

74

report to members

Of particular significance this year was the selection, effective October 1, 1974, of Bradford Computer & Systems, Inc. (Bradford), as facilities management contractor for NCC clearing operations. This contract was the latest step in a continual cost-cutting program implemented by NCC as a result of persistent low volume in the over-the-counter market. Of principal concern to the NCC Board of Directors was the need to protect the Clearing Corporation from incurring continuing losses and possibly requiring further rate increases. The net effect of the terms of the Bradford proposal was to eliminate the possibility of further losses and to improve the current cash flow. An important consideration in awarding the contract to Bradford was that no action be taken that would delay implementation of the long-sought industry objective of a single national clearing system for all securities transactions. So as not to impede progress toward a single national clearing system, provision was made in the contract for early termination, should it become necessary.

The NCC Board continues to set policy as in the past, and retains a staff to perform planning, legal support, surveillance over clearing members' financial status, uniform practice, internal audit, and membership matters. NCC's surveillance activities continue to be coordinated with others of the NASD and the exchanges.

On December 6, 1974, NCC began implementation, on a pilot basis, of a National Envelope Settlement System (NESS) in Minneapolis, New York and Philadelphia. This system, participation in which is voluntary, is an extension of the present envelope settlement system, which allows clearing banks and clearing members who maintain New York offices to deliver and receive envelopes from other clearing

members either with or without an assigned dollar value, making one daily money settlement with NCC. The National Envelope Settlement System expands this present service by allowing for inter-city receipts and deliveries between participants in different regional clearing cities. Inter-city deliveries are delivered and settled on a next-day basis. By early January, 1975, full NESS operations will be implemented in all other regional clearing cities.

Plans for the future include expansion of several present services, the development of a National Trade Comparison Service which will allow for the inter-regional comparison of trades in non-CNS eligible securities, and interfaces with other regional depositories.



1974 was a year in which the Association made meaningful progress in many areas, both in its own activities and in cooperative endeavors with other regulatory bodies. 1975 is expected to be equally productive. In the regulatory area, 1975 should see further progress on a number of projects already underway. Some examples are new computerized reports for detecting OTC market manipulation, more sophisticated surveillance methods over members' financial/operational condition, and upgraded qualification standards for registered principals and representatives.

In addition, the Board of Governors will address

the question of whether to purchase the NASDAQ System from Bunker Ramo Corporation. Work will continue on the feasibility of adapting the System to such new uses as the display of OTC options quotations and the display of block interest indications. Pending legislation, if enacted into law, could have a profound effect upon members' activities and will, therefore, be followed closely. NCC will continue to expand its services, at the same time continuing to participate in industry efforts to achieve a single national clearing system.

This changing environment will present a significant challenge to the Association in the years ahead.

and Direct Participation Program Registered Representative Examination will also be implemented during the first half of 1975.

Early in 1975, the Association will submit for member comment a revised Schedule C of the NASD By-Laws. This schedule will specify the registration requirements for various categories of representatives and principals. In addition to the registered representative categories noted above, the proposed schedule includes a number of new registration categories for principals. These include: General Securities Principal; Investment Company Products/Variable Contracts Principal; Security Trader Principal; Direct Participation Program Principal; Financial and Operations Principal; Underwriter Principal; and Options Principal. These categories extend the concept of specialization used at the registered representative level to principal registrations. To insure uniformity, the NASD will work closely with other regulatory bodies in the development of the principal examination programs. Pending final approval of the new Schedule C by the NASD Board and non-disapproval by the Commission, the new examinations will be put into effect as they are developed during the latter half of 1975 and in early 1976.

Investment Companies

During September 1974, the SEC held public hearings on the Association's Anti-Reciprocal Rule and Investment Company Portfolio Practices. Following the submission of a detailed written statement, including the results of a survey of mutual fund underwriters, the Association testified at these hearings in support of a revision of the Rule. The Association's suggested revision is intended to clarify that, subject to best execution, a mutual fund is not prohibited from following a publicly disclosed policy of selecting broker/dealers to execute portfolio transactions on the basis of sales of fund shares. The Association's proposal was based in part on indications that the Rule had been interpreted as requiring that sellers of fund shares be avoided when portfolio transactions were executed, with the unintended result that portfolio brokerage commissions had been diverted from otherwise qualified broker/dealers. By year end, the Commission had not published its views on the Association's proposed clarification.

In November 1974, the SEC published its Report on Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940. This Report, and the regulatory program stemming from it, resulted from public hearings held by the Commission in February and March of 1973. As announced by the Commission, its mutual fund distribution program involved:

- An amendment to Rule 134 under the Securities Act of 1933 (effective December 10, 1974) to allow greater flexibility in mutual fund advertising.
- A proposal to amend the Commission's Statement of Policy to permit more meaningful portrayal of investment results in mutual fund sales literature.
- An amendment to Rule 22d-1 under the Investment Company Act of 1940 (effective December 16, 1974) to provide greater opportunities for mass-marketing by allowing quantity discounts and other price variations for a wide variety of groups.
- An announcement of the Commission's intention to propose rules and to provide administrative relief to increase opportunities for price variations in specified circumstances.
- A request of the Association to adopt a rule eliminating contractual restrictions which prevent dealers from engaging in brokered transactions in mutual fund shares.
- An announcement of the Commission's intention to view favorably interpretive requests from brokers wishing to charge fees for services connected with the purchase of no-load mutual funds under certain circumstances.
- An indication to the Association that the Commission would not object to the implementation of its proposed rule on mutual fund sales charges. (This rule, which was submitted for membership comment in November 1972, is expected to be submitted to a formal vote of the membership early in 1975.)
- An announcement that the Commission would seek legislative authority to consider further steps needed to move toward price competition.

The Association is directly involved in several aspects of the Commission's program and it is therefore likely that the membership will be solicited for comments on several important issues during the forthcoming year.

During the year, the Commission also adopted an amendment to Rule 15c1-4 under the Securities Exchange Act of 1934. The revised rule, which was, in general, supported by the Association, permits quarterly statements in lieu of individual confirmations to be sent to certain types of tax-qualified investors in mutual fund shares.

Variable Contracts

In its regulatory program covering investment companies described in the preceding section of this report, the Securities and Exchange Commission in-

Chairman's Report



The effectiveness of the NASD in fulfilling its role as a regulatory body was strengthened throughout each of my three years on the Board of Governors. Existing programs were consistently improved and new programs started utilizing new and sophisticated techniques.

The breadth of the Association's regulatory activities in 1974 is illustrated by the following:

- Creation of new and highly sophisticated early warning reports relating to financial and operational conditions of members.
- Development of specialized qualification examinations for various categories of registered principals and representatives.
- Participation in the work of the SEC Report Coordinating Group to reduce unnecessary or duplicative reporting by member broker/dealers.
- Start of conversion of some 300,000 manually-kept registration records to an automated cost-effective system.

To complement the regulatory activities, effort was directed in 1974 to developing new ways in which the Association could assist its members. In my view, there need be no conflict between the Association's acting as a regulator and being helpful to its members. For example, the NASD initiated a program in several parts of the country in which an Association Governor, District Chairman or Committeeman, accompanied by NASD staff, visited members throughout the District. The purpose of these visits was not to conduct examinations or to deal with disciplinary problems. We sought, instead, to acquaint members with changes in the Association's regulatory program, to discuss other areas of NASD activity, to listen to and get a grasp of members' views and problems and to offer the Association's assistance in whatever way possible. The success of this program has resulted in plans to expand these endeavors in 1975.

A new type of meeting was held in Boston in October. An all-member committee ran a seminar designed to assist the membership in finding solutions to a variety of problems. In the sales area, 15 panelists, each a specialist in his respective field, explained marketing techniques for such products

as tax-exempt bonds, common stocks, options, new issues, secondaries, pension and profit sharing plans, mutual funds, tax shelters and insurance programs. A luncheon speaker discussed full service financial planning, i.e., the types of services which broker/dealers may have to be qualified to offer clients in the future. An operations panel discussed ways of cutting costs and increasing efficiency. Finally, a panel on regulation outlined programs designed to avoid duplication and reduce the expense of regulation. This seminar was attended by approximately 160 individuals representing 90 member organizations in District 13. As a result of this initial success, the Association is now planning similar seminars in other Districts.

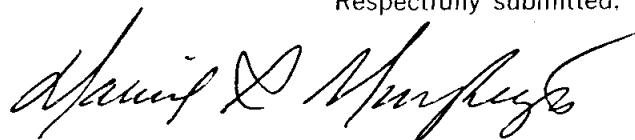
Another example of the broadened scope of NASD activities was the sponsoring of seminar programs in Chicago, New York and Los Angeles for principal executives of NASDAQ companies. These seminars provided these corporate officials with a better understanding of the NASDAQ market. Similar programs are being considered for 1975.

In addition, the Association is planning to hold seminars of a more specialized nature for its members throughout the country. Forthcoming revisions to SEC Rule 15c3-1, the net capital rule, including the proposal to adopt an alternative net capital requirement, will reshape existing financial standards considerably; therefore, meetings to educate the membership on these modifications should prove most beneficial. (In connection with the adoption of SEC Rule 15c3-3, the customer protection rule, the Association held 44 seminars of a similar nature attended by about 4,400 persons in 1972 and 1973.)

In summary, then, the Association's goal for the future will be to combine its regulatory responsibilities to protect the investing public with a series of programs to enhance the marketplace and assist its members.

New programs are possible because of the efforts, skills and enthusiasm of hundreds of securities industry personnel. These industry leaders, who give unsparingly of their time on local, district and national committees and on the Board of Governors, provide the planning and leadership which make the Association's programs so highly effective. To all of them, and to the NASD's truly capable and dedicated staff, my thanks.

Respectfully submitted,



David R. Murphey, III

President's Report



Without question 1974 has been an extremely difficult year for the securities industry and the investing public. Discouraging economic events on national and international levels resulted in a further deterioration of securities prices and low volume throughout most of the year. As a consequence, the securities industry continued to con-

tract, with many broker/dealers pursuing more intently a variety of budget cutting and cost savings programs to reduce overhead and the erosion of capital.

Since the financial resources of the Association are directly tied to overall membership conditions including, among others, the number of active firms, registrations of individuals and profitability of members, we too were compelled to initiate some belt-tightening measures beyond those previously implemented. For example, NASD staff was reduced over the course of the year from 575 to 498 full-time employees. All of these measures were thoroughly studied and examined to assure that there would be no lessening of our regulatory effectiveness or elimination of services provided. There were, in addition, other significant steps taken that will assist the Association's financial picture.

In the past, all costs associated with the development, operation and regulation of the NASDAQ market have been borne solely by members of the NASD. Now that the NASDAQ System has become firmly established and a much expanded regulatory mechanism is in place and functioning, the Association's Board of Governors concluded that it is appropriate and reasonable to have investors in NASDAQ companies participate to a limited extent through their NASDAQ companies in sharing those costs which directly relate to the operation and regulation of this market.

A schedule of annual fees and an entry fee plan became effective on June 1, 1974. Annual fees will result in approximately \$2,000,000 being contributed by NASDAQ companies to the regulation of the market—an amount equivalent to about fifteen per cent of direct industry expenses for System operation and regulation.

The fee schedules were adopted with support for

the concept expressed by a substantial majority of the NASDAQ companies that responded to the Association's request for comment. The Association will in turn respond to suggestions made by a number of NASDAQ companies by giving them representation in its policy-making deliberations.

Also significant in improving the financial outlook for the Association was the selection, effective October 1, 1974, of Bradford Computer and Systems, Inc. as the facilities management contractor for the clearing operations of the National Clearing Corporation (NCC), a wholly-owned subsidiary of the NASD. NCC's net loss for its fiscal year ending September 30, 1974, amounted to almost \$700,000. Additional infusions of capital from the Association to NCC and increased rates for clearing members loomed as likely prospects if losses continued to be incurred. The arrangement with Bradford eliminated the possibility of further losses and immediately improved the cash flow at NCC.

The selection of Bradford as facilities manager is notable as an illustration of the potential within the industry for saving money by sharing facilities. Bradford, the nation's largest securities processing organization, is able to share with the over-the-counter clearing operation computer facilities, space, couriers, other personnel and a communications network.

The Association continues to view the formation of a single national clearing system for all securities transactions, both on the exchanges and over-the-counter, as a most important step toward cutting costs by eliminating expensive and wasteful duplication of effort. The NASD will continue to work through the National Securities Processing Committee to achieve a merger of the various clearing entities and the establishment of a governing structure that will assure access to the clearing system by all broker/dealers on a fair and non-discriminatory basis.

As you read through this Annual Report, you will find in many areas programs that will serve to make more efficient both the operations of the Association and its membership. Even in these most difficult times, it is possible to see evidence that the long-term prospects for our industry are bright.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Gordon S. Macklin".

Gordon S. Macklin

1974—REPORT TO MEMBERS

The continuation of severely depressed conditions in the over-the-counter market throughout 1974 intensified the need for the Association to continue its program of close surveillance, to utilize automated techniques that serve to reduce costs to the Association and its members and to cooperate with other organizations regulating the securities industry.

Substantial progress can be reported in a broad list of areas. Furthermore, the benefits to the Association's membership of programs initiated this past year will become progressively more apparent in the years to come.

REGULATION

Continuing a program started in 1972, several steps were undertaken by the Association during 1974 to make more efficient the total regulatory environment within which the membership functions. First, Regulation Division staff representatives participated actively on a number of key industry committees and groups in a cooperative endeavor to achieve greater uniformity in industrywide regulatory practices. Second, the reorganization of the Regulation Division, started in 1973, was completed. Third, a number of the Association's regulatory programs and procedures were further refined. At the same time, many were modified to reduce costs substantially without lessening the entire program's regulatory effectiveness.

Some of these activities are described in this Report.

Membership

The number of Association members declined by almost 14 percent in 1974. During the year, terminations of member firms rose to 655 while new member additions totaled 164. The number of branch offices declined by 508. Contributing to these reductions was a growing tendency by many broker/dealers to consolidate into larger, better capitalized organizations and, as part of a variety of intensified budget cutting and cost saving programs, to close unprofitable branch offices. The number of registered representatives declined in 1974 by about 4 percent. At year end, slightly more than 200,000 individuals were registered with the Association.

Examination of Member Firms

Partly as a result of the Association's improved surveillance and examination of members, the number of firms referred to the Securities Investor Protection Corporation (SIPC) as in or approaching financial difficulty dropped dramatically during 1974. At the close of 1973, the Association was reporting to SIPC 57 members in that category. By the end of 1974, the number had been reduced to 27.

Likewise, only 14 firms for which the NASD was the designated examining authority were placed in SIPC liquidation during the year, compared with 27 in 1973 and 40 in 1972. The Association is continuing its close cooperation with SIPC with the aim of reducing firm failures and the resulting claims against SIPC funds.

During 1974, the Association conducted a total of 3,464 routine and financial/operational examinations of members' main offices and 71 routine examinations of branch offices. Also, 401 "cause" or "special" examinations were completed during the year.

As a result of this examination program, 234 Formal and Summary Complaints were filed and 268 Letters of Admission, Waiver and Consent were accepted. Disciplinary actions during 1974 resulted in the expulsion of 97 firms, the barring of 249 individuals, and the suspension of 55 firms and 145 individuals.

Anti-Fraud Programs

In 1972, a joint NASD/SEC Anti-Fraud Task Force was formed for the purpose of investigating cases involving fraud and manipulation in the sale and/or distribution of securities. More recently, the activities of NASD participants on the task force were centralized so that the staff now functions as the Anti-Fraud Section of the Department of Enforcement. The Section is manned by people who have had experience in the area of investigating manipulation and fraud. All possible fraud and manipulation cases, whether uncovered by District examiner personnel or some other source such as the NASDAQ Market Surveillance Section, are referred to the Anti-Fraud Section for investigation.

The work of the Anti-Fraud Section and the Joint

Task Force has resulted in the initiation of SEC administrative proceedings against 144 individuals and 39 broker/dealers. Five persons have been indicted, three of whom were convicted of criminal violations uncovered by the task force. Injunctions have been obtained against eleven persons, seven securities firms, and three corporations not engaged in the securities business. Additionally, the Commission suspended trading in twelve issues.

Joint NASD/SEC OTC Task Force

Another joint task force comprised of staff members of the NASD and SEC was formed in early 1973 to improve the computer capabilities of each in connection with ongoing OTC market surveillance and enforcement programs, particularly with respect to market manipulation. During 1974, the task force was successful in designing the specifications for two prototype NASD surveillance reports: one, a price-volume graph and the other, a quotation analysis report that will, among other things, analyze market maker quotation changes.

When the task force's projects become operational in 1975, the resulting reports will be more sophisticated than those presently available; will pinpoint more accurately, and on a timely basis, potential market manipulations in the OTC market; will free market surveillance analysts for more in-depth follow-through investigations on a greater number of situations; and should prove to be an effective deterrent to potential market manipulations.

SEC Report Coordinating Group

On May 1, 1974, the Report Coordinating Group, an SEC Advisory Committee, was formed for a two-year period to assist the Commission in its program of streamlining the reporting system for the securities industry. The program's objective is to reduce, consolidate and eliminate unnecessary and duplicative reports now required to be filed by broker/dealers.

In addition to one Association staff member who serves on this Committee, nine other NASD employees have assisted the Report Coordinating Group thus far by serving on staff work groups or subcommittees formed for the purpose of developing a uniform financial and operational report (FOCUS Report); uniform trading, assessment, and registration forms; and uniform record-retention periods.

The first phase of the Committee's work was completed in December when it delivered an "Interim Report" and a "FOCUS Report Revised Discussion Paper" to the Commission. The Committee recommended the adoption of a FOCUS Report which would

simplify current reporting requirements through the elimination of, where practicable, certain reports including, among others, SEC Forms X-17A-5, X-17A-10 and X-17A-11; Self-Regulatory Reports—Form M, Form Q, Joint Regulatory Report, and Income and Expense Report; and similar reports and forms used by other regulatory authorities. It also recommended that steps be taken to adopt uniform registration and trading forms, and that the industry consider steps to simplify the present system of collecting SIPC assessments.

Registration Records and Forms

During the year the NASD completed its pilot program involving the automation of facilities to maintain and retrieve records for registered representatives and registered principals. Full implementation of the program, involving nearly 300,000 records, was started in July 1974. When the program is completed in early 1976, the Association will be able to use cost-effective, modern computer techniques to gain access to records formerly maintained and retrieved manually.

Work also continued throughout 1974 to develop uniform industry application/registration forms so that one form could be used by broker/dealers and another by individuals for filing with all regulatory organizations. Thus, a multiplicity of forms would be reduced to two. This effort, dating back to October 1972, involved the participation by various securities and commodities exchanges, the SEC, the North American Securities Administrators, the NASD and other interested parties.

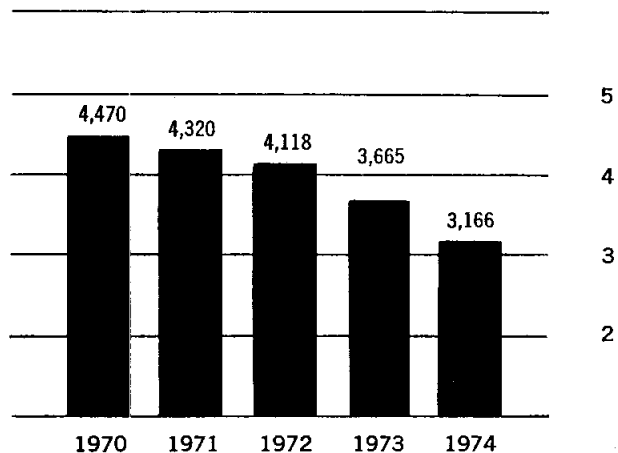
On December 27, 1974, the Association announced that, beginning January 1, 1975, Form U-4, the "Uniform Application for Securities and Commodities Industry Representative and/or Agent", would be accepted by the Association for requesting registration of persons required to be registered with the Association. This action was taken in cooperation with all national securities exchanges, certain commodities exchanges and 40 states which have agreed to accept this form in lieu of their own separate applications for registration. Form U-3, the "Uniform Application for Registration, Membership or License of Broker-Dealer Firms", was recently published for comment by the SEC. Upon expiration of the comment period in early 1975, it is expected that this form will also be adopted.

Although certain technical changes in these forms are likely, the acceptance of uniform registration forms represents yet another step taken by the Association, in concert with others, to eliminate costly, duplicative paper work for members.

1974 STATISTICAL REVIEW

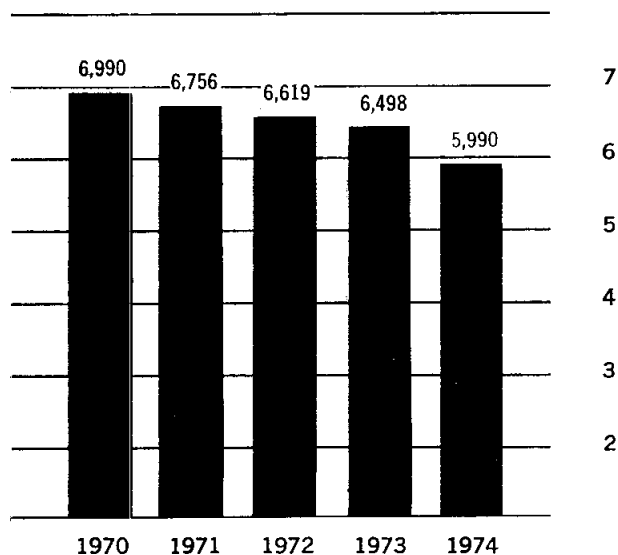
MEMBER FIRMS

Thousands



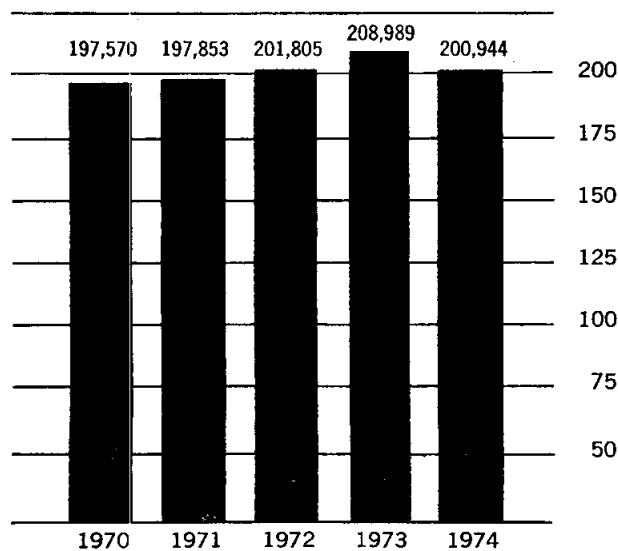
BRANCH OFFICES

Thousands



REGISTERED REPRESENTATIVES

Thousands



EXAMINATIONS ADMINISTERED BY THE NASD FOR THE FIVE YEAR PERIOD BEGINNING

January 1, 1970 and ending December 31, 1974

YEARS	QUALIFICATION EXAMS FOR NASD	EXAMS ADMINISTERED FOR OTHER INSTITUTIONS	TOTAL
1970	63,653	26,862	90,515
1971	32,366	21,696	54,062
1972	38,519	26,262	64,781
1973	46,312	26,286	72,598
1974	26,783	21,059	47,212

Qualifications

For the past three years, the Association has been working with industry task forces and other regulatory bodies on an extensive project designed to upgrade qualification standards for securities industry personnel. The primary goal of this project is to develop improved qualifying examinations geared to specific job functions in the securities industry. At the end of 1974, work had been completed or was near completion on five new examinations for registered representatives, including those for the following: General Securities Registered Representative; Investment Company Products/Variable Contracts Registered Representative; Security Trader; Real Estate Securities Registered Representative; and Direct Participation Program Registered Representative.

The new General Securities Registered Representative Examination program was inaugurated jointly by the NASD and the New York Stock Exchange in September 1974. The examination is given once a month and is composed of 250 multiple choice questions to be answered within six hours. During 1975, the Association will work closely with the New York Stock Exchange and other exchanges in developing both a uniform industry study guide for the General Securities Examination and additional examination forms for this program.

In the second half of 1974, the Association published study guides for both the Investment Company Products/Variable Contracts Examination and the Real Estate Securities Examination. The Real Estate Securities Examination was made available to state securities administrators in October and will become an NASD requirement during the first half of 1975. The Investment Company Products/Variable Contracts Examination, Security Trader Examination,

cluded two items of significance to members marketing variable annuities.

First, the Commission indicated that it would not object to the adoption of a proposed Association rule covering maximum sales charges on variable annuities. This rule was developed by the Variable Contracts Committee following an extensive study of variable annuities conducted by the management consultant firm of Booz, Allen & Hamilton in 1972. Members will be asked to vote for the adoption of the rule in early 1975.

Second, the Commission announced that in the near future it would publish for comment a proposed rule to relieve issuers of variable annuities from the restrictions of Section 22(d) of the Investment Company Act of 1940—the retail price maintenance provision.

A further recommendation of the Booz, Allen study was that the SEC's prohibition against the use of illustrations giving hypothetical investment results in the sale of variable annuities should be removed. It was felt that such illustrations would help to increase investor understanding of variable annuities and enhance competition. Both the Association and the insurance industry have been advocating such a course of action for some years. It was, therefore, with some regret that the Association felt it necessary to comment unfavorably on a proposal for the introduction of such illustrations which was issued by the SEC in August. The Association felt that the illustrations proposed were so complex and difficult to understand that they would not achieve the desired objectives.

Because most variable annuities are periodic payment plans and feature relatively small purchase payments at frequent intervals over many years, compliance with the confirmation requirements of federal securities regulations has been extremely costly to members marketing such contracts. Consequently, the Association welcomed proposals issued by the SEC during the year which would allow confirmations to be sent at less frequent intervals for certain group and tax-qualified pension plans. In its extensive comments on the proposals, the Association requested that the SEC broaden the scope of the proposed regulation to include all kinds of investment plans where payments were made periodically over long periods of time.

The Association continues to draw heavily on the personnel of insurance company members to provide the necessary expertise in developing and formulating policy. No less than 14 of the national committees of the Association's Board of Governors include representation from the insurance industry.

Real Estate Securities

The process of introducing real estate personnel to securities industry regulation has been a relatively smooth one mainly because of the efforts of two committees appointed by the NASD in late 1973.

The Ad Hoc Policy Committee continues to study the many rules of the Association to determine which may have an effect on the sale of real estate securities. The Committee, composed of representatives of both the NASD and the National Association of Realtors, has recommended major rule changes to the NASD Board of Governors. In September 1974, as a result of one such recommendation, the Board approved an amendment to the Markup Policy as it applies to certain real estate securities. The Committee has also dealt with many policy issues involving the interrelationship of NASD rules with Federal Reserve Board, state and SEC regulation of these securities.

The examination developed by the Special Subcommittee on Real Estate Examination will be put into use in 1975. Successful completion of this examination, designed to test an individual's knowledge of the basics of real estate and securities laws, will qualify him as a limited real estate securities salesman. The examination, designed as both an NASD and nonmember examination, has received the attention of many state securities administrators, some of whom have instituted its use as a qualification for licensing within their states.

SIPC Task Force

Early in 1974, a task force was formed by the Chairman of SIPC to study methods to improve and streamline procedures for the orderly transfer of assets and reimbursement of customer funds under the Securities Investor Protection Act of 1970 (the Act).

At the end of July, the task force, which included a member of the NASD's Regulation Division staff, completed its study and presented its report to the SIPC Board of Directors. Notwithstanding the fact that the Act has afforded protection to many customers who previously received none, the Task Force Report stressed the need for flexible statutory guidelines designed to allow SIPC and trustees to exercise discretion in making customers whole quickly and with a minimum of expense. The task force made numerous recommendations, most of which were based on the following basic policy determinations: SIPC's role should remain that of a liquidator, not a regulator; broker/dealers in financial difficulty whose customers require the protection of the Act should continue to be liquidated rather than re-

habilitated employing SIPC funds; SIPC or the trustee should have greater flexibility to provide prompt satisfaction of claims, more adequate customer protection and greater economy of administration; and the protection afforded customers under the Act should be adequate to enable SIPC to fulfill its function of maintaining investor confidence in securities firms and securities markets.

The SIPC Board of Directors endorsed most of the proposed changes to the Act recommended by the task force. The two recommendations not fully endorsed by the Board concerned a proposed increase in the present limits of coverage and a proposed elimination of the current exclusion of mutual fund and variable annuity firms from membership in SIPC. With regard to the present limits of protection, currently set at \$50,000 maximum per account (with a \$20,000 maximum for cash claims), the Board determined that any increase in coverage should coincide with future increases in FDIC coverage for bank accounts. Although the Board agreed with the task force recommendation concerning mutual fund and variable annuity firms, it directed that its report contain an alternative approach which would eliminate the holders of mutual funds and/or variable annuities from the protection features of the Act.

The proposed elimination of the mutual fund-variable annuity exclusion was strongly opposed by the Association's representative on the task force since the large number of firms which would be affected by this recommendation are smaller broker/dealers whose activities do not present the risks the Act is designed to protect. In a separate statement which accompanied the Task Force Report, he concluded that the recommendation would appear to be contrary to the intent of a recent Senate Resolution urging that steps be taken to assure the continued participation of small broker/dealers in the securities markets.

Draft legislation was subsequently submitted to the Congress on December 17, 1974 and thereafter bills were introduced in both houses of Congress.

Relations With State Securities Administrators

For the last fifteen years the Association has enjoyed a close working relationship with state securities administrators. Recently the Association has expanded its areas of cooperation with the states to reduce duplicate regulatory efforts. The result has been the development of uniform registration forms for broker/dealers and their representatives or agents, the administration of a newly developed real estate securities examination, and the coordi-

nation of regulations dealing with new issues of securities including tax shelters. In addition, the Association is working with state administrators to obtain "blue sky" exemptions for certain qualified NASDAQ-quoted companies. An important development in 1974 was the NASD's proposal to the administrators of a six-point cooperative program concerning the exchange of investigatory information and documents in an attempt to coordinate examinations of broker/dealers. The Association will continue to work with the states on these and other programs.

Tax Sheltered Programs

In a letter dated May 6, 1974, the Securities and Exchange Commission questioned the appropriateness of the NASD's enacting rules in the tax shelter area which would have imposed NASD regulatory control over all aspects of these public offerings. The Commission urged prompt submission by the Association of rules pertaining to traditional areas of regulation but requested that attempts to regulate issuers and sponsors who are not NASD members be avoided. The letter suggested instead the establishment of broad suitability standards to cover all offerings and urged the expansion of suitability standards to include private placements.

The Association has forwarded to the SEC an alternate approach which should achieve the necessary regulation in the area. If this approach is adopted, the NASD would impose significant regulation on members and their affiliates sponsoring tax sheltered programs and on members distributing these securities in nonmember sponsored programs. Rules governing tax sheltered programs are expected in early 1975. The Association continues to study the feasibility of adopting regulations covering private placements as suggested by the Commission.

Corporate Financing

Public offerings of securities in which NASD members intend to participate are reviewed by the Association to determine whether the underwriting terms and distribution arrangements are fair and reasonable. The bleak market conditions of 1974 had a significant impact upon the number of offerings filed for review. Only 701 were submitted, representing a dollar value of \$8.65 billion. These figures were down from 1,428 and \$14.1 billion respectively in 1973. The largest number of 1974 filings was in the category of tax sheltered programs, with 306 offerings filed for review, compared with 504 the previous year.

Underwriting terms and arrangements were found to be unacceptable under the Association's rules

and regulations in 273 of the offerings filed. In all cases modifications were made to comply with NASD regulations before the securities were sold to the public.

Advertising

The Association's Advertising Department reviews members' advertising and sales literature for compliance with SEC and NASD rules and guidelines. Reflecting industry conditions, the volume of literature reviewed in 1974 declined to slightly over 10,000 pieces from over 11,200 the previous year. The majority of advertising and sales literature filed by members continues to be mutual fund or variable annuity oriented, although the volume of this type of material declined from over 6,800 pieces in 1973 to 6,200 in 1974. Material regarding tax sheltered offerings also declined from over 1,200 pieces in 1973 to 950 in 1974.

In April 1974, the Association revised its filing requirements regarding investment company sales literature. Often literature filed in advance requires little or no change and it was felt that mandatory refiling of such material was an unnecessary burden on members. Under the revised requirements, literature filed in advance need not be resubmitted unless specifically requested by the Advertising Department.

Fidelity Bonding

The NASD's mandatory fidelity bonding rule became effective March 15, 1974. Association members who are not required to be members of SIPC or have no employees or are not subject to the SEC's Net Capital Rule are exempt from the fidelity bonding rule.

In November 1974, the Association determined that exemptions from the bonding rule should not be extended further to include other classes of members such as those introducing accounts on a fully-disclosed basis. In addition, the Board of Governors approved a proposed amendment which would permit a member purchasing insurance coverage in excess of that required under the rule to include in the policy a deductible amount greater than that currently allowed. The difference would then be self-insured by the member, who would take it as a deduction from net worth in computing net capital.

Options

The Association is currently assessing the feasibility of instituting a more organized and visible OTC options market by adapting the NASDAQ System for display of OTC options quotations. From a regulatory point of view, the visual display of options

quotations would be in the public interest and make more viable the OTC options market. While still in the conceptual stage, it is believed that, if adopted, this project would lay the groundwork for additional developments, including greater standardization of over-the-counter option contract specifications and, consequently, a stronger secondary trading market for OTC options. During 1975, presentations of the basic concept for display of NASDAQ options will be made before several industry trade groups.

In addition, the Association is exploring the need to develop specialized regulations pertaining to OTC options. Together with the pending adoption of proposed SEC Rules 238 and 9b-2, these efforts will contribute significantly to clarifying standards of conduct in the OTC options market.

Gold Trading

During the latter part of 1974, the Association accelerated its planning efforts and development of programs in anticipation of the removal of federal restrictions on the purchase, sale and ownership of gold by U.S. citizens. Although the ban was lifted on December 31, 1974, a number of steps had previously been taken by the Association including, among others, (1) meeting with the SEC to discuss the initial steps the Association planned to take to supervise properly members' activities in this area, (2) the formation of a Special Committee of the Board of Governors on Gold Trading, (3) the sending of several advisory notices to the staff on the regulatory aspects of members' participation in the gold market, (4) the publication of a Notice to Members detailing the problems that may arise in connection with dealings by members in gold and other precious metals, (5) a survey of the membership relative to actual or contemplated participation by members in the gold market, and (6) the adoption of closer-than-normal surveillance programs for firms intending to become active in the gold market.

Although the initial response of the public to the removal of restrictions was far less than expected, the Association considers it essential that definitive rules and regulations be developed for gold trading. Particularly since broker/dealer activities in the gold market have an impact upon their financial responsibility requirements, this area of member activity will continue to receive high priority attention by the Association.

Guide to Broker/Dealer Compliance

The SEC Advisory Committee on a Broker-Dealer Model Compliance Program, on which an NASD staff member served, submitted its report to the Com-

mission, in the form of a Guide to Broker-Dealer Compliance, in November 1974. The nineteen-chapter Guide is directed primarily to management and supervisory personnel. To assist them in having their firms comply with existing regulatory standards, there is a description of applicable laws and rules of various governmental and industry authorities, special problems arising in connection with such requirements, and suggested procedures for attaining compliance.

In reviewing the report, the Commission indicated that it would study the Guide and seek public comment in determining whether the concept of a Guide as a compliance tool is useful and whether the format and contents of the Guide are acceptable.

MEMBER SERVICES

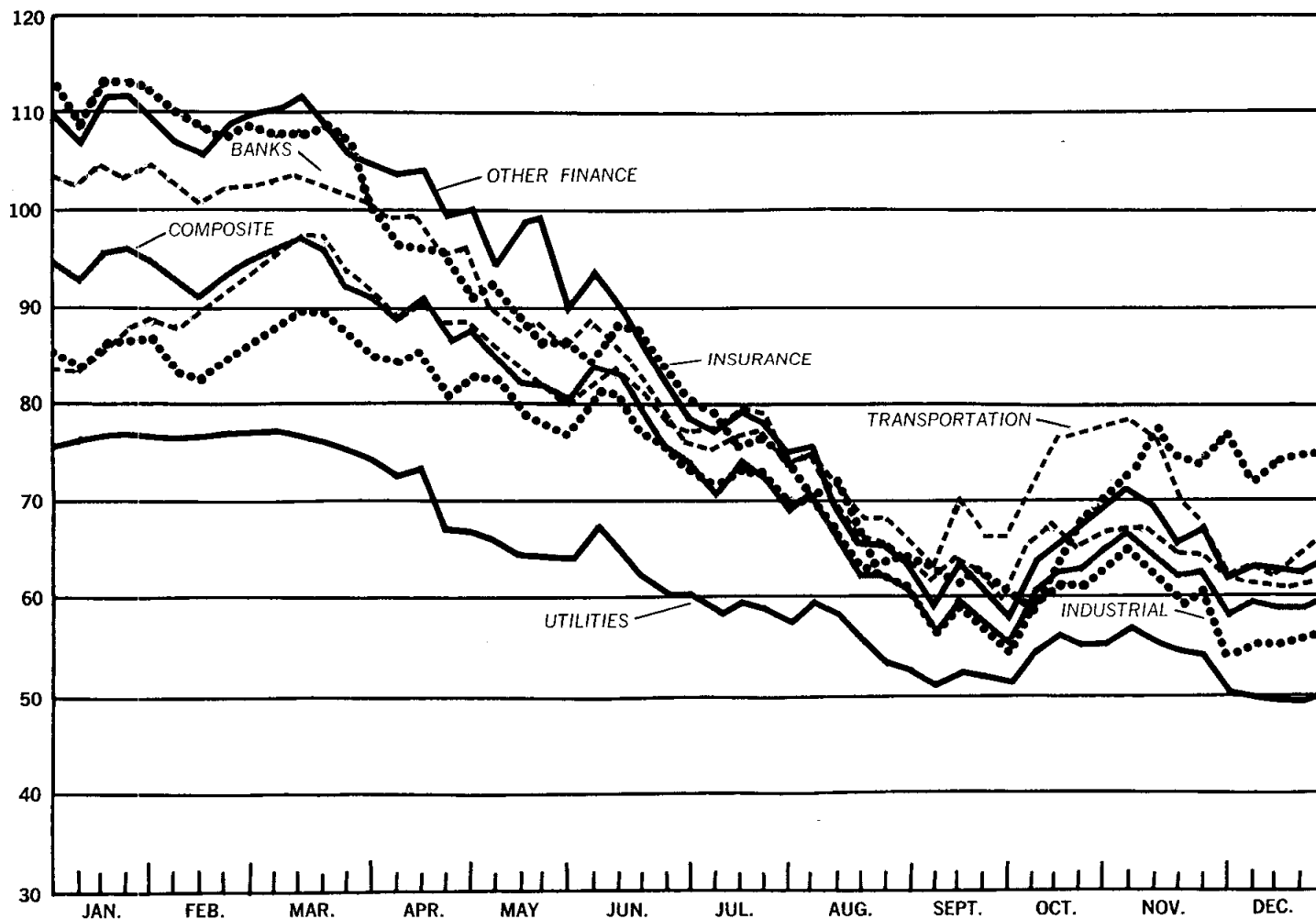
The Association's work toward elimination of duplication in rulemaking, enforcement and other regulatory activities is complemented by the programs of the NASD's Member Services Division. These programs include NASDAQ, the automated quotations network for the over-the-counter securities market, and a continuing communications effort aimed at members, investors and the NASDAQ issuer community.

NASDAQ

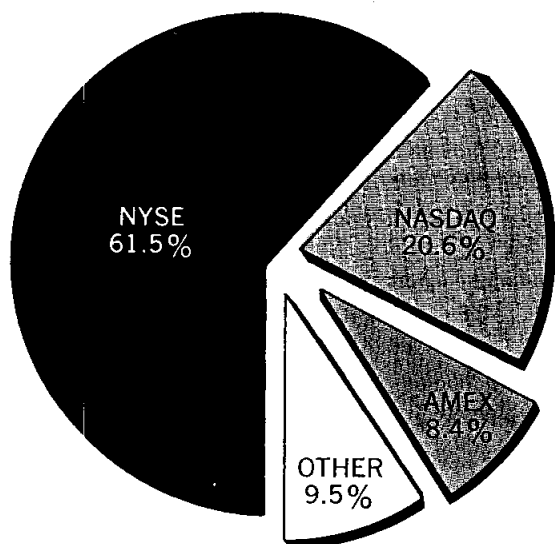
The NASDAQ market has not escaped the inactivity and depressed prices that have prevailed in

NASDAQ STOCK PRICE INDEXES
(WEEKLY CLOSING VALUES)
1974

INDEX: February 5, 1971 = 100



TRADING ACTIVITY ON NASDAQ AND EXCHANGES



1974 Share Volume

New York Stock Exchange	3,517,743,000
NASDAQ	1,179,723,000
American Stock Exchange	482,181,000
Other exchanges	541,880,000

all of the nation's securities markets. Yet the System continues to function well. Every business day, NASDAQ provides accurate and up-to-the-minute quotations and volume information on 2,600 securities throughout the nation. Further, representative quotations of NASDAQ securities are available worldwide through three foreign newswire services.

Share volume in NASDAQ securities in 1974 decreased 29 percent compared with 1973. Nevertheless, total NASDAQ shares traded during the year continued to be greater than the combined volume of all national exchanges other than the New York Stock Exchange.

Securities in the NASDAQ System at year end totalled 2,593 as contrasted to 2,932 at the end of 1973. Also, the number of NASDAQ market makers declined from 495 to 391, although the average of five market makers per security remained unchanged. Not surprisingly, the NASDAQ Composite Index showed a loss of 35 percent for the year, a figure substantially in line with indexes for other marketplaces.

Since System start-up, one of the cardinal rules governing companies' qualifications to enter and remain on NASDAQ has been a minimum share price

standard. Early in the year, however, it was found that companies were being forced off the System at an alarming rate because their markets were so depressed that they broke through the required price minimums. Many of these companies had substantial assets, good earnings and considerable investor interest. Because the securities markets were experiencing conditions never envisaged during the period that the criteria for qualifying securities were developed, the Board of Governors concluded that pricing standards were no longer appropriate and eliminated price altogether as a criterion for eligibility on the System. Procedures were then initiated to reinstate these companies and to bring in other qualified companies whose share prices are below \$1.00. At the same time, the monitoring procedures over financial and shareholder standards were strengthened by requiring companies to file directly with the NASD, at the same time they file with the SEC, their required quarterly and annual reports (Forms 10-Q and 10-K).

Another innovation stemming from the depressed state of the market was the extension of minimum NASDAQ trading hours by thirty minutes. The Board took this action in conjunction with the national securities exchanges as an expanded service to investors and in the belief that the additional time would give broker/dealers the opportunity to increase revenues.

Additional market summary information was made available on NASDAQ terminals in 1974. After the close of business each day, the terminal screen can now display the ten most active securities for that day, their volume and net change from the previous day. Also, the terminal will show throughout the day, when queried, the number of issues that have established new yearly highs or lows during that day. The System will continue to be enhanced so as to give the investment community a better grasp of current developments in the OTC marketplace.

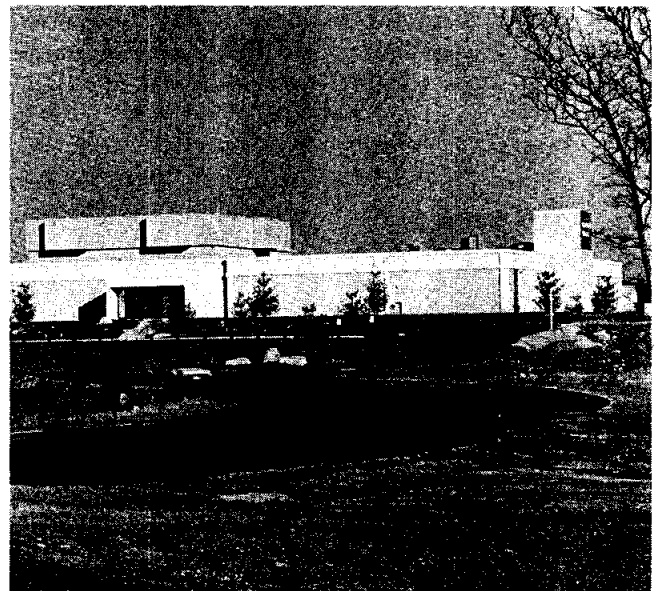
In September, the Board of Governors proposed to impose a new obligation on NASDAQ market makers. The proposal would require them to commit themselves to ninety days of continuous quotations when they register in a NASDAQ security. Should a market maker stop quoting a NASDAQ issue before the expiration of the ninety-day period, he would be prohibited from registering again in that issue for ninety days. Comments on the proposal have been received by the Association and a draft rule is currently being considered by the staff of the SEC.

Since it began operation in February 1971, NASDAQ has performed with a minimum of down time or technical problems. It has become the composite quotations system for the over-the-counter

market, with quotation lines running to NASDAQ units in the offices of virtually every major broker/dealer in the country. These units stand interconnected to a central computer by some 21,000 miles of leased telephone lines.

The NASD continues to monitor the service of the NASDAQ System Operator, Bunker Ramo Corporation, and to weigh the alternatives available to the NASD upon the expiration of the operating agreement in February 1976. Under the agreement either the Operator or the NASD has the right to terminate the arrangement by giving the other six months prior notice. Should either party elect to end the arrangement, the NASDAQ System would be transferred to the NASD for a sum equal to the Operator's undepreciated investment in the System plus the reasonable costs of the transfer. If neither party makes this election, the existing agreement continues on a year-to-year basis. Because of the potential for early termination by Bunker Ramo and the possible benefits to the membership should the Association initiate such action itself, both operating and financing alternatives to the present contract will be under consideration in 1975.

NASDAQ has brought to the OTC market increased visibility of current quotations, wider publication of market information, advanced market surveillance techniques, and greater public awareness and confidence. Because these benefits accrue to corporations with securities quoted on the System as well as to the broker/dealer community, the Board of Governors determined that NASDAQ issuers should share in the cost of regulating and maintaining the



NASDAQ Central Processing Complex in Trumbull, Connecticut, designed by Bunker Ramo Corporation.

NASDAQ System as well as participate in the development of NASDAQ policy.

Therefore, effective June 1, 1974, the Association adopted a schedule of fees to corporations for inclusion of their securities in NASDAQ. There is now an annual fee of $\frac{1}{2}\%$ of a cent per share for each issue, with a minimum of \$250 per issue up to a maximum to each issuer of \$2,500. When a security is admitted to the System, there is also an entry fee of $\frac{1}{2}\%$ of a cent per share for each issue, with a minimum of \$1,000 per issue up to a maximum to each issuer of \$5,000. To provide representation of the NASDAQ issuer community in the setting of policy, Roger H. Morley, Executive Vice President and Senior Financial Officer of American Express Company, has been elected as a member of the NASD Board of Governors. In addition, Eric W. Anderson, Vice President of Friendly Ice Cream Company and Douglas H. Curtis, Vice President (Finance), Franklin Electric Company, have been appointed by the NASD Board to serve in 1975 on the NASDAQ Committee, the committee charged with the primary responsibility for the overall administration of the NASDAQ System.

The computers, communication lines and terminals utilized in the NASDAQ System are readily adaptable to serve the industry's future needs in any number of ways; for example, by providing quotations on additional types of securities and by offering new kinds of services. It is the Association's expectation that NASDAQ's potential will be realized over the years ahead.





Corporate executives attending NASDAQ seminar in New York City on October 31, 1974. On the opposite page, the front cover of the NASD publication containing speakers' remarks and a compendium of questions and answers.

Seminars on NASDAQ

To inform management of companies whose securities are quoted on NASDAQ more fully of the operations of the NASDAQ market and the Association, the NASD sponsored a series of one-day seminar programs in the fall of 1974. Participation in the seminars, which were held in Chicago, New York City and Los Angeles, was limited to chief executive, chief operating and chief financial officers of NASDAQ companies.

The seminar program, titled "The NASDAQ Company and the NASDAQ Market", included a series of speeches by NASD officers and securities industry leaders covering both recent changes which had taken place in the nation's securities markets and those under study for the future. With particular emphasis on the OTC-NASDAQ market, the speakers discussed the reasons for the depressed securities markets, steps being taken to broaden ownership of NASDAQ securities and investment banking and market making in OTC securities.

SEC Commissioner A. A. Sommer, Jr. addressed the NASDAQ company executives at lunch on the topic of SEC corporate disclosure requirements. In

an afternoon panel discussion, representatives of national and regional underwriters discussed what an investment banker looks for in making an underwriting commitment and what an issuer should seek when selecting an underwriter. The last portion of the afternoon was devoted to workshops, which gave participants an opportunity to ask questions and join in informal discussions with experts on the subjects covered earlier in the day. Each corporate executive attending the seminar was able to meet with a representative of the NASD, a NASDAQ market maker and an expert on corporate finance.

More than three hundred fifty representatives of NASDAQ corporations attended the three seminars, which received a highly favorable response.

Dissemination of OTC Market Information

A major objective of the Association is to ensure that information on OTC activities is readily available to investors. To this end the Association continued efforts in 1974 to gain expanded coverage of NASDAQ and local OTC quotations. It also continued work toward convincing financial editors of

every major newspaper in the country that such NASDAQ market data as volume, indexes, most active stocks and advance-decline figures should be included as part of their market information.

As a basis for determining which securities ought to be carried in the newspaper space available, NASDAQ securities are ranked by dollar volume of shares traded. The first 1,410 constitute the National OTC-NASDAQ List and the next 990 the Additional OTC-NASDAQ List. Quotations and volume for securities on the National List are carried by more than fifty major newspapers throughout the country. Through the efforts of a network of over 135 local quotation committees, the Association selects securities with local investor interest for newspaper listing in various regions of the country. Over 225 newspapers now include listings of local stocks.

Under the auspices of the OTC Information Bureau, which is sponsored jointly by the NASD and the National Security Traders Association, NASDAQ volume and market indexes were supplied during the year to the three major radio networks for their daily broadcasts. Because not all affiliated stations are required to use the network news package, a pro-

gram was started during the year and is underway to determine which local radio stations are not picking up OTC financial data in their broadcasts with a view toward working for inclusion of this information. The carrying of OTC market data by network evening television newscasts is also an objective of the Bureau.

SYSTEMS AND ADMINISTRATION

Use of advanced technology offers the Association another path toward reducing costs and eliminating wasteful duplication of effort. The Systems and Administration Division is seeking more efficient records handling and information retrieval methods that can save members and the Association thousands of man-hours.

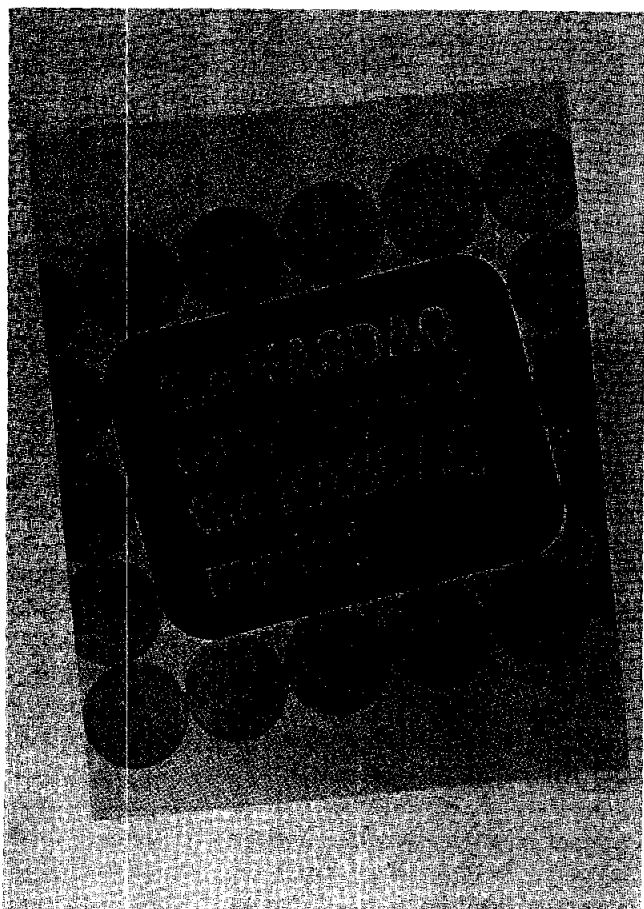
Automation Programs

The responsibilities of the Automation Programs Department are threefold: (1) analysis and design of NASDAQ enhancements and major developments; (2) review and monitoring of NASDAQ System performance including subscriber equipment; and (3) contractual and financial oversight of both the NASDAQ System operator, the Bunker Ramo Corporation, and the NASDAQ Level I distributors.

During the year the department completed contractual negotiations for the implementation and operation of a Third Market Trade Reporting System (TMTR) to enable OTC trades in securities listed on the national exchanges to be displayed on the new consolidated tape. The consolidated tape is the first step in the SEC's planned central market system. The TMTR system, which enables NASD members to report third market trades through their NASDAQ terminals, has been part of the Phase I test of the consolidated tape, which is expected to be fully operational sometime in 1975. Association staff participated in the TMTR system design and are overseeing its full implementation.

Preliminary research and analysis is being conducted on the feasibility of a Block Interest Display System as another possible major development for the NASDAQ System. Such a system would allow firms throughout the country to use their NASDAQ terminals to indicate their interest in buying or selling blocks of securities.

The department has also participated in a series of demonstrations to the SEC and members of the securities industry of potential ways the existing NASDAQ System could be expanded to handle a



composite quotations system for all exchange markets. These demonstrations, given in Trumbull, Connecticut and New York City, illustrate the technical flexibility of the computers and other equipment currently being used in the System.

EDP Services

During 1974, the NASD continued to develop and refine its computer systems designed to augment the Association's total regulatory capability. A report series designed to consolidate and organize various financial and operational data was recently developed as an adjunct to the Association's early-warning special surveillance program. The financial data, which are key to the operation of a broker/dealer, such as excess capital, inventory positions, fails positions, cash position, etc. are received from the National Clearing Corporation, the NASDAQ System, and various reports submitted by members. The consolidated report can be furnished to the Districts on an immediate basis when necessary. It is anticipated that reports of this type will be the core of the NASD/NCC surveillance program in the future.

In addition, the EDP Services Department, in cooperation with the Regulation Division, developed a system to assist in coordinating the field examination programs of various regulatory agencies in order to avoid duplication of effort through improved scheduling. As inspections are begun by the NASD, information regarding them is furnished to all state securities administrators and the SEC on a monthly basis by means of computer-produced reports. Data supplied to the SEC are integrated with similar information supplied by others and a composite tape is provided which is then supplied to each regulatory organization. The resulting report should help alleviate the burden to the membership of back-to-back examinations.

Other efforts during the year included: automating the scoring and score reporting of the Qualification Examination for General Securities Registered Representatives with the use of an optical reader; developing a Management Responsibility System for the control of Association cash disbursements; developing a system to invoice NASDAQ issuer fees; completing a pilot operation to automate the Association's membership and registration records; and refining of market surveillance reports for the detection and proof of manipulation.

Arbitration

1974 marked the first full year during which the Association's Code of Arbitration Procedure required the submission to arbitration of all controversies arising from the securities business of members

and persons associated with members. Thus, the program now encompasses both disputes arising from securities transactions and other controversies of a proprietary nature, such as employer-employee disputes, member corporate and partnership disputes and others arising between members. During 1974, over 200 disputes were submitted to arbitration.

The Association's arbitration program began six years ago and initially was administered on a voluntary basis restricted to transactional controversies. In March 1972, the submission of such disputes became mandatory upon the request of either party. Since the program began, over 300 disputes have been settled.

The present program permits submission of all aspects of a controversy before a single forum for resolution with a period for submission of disputes of up to five years. Members or persons associated with members who fail to arbitrate, to appear or produce documents at a hearing, or to honor an award of arbitrators may be subject to disciplinary action.

GOVERNMENT RELATIONS AND LEGAL MATTERS

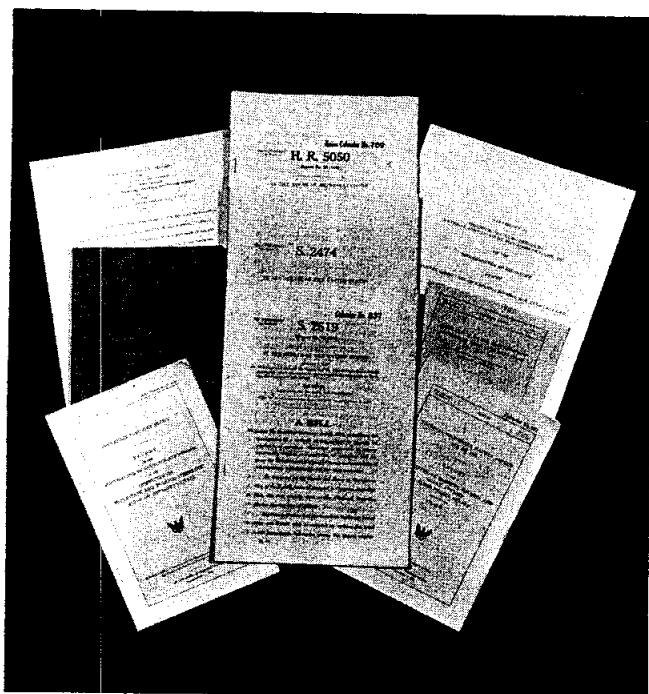
The Association's Office of General Counsel gives legal advice and assistance in connection with all activities of the Association including changes in Association rules, policies or interpretations. It assists in disciplinary proceedings involving members, handles any litigation involving the Association, and reviews proposed legislation which would affect the Association or its members.

Legislation—

U. S. House of Representatives

H. R. 5050, introduced by Congressman John E. Moss early in 1973, would have amended substantial portions of the Securities Exchange Act of 1934. While the Association indicated general support for the bill, reservations as to particular provisions were noted. These concerns were formally expressed in testimony before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce. The Subcommittee subsequently reported a revised version of the bill which the full Committee approved in October 1974.

As originally drafted, the bill would have required that at least one-half of the Association's Board of Governors be comprised of persons not associated



with NASD members who would represent issuers and the public in general. Although requiring the inclusion of "public representatives" on its Board, the revised version of the bill eliminated the specific numerical requirement.

The revised bill also eliminated language which would have required that every Association disciplinary action be sent to all members and published in a manner designed to reach the investing public. The Association in its earlier testimony had expressed concern that publication of all disciplinary actions, irrespective of how minor the penalty, could be misleading to the public and unfairly prejudicial to members. The revised bill required that Association disciplinary actions be "publicly noticed" in accordance with procedures adopted by the SEC.

While the original language empowering the SEC to seek court injunctions against violations of the Association's rules was not eliminated, the revised bill contained additional language which required the Commission, in most cases, first to notify the Association of alleged violations and give it an opportunity to take action on its own.

Furthermore, the revised bill eliminated language which would have given the SEC authority to initiate disciplinary action directly against members for violations of Association rules.

However, the revised bill left basically unchanged the proposals for new procedures concerning the alteration or amendment of Association rules by the SEC, new procedures governing the manner in

which the Association adopts its rules, and additional authority for the SEC to establish qualification standards for persons associated with NASD members. The Association in its earlier testimony had expressed reservations about these proposals.

The revised bill also contained new provisions dealing with the development of a national securities market system. The revised bill proposed that the SEC be given broad rulemaking authority to perfect a national market system and directed it to study the need for a National Market Board to administer the system.

Although H. R. 5050 failed to reach the floor of the House of Representatives in 1974, a bill with substantially the same provisions as the revised version is considered certain to be introduced in the 94th Congress.

Legislation—U. S. Senate

S. 2519, introduced by Senator Harrison A. Williams and passed by the Senate in 1974, would have facilitated the development of a national market system. The Association expressed its general support of the bill in testimony before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs.

Another bill introduced by Senator Williams, S. 2474, provided for the regulation of the municipal securities activities of banks and broker/dealers. The Association supported the provisions of the bill which would have required registration with the SEC of municipal bond departments of banks and broker/dealers engaged exclusively in the sale of municipal securities. The Association expressed concern, however, as to those provisions which would have authorized the establishment of a national association of municipal securities dealers having self-regulatory powers. It was noted that such an organization might duplicate already effective self-regulatory efforts and would place additional financial burdens on the industry.

A revised version of S. 2474 was introduced by Senator Williams and passed by the Senate in 1974. The revised bill provided for the establishment of a Municipal Securities Rulemaking Board having authority to adopt rules, subject to SEC approval, governing transactions in municipal securities. The responsibility for enforcing the rules of the Board would rest with the Association as to its members, the SEC as to nonmember broker/dealers, and existing bank regulatory authorities as to banks.

Although neither S. 2519 nor S. 2474 became law, their provisions were largely incorporated into a new bill expected to be introduced in the 94th Congress.

Litigation

In December 1973, the U. S. District Court for the District of Columbia dismissed a complaint brought by the Justice Department as well as two other complaints brought by private parties alleging that the Association and other defendants, primarily mutual fund underwriters, had engaged in a conspiracy to violate the antitrust laws by preventing mutual fund shares from being bought or sold at other than the public offering price. In May 1974, the Justice Department appealed the District Court's ruling directly to the United States Supreme Court, and the Association and other defendants filed motions to affirm the District Court's dismissal. In October 1974, the Supreme Court noted probable jurisdiction and agreed to consider the appeal by the Justice Department, at which time the two private proceedings, which had been appealed to the U. S. Court of Appeals for the District of Columbia, were stayed. A number of additional private proceedings in the initial stages of litigation, which allege substantially similar antitrust violations, have also been stayed. It is anticipated that the Supreme Court will hear oral argument on the Justice Department's appeal in early 1975.

In October 1973, the U. S. District Court for the Northern District of Texas directed a verdict in favor of the Association in a proceeding brought by a member alleging injury as a result of the decision by the Association to initially preclude third market securities from inclusion in the NASDAQ System. The plaintiff also alleged that the composition of the Association's Board of Governors unfairly discriminates against non-exchange members. The plaintiff appealed the District Court's decision in favor of the Association to the U. S. Court of Appeals for the Fifth Circuit, which has heard oral argument but has not as yet rendered a decision.

A final disposition occurred in a proceeding brought in 1966 by certain mutual fund shareholders which alleged that the Association's interpretation respecting mutual fund withdrawal and reinstatement privileges was violative of the antitrust laws and an unlawful interference with the performance of contracts. In June 1974, the District Court for the Western District of Texas issued a final judgment approving a stipulation and settlement entered into by all parties which barred further action as to the claims alleged and released the Association from any liability in connection therewith.

The Association is also named, with others, in a number of other proceedings in which damages are sought. The claims relate primarily to the Association's responsibilities in the area of enforcement of

its own rules. These matters are in various stages of litigation.

NATIONAL CLEARING CORPORATION

National Clearing Corporation (NCC), the NASD's wholly-owned subsidiary for the clearance and settlement of over-the-counter transactions, continued to expand its services to the industry during 1974. NCC provides services to approximately 300 member firms through its clearing facilities located in Atlanta, Boston, Chicago, Dallas, Milwaukee, Minneapolis, New York, Philadelphia, St. Louis and Washington, D. C. Utilizing the continuous net settlement (CNS) method, member firms report and settle transactions directly with the Clearing Corporation rather than with the contra firm to the trade. In addition to simplifying broker/dealer accounting, this method reduces physical delivery requirements by about 65 per cent over trade-for-trade settlement.

The interface with the Depository Trust Company (DTC), which facilitates bookkeeping movements and reduces physical delivery requirements, became fully operational by the end of 1974. This interface, utilizing bookkeeping entries, allows for: both automatic and manual deposit of shares from a member's free position at NCC to its general unpledged account at DTC; the automatic or manual coverage of a member's short position at NCC from his account at DTC; and the free or valued delivery of securities between members of both organizations. At year end, this interface was being used by 143 dual members and 110 sole members of NCC or DTC.

During October, an interface clearing operation was implemented with the Pacific Clearing Corporation (PCC), the clearing facility for the Pacific Stock Exchange. A pilot operation was started with seventeen firms, and before the year was over, it was made available to the total membership of both NCC and PCC. The interface provides a mechanism for the comparison and settlement of over-the-counter securities transactions between PCC and NCC members. Sole members of PCC settle their transactions directly with PCC, while sole members of NCC settle directly with NCC. Firms who are members of both clearing corporations have the option, on a trade-by-trade basis, to settle in either system. The interfaces with the Depository Trust Company and the Pacific Clearing Corporation, in addition to being significant expansions of NCC's services, are also major steps toward the industry goal of certificate immobilization.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
STATEMENTS OF FINANCIAL POSITION

	Year ended September 30	
	1974	1973
Current assets		
Cash	\$ 232,408	\$ 237,909
Investment securities at cost (approximate market value \$6,333,000 and \$5,216,000 respectively)	6,493,209	5,371,524
Loan to National Clearing Corporation (Note 2)	100,000	
Other current assets	320,939	201,563
Total current assets	7,146,556	5,810,996
Less: Current liabilities		
Accounts payable and accrued expenses	736,681	859,554
Assessments and other income collected in advance (Note 1)	37,390	5,044
Prepaid NASDAQ fees (Note 1)	1,395,773	
Current portion of mortgage payable (Note 3)	89,331	84,561
Total current liabilities	2,259,175	949,159
Working capital	4,887,381	4,861,837
Land, building and improvements, at cost		
less accumulated depreciation of \$247,828 and \$179,388 (Notes 1 and 3)	3,185,299	3,213,458
Investment in wholly-owned subsidiary,		
National Clearing Corporation, at equity in net assets (Note 1)	792,126	1,486,949
Special investment account, at lower of cost or market (Note 1)	150,745	207,592
Other assets	130,039	135,916
	9,145,590	9,905,752
Less: Long-term liabilities		
Reserve for deferred compensation	150,745	207,592
Mortgage payable (Note 3)	1,234,401	1,323,732
	1,385,146	1,531,324
Association equity (Notes 4 and 5)	\$7,760,444	\$8,374,428

**Note 1—Summary of Significant Accounting Policies
Investment in National Clearing Corporation (NCC)**

The Association's investment in NCC is recorded at its equity in the net assets of NCC and accordingly is adjusted for the net income or loss of NCC. The opinion of independent accountants on the September 30, 1974 and 1973 financial statements of NCC is included elsewhere in this report.

Retirement Benefits and Deferred Compensation

The Association maintains a non-contributory trustees pension plan for the benefit of all eligible employees. Certain employees have been granted extended retirement and death benefits. It is the Association's policy to fund pension cost and provide for the cost of other benefits as they accrue. Pension and deferred compensation costs were \$270,601 and \$235,735 for the years ended September 30, 1974 and 1973, respectively.

The Special Investment Account represents amounts set aside to fund the reserve for deferred compensation which relates to five former or current employees.

Depreciation

Building and improvements are being depreciated on a straight-line basis over lives of 38 and 10 years respectively. Depreciation expense in fiscal 1974 and 1973 aggregated \$68,440 and \$66,810, respectively.

Purchases of office furniture and equipment are treated as an expense in the year acquired.

Prepaid Fees and Assessments and Other Income Collected in Advance

Prepaid fees, assessments and other income collected in advance are deferred and included in income of the applicable fiscal year.

A new annual fee was established for NASDAQ issuers in 1974 and payments for this fee were received for the period June 1, 1974 to May 31, 1975. Accordingly, that portion of the amounts collected representing advance payments for the period subsequent to September 30, 1974 has been deferred and will be included in the income of the following year.

Note 2—Loan Receivable from NCC

The Board of Governors has authorized the Association to loan NCC up to \$500,000. As of September 30, 1974 \$100,000 has been loaned with interest at 1% over prime. The loan was repaid in January, 1975.

Note 3—Mortgage Payable

The Association's land and building are pledged as security for a 5½% mortgage. The mortgage loan of \$1,323,732 at September 30, 1974 is payable through 1985 in equal monthly installments of principal and interest of \$13,326.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
STATEMENTS OF INCOME, EXPENSES AND ASSOCIATION EQUITY

	Year ended September 30	
	1974	1973
Income		
Member assessments and branch office fees	\$6,425,615	\$6,277,177
Registered representatives fees		
Applications	1,916,111	2,400,803
Examinations	1,233,738	1,666,123
Corporate finance fees	881,357	1,331,872
Fines and costs	468,692	471,910
Interest and other income	564,143	487,493
NASDAQ fee (Note 1)	712,110	
	<u>12,201,766</u>	<u>12,635,378</u>
Expenses		
Salaries and employee benefits (Note 1)	8,568,845	8,186,212
Travel, meetings & investigation expenses	889,677	1,154,382
Publication, stationery & postage, net of publications sales of \$48,863 in 1974 and of \$109,399 in 1973	561,353	580,458
Professional and other services	737,433	845,129
Occupancy expenses	918,237	837,443
Office, insurance & miscellaneous	403,215	575,414
Furniture and equipment	42,167	110,853
	<u>12,120,927</u>	<u>12,289,891</u>
Excess of income over expenses before National Clearing Corporation	80,839	345,487
Net loss of National Clearing Corporation (Note 1)	<u>(694,823)</u>	<u>(308,105)</u>
Excess of income or (expenses)	(613,984)	37,382
Association equity, beginning of year	8,374,428	8,337,046
Association equity, end of year	<u>\$7,760,444</u>	<u>\$8,374,428</u>

Note 4—Commitments and Contingencies

The NASDAQ quotation system commenced service on February 8, 1971. By agreement, Bunker Ramo Corporation was established as the operator of the NASDAQ system. In the event such agreement is terminated at either the request of Bunker Ramo or NASD, the Association is committed to reimburse the operator for its undepreciated investment in the NASDAQ system. It is estimated that the undepreciated investment of \$16,100,000 as of September 30, 1974 will decrease to approximately \$10,000,000 on February 8, 1976, the expiration date of the original agreement. Aside from expenses incurred in the supervision of system activities, the accompanying financial statements do not include any amounts relating to the construction or operation of the NASDAQ system.

Additionally, the Association has entered into a contractual agreement to pay Bunker Ramo Corporation a maximum of \$336,000 over a two year period beginning in 1975 for modifications to the NASDAQ system to permit third market transaction reporting for the consolidated tape under SEC Rule 17(a)(15). This amount is expected to be recovered in future years by charges to firms reporting through the modified system.

In connection with the operation of its district offices, the Association leases office space in various

locations. Rental expense for 1974 and 1973 was \$675,832 and \$643,885, respectively. Minimum annual lease payments for the five succeeding fiscal years are as follows: \$560,000—1975, \$486,000—1976, \$377,000—1977, \$334,000—1978, \$292,000—1979. For the succeeding two year period an aggregate amount of \$147,000 is obligated. No leases extend beyond 1981. The majority of these leases contain escalation clauses providing for increases in the lease payments based on increases in property taxes and building operation costs.

The Pension Reform Act of 1974 will require certain amendments to the pension plan concerning earlier participation and vesting. This is expected to provide some increase, that is not presently determinable, in the annual cost of the plan in years after 1975.

Note 5—Litigation

The Association has been named, separately or with others, in several legal actions in which damages of substantial or as yet unspecified amounts are claimed. Certain of these actions allege violations of the antitrust laws or the failure of the Association to take appropriate action in the exercise of its regulatory responsibility. Counsel for the Association advises that, although the Association has meritorious defenses to all the pending litigation, the outcome of the litigation cannot be predicted.

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
STATEMENTS OF CHANGES IN FINANCIAL POSITION**

	Year ended September 30	
	1974	1973
Financial resources were provided by		
Excess of income or (expenses)	\$ (613,984)	\$ 37,382
Items not affecting working capital in the period		
Net loss of National Clearing Corporation	694,823	308,105
Depreciation	68,440	66,810
Decrease in other assets	5,877	
	155,156	412,297
Financial resources were used for		
Purchase of building improvements	40,281	49,577
Decrease in long-term mortgage	89,331	84,560
Increase in other assets		48,341
	129,612	182,478
Increase in working capital	\$ 25,544	\$ 229,819
Analysis of Changes in Working Capital		
Increase (decrease) in current assets		
Cash	\$ (5,501)	\$ 72,539
Investment securities	1,121,685	210,219
Loan to National Clearing Corporation	100,000	
Other current assets	119,376	57,992
	1,335,560	340,750
Decrease (increase) in current liabilities		
Accounts payable and accrued expenses	122,873	(107,944)
Assessments collected in advance	(32,346)	1,528
Prepaid NASDAQ fees	(1,395,773)	
Current portion of mortgage payable	(4,770)	(4,515)
	(1,310,016)	(110,931)
Increase in working capital	\$ 25,544	\$ 229,819

The Board of Governors of the National Association of Securities Dealers, Inc. has examined the financial statements of the National Association of Securities Dealers, Inc. for the years ended September 30, 1974 and 1973, and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles. The financial statements were prepared by the National Association of Securities Dealers, Inc. and the results of its operations are subject to the ultimate review of the financial statements prepared by the National Association of Securities Dealers, Inc. for the years ended September 30, 1974 and 1973, and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles.

PRICE WATERHOUSE & CO.

Washington, D.C.
March 11, 1975

NATIONAL CLEARING CORPORATION

BALANCE SHEETS

September 30, 1974 and 1973

Assets	1974	1973
Current assets:		
Cash	\$ 215,230	\$ 34,352
Accounts receivable, net of estimated uncollectable amounts of \$223,350 in 1974 and \$265,000 in 1973 (note 3)	673,581	5,756,632
Accrued interest receivable	83,522	67,944
Other current assets	97,876	129,049
Total current assets	<u>1,070,209</u>	<u>5,987,977</u>
Furniture, equipment and leasehold improvements, at cost (notes 4 and 9)	987,111	1,028,557
Less accumulated depreciation and amortization	261,854	155,680
	<u>725,257</u>	<u>872,877</u>
Deferred computer software costs, less accumulated amortization of \$580,937 in 1974 and \$366,437 in 1973 (note 9)	491,600	706,100
	<u>11,335,000</u>	<u>13,456,000</u>
Clearing fund assets (note 5)	<u>\$13,622,066</u>	<u>\$21,022,954</u>
Liabilities and Stockholder's Equity		
Current liabilities:		
Loan payable to NASD (note 2)	\$ 100,000	\$ —
8½% subordinated promissory notes due 1975	822,682	—
Drafts issued to members	—	4,889,939
Accounts payable and accrued expenses	561,562	353,986
Payroll taxes accrued and withheld	10,696	13,398
Total current liabilities	<u>1,494,940</u>	<u>5,257,323</u>
8½% subordinated promissory notes due 1975	—	822,682
Clearing fund (note 5)	<u>11,335,000</u>	<u>13,456,000</u>
Stockholder's equity:		
Common stock, par value \$1; 10,000 shares authorized; 100 shares issued and outstanding	100	100
Additional paid-in capital	2,009,900	2,009,900
Deficit	(1,217,874)	(523,051)
Total stockholder's equity	<u>792,126</u>	<u>1,486,949</u>
Commitments and contingent liabilities (notes 8 and 9)		
	<u>\$13,622,066</u>	<u>\$21,022,954</u>

See accompanying notes to financial statements.

**Notes to Financial Statements
September 30, 1974 and 1973**

(1) Summary of Significant Accounting Policies

(a) Depreciation and Amortization

Depreciation of furniture and equipment is provided on the straight-line basis, generally over ten years. Leasehold improvements are amortized on a straight-line basis over the terms of the respective leases.

(b) Computer Software Costs

Computer software development costs incurred from inception in 1970 through January 15, 1972, are being amortized on a straight-line basis over sixty months.

(c) Pension Plan

Pension expense consists of current service costs pursuant to the Corporation's defined contribution pension plan. Pension benefits are limited to the assets of the pension fund. The Corporation's policy is to fund annually pension costs accrued (see note 7).

(d) Estimated Uncollectable Accounts

The estimate of uncollectable accounts is based on losses expected from the close out of clearing members' pending settlement positions once the Corporation ceases to act for such members pursuant to its Operating Rules.

(2) Transactions with Parent

National Clearing Corporation is a wholly-owned, not-for-profit subsidiary of the National Association of Securities Dealers, Inc. (NASD) formed for the purpose of establishing a nationwide clearing system for over-the-counter transactions in securities. The NASD billed to the Corporation \$280,039 in 1974 and \$178,290 in 1973 for expenses incurred on behalf of the Corpo-

ration. The Corporation billed to the NASD \$242,204 in 1974 and \$125,165 in 1973 for expenses incurred on behalf of the NASD.

The Corporation has outstanding a \$100,000 subordinated promissory note payable to the NASD on January 1, 1976. Interest, payable semi-annually, is adjusted monthly to reflect 1% above the prime interest rate of the Chemical Bank of New York, (effective rate of 13% at September 30, 1974). On December 18, 1974, the Board of Directors of the Corporation voted to prepay the entire balance plus accrued interest. The loan was paid on January 31, 1975.

In addition, the Corporation has available from the NASD an unused line of credit of \$400,000 at September 30, 1974.

(3) Accounts Receivable

Accounts receivable in 1974 and 1973 include \$798,733 and \$5,888,072, respectively, due from members. In 1973 \$5,263,069 was collectable from members upon their receipt from the Corporation of certain securities in the Corporation's possession or in the process of transfer and therefore under the Corporation's control at September 30, 1973. With the addition of a bookkeeping settlement capability via the implementation of the Corporation's Free Account Net Settlement System (FANS), the need to temporarily finance certain securities in NCC's possession has been eliminated, thereby reducing the amount of outstanding accounts receivable at September 30, 1974.

(4) Furniture, Equipment and Leasehold Improvements

A summary of furniture, equipment and leasehold improvements follows:

	Cost at September 30,	
	1974	1973
Furniture and equipment	\$434,290	\$ 449,831
Leasehold improvements	552,821	578,726
	<u>\$987,111</u>	<u>\$1,028,557</u>

NATIONAL CLEARING CORPORATION
STATEMENTS OF LOSS AND DEFICIT
Years ended September 30, 1974 and 1973

	<u>1974</u>	<u>1973</u>
Revenue (note 9):		
Clearing services	\$ 8,116,461	\$8,291,866
Investment income	567,099	312,785
Other income	68,649	—
Net revenue	<u>8,752,209</u>	<u>8,604,651</u>
Expenses (note 9):		
Employee compensation, benefits, and related expenses	4,719,238	4,588,582
Travel and expenses incurred by employees	543,158	442,986
Data processing	1,331,340	1,268,641
Occupancy	884,865	776,566
Stationery, printing and supplies	536,182	460,453
Communications	472,627	347,508
Depreciation and amortization	354,659	324,788
Provision for uncollectable accounts	—	235,000
Interest expense	80,740	168,991
Clearance and service charges	221,452	143,896
Insurance and taxes	126,948	120,367
Professional services	172,485	118,908
Other expenses	3,338	36,556
Total expenses	<u>9,447,032</u>	<u>9,033,242</u>
Loss	<u>(694,823)</u>	<u>(428,591)</u>
Reversal of taxes on income (note 6)	—	120,486
Net loss	<u>(694,823)</u>	<u>(308,105)</u>
Deficit at beginning of year	<u>(523,051)</u>	<u>(214,946)</u>
Deficit at end of year	<u>\$ (1,217,874)</u>	<u>\$ (523,051)</u>

See accompanying notes to financial statements.

Notes to Financial Statements, Continued

(5) Clearing Fund

The Corporation requires from each member a deposit to a clearing fund before participation in clearing is allowed. The clearing fund at September 30, 1974 and 1973 is as follows:

	<u>1974</u>	<u>1973</u>
Cash	\$ 394,913	\$ 299,656
Investments—U.S. Government guaranteed obligations at cost (market value, \$3,871,000 in 1974 and \$5,357,000 in 1973)	3,900,000	5,397,344
Amounts receivable on demand, secured by U.S. Government, state and municipal obligations, which have a market value of \$12,825,000 in 1974 and \$11,480,000 in 1973	7,040,087	7,759,000
Total clearing fund	<u>\$11,335,000</u>	<u>\$13,456,000</u>

(6) Income Taxes

The reversal of taxes in 1973 consists of the recovery of Federal income taxes resulting from the carryback to 1970 of the 1973 net operating loss and the carryback of \$18,000 of investment tax credit to 1969.

At September 30, 1974, the Corporation has approximately \$1,082,000 of loss carryforward available to offset taxable income in future periods for Federal income tax and financial statement purposes. This loss carryforward expires as to \$174,000, \$52,000, \$144,000 and \$712,000 in 1975, 1976, 1978 and 1979, respectively. Also available at September 30, 1974 are investment tax credits of \$12,000, \$20,000, and \$83,000 expiring in 1979, 1980 and 1981, respectively, however, it is anticipated that virtually all of the investment tax credit carryforward will be eliminated in fiscal 1975 as a result of the service agreement with Bradford Computer and Systems, Inc. (see note 9).

(7) Pension Plan

All employees who have attained either age twenty-five and completed three full years of constructive employment or attained age forty are eligible to participate in the NASD/NCC retirement plan. Such plan is a trustee plan with defined contributions fully paid by the Corporation. Ultimate pension benefits are limited to the assets of the pension fund held by the trustee.

Pension expense was \$14,322 in 1974 and \$32,000 in 1973. The Pension Reform Act of 1974 will require certain amendments to the pension plan concerning earlier participation and vesting. This is expected to provide some increase, that is not presently determinable, in the annual cost of the plan in years after 1975.

(8) Contingent Liabilities and Lease Commitments

(a) The Corporation is a defendant, together with the New York Stock Exchange, Stock Clearing Corporation, the American Stock Exchange and American Stock Exchange Clearing Corporation, in a legal action initiated in 1966 by a former clearing member. The action seeks judgment of \$3,000,000 against all defendants for allegedly destroying the plaintiff's business by reason of suspensions and other actions. The Corporation is also named as a defendant, among others, in a complaint initiated pro se in October 1974 by a broker/dealer. The action seeks judgment of \$2,000,000 against the Corporation. On February 22, 1975 the United States District

Court for the Southern District of New York dismissed the complaint with prejudice and on February 28, 1975 also dismissed plaintiff's Motion for Reargument. Counsel has advised that it believes the Corporation to have meritorious defenses in both actions.

(b) The Corporation occupies certain office facilities under lease agreements expiring in 1979 (see note 9). A summary of rent expense follows:

	<u>Expense at September 30</u>	
	<u>1974</u>	<u>1973</u>
Rental expense	\$690,934	\$676,502
Less sublease income	(32,170)	(6,070)
	<u>\$658,764</u>	<u>\$670,432</u>

Annual rentals pursuant to non-cancellable lease commitments are summarized as follows:

1975	\$47,232
1976	47,232
1977	47,232
1978	47,232
1979	27,552

(9) Subsequent Events

On October 1, 1974, the Corporation entered into a service agreement with Bradford Computer and Systems, Inc. ("Bradford") whereby Bradford has agreed to provide the necessary facilities, personnel, and services in support of the Corporation's clearing services and related functions.

Pursuant to the terms of such agreement, Bradford is committed to:

1. Sublease or reimburse the Corporation for rental facilities in the regions and space used by Bradford in the New York Office.
2. Reimburse the Corporation for the amortization of software costs and certain leasehold improvements, furniture and equipment.
3. Maintain insurance coverage in an amount and type required by the Corporation.
4. Sublease or reimburse the Corporation for full costs incurred for leasing existing computer and other equipment.
5. Reimburse the Corporation for materials and supplies of \$61,509 which is included in other current assets in the accompanying balance sheet at September 30, 1974.

Bradford's management fee under the agreement is stipulated at a certain percentage of the monthly revenue (ranging from 80% to 84% at varying revenue levels) with the balance retained by the Corporation; however, the Corporation's minimum monthly share will not be less than \$70,000. In addition, the agreement states that funds used in clearing operations after October 1, 1974 are to be maintained in a demand deposit account for the Corporation by Bradford. Any investment income to be derived from such deposits and the invested cash portion of members' clearing fund deposits will inure to the benefit of Bradford.

The aforementioned service agreement is for a period of five years and may be terminated by the Corporation between October 1, 1974 and September 30, 1976 upon payment of \$250,000 and between October 1, 1976 and September 1, 1977 upon payment of \$125,000. After October 1, 1977, no payment is required to terminate the agreement.

NATIONAL CLEARING CORPORATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION
Years ended September 30, 1974 and 1973

	<u>1974</u>	<u>1973</u>
Sources of working capital:		
Loss	\$ —	\$ (308,105)
Items not requiring outlay of working capital—depreciation and amortization	—	324,788
Working capital provided by operations	—	16,683
Proceeds from disposal of furniture and equipment	22,644	3,370
Total sources of working capital	<u>22,644</u>	<u>20,053</u>
Uses of working capital:		
Loss	694,823	—
Items not requiring outlay of working capital:		
Depreciation and amortization	(354,659)	—
Write-off of leasehold improvements	(24,112)	—
Loss on sale of furniture and equipment	(27,405)	—
Working capital used by operations	288,647	—
Reduction of long-term debt	822,682	—
Purchase of furniture, equipment and leasehold improvements	66,700	490,821
Total uses of working capital	<u>1,178,029</u>	<u>490,821</u>
Decrease in working capital	<u>\$ 1,155,385</u>	<u>\$ 470,768</u>
Changes in working capital:		
Current assets—increase (decrease):		
Cash	\$ 180,878	\$ 8,525
Accounts receivable	(5,083,051)	1,489,851
Accrued interest receivable	15,578	(6,663)
Other current assets	(31,173)	14,338
	<u>(4,917,768)</u>	<u>1,506,051</u>
Current liabilities—increase (decrease):		
Loan payable to NASD	100,000	—
8½% subordinated promissory notes due 1975	822,682	—
Drafts issued to members	(4,889,939)	1,955,790
Accounts payable and accrued expenses	207,576	108,565
Payroll taxes accrued and withheld	(2,702)	(36,668)
State and local income taxes payable	—	(50,868)
	<u>(3,762,383)</u>	<u>1,976,819</u>
Decrease in working capital	<u>\$ 1,155,385</u>	<u>\$ 470,768</u>

See accompanying notes to financial statements.

The Board of Directors
National Clearing Corporation:

We have examined the balance sheets of National Clearing Corporation (a wholly-owned subsidiary of the National Association of Securities Dealers, Inc.) as of September 30, 1974 and 1973 and the related statements of loss and deficit and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The Corporation is currently defendant in two lawsuits as described in note 8; the final outcome of these suits is not presently determinable and no provision has been made in the financial statements for the effect, if any, of such litigation.

In our opinion, subject to the effect of the resolution of the matter referred to in the preceding paragraph, the aforementioned financial statements present fairly the financial position of National Clearing Corporation at September 30, 1974 and 1973 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Washington, D.C.
February 28, 1975

Peat, Marwick, Mitchell & Co.