Lane Opinion Discusses Brokerage Transactions Under Section 22(d) Explains Application of Provision of Investment Company Act to Execution of Such Orders Letter Issued at Request of NASD

The SEC recently made public a letter from its General Counsel, Chester T. Lane, to the Association regarding the application of Section 22(d) of the Investment Company Act of 1940 to brokerage transactions in redeemable securities of registered investment companies.

The text of the letter, which is self-explanatory, is as follows:

"Gentlemen:

"You have requested my opinion concerning the application of Section 22(d) of the Investment Company Act of 1940 to a broker-dealer executing a brokerage order for a customer in the redeemable securities of a registered investment company. I assume such securities are being currently offered to the public by or through an underwriter at a price described in the prospectus covering such securities.

"Section 22(d) of the Investment Company Act of 1940 provides in part are follows:

"No registered investment company shall sell any redeemable se-

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New Canadian Security Transfer Policy Given

Attention of members is called to the revised policy, effective January 27, 1941, announced by the Canadian Custodian of Enemy Property on January 13, 1941, to be followed in matters relating to the transfer, sale, disposition or redemption of securities owned by the "Regulations Respecting Trading With the Enemy (1939)" of Canada. The letter in which the revised regulations are announced sets forth certain instructions, stating that "compliance in good faith with the following instructions will constitute

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Frank Nominated Judge

Jerome N. Frank, SEC Chairman, has been nominated by President Roosevelt to be a judge of the United States Circuit Court of Appeals in the 2nd District, which embraces New York, Vermont and Connecticut. Mr. Frank has been a member of the Commission since 1937 and Chairman since 1939.

Considerable speculation has arisen as to his successor, both as Commissioner and as Chairman, but no official announcement has as yet been made.

The judgeship to which Mr. Frank was nominated is that vacated by Robert P. Patterson who left that post last year to join the War Department and was later made Under Secretary of War. If confirmed, the Commissioner will be the second SEC member to be appointed to the Bench. In 1939, William O. Douglas, then SEC Chairman, was appointed as Associate Justice of the Supreme Court.

SEC Hypothecation Rules Are Subject of Meetings

Rosenfeld, Green Hold Conferences to Clarify New Regulations—Explanatory Memorandum Issued

Henry L. Rosenfeld, Jr., of Salomon Bros. & Hutzler, New York, N. Y. and Francis T. Greene, Assistant Director of the Trading and Exchange Division of the Securities and Exchange Commission, recently conducted a series of meetings with securities dealers in important financial centers for the purpose of explaining and clarifying SEC rules and regulations.

Mr. Rosenfeld is Chairman of the Technical Committee of the NASD which was formed for the purpose of dealing with all business and regulatory problems affecting the securities business and involving special technical knowledge and treatment. This Committee, for example, worked on, and made recommendations and suggestions to the Association's Board of Governors and the SEC on, such matters as the Commission's over-the-counter rules, the stabilizing rules and program, rules

(Turn to Page 3)

Members Approve Proposed Additions to NASD Rules By a Three-to-One Vote

Favor Regulation of Underwriting and Distribution of Securities of Open-End Investment Trusts

Submitted to SEC for Approval

Members have approved the proposed additions to the Rules of Fair Practice of the Association governing certain aspects of the underwriting and distribution of securities of open-end investment trusts by a three-to-one vote. The rule has been submitted to the Securities and Exchange Commission for approval as provided by Section 15A(j) of the Securities Exchange Act of 1934. The effective date of the rule, if approved by the SEC, is June 1, 1941.

Under the By-Laws of the NASD, amendments or additions to its rules, to become effective, must be voted on by a majority of its members and a majority of those voting must approve. The voting was as follows: 62 per cent of the members voted; 46 per cent of the members voted approval; and 16 per cent of the members voted disapproval. However, of those voting, 74 per cent voted approval against only 26 per cent disapproving, making a roughly three-to-one majority of members voting in favor of the rule.

It is generally believed that this addition to the Rules of Fair Practice of the Association will effectively accomplish a real improvement in the business of distributing shares of open-end investment companies, in keeping with the spirit of the recently enacted Investment Company Act of 1940 and the general purposes of the NASD.

Standardization of Procedure

In addition to the benefits to investors from the elimination of certain problems which appeared in the rapidly expanding investment trust business, constructive standardized procedure has been accomplished for underwriters and dealers. The open-end investment company is distinctly an American type of investment trust, the distinguishing characteristic of which is that share-
Rule Additions Approved
(Continued from Page 1)

holders have the right to redeem their shares at approximately asset value.

Assets of these companies have grown in recent years to around $600,000,000 and
recently and underwriters will be affected by the rule which has been adopted. This
action by the NASD represents the first
time that cooperative self-regulation has been accomplished in the sale and
repurchase of shares of open-end inv
vestment companies.

Provisions of Rule

Among the provisions of the rule is
one placing the pricing of shares on a
twice a day basis, rather than on a
once a day basis which has hitherto
been the generally accepted practice.
This provision is aimed at eliminating
as much as possible any "dilution" of
and also eliminated the so-called
"two-price system." The rule limits the
"load" or selling commission to an
amount which is "not unfair." It
establishes a "placement period" in that
if new shares issued are redeemed by
the company within seven days, both
the underwriter and dealer lose their
commissions. This is designed to
dis
ourage so-called "riskless trading."

Lane Opinion
(Continued from Page 1)

curity issued by it to any person
except either to or through a prin
cipal underwriter for distribution
at a current public offering price
described in the prospectus, and, if
such class of security is being cur
rently offered to the public by or
through an underwriter, no prin
cipal underwriter of such security
and no dealer shall sell any such
security to any person except a
dealer, a principal underwriter or
the issuer, except at a current pub
lic offering price described in the
prospectus.

"In my opinion the term 'dealer,' as
used in Section 22(d), refers to the
capacity in which a broker-dealer is
acting in a particular transaction. It
follows, therefore, that if a broker-
dealer in a particular transaction is
acting solely in the capacity of agent for
a selling investor, or for both a selling
investor and a purchasing investor, the
sale may be made at a price other than
the current offering price described in
the prospectus. Of course disclosure
of the fact that the broker-dealer is
acting as agent, and of the amount of
his commission, must be made to his
principal or principals in accordance
with the requirements of the Rules and
Regulations promulgated by the Commis
sion under Section 15(c) (1) of the Se
curities Exchange Act of 1934.

"On the other hand, if a broker-
SEC Held Without
Authority to Require
Competitive Bidding

Committee Report Finds No Statutory
Power for Commission to Promulgate
Rule for Utility Securities

View Supported by Legal Opinion

The Securities and Exchange Com
mission has no statutory authority to
promulgate a general rule requiring
competitive bidding for utility security
issues, according to a report to the
Board of Governors by a special com
mittee of the Association. In addition,
the report opposes the rule suggested
by the Commission's staff requiring
such action and opposes in principle
competitive bidding for the classes of
securities comprehended in the pro
posed rule.

Accompanying the report, which was
filed with the Commission on January
18, 1941, was an opinion by Baker,
Hostetler & Patterson of Cleveland,
attorneys for the Association, holding
that the Commission was without stat
utory authority to promulgate such
rules. The opinion, in addition, said
that even if such authority should exist,
it would certainly appear to be permissi
ve and not mandatory.

Examined on Merits

In discussing the proposed competi
tive bidding rule, the report said that
whether or not such powers exist does
not settle the matter, for if competitive
bidding were desirable and the SEC
did not have such powers at present,
Congress could always grant those pow
ers. Therefore, the Committee decided
that this question should also be ex
amined on its merits. The report was
prepared by a special committee of the
Association, headed by Francis Kernan,
Jr., of White, Weld & Co., New
York City, and has been approved by
the Association's Board of Governors
as the basis for further discussion of
the subject with the SEC.

"Such a rule would mean radical
changes in the present system for the
purchase and distribution of securities
in respect to a large segment of the
capital market of this country," the
report said. "Obviously, at such
time of emergency in our national af
airs, an experiment of this kind is not
warranted unless necessary to prevent
existing evils. This Committee is un
aware of any 'widespread abuses' in the
operation of the present system of nego
tiated transactions in regard to util
ity securities approved by your Com
mission under the 1935 Act. The Pub
lic Utility Division staff's report not
ably fails to cite such abuses. The
report does infer that no standards
exist whereby the Commission can
judge the fairness of underwriting
spreads. The Commission is furnished
with all information as to underwriting
compensation paid with respect to all
public issues of industrial and utility
corporations. To assume that such in
formation does not provide broad and
adequate evidence as to standards of
underwriting spreads is to pre-suppose
that all American business is under
the domination of investment bankers.
This conclusion seems to us absurd."

Overpricing of Issues

The report noted that the Commis
sion's staff had dismissed possible over
pricing of utility issues under competi
tive bidding as of minor consequence
and expressed the opinion that this was
against public interest, in contraven
tion of the terms of the Act and in con
tradiction to the position taken by the
Commission in numerous specific cases.

The NASD report expressed a belief
that competitive bidding would lead in
practice to the virtual dictation of cap
ital issues by the Commission as a sub
stitute for negotiation, because it would
lead to standardized forms of financ
ing and indentures, with a sacrifice of
the diverse needs of individual com
panies to a regimented pattern.

"This is a step toward the complete
control by government of the private
capital market," the report declared.

"We are sure that Congress did not in
tell this, because Congress limited the
powers of the Commission in those mat
ters to a supervisory rather than a
managerial capacity."

The staff disregarded the conse
quences of competitive bidding on
smaller dealers, according to the re
port, which said that many of those
dealers would be put out of business,
seriously crippling facilities for nation
wide distribution of securities, and
would give large buyers in metropol
itan centers a buying monopoly at the
expense of investors.
Baird Elected Chairman
Of Board; Limbert and
Davis Vice Chairman

Jinks Made Treasurer—Fulton Re-
named Executive Director—Action
Taken on Four Important Matters

National Committees for 1941 Appointed

Robert W. Baird of The Wisconsin
Company, Milwaukee, Wis., was
elected chairman of the Board of Gov-
ernors of the National Association of
Securities Dealers at the recent meet-
ing of the Board. George W. Davis of
Davis, Skaggs & Co., San Francisco,
Calif., and Lee M. Limbert of Blyth &
Co., Inc., New York, N. Y. were
named as Vice Chairmen. Laurence M. Marks
of Laurence M. Marks & Co., New York,
N. Y. was elected Treasurer. Wallace
H. Fulton of Washington, D. C. was re-
elected Executive Director of the
NASDAQ.

The Board also took action on four
important matters: (1) It approved as
a basis for further discussion with the
SEC, the Arm's-Length Bargaining
Committee's report on proposals of the
Commission's staff for competitive bid-
ing on utility security issues; (2) It
approved the proposed open-end in-
vestment company rules recently voted
on by the members; (3) It approved a
comprehensive uniform trade practice
code; and (4) It approved the work of the
special Securities Acts Committee.

National Committees Appointed

The national standing committees of the
Association, including Executive,
Finance, Technical, Quotations, Busi-
ness Conduct, Uniform Practice, and
Investment Trust Underwriters, were
recently appointed for 1941. Personnel of
these committees is as follows:

Executive: Robert W. Baird of The
Wisconsin Company, Milwaukee,
Chairman; George W. Davis of Davis,
Skaggs & Co., San Francisco; H. H.
Dewar of Dewar, Robertson & Pan-
coast, San Antonio; Lee M. Limbert of
Blyth & Co., Inc., New York; John R.
Longmire of I. M. Simon & Co., St.
Louis; Laurence M. Marks of Laurence
M. Marks & Co., New York; Francis F.
Patton of A. G. Becker & Co., Chicago;
and Wallace H. Fulton of Washington,
D. C. (ex officio).

Finance: Laurence M. Marks of
Laurence M. Marks & Co., New York,
Chairman; Robert W. Baird of The Wis-
sconsin Company, Milwaukee; Hermann
A. Clarke of Estabrook & Co., Boston;
William A. Fuller of Fuller, Crut-
tenden & Co., Chicago; and Wallace H.
Fulton of Washington, D. C. (ex offi-
cio).

Technical Committee

Technical: Henry L. Rosenfield, Jr.,
of Salomon Bros. & Hutzler, New York,
Chairman; Benjamin J. Buteniewser of
Kuhn, Loeb & Co., New York; James
H. Coolidge of McDonald-Coolidge &
Co., Cleveland; William A. Fuller of
Fuller, Cruttenden & Co., Chicago; and
Lee M. Limbert of Blyth & Co., Inc., New
York.

Quotations: Frank Weeden of
Weeden & Co., San Francisco, Chair-
man; William Bayne of Arthur Perry &
Co., Incorporated, Boston; Edward E.
Chase of Maine Securities Company,
Portland; Carey S. Hill of Hill, Rich-
ards & Co., Los Angeles; E. H. Ladd,
3rd, of the First Boston Corporation,
New York; Elwood Miller of E. W. &
R. C. Miller & Co., Philadelphia; A. W.
Snyder of A. W. Snyder & Company,
Houston; Oliver J. Troster of Hoit, Rose
& Troster, New York; and Thompson
M. Wakely of A. C. Allyn and Com-
pany, Chicago.

Business Conduct: Donald C. Brom-
field of Garrett-Bromfield & Co., Inc.,
Denver, Chairman; Edward Brockhaus of
Edward Brockhaus & Co., Cincinnati;
Arthur S. Burgess of Biddle, Whelen
& Co., Philadelphia; Frank Dunne of
Dunne & Co., New York; John A. Pres-
cott of Prescott, Wright, Snider Com-
pany, Kansas City, Mo.; Harvey Roney
of Banks, Huntley & Co., Los Angeles;
and Lawrence B. Woodard of Woodard-
Elwood & Co., Minneapolis.

Uniform Practice Group

Uniform Practice: Joseph T. John-
son of The Milwaukee Company, Mil-
waukee, Chairman; Laurence B. Car-
rall of Prescott, Wright, Snider Com-
pany, Kansas City, Mo.; K. F. Deitrick
of Blair, Bonner & Company, Chicago;
A. L. Godie of Fuller, Cruttenend & Co.,
Chicago; Robert R. MacGregor of El-
worthy & Co., San Francisco; Robert L.
Osswalt of Blyth & Co., Inc., New
York; William T. Patten, Jr., of Badgley,
Frederick, Rogers & Morford, Inc.,
Seattle; Henry B. Rising of Whiting,
Wecks & Stubbs, Inc., Boston; John J.
Sullivan of Sullivan & Company, Den-
ver; and Frank Rizzo of 44 Wall Street,
New York, Secretary to the Committee.

Investment Trust Underwriters:

Henry T. Vance of Massachusetts Dis-
tributors, Inc., Boston, Chairman;
Robert S. Adler of Selected Invest-
ments Company, Chicago; Herbert A.
Bradford of Calvin Bullock, New York;
John Sherman Myers of Lord, Abbott
& Co., Inc., New York; Ivan C. Patter-
son of The Parker Corporation, Boston;
and A. W. Smith of General Investors
Corporation, Boston.

709 Registered Advisers

A total of 709 investment ad-
visers had registered with the SEC
under the Investment Ad-
visers Act of 1940 as of February
18, 1941, the SEC announced re-
cently. During the period of De-
ceiber 19, 1940, to February
18, 1941, inclusive, 53 applications
for registration of investment ad-
visers became effective, the regis-
trations of six investment advisers
were withdrawn, and the registration
of one investment adviser was can-
celled.

SEC Hypothecation Rules
(Continued from Page 1)

having to do with keeping and pre-
servation of records and the new rules
governing the pledging of customers' securities.

Affect All Firms

Principal emphasis was laid on the expla-
nation of the 8(e) or "hypotheca-
tion" rules, which affect all brokers and
dealers as well as stock exchange mem-
bers. In promulgating these rules, the
Commission explained that they were
designed to put into operation three
simple principles laid down in the Se-
curities Exchange Act of 1934 as fol-
lows: (1) brokers or dealers must not
congregate the securities of different
customers as collateral for a loan with-
out the consent of each customer; (2)
a broker or dealer must not congregate
his customers' securities with his own
under the same pledge; and (3) a
broker or dealer must not pledge cus-
tomers' securities for more than his cus-
tomers owe him.

These rules became effective Febru-
ary 24, 1941.

Memorandum Issued

The NASD and SEC hope, by means
of these meetings and discussions with
brokers and dealers, to bring about a
better understanding of these rules and
to assist brokers and dealers in making
the necessary changes in present busi-
ness practices and banking arrange-
ments to effect compliance. Cities
visited include Boston, Detroit, Clevel-
and, Chicago, San Francisco, Los An-
geles, Kansas City, Mo., St. Louis, Cin-
natti, Pittsburgh, Philadelphia, New
York and Baltimore.

As a further aid in this work, The
Association recently sent to all of its
members a memorandum explaining the
provisions of these rules. The memo-
randum points out that the rules affect
practically all brokers and dealers in
one way or another even if they do a
strictly "cash" business.
Canadian Transfer Policy
(Continued from Page 1)

protection to all persons against any claim which the Custodian might otherwise assert", and further states:

"(a) Transfers, sales or other dispositions of securities are prohibited which, according to the addresses on the books of the company or its transfer agents, or records in their possession, are registered in the names of, or beneficially owned by, persons who are enemies or which appear to be enemy owned as disclosed by any declaration of ownership. Such securities must be reported to the Custodian.

Ownership Declarations

"(b) Transfers, sales or other dispositions of securities registered in the names of persons who, according to the addresses on the books of the company or its transfer agents, or records in their possession, are documented as outside of enemy and proscribed territory and outside of Canada, the United Kingdom and the United States, must be accompanied by a declaration of ownership conforming to Form G.

"Transfers, sale or other dispositions of bearer securities must also be accompanied by Form G."

"Provided however, that if the registered holders' address on the books of the company or its transfer agents, or the address of the person beneficially interested as disclosed by the declaration of ownership is in Continental Europe, the transfer, sale or other disposition must not be effected without the specific approval of the Custodian.

"Provided further that transfers, sales or other dispositions of securities registered in the name of a bank, broker, investment house, trustee (in whatever capacity they may be acting), or a nominee, located in the United Kingdom or the United States, or their or endorsed, thereon, a declaration of ownership conforming to Form G.

Sign of Declarations

"(c) The declaration must be signed by an official of or a signatory for: a Canadian chartered bank; any bank in the United Kingdom; any United States commercial bank or trust company located in New York City or having a New York City correspondent bank or trust company; a Canadian trust company; a transfer agent or registrar for a Canadian security; or a member or member firm of the Investment Dealers' Association of Canada. The Investment Bankers Association of America, a Canadian stock exchange or Canadian Curb Market, the New York Stock Exchange or the New York Curb Exchange Securities Clearing Corporation; and be signed by or on behalf of the person whose beneficial interest in the security is being transferred, sold or otherwise disposed of."

As described in the instructions, "ENEMY:"— nationals and residents (regardless of nationality) of the Greater German Reich, Moravia, Bohemia, Slovakia, Poland, Denmark, Norway, Netherlands, Belgium, Luxembourg, Italy and possessions, Albania, Channel Islands, Roumania, French Territory in Europe and contiguous territories of Andorra and Monaco, the French Zone of Morocco, Corsica, Algeria and Tunisia, and all other enemy, enemy occupied or proscribed territory, and any person included in the List of Specified Persons published in the Canada Gazette."

Sample copies of Form G may be obtained from: The office of the Custodian, Department of the Secretary of State, Room 45 S, Central Chambers, Toronto, Ontario, or the Association of Securities Dealers, Inc., District No. 13, 44 Wall Street, New York.