

# N.A.S.D. NEWS

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## FORMAL COMPLAINTS FILED AGAINST ABOUT 100 FIRMS CHARGING RULE VIOLATIONS

Dealers Have Presented Answers to  
Allegations of Misconduct  
in PSI Case

### District Conduct Committees to Act

Formal complaints have been drawn up against nearly 100 member firms charging violation of the Association's Rules of Fair Practice in connection with the recent offering of \$48,000,000 bonds and debentures of Public Service Company of Indiana. Nearly all of these complaints have been filed by the District Business Conduct Committees of the Districts in which the alleged violation occurred and answers have been received from the firms named.

The magnitude of this investigation may be seen from the fact that the original selling group comprised around 400 dealers, 48,000 individual bond numbers were involved, and there were over 65 pages listing securities taken in exchange in the sale of the new issue. All of the exchange bonds had to be priced as of the day of the transaction and the prices compared with the prices reported by the several houses as a basis upon which the exchange was made.

### New Procedure Evolved

In the interest of uniformity and preventing unfair discrimination in view of the fact that so many alleged violations were found and that they were reported from all parts of the country, a special procedure has been evolved for the handling of this case. The District Business Conduct Committees will file the actual complaints and provide opportunity for hearings. The results of these hearings, together with recommendations for action, will be sent to the Executive Committee. This Committee, in turn, will review all of these results and recommendations and indicate to the local Committees what action the Executive Committee be-

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## THE FIRST YEAR

The Association rounded out its first year as a national securities association on August 7. In addition to the vast administrative machinery—involving the use of more than 140 committees—which has been created in this short time, six different subjects stand out as real accomplishments—its work in connection with the recent modification of the 20-day "incubation" clause of the Securities Act of 1933, the extension of quotations on over-the-counter securities to a number of large cities throughout the country, the work of its Uniform Practice Committee which has reached a point where proposed nationwide uniform trade practice standards may soon be drafted into form for consideration and adoption, the handling of trade practice complaints (including PSI), the work of its Investment Trust Underwriters Committee in connection with rules governing marketing of securities of open-end trusts, and its work in connection with its program to educate members generally as to the Association and the rules under which they do business. These subjects are discussed more fully elsewhere in this issue.

## BOARD TAKES ACTION ON IMPORTANT QUESTIONS

Governors Gather for Third Time to  
Discuss and Act Upon National  
Problems; Meet in Chicago

The Board of Governors and Advisory Council of the Association held their third meeting since registration on July 22 and 23 in Chicago. Among the important actions undertaken at this meeting was the approval of the Association's national representatives' collaboration with the Securities and Exchange Commission on proposed revision of the 20-day "incubation" clause in the Securities Act of 1933. A complete story of the Association's activities in this direction will be found elsewhere in this issue.

Francis A. Bonner, Chairman of the  
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## CONGRESS PASSES BILL MODIFYING "INCUBATION" CLAUSE OF SECURITIES ACT

Action Follows Agreement Among  
SEC, NASD and IBA on Cut  
in 20-Day Period

### Rider to Investment Trust Bill

Under legislation recently passed by both Houses of Congress amending the 20-day waiting clause (Section 8a) of the Securities Act of 1933, the Securities and Exchange Commission is given discretionary control as to how long this waiting period shall be in future issues.

The amendment, a rider to the Investment Trust Bill, was passed after a letter expressing agreement on the change was sent to Congress signed by officials of the SEC, the Association, and the Investment Bankers Association. This letter read as follows:

"The Securities and Exchange Commission in conjunction with representatives of the National Association of Securities Dealers, Inc. and the Investment Bankers Association of America suggests the enclosed modification of Section 8(a) of the Securities Act of 1933, as amended, for the consideration of the Congress and respectfully urges that it may be enacted at the present session.

### Proposal Experimental

"The Commission and the representatives of the National Association of Securities Dealers and the Investment Bankers Association wish to make it clear to the members of the Congress that this proposal is experimental. They have already agreed to present to the Congress in January their joint and several views as to modifications of this statute, based on study and conferences to be conducted in the meantime. They all, therefore, expressly wish to reserve the right to make, at that time, any further suggestions for the modification of Section 8(a) which they may believe to be desirable.

"The representatives of the National Association of Securities Dealers and  
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## 20-DAY PERIOD

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the Investment Bankers Association express the view that the proposed amendment should be helpful, although not a complete solution of the problem. They, therefore, intend in January to make suggestions for further changes in this Section as well as in other Sections of the Act, in order to make it possible to shorten the time in which securities may be registered and offered, they join in the request that this single amendment be enacted into law at the earliest possible moment during the present session of the Congress."

**Robert E. Healy**, Acting Chairman.

**Francis A. Bonner**, Chairman, National Association of Securities Dealers, Inc.

**E. F. Connely**, President, Investment Bankers Association of America.

### First Step in Program

The modification of the 20-day clause, however, represents merely the first step in a program to examine the workings of the various securities acts in an effort to weed out all possible unnecessary restrictions on the free flow of capital into private industry which may be found. To aid in this work, the Association, at the request of the SEC has taken several steps.

In the first place, the Executive Committee has been designated as the policy committee having complete charge of all recommendations as to possible changes in the Securities Act and the Securities Exchange Act of 1934. In addition, a special Securities Act Committee has been named to work with the policy committee, the SEC and other groups toward desirable changes in the Acts.

The plan is that these committees, and other interested parties, will confer with the Commission on all aspects of the problem to the end that areas of agreement between the government and the business with respect to desirable changes in the acts may be ascertained and such disagreements as may arise may be outlined as definitely as possible and a report made to Congress by the Commission in January, 1941.

### Small Issues Committee

In addition to this committee, a sub-committee on small issues has been appointed composed of John Longmire of I. M. Simon & Co., St. Louis, Edward Costigan of Whitaker & Company, St. Louis, and John Prescott of

Prescott, Wright, Snider Company, Kansas City, Mo. It is anticipated that additional appointments will be made to this Committee.

What changes will actually be recommended to Congress by the Commission will depend, of course, on the results of these studies. The fact that the various groups in the business are working with the SEC in formulating these recommendations will not prevent them from offering recommendations of their own if they desire to do so. All of the groups involved have endorsed the basic principles of the acts and merely wish proper amendments which will speed up the flow of capital into industry.

## BOARD MEETING

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Board, presided at the meeting. Reports of activities of the 14 Districts were received from District Chairmen on the first day. Joseph T. Johnson, chairman of the national Uniform Practice Committee, presented and discussed a draft of a comprehensive set of uniform practice standards for the Association. It is hoped that these can be put into effect in the near future.

### More Committee Reports

Henry T. Vance, chairman of the Investment Trust Underwriters Committee outlined the work of his group in connection with the preparation of certain proposed rules of the Association governing the marketing of securities of open-end investment trusts as provided for in the Investment Trust Bill recently passed by Congress and signed by the President. A report by Y. E. Booker, chairman of the Education Committee, on the work of his group in connection with the publication of the NASD NEWS and laying out of a general education program for members was read.

Wallace H. Fulton, Executive Director, reported from the administrative end the status of various cases of alleged business misconduct now before the District Business Conduct Committees. The Association, in the course of its regular activities, has received around 50 informal complaints and about a dozen formal ones. Decisions in these cases show that not only has misconduct been punished, but that dealers have been protected where complaints were the result of mere misunderstandings or honest mistakes.

## QUESTIONS AND ANSWERS

**QUESTION:** May a member buy from or sell to a non-member broker or dealer or a bank, government or municipal securities at prices or on terms and conditions different from those accorded to members of the general public?

**ANSWER:** Yes, if the governments or municipals fall within the definition of the term "exempted securities" as contained in the Securities Exchange Act of 1934.

**REASON:** Article I, Section 4, of the Rules of Fair Practice provides that the Rules shall not apply to "exempted securities" as that term is defined in Section 3(a)(12) of the Securities Exchange Act. Substantially all securities which are generally referred to as municipal bonds or governments come within the scope of the definition of "exempted securities."

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**QUESTION:** May a member of the Association pay a commission to a member of a national securities exchange, who is not a member of the Association, for executing a brokerage order over-the-counter, in other than "exempted securities"?

**ANSWER:** No.

**REASON:** With respect to over-the-counter transactions, in other than "exempted securities," such exchange member comes within the definition of the term "non-member broker or dealer" as contained in Rule 25(d). Rule 25(a) is, therefore, applicable.

\* \* \*

**QUESTION:** May a member of the Association, when acting as an underwriter, or member of a selling group, in the over-the-counter distribution of an issue or block of securities, other than "exempted securities," allow a selling concession, discount, or other allowance, as such, to a bank which is not a member of the Association?

**ANSWER:** No.

**REASON:** As a bank, by definition, is not a broker or dealer within the meaning of the By-Laws or Rules of the Association, Rule 24 applies and prohibits such allowance.

## HOW COMMITTEES ARE HANDLING TYPICAL VIOLATIONS OF RULES

### Action of District Business Conduct Groups in Two Different Types of Cases Described

#### Profits, Recommendations Discussed

##### Case No. 1

A customer of a member firm complained to the Business Conduct Committee in the District in which she lived that the firm, which was located in another District, had made recommendations for the purchase and sale of securities which were not suitable for her account in view of her financial situation and needs. Such recommendations, if true, would violate Article III, Section 2, of the Rules of Fair Practice. As a result of these recommendations, she stated she had been switched out of certain high grade securities into low grade securities, with resultant losses. The securities sold were in the main composed of fairly good grade utility bonds and preferred stocks and those purchased were common stocks of five companies and the preferred stock of one.

The Complaint was turned over to the Business Conduct Committee in the District in which the member did business and that Committee investigated. The Committee found that the sale of the customer's original securities were usually executed by the firm as broker. The purchases, on the other hand, were made from the firm as dealer. In the case of the purchases, the Committee expressed a belief that while in some cases the profit taken was substantial, it was not exorbitant. Although the Committee called the firm's attention to those cases, it came to the conclusion that no severe criticism was justified.

#### Disclosure Rule Violated

In regard to the quality of the securities purchased and sold, the Committee expressed the opinion, in substance, that the question was such a debatable one and so close that it did not feel justified in criticizing the recommendations.

The Committee also found that the firm had sometimes neglected to disclose in its confirmations the capacity in which it was acting and decided that the firm should be censured for this omission. In addition, the Committee warned the firm that future violations of this disclosure rule (Article III, Section 12, Rules of Fair Practice)

would be dealt with more severely. Inasmuch as no basis for action had been found in regard to prices charged in the transactions or in regard to the appropriateness of the recommendations made, the Committee dismissed these charges, noting that the customer had subsequently asked that they be dropped.

##### Case No. 2

A customer complained to the Business Conduct Committee in his District that a member firm had taken excessive profits from him in transactions in a certain industrial stock. Such action, if true, would violate Article III, Section 4, of the Rules of Fair Practice.

The member said that it had explained to customers that it was taking a relatively large profit on the stock, and said it was due to the following reasons: that the member firm had incurred considerable expense in investigating the company; that the firm had performed a valuable service to its customers in bringing to their attention a situation with possibilities for appreciation; and that the firm used the "yardstick customarily used by other brokers in similar situations."

However, the Committee concluded, after investigation and on the basis of a report submitted by auditors engaged to examine the books of the firm in respect to the transactions, that the firm had sold stock for its own account to a customer at a net price which was excessive in view of the prevailing market and that the facts offered in explanation of the size of the gross profit were not adequate to justify such a profit.

The Committee thereupon sent a letter of censure to the firm noting its disapproval of the manner in which the transactions were carried out and warning the firm of its intention, should it find at a future date similar transactions, to adopt severer measures as provided in the Rules and Code of Procedure.

## PSI CASES

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lies should be taken. The District Business Conduct Committees will then take action.

The types of apparent violations varied greatly. Some of these alleged violations might be described as follows:

1. Trader, without consulting the firm, and in the belief that bonds were

## INVESTMENT ADVISERS

Under Title II of the Investment Trust Bill which recently became a law, it will be necessary for members who act as investment advisers or investment counsellors, and who receive special compensation therefor, to register with the Securities and Exchange Commission as such. Registered investment advisors will also be subject to the other regulatory provisions contained in this Title, and as the provisions of this Title will become effective on November 1, 1940, it is important that members falling within the scope of this Bill familiarize themselves with its provisions and take steps necessary to effect registration with the Commission before that date.

It is anticipated that the staff of the Commission charged with its administration will confer with representatives of the Association and other interested parties on the form and content of the registration forms to be prescribed early in September.

free, sold them out on an end-of-year inventory valuation.

2. Trader in serial debentures confused the allowances permissible on one series with that of another series.

3. Bonds taken against customer's order, which was subsequently cancelled, were disposed of without restriction in the open market.

4. Bonds taken which house couldn't sell were sold out on an investment guaranteed basis.

#### Prices Cut

5. Bonds sold to private customers at cut prices without any apparent restrictions.

6. Salesman, without the approval of the firm, accepted in exchange other bonds at over the market price.

7. Securities accepted, apparently with the approval of the firm, in exchange for new issue at prices over the market.

8. Discounts allowed to non-members of the Association.

9. More than permissible allowances made to members of the Association.

10. Bonds sold by selling group members and underwriters direct to dealers, who were not members of the selling group, passing on full concession.

Replies to the questionnaire sent out in connection with this investigation were all carefully analyzed and every precaution was taken to insure confidential treatment of all replies. Upon completion of the investigation, all replies will be returned to the firms which submitted them.

# DISTRICT ACTIVITIES

## District No. 1

Principal activity in our District was a meeting of the full Committee at which a report was made on the completion of arrangements for regular weekly publication in Spokane, Portland and Seattle newspapers of quotations on local securities.

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## District No. 2

Our District has continued its efforts to educate members as to the purpose of the Association, laying particular emphasis on business conduct. There is a gratifying response from members, which is evidenced through the countless number of inquiries. What constitutes a fair profit seems to be of utmost importance. The routine activities of the Uniform Practice Committee have continued. Suggestions have been made for the expansion and clarification of California delivery rules, but it was felt no action should be taken pending the setting forth of national standards. Southern California has added about 60 quotations to its list in addition to bank and insurance stocks. Northern California continues to quote bank and insurance stocks.

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## District No. 3

Quotations of local securities in the Denver newspapers, inaugurated in May, are being continued and this service is being improved. Our Uniform Practice Committee is about ready to render its final recommendations for uniform standards in our District.

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## District No. 4

Our District is launching an educational program and it is planned to conduct meetings on separate phases of the investment banking business, such as one meeting for salesmen, one for bookkeeping and office employees, etc. James MacRae of Blyth & Co. will head this work. Our Quotations Committee expects to complete arrangements soon for publication of quotes in the local press. Our Uniform Practice Committee is drawing up regulations in connection with local stocks.

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## District No. 5

Steady progress has been made toward completing the framework of the Association in our District. Our Uniform Practice and Quotations Committees have completed the first phase of their work and submitted their reports. Quotations are scheduled to appear in the local press shortly after August 1. It is planned to extend this service to cities outside Kansas City as soon as

possible. Two lists will be used—an active one daily and an inactive one weekly. The committee is considering annual publication of a manual of local securities. Considerable interest has been manifested over the appointment of a special Securities Act Committee to work with the Executive Committee in advocating desirable amendments to the various securities acts.

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## District No. 6

Our District has recently devoted most of its efforts to setting up machinery for publishing quotations. It was decided to start out by carrying quotes on 30 stocks, which should appear in the newspapers by the time this article is published.

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## District No. 7

Our District has carried forward an educational program designed to reach members and their various employees in St. Louis and Little Rock. A series of three meetings were held in each city. We have received a number of favorable comments on the results of these meetings. Our Quotations Committee has been actively engaged in an endeavor to set up some system for the publication of quotations. The exact method is not as yet outlined. The Uniform Practice Committee has made a report to the District Committee in which it has recommended the adoption of standards of uniform practice.

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## District No. 8

Principal efforts of our District recently have been devoted to educational work and many meetings have been held in the larger cities supplemented by a number of personal calls on members. The Quotations Committee has about completed its preliminary work and it is hoped the actual publishing of quotations will begin this month.

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## District No. 9

Several educational meetings, led by national representatives, have been held in the larger cities in our District recently. The meetings were well attended and the members indicated a keen interest. We are giving consideration to the employment of a part or full time secretary for the District.

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## District No. 10

Our District has decided to push more vigorously on both the educational program and our quotations problem.

The Quotations Committee has appointed subcommittees in the principal cities of the District, which are preparing lists of local securities to run in their own newspapers. We hope to eventually evolve one general list as well as the purely local ones. In order to assist in carrying out these programs, it was decided to employ a full time secretary.

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## District No. 11

Our District set July 28 as the deadline for quotations to appear in the newspapers and most of the leading newspapers in the District are now carrying our quotations under the by-line of the Association. It has been decided that the quotes will be handled locally at first and that a District formula will be worked out later. The efforts and cooperation of this committee has been very gratifying.

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## District No. 12

The two local Quotations Committees in our District are now supplying quotes to the Philadelphia and Pittsburgh newspapers. A number of problems have arisen, but have been overcome satisfactorily. Tentative uniform practice standards have been drawn up for the Eastern and Western sections of the District, but have not been adopted, pending the issuance of national standards. A District Committee meeting was held in Pittsburgh July 24 at which the Governors' meeting was discussed.

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## District No. 13

Our Quotations Committee has relaxed its requirement that there need be substantial local interest to quote investment trust securities because of requests for these quotes from outside of this region. The Secretary's office has issued numerous uniform practice rulings. The subcommittee on delivery rules submitted its final draft to the full Committee and their report is now in the hands of counsel for checking. It is expected that by the date of this issue they will be ready for formal approval.

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## District No. 14

Our Quotations Committee has continued the study and supervision of quotations in various cities within this District with cooperation of the dealers. The Committee is awaiting any action the national group may take which may lead to a uniform system of quotes throughout the country. Tentative uniform practice standards have been drawn up, but will not be submitted to members pending action by the national committee.