sent to the membership for a vote, which would establish special requirements for "best efforts" offerings. "This rule," he commented, "is aimed at those situations where a restricted supply of stock has an effect on the aftermarket price."

The proposed rule would prohibit trading in the aftermarket or the publication of quotations for any security which is the subject of a best efforts offering until a formal notice of release for trading has been filed with the District where the underwriter's main office is located. The notice would specify the date and time of release and the total number of shares distributed as of the filing date. Regardless of the number of shares registered as constituting the offering, the completed offering would be limited to those shares sold as of the filing date. Certificates would be required to be delivered within seven business days thereafter.

"We believe," Burke said, "this rule, once implemented will have a direct impact on the ability of some unscrupulous firms to keep the price of a security artificially high because, if the shares are in the hands of the purchasers, they can sell them anytime through any broker/dealer and the counterbalancing forces of supply and demand will have been set in motion."

" 'Free-riding and withholding' can be a factor in creating a 'hot issue' market," Burke noted, "since the practice would keep stock in the hands of insiders rather than broadly disseminated in the hands of the public where it should be." He reviewed the NASD's continuing efforts to police improper "free-riding".

The thrust of the Association's present policy is to insure that members make a bona fide public offering, at the public offering price, of securities acquired in any distribution. To accomplish this purpose, the Association places restrictions on sales of "hot issues" securities to various types of accounts, such as the member's own account, the accounts of officers, directors, partners, employees, agents of the participant firm and accounts of their immediate families (including brothers and sisters); accounts in which these persons have a beneficial interest; accounts of other broker/dealers; and accounts of senior officers of institutions, finders and persons acting in a fiduciary capacity to the managing underwriter.

Before outlining NASD suggestions for corrective action to curb abuses in "hot issue" markets Burke emphasized that "a trading moratorium of any kind whatsoever should *not* be imposed." He outlined the effects of a moratorium as: (1) the possible development of blackmarkets—such as in Canada which is only a telephone call away; (2) superheating—a genuine demand will continue throughout a moratorium with an explosive reaction when restrictions are lifted; (3) supercooling—in a slow moving issue, the downward action of the market would be equally explosive because of the desire of investors to sell the shares of that which they know to be a cold deal; and (4) cost of the financing—a moratorium would involve greater potential risk of the underwriter's capital, requiring him to seek greater compensation or to avoid the deal altogether.

Concluding his testimony, Burke discussed Association proposals for controlling a speculative market. He suggested the establishment of new and higher standards for underwriters, noting that the Association is already in the process of raising minimum capital requirements for all of its members, and discussing the establishment of a category of registration entitled "Underwriter Principal" to insure knowledge of the underwriting and distribution segments of the securities business within those firms that undertake to underwrite new issues. The importance of ready availability of certificates was emphasized; however, he cautioned against instituting new rules without fully exploring the operational problems involved.

He suggested some new restrictions on initial offerings including: (1) limiting improper activities in discretionary accounts; and (2) requiring a company to have actively been engaged in the business represented for a specified number of years before being permitted to make an offering. Suggested alterations and improvements in prospectuses were outlined as well as a recommendation that the self-regulatory agencies warn the investing public of the risks of investing in speculative offerings. Burke concluded his review of the NASD's proposals by urging more vigorous enforcement of existing rules, noting that, in view of accelerated market interest, the Association had already begun to strengthen its regulatory framework.

The SEC has indicated that at the conclusion of these hearings, which are expected to last two months, the Commission will develop legislation and new rules to try to curb problems that arise in speculative markets. Burke cautioned the Commission against the institution of regulations which would injure an entire industry in an attempt to curtail the abuses of a few.

QUALIFICATION TASK FORCE MAKING PROGRESS

The Association is moving into the second phase of its comprehensive program to upgrade the system of qualifications for security industry personnel. Members of the NASD/Industry Task Force, which was established in the final months of 1971 to organize an improved qualifications system, met last month in New York City to begin the development of test questions for the various categories of registration that have been established in the first phase of the project.

The plan to revamp the qualifications system grew out of a study conducted by the Association during the early months of 1971. Including participants from other regulatory bodies and member firms of the Association, the program is intended to result in a significantly improved qualification system for the NASD—one that is based on two primary objectives: (1) the creation of different classes of registration in line with actual job functions—initially: operations principals, OTC traders, general securities salesmen, and mutual fund-variable annuity salesmen; and (2) the development of an enforceable system of standards for member training programs. In its final form this new qualifications and training standards program will mean that an individual will no longer automatically become registered by merely passing the traditional qualification examination, but will be required, in addition, to have successfully completed an approved training program within his firm.

The program was launched with a three-day workshop held at the New York Institute of Finance in late November. In this first phase, industry volunteers began the task of developing exhaustive job descriptions for each class of registration, the establishment of performance objectives which state precisely what a trainee must be able to do before he can be qualified for a particular job function, and the ordering of these performance objectives in a learning sequence—from simple to complex knowledge and skills. The NASD/Industry Task Force was divided into sub-groups, each group concentrating on one of the four categories of registration under study. A fifth group was assigned the responsibility of revising the training program for NASD Examiners.

In phase two, the groups of volunteers again met in workshops to develop examination test items to measure how well a trainee can perform the required tasks—tasks which were detailed in phase one. While test questions and performance objectives identify what a trainee must be able to do and how well he must do it, it is also necessary to analyze the learning process, and rank the steps that the trainee must take to properly absorb the material. The result of this ranking will be the basic design of a training program.

As a result of the dedication of the participants in the Industry Task Force, it is anticipated that some facets of the new qualification program will be implemented by late summer.

P-B-W QUOTES TO APPEAR ON NASDAQ

The NASD has decided on an experimental basis to allow specialists firms on the Philadelphia-Baltimore-Washington Stock Exchange to display their bid and ask quotations on listed stocks in the Association's new, automated quotations system, NASDAQ. The decision, unanimously approved by the Board of Governors in a March meeting in Washington, came as a result of a written request from Elkins Wetherill, president of the PBW Exchange.

The NASDAQ system presently carries current quotations on some 3,000 over-the-counter stocks and 84 exchange listed securities which are traded off the exchanges by OTC firms that make markets in these securities.

Initially, only PBW specialists who are also members of the NASD may apply for registration as NASDAQ market makers. All PBW specialists will carry a common identifying symbol in NASDAQ, and NASD firms that are not members of the exchange will be required to deal with the specialists through another member firm of the exchange in accordance with PBW minimum commission schedules and rules. Recently the exchange adopted a 40% discount from its standard commission schedule for NASD broker/dealer members wishing to execute customer orders on the exchange. Previously, NASD broker/dealer members were charged the full stock exchange commission which, when passed along to customers, did not compensate these non-member firms for placing the order.

The NASD Board feels that the NASDAQ system offers the most effective and economical means of pulling together the quotations of the various exchanges and over-the-counter market makers for simultaneous display. The decision to permit exchange specialist quotations on NASDAQ was not limited to the PBW Exchange. Several other regional exchanges have inquired about putting their specialists' quotes on NASDAQ. The Association will consider applications from any regional or national exchange so long as the specialists are members of the NASD and willing to abide by NASDAQ regulations. The primary requirement is that there must be at least two market makers registered in any stock in NASDAQ. If the exchange specialist was the only firm wishing to quote a listed security in NASDAQ, the stock would not be approved for inclusion in the system. The proposed arrangement between the NASD and the PBW Exchange has been approved by the PBW Exchange's Board of Governors and the Securities and Exchange Commission.

In his letter to the NASD, PBW President Wetherill stated that his exchange had long supported the concept of competing market makers and instant accessibility to securities quotations. Wetherill stated that after reviewing the constitution and rules of the Philadelphia-Baltimore-Washington Stock Exchange, his staff concluded that there were no exchange rules or provisions that would preclude the registration of NASD member specialists as market makers on NASDAQ.

It is expected that minor technical reprogramming to the NASDAQ system will be completed swiftly in order to accommodate the new PBW arrangement.

OTC MARKET STRONG IN FIRST QUARTER

Investor interest in the over-the-counter market was strong during the first quarter, as evidenced by the NASDAQ stock price indices and reported NASDAQ volume. The NASDAQ Industrial Index, which includes nearly 1,800 OTC industrial securities, rose 17.1 percent in the three months ended March 31, 1972, closing at 136.51. The more broadly based NASDAQ Composite Index, ending the quarter at 128.14, rose 12.3 percent. The first quarter figures for the other five NASDAQ indices were: Banks, 104.05—a 2% rise; Insurance, 136.50—up nearly 13%; Other Finance, 127.33—up 9%; Transportation, 129.42—an 8% increase; and Utilities, 98.24—up 4%.

Trading of NASDAQ securities totaled 632,763,600 shares during the period, a little more than half the 1,159,120 shares traded on the New York Stock Exchange. An average of 48,674,123 shares of NASDAQ issues changed hands each week during the first quarter of 1972.

NASDAQ BOOKLET A BEST-SELLER

Increasing investor interest in NASDAQ and the OTC market was also demonstrated by the deluge of requests for copies of a recently published NASD booklet which explains the automated quotations system and the functioning of the OTC market. Orders for the NASDAQ booklet were stimulated by full-page advertisements which began appearing in national publications in mid-February. In less than two months, the Association has filled nearly 4,000 individual requests

—originating not only from investors throughout the United States, but from Canada, Europe, South America and the Far East.

The information campaign, which carries the theme "NASDAQ: The Electronic Stock Market," will run for a total of 39 weeks, with educational advertisements in Time Magazine, Life, U. S. News and World Report, Barron's, the New York Times, the Wall Street Journal, Institutional Investor and Investment Dealers' Digest. The complete schedule is outlined below:

NASDAQ ADVERTISEMENT SCHEDULE—1972

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Time "B" (businessmen)			13	10	22 Annual Report				11	9	6	
Wall Street Journal												
National		14	22	19	4				18		20	
Eastern					25					16		
U.S. News		28	27	24					25		13	
Life (Metro)				7					18			
Barron's		14	20	17					11	23	13	
N.Y. Times	9	22	14	18					21	18		
I.D.D. (3x)		29										
Institutional Investor (3x)												
Over-The-Counter Securities Review			1									

The series of three advertisements highlights NASDAQ, briefly describing this remarkable communications system, and provides a coupon for the reader to order the booklet, "NASDAQ & The OTC".

"NASDAQ & The OTC", specifically designed for investors and the general public, pictures the new OTC market in an interesting and informative format. Individual copies are available at 25 cents apiece. Broker/dealers, companies whose securities are listed on NASDAQ, and others may order the booklet in quantity, at reduced rates, for distribution to investors. Bulk orders amounting to nearly 30,000 booklets have already been filled.

This attractive presentation of the NASDAQ story and description of the new OTC market is just part of the consumer information material that will be available in the coming months from the NASDAQ Education Program. Tie-in advertisements are being prepared for local use by broker/dealers as are brief radio announcements. Now in the final stages of production is a 13½ minute motion picture film entitled, "The Electronic Stock Market". It is anticipated that the film will be a useful customer relations tool for broker/dealers, an educational vehicle for schools and institutions, and a shareholder relations medium for companies whose securities are listed on NASDAQ. A packaged seminar including slides and script for registered representative use will also be available shortly.

INTERNATIONAL EXECUTIVE SERVICE CORPS

Retired securities industry executives with a yen to be back in action or mid-career executives who want the practical experience of advising an overseas firm have an opportunity to fulfill their desires by volunteering for service with the International Executive Service Corps.

IESC is a business-to-business operation—a non-profit corporation which recruits seasoned business executives and sends them on short-term assignments abroad to advise companies requesting assistance on management problems. It augments U.S. monetary aid to developing countries, by providing management competence.

An IESC project begins when a locally-owned company in a developing country asks for assistance. If the company conforms to IESC qualifications, IESC seeks out the executive in the United States who can best help. He must have a substantial record of achievement in the same field as the company-client's problem, and be willing to serve without salary. He will, however, receive travel and living expenses while overseas (on the average—about a three month period).

It was in this fashion that John Kelly, retired counsel for the NASD in the District 12 office in New York, recently agreed to go to Brazil for a three month assignment. He will act as advisor to an investment banking-insurance-brokerage complex in Brazil, helping to establish an efficient over-the-counter securities market, with procedures acceptable to the Brazilian Government.

For further information on IESC, write to:

International Executive Service Corps
545 Madison Avenue
New York, New York 10022

OPTIONS TRADING PLANNED FOR CHICAGO

The Chicago Board of Trade is establishing an organized exchange for the trading of securities options to be known as the Chicago Board Options Exchange. Plans are to provide a secondary market where options originated on the new CBOE can thereafter be freely traded, transforming securities options into marketable investment instruments.

Trading would be conducted primarily on an auction basis, with orders being directed to posts on the floor of the new exchange. In addition, the Chicago Board envisions several competing market makers in each security who will share the responsibility for maintaining fair and orderly trading. Prompt reporting of all transactions on an exchange tape is expected.

Fundamental to the formation of a secondary market in securities options is the standardization of the terms of option contracts. The Chicago Board intends to limit dealings on the new exchange to options with a few standardized contract terms.

The Chicago Board anticipates that the new Options Exchange will begin operations sometime late in 1972, assuming acceptance of its registration with the Securities and Exchange Commission as a national securities exchange. In the beginning it is expected that the CBOE will deal in call options alone, starting with markets in approximately 20 to 50 widely held, actively traded, listed stocks.

For further information write to:

The Chicago Board of Options Exchange
LaSalle at Jackson
Chicago, Illinois 60604