

## Chairman's Report

Future historians of the U.S. securities industry may conclude that in 1976 significant progress was made toward a National (or Central) Market System. If they so conclude, they are likely to acknowledge that the NASD was one of the major contributors to such progress.

### **The Discussion Paper**

The Association's April 1976 *Discussion Paper on Three Issues in the Development of a Central Securities Market System* answered a November 1975 request for ideas from the National Market Advisory Board, established by the SEC pursuant to the Congressional mandate of the Securities Acts Amendments of 1975. The *Discussion Paper* focussed on three areas—regulation, trading facilities and clearing—in which the Association has expertise.

The Paper dealt with: (1) the concept of a sole self-regulator of the securities industry (2) the potential uses of NASDAQ facilities in a Central Market System, and (3) clearing in a Central Market environment.

The *Discussion Paper* reported that the NASD Board of Governors considered a sole self-regulator for the securities industry to be feasible, viable and desirable. It would provide optimum regulatory effectiveness and produce major cost savings. However, the Paper said, industry politics could delay implementation of the concept.

The Paper went on to illustrate three hypothetical services which NASDAQ could provide to a Central Market System: a Consolidated Quotations Service, an automatic execution capability, and a single, consolidated public book maintained by the System. The principal purpose of these illustrations was to show that the adaptation of existing facilities to the requirements of the Central Market System was possible and the most economical way to proceed.

With regard to clearing, the *Discussion Paper* advocated a single national clearance and settlement system. Such a system would be the best way to remove the cost of clearing from having an effect on order execution.

In conclusion, the Paper said: "The Board of Governors of the NASD is unanimous in its belief that any restructuring of the securities industry should recognize the many excellent facilities already in place and should use these assets to the maximum extent possible."

### **The Consolidated Quotations Service (CQS)**

In one such use of existing assets, the Association added to NASDAQ the Consolidated Quotations Service (CQS), which will become operational

in January 1977. CQS will show, on adapted NASDAQ terminals, quotations on all New York Stock Exchange listed stocks which are released by participating exchanges and Third Market makers. The service will thus allow subscribers to see at a glance various markets in the country for NYSE listed securities.

CQS will be an important step, after the Consolidated Tape, toward the Central Market. The SEC's 1973 *Policy Statement on the Structure of a Central Market System* described such a service as being essential to a National Market System, and for fostering effective competition among markets.

### **Clearing Consolidation**

In a second implementation of what the *Discussion Paper* had recommended, the Association in 1976 went forward on the consolidation of its National Clearing Corporation with the clearing corporations of the New York and American stock exchanges. The consolidated entity, the National Securities Clearing Corporation, will be operational in 1977 and will handle the clearance and settlement of OTC and listed securities. It will thus be a major step toward a single national clearing system.

### **Regulatory Responsibility**

As the *Discussion Paper* noted, the assignment of regulatory responsibility is an especially difficult issue in the development of a Central Market System. The SEC in 1976 addressed the issue by promulgating Rule 17d-2, which required the self-regulatory organizations to furnish plans to the Commission, allocating among themselves regulatory responsibilities with respect to members which they have in common.

In testifying at SEC hearings on Rule 17d-2, the Association declared that the concept of a sole self-regulator continued to be the most appropriate solution for eliminating regulatory unevenness and duplication. However, the Association said the long-term goal of a sole self-regulator could not be achieved in a single step. For an interim phase consistent with the ultimate objective, the Association declared itself ready to assume—in addition to its present obligations to its sole members and to those exchange firms already designated to it—inspection and examining responsibility for all NASD/exchange members, other than NASD/NYSE members in the New York City area. With respect to these NASD/NYSE members, the Association proposed to continue its joint inspection with the NYSE and to retain responsibility for the regulation of their over-the-counter and municipal

securities business. The Association also proposed to provide central record-keeping services for the entire securities industry.

The Association and other self-regulators must file their plans for the allocation of responsibility with the SEC by March 15, 1977. Hopefully, the plans and the SEC response to them will lead to greater effectiveness and economy in regulation.

### **The National Market Association**

Consistent with its commitment to a Central Market System, the NASD in late 1976 joined with the exchanges in the National Market Association. This voluntary industry group proposed a better linkage of the various market centers, and has much more to do in the coming year. The NASD should find the National Market Association a good forum for promoting the goal of integration of the securities industry.

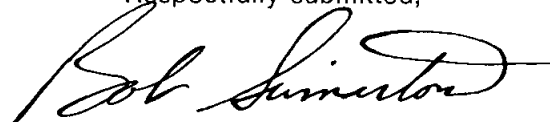
### **The Value of Self-Regulation**

Thus, it was my privilege to be the Chairman of the Board of Governors during a year in which the outreach of the Association had real impact. At the same time, the work we did to strengthen the OTC market was substantial. The achievements in both areas were renewed demonstrations of the value of self-regulation as the Association practices it, through:

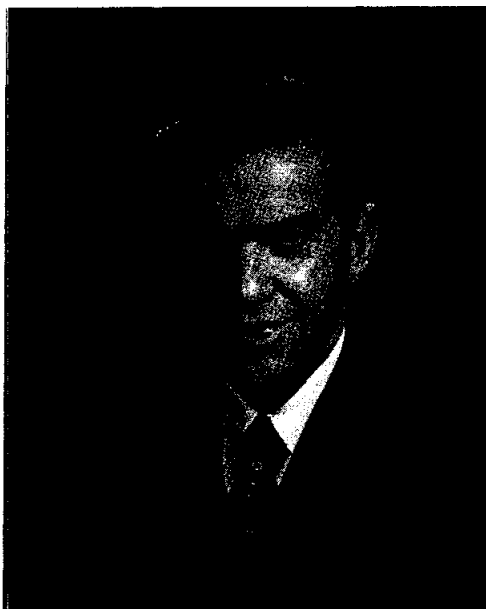
- A membership-controlled Board of Governors;
- The utilization of a Committee System in the development of rules and regulations governing members' business conduct, and other matters;
- A nationwide system of locally-elected committees; and
- The operation of a nationwide network of District offices.

Self-regulation has accomplished one thing more: it has brought strong new teams of Board Officers, Governors, National Committees and District Committees into the leadership of NASD affairs in 1977. The new leadership of the NASD is fully equal to the challenges of further strengthening the OTC market and of integrating it into a National Market System.

Respectfully submitted,



Robert W. Swinarton



## President's Report

In many ways 1976 was a fine year for the over-the-counter market as well as the NASD. Trading volume was up significantly, average prices were higher, and most Association member firms shared in the improved prosperity.

Activities at the Association continued to focus on improvements in regulation of and service to the over-the-counter market. Some of the highlights of the year were:

### **NASDAQ Purchase and Enhancements**

The February 1976 purchase of the NASDAQ System from the Bunker Ramo Corporation, its builder, was a major milestone in Association affairs. The purchase gave the NASD greater flexibility in adding enhancements to the System, and a new four-year operating agreement with Bunker Ramo insured the continued high performance of NASDAQ.

In addition to the Consolidated Quotations Service, two other services using NASDAQ facilities were worked on: the NASDAQ Options Program and the Block Interest Display Service (BIDS). The Options Program, which initially will display quotations for options on about ten NASDAQ securities, is slated for implementation in mid-1977. The potential regulatory benefits and cost savings of BIDS were thoroughly explored with broker/dealers and institutions. Toward the end of the year, it appeared, however, that the Association might be able to achieve its objectives for BIDS through cooperation with other parties, rather than through the construction of its own block information system.

There were 48 more securities in the NASDAQ System at the end of 1976 than at the beginning of the year. Communications with NASDAQ issuers were improved by the election of Eric W. Anderson, a NASDAQ company officer, to the Board of Governors and through the inception of *NASDAQ News*, a quarterly publication directed to the companies.

The NASDAQ/OTC market and its performance became better known to the investing public. Approximately 1,500 radio and TV stations across the country began to include NASDAQ information in their stock market reports. This coverage was secured through the cooperation of station news directors, NASD members who broadcast market reports, the wire services, and national and

regional radio networks. Newspaper publication of full or partial NASDAQ stock tables continued in nearly 300 cities.

### **Clearing**

The National Clearing Corporation continued to give excellent service in the clearance and settlement of OTC transactions and to operate profitably. It expanded its usefulness by opening new clearing centers in Cleveland and Jersey City. At the same time, a great deal of NCC's effort went into the complex preparations for its 1977 consolidation with the clearing corporations of the New York and American stock exchanges into the National Securities Clearing Corporation.

Our Board believes that as a result of merging these clearing corporations more of our members will be able to clear a significantly larger portion of their total transactions through a local or nearby facility at an economical price. This is, as Bob Swinarton said in his Report, a major step toward the much discussed Central Market System.

### **Regulation**

Compliance with applicable rules by the membership was good in 1976, and the number of disciplinary actions decreased. The Association continued to stress preventive regulation through its member communication program to keep broker/dealers abreast of changing regulations and requirements. The program was carried out through visits of the officers to the Districts, member seminars, conferences of District Committeemen with members, staff visits, and expanded use of the *NASD Newsletter*.

Special efforts were made to acquaint the 246 municipal securities firms which joined the Association in 1976 with the conditions of membership. This work included not only informal conferences with the firms but also pilot examinations of them so that they could become familiar with what forthcoming MSRB and SEC rules governing them might be like.

Greater effectiveness of our regulatory programs was achieved by more efficient examination procedures, better training of examiners, and greater sophistication in automated procedures for the early detection of approaching financial or operational problems of member firms.

Regulatory policy was improved by the updating of a number of Association rules, the streamlining of reporting requirements, and by the preparation for 1977 introduction of higher qualification standards for NASD members and their personnel. In addition, at the request of the Municipal Securities Rulemaking Board and the SEC, NASD member views on the development of regulatory policy in the municipal securities field and other areas were compiled and submitted.

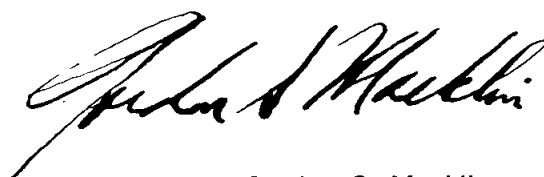
As an administrative service to the membership, the Association completed the automation of the records of the approximately 300,000 persons presently and formerly registered with it. This automation made it possible to register new entrants into the industry more promptly and to retrieve information from the registration files more rapidly.

### **Reduction of Duplication**

Cooperation with other regulatory organizations was intensified in order to reduce the burdens on the industry of duplicative programs and to increase the evenness of regulation. Much has been done in these directions but much more remains to be done.

The following pages of our Annual Report explain the Association's activities last year in more detail. The basic groundwork for many of the Association's accomplishments in 1976 was set in place in prior years. A significant amount of our Board and Committee time and efforts during the year was directed toward programs which will come on line in the future. The total thrust of all these activities is to protect investors while endeavoring to make our securities markets more efficient and attractive.

Respectfully submitted,



Gordon S. Macklin

# 1976 REPORT TO MEMBERS

## Membership

### Members, Branches, Registered Representatives

The number of Association members was 2,877 at the end of 1976, or 16 less than at the end of 1975. New members totaled 351 and there were 367 terminations.

Included in the new members were 246 firms doing a municipal securities business. To qualify these firms, the Association conducted pre-membership interviews and pre-membership examinations for each of them.

The number of branch offices at year end was 5,949, exactly the same as a year earlier. 889 new branch offices were opened and an identical number were closed.

The number of registered representatives at the close of 1976 was 190,862, a decline of 4,812 or 2.5% from the year before.

### Membership Communications Program

The nationwide membership communications program, expanded in 1975, was carried on in 1976. It encompassed personal visits by District Committeemen and District Directors to the offices of 151 members, and 51 group meetings attended by 1,209 persons representing 637 firms. The group meetings included special sessions for mutual fund underwriters in Minneapolis and for insurance company members in Boston. In view of the positive response of members to the program it will be continued in 1977.

Also a part of the membership communications program was the *NASD Newsletter*, published in March, June, September and December of 1976. The average distribution of the *NASD Newsletter* to principals and registered representatives in main and branch offices was 65,000 copies per issue.

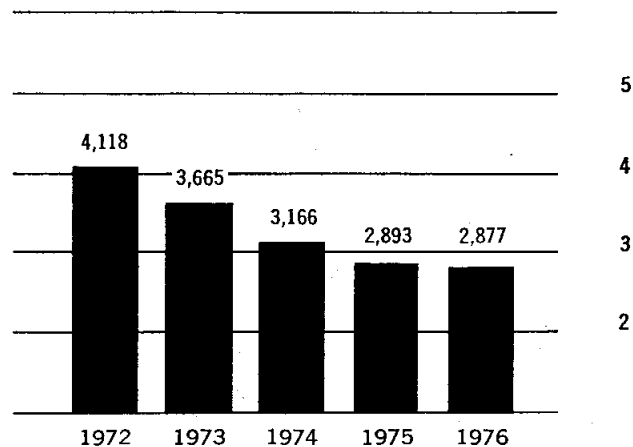
### Qualification Examinations

The total number of qualification examinations administered during the year, both for the NASD

## 1976 STATISTICAL REVIEW

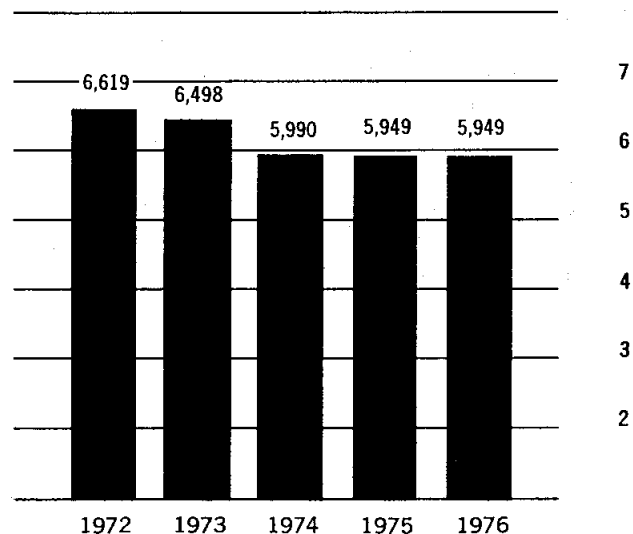
### MEMBER FIRMS

Thousands



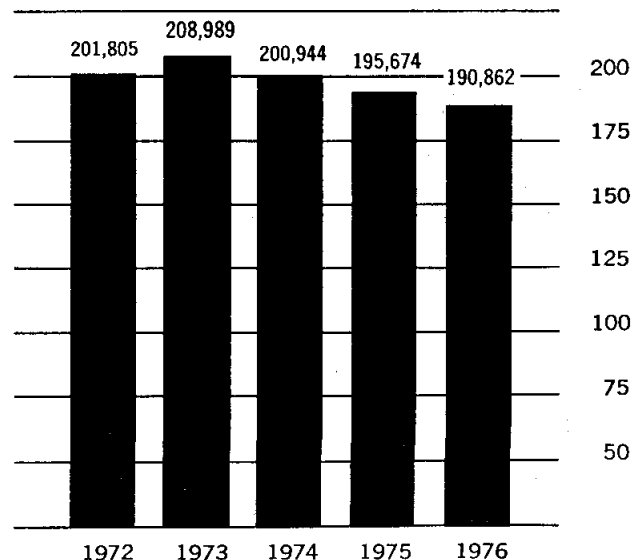
### BRANCH OFFICES

Thousands



### REGISTERED REPRESENTATIVES

Thousands



and other institutions, was 42,093. This represented an increase of 1,794, or 4.4%, over that of 1975.

Examinations administered by the NASD for the five-year period beginning January 1, 1972 and ending December 31, 1976 were as follows:

Year	Qualification Exams for NASD	Exams for Other Institutions	Totals
1972	38,519	26,262	64,781
1973	46,312	26,286	72,598
1974	26,783	21,059	47,842
1975	21,487	18,812	40,299
1976	22,855	19,238	42,093

As an improvement of its service to members, the Association in August began telephone notification to sponsoring member firms of the candidate pass/fail grade reports on the General Securities Representatives Examination (Series 7). This was in addition to written notification of registration and grade results.

### Registration Records of Individuals and Firms

#### *Automated Registered Representative System*

The Automated Registered Representative System (ARRS) became fully operational in March 1976. This system is an automated record-keeping and data retrieval system designed to maintain and update the data files of individuals required to be registered with the Association. The ARRS file now consists of approximately 200,000 active registrants and further includes the records of roughly 100,000 individuals who have terminated their registration with the NASD in recent years.

#### *Members' Personnel Lists*

The Association's Membership Department in 1976 began to produce for each member firm a listing of its personnel registered with the NASD and the status of its NASD registration. This program is designed to produce conformity of registration records in both member firms and the Association.

#### *Fingerprinting Program*

SEC Rule 17f-2 requiring fingerprinting of certain securities industry personnel became effective July 1, 1976. As a service to the membership, the Association processed 10,315 fingerprint record cards, and rolled fingerprints for members. The Association is also processing record cards from SECO broker/dealers and transfer agents and from CBOE broker/dealers.

## Regulatory Policy

Developments in regulatory policy during 1976 included:

1. Progress on higher qualification standards for NASD members, registered representatives and principals;
2. The FOCUS Reporting Program;
3. SIPC filing changes;
4. Pending changes in new issue regulation;
5. Progress on municipal securities regulation, and on municipal securities qualification examinations; and
6. Proposed changes in processing of customer disputes.

### Toward Higher Qualification Standards

#### *Schedule C Amendments*

The Securities Acts Amendments of 1975 contained a Congressional mandate to the SEC to upgrade the standards of professional qualification in the securities industry. The Association in November 1975 filed for approval with the SEC an extensively amended Schedule C of its By-Laws, which specified higher qualification standards for both new and existing NASD members. The SEC has taken this into account in developing its own new qualification rule, which will apply to both NASD members and to the SECO broker/dealers who are registered only with the Commission. The SEC is expected to publish its qualification rule for comment early in 1977.

#### *New Qualification Examinations*

In anticipation of the adoption of the new qualification standards, the Association developed examinations for the following categories of representative registration:

- Investment Company Products/Variable Contracts Representative;
- Direct Participation Programs Representative;
- Real Estate Securities Representative; and
- Securities Trader Representative.

These examinations are to be introduced when the new standards are effective.

Principals will also have to meet the higher standards, and the Association is preparing new examinations for several categories of them: General Securities, Financial and Operations, Underwriter, Investment Company Products/Variable Contracts, and Direct Participation Program Principal.

## **FOCUS Reporting Program**

The Association in 1976 implemented a new financial reporting program, utilizing the FOCUS Report. This program was the result of almost two years of effort on the part of the securities industry and the SEC to streamline the financial and operational reporting requirements of all broker/dealers. To minimize transition difficulties for members, the Association disseminated educational material and conducted regional conferences to explain the new FOCUS Report and the changes that it had brought about.

## **SIPC Filing Changes**

After the adoption of the FOCUS Report, SIPC changed its requirements for the filing of forms and assessments from a calendar year basis to that of the fiscal quarters and fiscal years of broker/dealer firms. The Association, as the SIPC collection agent for many of its members, provided information and administrative services to help them with the changeover.

## **Pending Changes in New Issue Regulation**

### ***Hot New Issues***

In April of 1975, the Board of Governors submitted to the membership for comment new rules and interpretations of existing rules regarding "Hot New Issues." Those proposals included controls over use of discretionary accounts for new issues; amendments to existing limitations on use of issuer reserved or directed stock; more emphasis on customer suitability in new issues; and regulations governing the distribution of "best efforts" offerings of securities to the public.

Comments on the proposals were considered and revised proposals were approved by the Board of Governors. The rule changes have been approved by vote of the membership and are to be filed with the SEC for approval, while the proposed Board of Governors' interpretations have been filed with the SEC and are awaiting comment from it.

### ***Direct Participation Program Rule***

The long-proposed "Tax Shelter" Rule, which has been renamed the Direct Participation Program Rule, was the subject of extended delay due to discussion on technical aspects of the Rule. The technical issues were resolved and the Rule was released to the membership for vote in late 1976.

## **Municipal Securities Regulation**

### ***Cooperation with SEC and MSRB***

Throughout 1976, the NASD continued to cooperate with the SEC and the Municipal Securities Rulemaking Board (MSRB) toward the development of an appropriate regulatory program for the municipal securities industry. This was done through the submission of comments on the proposals of these organizations and through frequent contacts and meetings on matters concerning the operations and procedures utilized in the municipal securities industry and necessary rules attendant thereto.

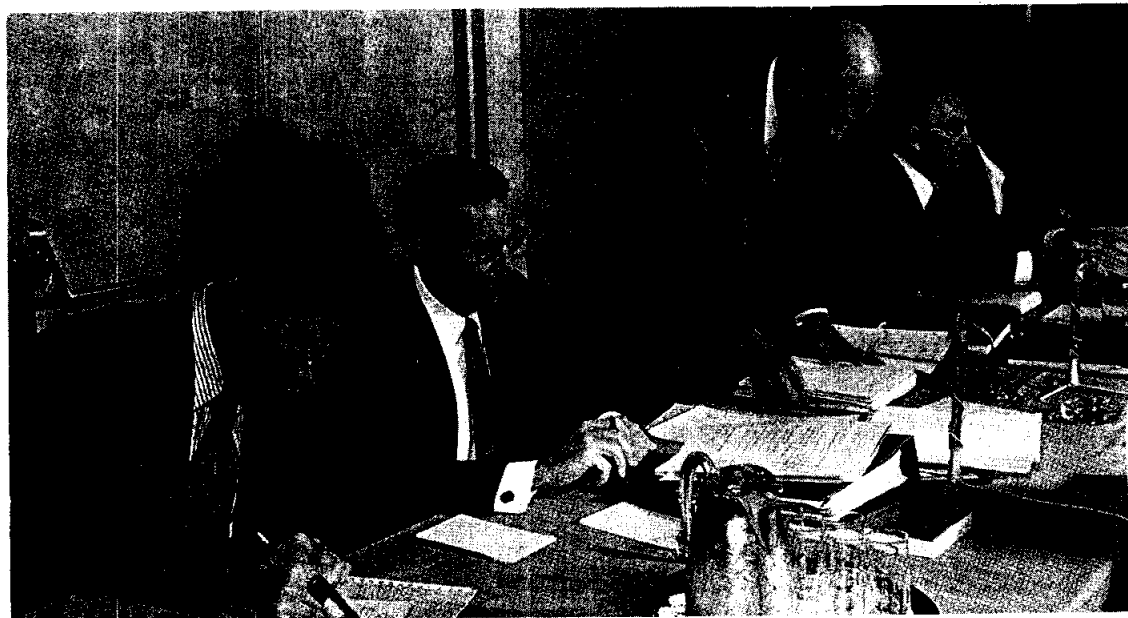
### ***Qualification***

The MSRB qualification rule (G-7) was approved by the Commission and became effective on No-

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*Chairman Swinarton (standing) opens November 1976 Board meeting. Seated from left are Vice Chairman-Finance Rolland, President Macklin, Vice Chairman Rinker and Vice Chairman Vermillion.*

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vember 3, 1976. Additional rules of the MSRB identifying the specific testing requirements for municipal securities representatives and principals will be adopted during 1977 to coincide with the introduction of new qualification examinations in the municipal area. During 1976 the Association's staff worked with the MSRB in developing test questions for use in the qualification examinations for Municipal Securities Representatives, Principals, and Financial and Operations Principals.

### **Changes in Processing of Customer Disputes**

In 1976 as previously, the Association considered the investigation and disposition of investor complaints as one of its important responsibilities. The District offices processed 902 such complaints during the year.

To facilitate the resolution of small claims, the Board of Governors approved amendments to the NASD's Arbitration Code and filed them with the SEC for approval. The amendments, proposed by the Ad Hoc Committee on Consumer Affairs, create a new public dispute category under the Arbitration Code, which permits the resolution of claims of \$500 or less upon the pleadings and documentary evidence by a single arbitrator from without the securities industry. The arbitrator would have the right to conduct a hearing, however, if he believed such was necessary to resolve the dispute. At a hearing, unless otherwise provided by law, if the public customer is not represented by counsel, the broker/dealer would not be permitted to be represented by counsel either.

Also in 1976, the Association developed comments on the SEC's recommendations for the creation of a nationwide system for handling investor disputes. With regard to an SEC recommendation that brokerage firms with public customers be required to institute a system for handling investor complaints, the Association said that this should be accomplished within the framework of the existing rules and regulations of the various self-regulatory organizations and not by means of a new SEC rule. Concerning the SEC call for a uniform mediation-arbitration code for investor disputes, the Association recommended that a securities industry task force be established to develop one. Further, the Association strongly opposed an SEC proposal for the creation of a nationwide network of small claims adjusters, saying that the needs of the public investor would best be served by an industry-developed, single arbitration forum, without the additional administrative entity proposed by the SEC.

## **Examinations and Surveillance**

In 1976, there was a decrease from previous years in formal complaints and in disciplinary actions taken against members. The Association's examination and surveillance activities sought not only to promote compliance but also to help detect operational and financial problems among the membership early enough for members to take corrective steps and eliminate the problems.

### **Examinations of Members**

#### ***Overall Statistics***

During 1976, the Association conducted 2,056 routine examinations and 876 financial and operational examinations of members' main offices, and 611 special examinations. The corresponding statistics for 1975 were 1,866 routine and 792 financial and operational examinations of main offices, and 326 special examinations.

#### ***Complaints and Disciplinary Actions***

As a result of these examinations, 205 Formal and Summary Complaints were filed (compared to 218 in 1975 and 234 in 1974) and 74 Letters of Admission, Waiver and Consent were accepted (compared to 101 in 1975 and 268 in 1974). Disciplinary actions in 1976 resulted in the expulsion of 46 firms (43 in 1975, 97 in 1974), the barring of 177 individuals (194 in 1975, 249 in 1974), the suspension of 11 firms (25 in 1975, 55 in 1974) and the suspension of 77 individuals (99 in 1975, 145 in 1974).

#### ***Municipal Securities Members***

Included in the overall 1976 examinations statistics are pre-membership examinations, routine and financial and operational examinations of the municipal securities firms which have joined the Association. Also included in the overall figures are examinations of the municipal departments of NASD/exchange members, in accordance with the Association's mandate under the 1975 Securities Acts Amendments to monitor the municipal securities businesses conducted by all NASD members.

#### ***Examination Cycles***

NASD members not belonging to any exchange and engaged in a general securities business were subjected to one routine examination during 1976;



such firms which cleared their own securities transactions underwent at least an additional financial and operational examination; and those exchange members for which the NASD has been designated the financial examining authority were treated the same as sole NASD firms. NASD/exchange members for whom the Association is not the financial examining authority receive a routine examination every two years. Certain firms engaged in limited activities (i.e. exclusively in the sale of mutual fund shares) are examined once every three years and insurance members once each year.

### **Subordination Agreement Program**

On September 1, 1975, pursuant to Appendix D of the Uniform Net Capital Rule, the NASD assumed responsibility for the review and approval of subordination agreements for broker/dealers for whom the Association is the designated financial examining authority. The Association introduced standard subordination agreements, disclosure requirements and filing instructions for each type and class of subordination. Since the effective date of the Rule, the Association has received 1,085 agreements for a total of \$72,330,619. Of these, 866 agreements totaling \$62,542,400 were found acceptable.

### **Membership Role in Examiner Training**

Various Association member firms gave valuable assistance in the broadening of training programs for newly-employed and veteran examiners, by lending key personnel to teach on such subjects as municipal securities, options and margin.

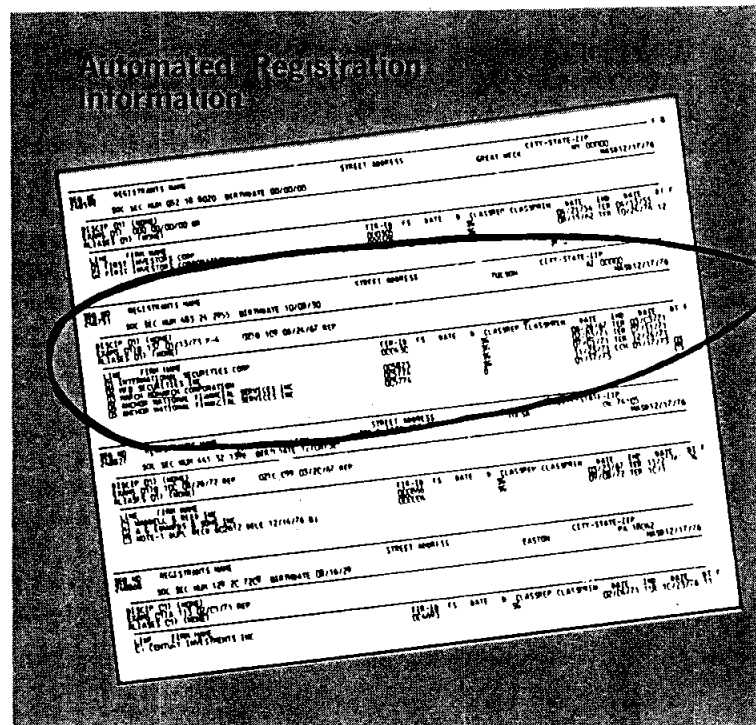
### **Computerized Surveillance Reports**

#### **FOCUS Reviews**

The Association in 1976 converted its automated programs for surveillance and early warning to the processing and review of the FOCUS Report and other new forms. As a part of the Association's early warning systems, the FOCUS review included a computerized editing program to detect financial and operational difficulties of firms, and to test for compliance with applicable financial responsibility rules.

#### **National Early Warning System**

During the year, the Association did program testing of its National Early Warning System (NEWS), a computerized surveillance report designed to signal potential or existing difficulties being experienced by NASD/National Clearing Corporation (NCC) members. NEWS is scheduled



*Microfiche frame of individual work histories of securities industry personnel is type of data NASD can process for other organizations.*

to become operational in 1977, although some further adjustments will be required after the merger of NCC into National Securities Clearing Corporation (NSCC).

### **Financial Early Warning System**

The Association's Financial Early Warning System (FEWS) was in the final stages of testing at the end of 1976. FEWS will be used to assist in forecasting the financial viability of members by comparing the characteristics of active NASD members with various computer-calculated profiles of firms that have failed.

### **Work With SIPC**

In 1976, there were four NASD firms placed in SIPC liquidation. The liquidations resulted in a total outlay of \$825,800 in SIPC advances for 1,795 responses from customers making claims for cash or securities against the four firms.

The Association during 1976 worked with other self-regulatory agencies, the North American Securities Administrators Association and various states to reduce regulatory duplication.

Joint examinations with the New York Stock Exchange were continued for NASD/NYSE mem-

bers in the New York area. Formal discussions were begun with the Boston Stock Exchange for the consolidation of its field examinations program with that of the Association, as a result of an informal working arrangement under which the NASD has been examining BSE members on the West Coast and forwarding the results to the Exchange.

Also in 1976, the Association worked toward eliminating duplication in the area of registration information. With the growing acceptance of uniform registration forms, the Board of Governors endorsed the concept of the NASD acting as a central depository for industry registration data

for other self-regulatory organizations and state jurisdictions. This offers the potential for significant cost savings to members by permitting them to complete a single registration form which the NASD would process through its facilities as a clearing house on behalf of other organizations. To test the viability of such a program, the NASD shared computerized firm registration data (Form BD) with twelve state jurisdictions in a pilot program and prepared to embark on a similar pilot program for individual registration data (Form U-4) with the state of Minnesota.

Further efforts to reduce duplication will be made in 1977.



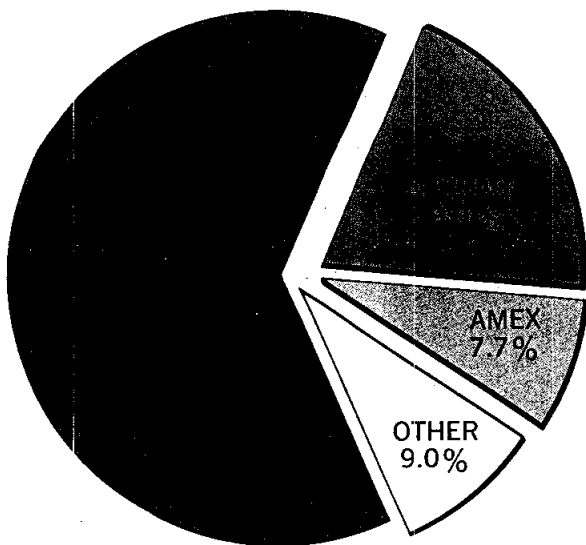
*In NASD purchase of NASDAQ System, President Macklin presents check to Bunker Ramo's J. R. Coutts, as former Governor Lewis M. Weston (standing) and former NASD General Counsel Lloyd J. Derrickson look on.*

## Principal NASDAQ Developments

The principal developments relating to the NASDAQ System in 1976 were:

1. NASD acquisition of the System;
2. A continued high level of System performance with enhanced System services;
3. Preparation of the Consolidated Quotations Service (CQS) for January 1977 startup;
4. Preparation for the display of options on the system in mid-1977;
5. Exploration of a Block Interest Display Service (BIDS);
6. New additions of NASDAQ securities to the Federal Reserve Board's list of marginable OTC securities;
7. Increasingly effective market surveillance;
8. Expanded communications with NASDAQ companies; and
9. Expanded media coverage of NASDAQ data.

### TRADING ACTIVITY ON NASDAQ AND EXCHANGES



1976 Share Volume

New York Stock Exchange	5,360,116,000
NASDAQ	1,683,933,000
American Stock Exchange	648,297,000
Other Exchanges	764,682,000

## NASD Acquisition of the NASDAQ System

### Reasons for Purchase

On February 9, 1976, NASDAQ, Inc., a wholly-owned subsidiary of the NASD, purchased the NASDAQ System for approximately \$10 million from the Bunker Ramo Corporation, the System's builder and operator, and signed a new, four-year operating agreement with Bunker Ramo.

The decision of the Board of Governors to make the purchase was based on: (1) the financial soundness of the System; (2) the consideration that NASD ownership would allow more economical upgrading of the System, and reinforcement of the NASD's ability to perform regulatory functions related to the System; and (3) the probability that System rates to subscribers can be reduced after the loan for buying the System is repaid.

### Operating Agreement

The new operating agreement with Bunker Ramo calls for: (1) Bunker Ramo to provide services similar to those stipulated under its previous operating contract, including operation of the System and maintenance of subscriber terminals, during the next four years for a fixed annual fee; (2) NASDAQ, Inc., as owner of the System hardware, to pay for all major repairs or replacements; (3) Bunker Ramo to provide a dedicated staff of programmer/analysts to make changes or developments specified by NASDAQ, Inc.; (4) major changes or developments in the System to be let out for competitive bids at the discretion of NASDAQ, Inc.; and (5) Bunker Ramo to continue to handle subscriber billing, but revenue to flow directly to NASDAQ, Inc.

### System Performance and Enhancements

#### Performance

The NASDAQ System in 1976 continued to provide, on every business day, accurate and up-to-the-minute quotations information on some 2,600 OTC issues to 31,500 computer terminals in broker/dealer offices and institutions throughout the U.S. and the world.

Quotations for 2,627 securities were in the System at the end of 1976 compared with 2,579 at the end of 1975. Trading volume averaged 6,655,800 shares per day, as against 5,495,700 per day in 1975. Total aggregate volume for the year reached 1.68 billion shares and continued to be greater than the combined share volume of all national exchanges, other than the New York Stock Exchange.

During all twelve months of the year, NASDAQ

processed OTC transactions in listed securities for reporting to the Consolidated Tape. 276,150 transactions were reported by 190 NASD members, with an aggregate volume of 290 million shares of securities whose primary markets are on the New York and American Stock Exchanges.

The average number of market makers per NASDAQ security rose to 6.5, up from 5.6 in 1975. The number of market makers was 365 at year's end, compared with 369 in 1975, and their market-making positions totalled 16,960, compared with 14,815 in 1975.

The NASDAQ/OTC Composite Index ended

1976 at 97.88, up 26.1% from year-end 1975.

The performance of the NASDAQ System facilities continued to be excellent. The average number of calls processed per day was 737,608, and the peak number of calls was 892,695. The average response time per terminal call was less than three seconds. Average downtime per terminal due to equipment failure was 1½ hours.

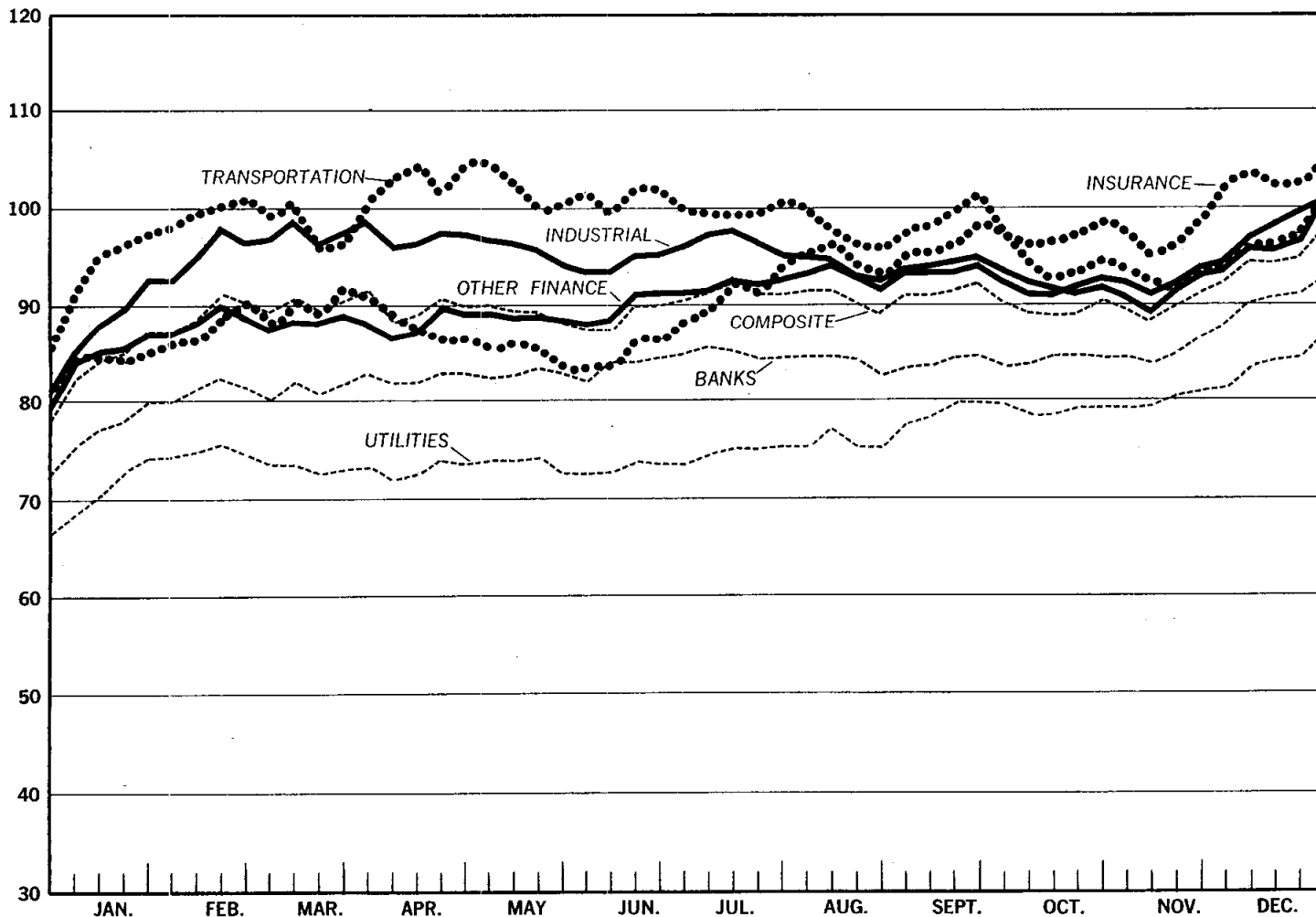
**Consolidated Quotations Service (CQS)**

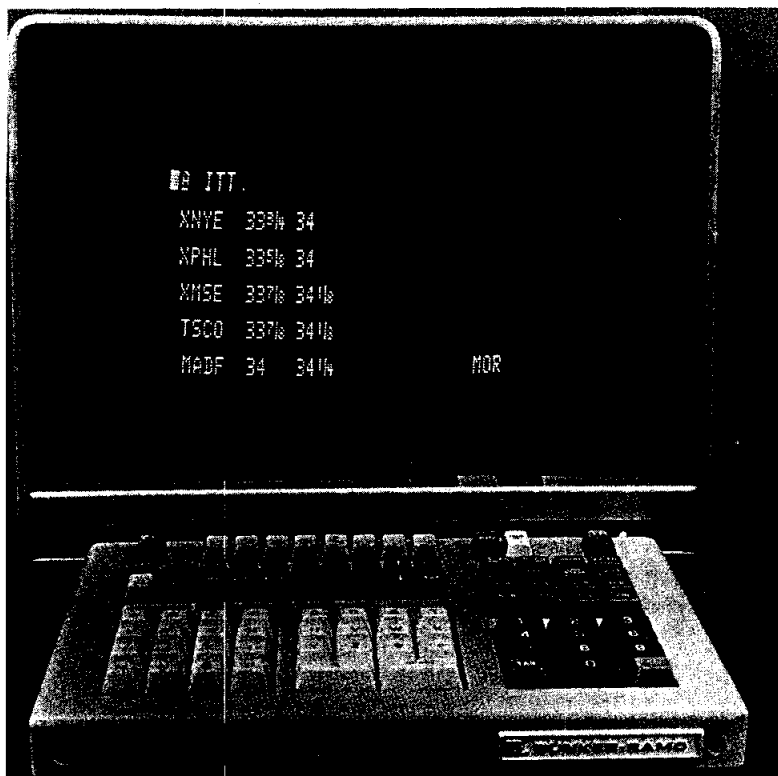
The necessary work was done during 1976 for the startup of the Consolidated Quotations Service

**NASDAQ STOCK PRICE INDEXES**  
(Weekly Closing Values)

1976

INDEX: February 5, 1971 = 100





CQS shows quotations from three exchanges and two Third Market Makers of ITT stock.

(CQS) on NASDAQ in January 1977. CQS shows, in a composite display, the most recently released quotations on all New York Stock Exchange listed stocks, common and preferred, and warrants and rights, from the Boston, Midwest, New York, Pacific and Philadelphia Stock Exchanges and from participating Third Market Makers.

CQS enables subscribers to see at a glance the various markets in the country for NYSE listed securities. It is an important step, after the Consolidated Tape, toward a National Market System.

CQS may be added to existing NASDAQ terminals or received on separate terminals, without NASDAQ service.

#### **NASDAQ Options Program**

Progress was made toward another major use of the NASDAQ facilities, the NASDAQ Options Program. It is projected for implementation in mid-1977, subject to approval by the SEC.

During 1976, rules governing the methods by which standardized options are to be entered and displayed on the NASDAQ System were developed and published for comment. Pursuant to these rules, NASDAQ options will be issued by the Options Clearing Corporation (OCC). The options to

be displayed on the NASDAQ System for which quotations will be entered by registered NASDAQ options market makers will be limited to options authorized by the Association in underlying securities selected in accordance with requirements of the SEC, the Association and OCC.

The terms of the options to be displayed will be standardized as to exercise price and expiration date, in accordance with the rules of the Association and the By-Laws and Rules of OCC. Comparison of trade input will be accomplished by a processor under contract to the Association. Matched trades will be forwarded on a daily basis to OCC for clearance and settlement in accordance with its By-Laws and its Rules.

During 1976, a critical element of the Association's NASDAQ Options Program received the tentative approval of the SEC. The approval of the Commission relates to that portion of the Association's NASDAQ Options Program which would permit simultaneous dual market making in options and their underlying securities by NASDAQ market makers. The Commission's approval of the entire NASDAQ Options Program is anticipated for early 1977.

#### **Block Interest Display Service (BIDS)**

During the second half of 1976, the Association tested the market for a Block Interest Display Service (BIDS) on NASDAQ. BIDS had been designed under the supervision of a subcommittee composed of representatives of broker/dealers and institutions. The Association's goals for the design are (1) a regulatory mechanism for the oversight of block information display systems (2) savings to firms already participating in block-size transactions, and (3) better availability to smaller broker/dealers of information and services to facilitate block-size transactions. The test-marketing of the service, through demonstrations in major financial centers across the country, produced substantial expressions of interest from institutions and broker/dealers.

The Board of Governors at its November meeting reviewed this response. It also reviewed inquiries by other parties, which raised the possibility of a cooperative effort whereby the NASD might achieve the regulatory, cost-saving and service objectives of BIDS. The decision of the Board was to defer action on the development of BIDS in order to explore this possibility.

#### **More NASDAQ Securities Marginable**

Twice during 1976—in May and December—the Federal Reserve Board (FRB) added NASDAQ

securities to the list of OTC securities qualifying for the extension of margin. Sixty-five NASDAQ stocks were added in May and 169 in December, bringing the total number of marginable NASDAQ Securities on the FRB's list to 967.

The 169 stocks added in December met the amended requirements for inclusion in the list which the FRB adopted in the latter part of 1976. The requisite number of market makers in a security was reduced from 5 to 4, and the average share price from \$10 to \$5. Further, an average daily volume of 500 shares became an alternative to the requirement of 1200 public shareholders of record. Regarding these amendments, the FRB stated that they reflected "changes that have occurred in the OTC Market in recent years, particularly the increased competition among securities markets and the impact of . . . NASDAQ".

Also in the year, the Association proposed to the FRB that it include those over-the-counter corporate non-convertible bonds in the OTC margin list which are rated Baaa or better by at least one of the nationally-recognized rating services, and which are issued in principal amounts of \$25 million or more. At the same time, the Association recommended the removal of credit restrictions on broker/dealers which are more stringent than those imposed on banks.

### **Market Surveillance**

The Association's computer facilities during 1976 continued to generate the daily Stockwatch Report, which signals unusual price and volume activity in any of the stocks quoted on the NASDAQ System. Market Surveillance analysts conducted 682 routine reviews of price and volume parameter breaks shown by the Stockwatch Report, and pursued 66 detailed investigations. This work resulted in the referral of 18 cases to the Association's District offices, State Securities Commissions and the SEC, for further investigation and action.

A concern of the Market Surveillance Section continued to be the full and prompt disclosure of material corporate developments by NASDAQ issuers. The Section routinely examined for evidence of trading on inside information in NASDAQ securities, which might have taken place prior to the publication of material news affecting those securities.

The Association has encouraged the use of temporary quotations halts, prior to the release of material news by NASDAQ issuers. A quotations halt allows time for investors to become aware of corporate developments before initiating trades in the corporation's securities. There has been a

steady increase in quotations halts from 4 in 1973 to 21 in 1974, 40 in 1975, and 82 in 1976.

### **Communications with NASDAQ Companies**

The Association's Board of Governors directed that there be an expanded program of communications with NASDAQ companies. This was implemented by (1) *NASDAQ News* (2) preparation of the *NASDAQ Fact Book*, and (3) publication of the NASDAQ company seminars proceedings.

#### ***NASDAQ News***

*NASDAQ News*, the new publication for NASDAQ companies, was issued in July and October. It presented feature articles of interest to the companies on financial communications, NASDAQ market surveillance, the regulation of broker/dealers in the NASDAQ market and other subjects. It also recorded securities added to the NASDAQ System, NASDAQ securities added to the Federal Reserve Board's margin list and NASDAQ market statistics.

#### ***NASDAQ Fact Book***

The first edition of the *NASDAQ Fact Book* is scheduled for publication in early 1977. It is to be a reference work, containing data on shareowners, market value, volume, most active securities and on the performance of all individual securities in the NASDAQ/OTC market. The *Fact Book* will also list market makers in NASDAQ stocks, all marginable NASDAQ securities and other data. It will be distributed to NASDAQ companies and NASD members, and made available to the general public.

#### ***NASDAQ Seminar Booklet***

*The NASDAQ Company and the NASDAQ Market*, published in 1976, was a record of the proceedings of five NASD seminars for NASDAQ companies, and was distributed to all the companies and to NASD members. The day-long seminars were held in December 1975-January 1976, in Atlanta, Chicago, Dallas, New York and San Francisco, and were attended by 243 NASDAQ company executives.

### **Media Coverage of NASDAQ Data**

The Association made efforts in 1976 to increase radio and TV coverage of NASDAQ market statistics (Composite Index, Industrial, volume, etc.) and newspaper coverage of NASDAQ stock quotations, as well as market statistics. Gains in radio coverage and some gains in TV coverage were obtained, while newspaper coverage held steady.

### **Radio Coverage**

On approximately 250 radio stations across the country, NASDAQ data is included in stock market reports from local NASD member firms. Better than 90% of these reports started including NASDAQ data in 1976.

Three national press services, four national radio networks and three regional networks include NASDAQ data in the stock market reports which they provide to a great number of radio stations, as follows:

- \* ABC Radio (Contemporary, Entertainment, FM and Information Networks)—1,400 stations
- AP Audio Wire—400 stations
- AP Broadcast Wire—3,400 stations
- \* Arkansas Radio Network—62 stations
- \* Intermountain Network—93 stations
- \* Mutual Broadcasting System—900 stations
- \* NBC News & Information Service—60 stations
- \* NBC Radio Network News—215 stations
- \* North Carolina News Network—55 stations
- UPI Broadcast Wire—3,600 stations

(Asterisks indicate addition of NASDAQ data in 1976.)

An estimated 1,250 radio stations served by one or more of the press services or networks actually broadcast NASDAQ data in their stock market reports. (Stations are not required to use news from the press services or the networks, nor to report usage to them.) These and the approximately 250 stations supplied by NASD member firms make an estimated grand total of 1,500 radio stations now carrying NASDAQ market statistics.

### **TV Coverage**

TV coverage of NASDAQ is provided by *Wall Street Week*, the weekend program carried by better than 200 affiliates of the Public Broadcasting Service, and by the Reuters Business and Financial Wire, whose NASDAQ and other market information appears on 160 cable TV stations. In addition, a number of local TV stations in 1976 included NASDAQ data in stock market reports of their own.

### **Newspaper Coverage**

In 1976 as in 1975, some 50 major metropolitan newspapers regularly published the National NASDAQ/OTC list of the 1,410 issues which rank highest by dollar volume of shares traded. In addition, some 225 newspapers throughout the United States continued to carry information on NASDAQ and other OTC stocks of particular interest to local investors. This coverage was largely the result of the cooperation of over 135 local NASD Quotations Committees with the newspapers.



### **Legislation**

#### ***Amendments to Securities Investor Protection Act of 1970***

Congress in the 1977-78 session will most likely consider the bill previously introduced by Representative Harley O. Staggers to amend the Securities Investor Protection Act of 1970. The bill would provide for expedited procedures for handling SIPC trusteeships and increase the overall coverage afforded to investors who deal with SIPC members.

NASD President Gordon S. Macklin has testified in general support of the bill. However, he expressed the NASD's opposition to a provision of the bill which would assess income from the sales of mutual funds and variable contracts, and would require broker/dealers distributing only mutual funds and variable contracts to become members of SIPC, because of the extremely limited risk to the public caused by such sales and such firms. The NASD also opposed, as unnecessary, costly, and sometimes misleading, a provision of the bill requiring SIPC members to display the SIPC symbol and to use it in certain advertising material.

#### ***Municipal Bond Fund Act of 1976***

The passage of the Municipal Bond Fund Act of 1976 as part of the Tax Reform Act of 1976 was a significant development for both the mutual fund and municipal bond markets. This bill amended the Internal Revenue Code to provide for the distribution of tax-exempt income, received by regulated investment companies dealing in municipal bonds, to their shareholders without a change in the tax-exempt status. Under the new legislation, mutual funds which invest in tax-exempt securities may be organized as corporations and are allowed to shift their portfolios to respond to market fluctuations.

#### ***Study of Other Legislative Developments***

The Association's Office of General Counsel continued to follow significant legislative developments relating to the securities industry. Of particular interest to the Association and its members were (1) the studies concerning "The Securities Activities of Commercial Banks," being made by the Subcommittee on Securities of the Senate Banking, Housing and Urban Affairs Committee,



SEC Chairman Roderick M. Hills speaks at NASDAQ purchase ceremony, as SEC Commissioner John Evans (left front) and NASD General Counsel and Senior Vice President Frank Wilson listen.

and (2) the study of the brokerage activities of banks, required to be conducted by the Securities Exchange Commission under the Securities Acts Amendments of 1975.

### Litigation

During the course of the year, three matters were resolved favorably to the Association and there remain six matters pending against the Association for 1977. Two interesting pending cases are *Quinonez v. Merrill Lynch, et al* and *Baty v. Pressman, Frohlich & Frost, et al*. The *Quinonez* case in the District Court for the Northern District of Texas names twenty broker/dealers and the Association as defendants and alleges a conspiracy to enter into a group boycott to deny the plaintiff employment. Plaintiff alleges the NASD constitutes a monopoly of brokerage houses and investment banking firms, and that without the sponsorship of a firm it is impossible to function in the securities industry. Plaintiff was refused employment by broker/dealers because he failed to disclose on his New York Stock Exchange application for approval of employment that he had been arrested twice.

The *Baty* action alleges the plaintiff was dam-

aged by a registered representative's sale to her of \$154,000 in unregistered securities which subsequently became worthless. Plaintiff claims the Association, the New York Stock Exchange and others failed to investigate the background of the representative, the broker/dealers who employed the representative failed to supervise his activities properly, and the Association and the New York Stock Exchange failed to ensure that the employing broker/dealers were properly supervising him.

The General Counsel's Office has no reason to believe that meritorious defenses are not available in these cases. As to the other cases pending against the Association, the General Counsel's Office believes that meritorious defenses are available; however, the outcome cannot be predicted.

Also, the Association is named in an arbitration proceeding entitled *Bunker Ramo v. NASD*. This action alleges that the NASD was obligated to purchase from Bunker Ramo, at the time the NASD purchased the assets of the NASDAQ System from Bunker Ramo, certain parts valued at approximately \$215,721. The NASD denies any such obligation; initial pleadings have been filed. The General Counsel's Office believes that meritorious defenses are available and that no material liability will result.





# Purposes

To promote the investment, banking, and securities business

To standardize its principles and practices

To promote high standards of commercial conduct and to promote among its members observance of Federal and State securities laws

To provide a medium through which the membership may seek suit with governmental and other agencies

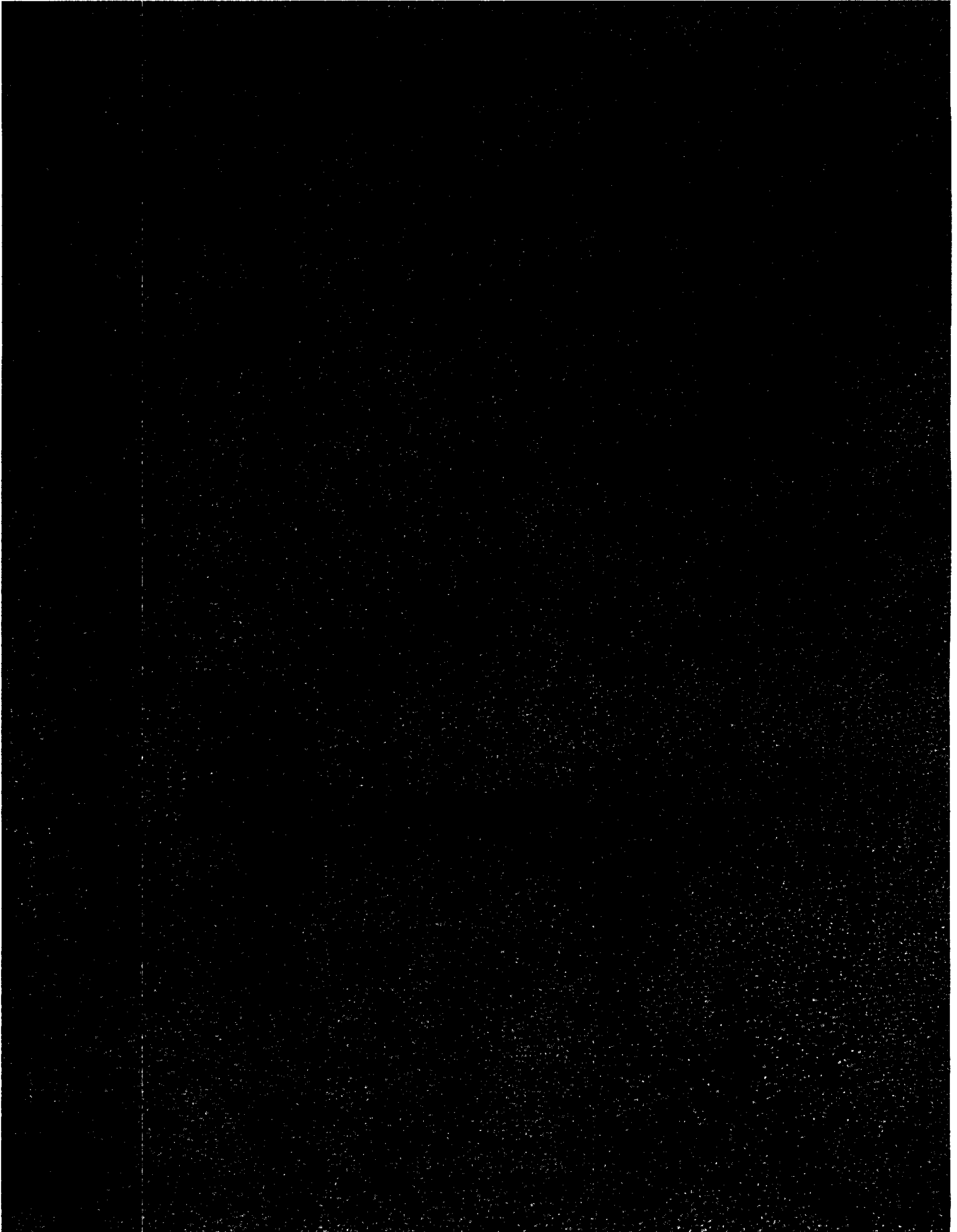
To cooperate with governmental authority in the solution of problems affecting this business and investors

To adopt and enforce rules of fair practice in the securities business

To maintain the highest standards of integrity and conduct in the operation of its business

To conduct its business in a prudent and ethical manner

To investigate and settle any controversy between its clients and members



CONDENSED VERSION

# NASD

REPORT TO MEMBERS 1976