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IN THE

Supreme Court of the United States

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OCTOBER TERM, 1987

STATE OF DELAWARE,

Plaintiff,

vs.

STATE OF NEW YORK,

Defendant.

DOCUMENTS LODGED WITH THE CLERK

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Committee on Stockbrokerage Auditing, American Institute of Certified Public Accountants, Audits of Brokers and Dealers in Securities (1973)..... C

New York Institute of Finance, Introduction to Brokerage Operations Dept. Procedures (1979)..... D

Prudential Insurance Company of America v. Alabama, No. C-4937-83E (N.J. Super. Ct. Ch. Div. filed Nov. 23, 1983):

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STATE OF NEW YORK
DEPARTMENT OF LAW
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ROBERT ABRAMS
ATTORNEY GENERAL

May 9, 1988

The Honorable Charles M. Oberly, III
Attorney General
State of Delaware
Department of Justice
State Office Building
820 N. French Street, 8th Floor
Wilmington, Delaware 19801

Re: Delaware v. New York

Dear Charlie,

I have enclosed a copy of New York's brief in opposition to Delaware's motion for leave to file a complaint in this case. As you can see from our brief, we believe this case boils down to a dispute over the number of addresses of creditor brokers which have abandoned dividend and interest overpayments that are located in Delaware and the number of addresses that are unknown.

We believe that this factual issue could be settled amicably by having people from each of our offices meet to establish a mutually agreeable mechanism for determining which creditor brokers have Delaware addresses and which addresses are unknown. While we believe that the complexity, cost, and length of time required to reconstruct every individual transaction makes it impracticable to attempt a review of all transactions, it should be possible to develop a sampling technique that would provide a basis for making an equitable apportionment.

In our brief, we also suggest an alternative approach which the other states have used, that is New York's claim procedure. Delaware may wish to file a claim with the Comptroller for any overpayments abandoned by creditor brokers with Delaware addresses or by creditor brokers whose addresses are unknown. If Delaware were to be dissatisfied with the decision of the Comptroller on any claim, it would be entitled

to a fair hearing to review and redetermine the claim and to judicial review.

I do not know if you are already aware, but New York and several other states including Idaho, Massachusetts, Minnesota, North Carolina, North Dakota, Virginia, and Wisconsin have entered into reciprocity agreements whereby each state agrees to transfer to the other abandoned property owed to individuals and corporations whose address is in the other state. This appears to be a useful approach for the future and should be explored.

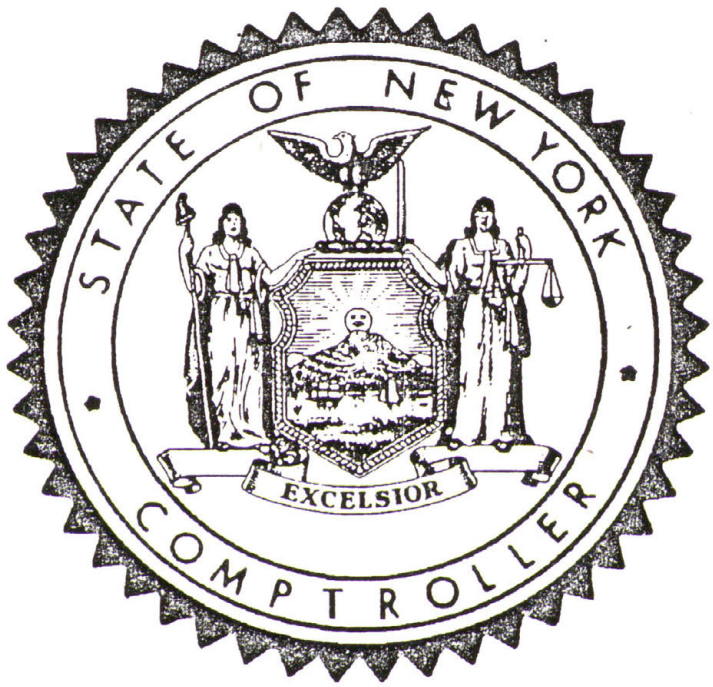
I am convinced that by working together to seek a mutually acceptable resolution, we can avoid both the high costs of litigation to our respective states and imposition of burdens on the Court's overtaxed docket. I look forward to hearing from you soon.

Sincerely,

ROBERT ABRAMS

HANDBOOK FOR REPORTERS OF UNCLAIMED FUNDS

SECOND EDITION



1988

EDWARD V. REGAN
STATE COMPTROLLER

STATE OF NEW YORK
OFFICE OF UNCLAIMED FUNDS

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I. INTRODUCTION

The New York State Abandoned Property Law requires the transfer of certain unclaimed funds to the custody and protection of the State Comptroller. In order to protect the interests of the rightful owners and facilitate the return of their funds, specific reporting and refund claim procedures have been established.

This handbook will inform organizations of their responsibilities under the Abandoned Property Law and assist in the preparation of abandoned property reports. The handbook is **not** intended to be used as an organization's sole source of information in regard to its legal obligations under the Abandoned Property Law. Each organization should review the entire law, which is published in **Book 2 1/2 of McKinney's Consolidated Laws of the State of New York**, to ensure all reporting requirements are understood. The review of the law should be ongoing, as revisions to the statute may cause changes in reporting requirements. **McKinney's** is published and sold by West Publishing Co., P.O. Box 64526, St. Paul, Minnesota 55164-0526, telephone number (612) 228-2500.

To assist reporters, the New York State Comptroller's Office of Unclaimed Funds regularly issues letters and instructional announcements designed to help reporting organizations comply with the Abandoned Property Law. Using this material can aid an organization in preparing the required reports correctly.

To ensure complete, accurate and timely reporting of Unclaimed Funds, it is of utmost importance that this handbook and all other related materials be forwarded to the person(s) in your organization responsible for the preparation of the abandoned property report.

II. DIRECTORY

REPORTS, REMITTANCE AND SECURITIES	(518) 473-7002	New York State Comptroller Office of Unclaimed Funds Capital Station Annex P.O. Box 7009 Albany, New York 12225
REQUESTS FOR FORMS AND ADDITIONAL COPIES OF HANDBOOK	(800) 221-9311 Within NYS **OR** (518) 474-4038 Outside NYS	New York State Comptroller Office of Unclaimed Funds Att: Reports Processing State Office Building Albany, New York 12236
REQUESTS FOR WAIVERS, EXTENSIONS AND QUESTIONS REGARDING ADVERTISING	(518) 474-1769	New York State Comptroller Office of Unclaimed Funds State Office Building Albany, New York 12236
REPORTING REQUIREMENTS	(518) 473-7002	

REFUND PROCEDURES (Address correspondence to appropriate unit):

Individual Claims Unit Corporate Claims Unit Outreach Specialist	(800) 221-9311 Within NYS **OR** (518) 474-4038 Outside NYS	New York State Comptroller Office of Unclaimed Funds State Office Building Albany, New York 12236
LEGAL ISSUES AND ALL QUESTIONS REGARDING RECIPROCAL REPORTING	(212) 587-5242	New York State Comptroller Office of Unclaimed Funds 270 Broadway - Room 911 New York, New York 10007

III. GENERAL REPORTING INSTRUCTIONS

REPORTING REQUIREMENTS

All holders of abandoned property required to report such property under the Abandoned Property Law of New York State must submit their reports on magnetic tape if they are reporting 501 or more items. Holders of 500 or fewer items may report on FORM AC 2686 - REPORT OF ABANDONED PROPERTY. Reports filed on Form AC 2686 must be typed or legibly printed. It should be noted that Form AC 2686 is a four part manifold form. The original green and white copy is used for filing all final reports. If securities are physically transmitted with the report, an additional copy of this form must also be included. A copy will be returned to the reporter acknowledging receipt of the securities.

Reporters required to file preliminary reports (e.g., banking institutions, utilities and insurers) should submit the fourth (goldenrod) copy as the preliminary report. To save re-preparation when the final report comes due you need only complete the field "Escheated Amount" for the actual amounts to be reported and mark "Removal Indicator" for deleted items.

Each report, whether on paper Form AC 2686, Report of Abandoned Property, or on magnetic tape, must be accompanied by a completed Form AC 2709, VERIFICATION AND CHECKLIST, signed by an authorized officer declaring that said report is true and complete to the best of the authorized officer's knowledge. Form AC 2709 must be notarized.

In order to expedite the processing of reports and in turn facilitate subsequent claims processing, it is imperative that reporting organizations file complete and accurate tape or paper reports in accordance with the following instructions. Since failure to follow these instructions may result in a report's being returned to the reporting organization for correction, please take the time to review them carefully.

Page 6 entitled **CALENDAR OF ABANDONED PROPERTY REPORTS AND PAYMENTS** indicates the types of organizations required to file, types of property subject to the statute, dormancy periods and due dates for compliance. In addition, your attention is called to the section entitled **CLARIFICATION OF ISSUES MOST FREQUENTLY RAISED BY REPORTING ORGANIZATIONS** with respect to issues that may relate to your industry.

PAYMENT

Each report of abandoned property should be accompanied by the applicable remittance payable to:

COMPTROLLER, STATE OF NEW YORK

WAIVERS AND EXTENSIONS

Organizations reporting 501 or more items and wishing to file a paper report on form AC 2686, Report of Abandoned Property, must request a waiver in writing within 30 calendar days prior to the time the report is due.

Requests for an extension of time for filing a report of abandoned property should be in writing, setting forth the extenuating circumstances which preclude timely reporting. The granting of an extension only applies to preparation of the report. In order to avoid penalties and/or interest, payment must be made when due (see Penalties below).

NEGATIVE REPORTS

Banking organizations, credit unions, brokers and dealers, insurance companies and utility corporations, which neither hold nor owe abandoned property are nevertheless required to submit an abandoned property report.

This negative report will consist of an AC 2709, Verification and Checklist, showing the report date, all requested information identifying the reporting organization, contact personnel, and the word "None" on the "Totals" lines. The form must be executed and signed by an authorized officer of the reporting organization and notarized.

ADVERTISING

Based upon statutory requirements, certain reporting organizations, as reflected in the Calendar of Abandoned Property Reports and Payments, are required to annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned cash amounts. For detailed information regarding publication, refer to the annual abandoned property circular letter provided by this office. Note: A name should only be published once regardless of the number of items held in that name to be reported in a given year.

RETENTION OF RECORDS

Section 513-a of the Abandoned Property Law requires that brokers and dealers retain records for eight years following the end of the year in which they were created. These records must be made available to the State Comptroller upon his request.

Other organizations should refer to Section 1412-a of the Abandoned Property Law, which specifies that books and records shall be retained for a period of five years following December 31 of the year for which a report was filed.

In order to ensure proper compliance with the aforementioned record retention requirements, copies of Section 513-a or 1412-a should be distributed to the appropriate personnel within the various operational departments and to employees responsible for determining archival record retention schedules.

After reviewing the appropriate section of the law, should your organization have any further questions, please contact this office.

PENALTIES

Holders failing to file full and complete reports or to file any affidavit required by the statute and in the manner prescribed by the Comptroller may be subject to penalties in the sum of one hundred dollars for each day of delay pursuant to Section 1412 of the New York State Abandoned Property Law.

PENALTY FOR FRAUDULENT RETURNS

The filing of a willfully false report or the making of a false verification is punishable under the provisions of the Penal Law.

INTEREST CHARGES FOR LATE PAYMENT OR DELIVERY OF ABANDONED PROPERTY

Section 1412 of the Abandoned Property Law provides for the payment of interest to the State for late delivery or payment of abandoned property held by any reporting organization, effective June 22, 1971. Interest is assessed from the date payment or delivery was required to the date payment or delivery is made. Interest is at the rate of 10% per annum for any period of lateness on or after June 29, 1981 and at a rate of 6% for any period of lateness prior to June 29, 1981. The interest charge on securities is based on the closing price of the securities as of the tenth day of the month delivery was due.

IV. CALENDAR OF ABANDONED PROPERTY REPORTS AND PAYMENTS STATE OF NEW YORK

Types of Business and Properties	Statute Article	Dormancy Period in Years	Due Dates: Preliminary Report	Due Dates: Publication of Report	Due Dates: Final Report & Payment	Verification Checklist Item No.(s)	Additional Requirements
Real Estate	II	Title vests in the state upon death without heir					
Banks	III		8/1 as of 6/30	8/31	11/10		Written notice
Deposits		5				1a - 1f	sent 1st class
Interest on bonds & mortgages		5				1g	mail 8/1 to
Negotiable instruments		5				2a - 2g, 2x	each person
Contents of safe deposit boxes		3				1j, 8j	listed in
Dividents & interest on securities		3				1i, 3a - 3x	report
Securities due:							
Trust customers		3				8f - 8h	Proof of 8/31
Unknown		3				4a - 4f, 4x	publication by
Payments on own capital stock		3				3a	9/10
Lost property		5				8e, 8i	
Time deposits		5				1c	
Utilities	IV		8/1 as of 7/1	8/31	10/10		Proof of 8/31
Security deposits, advance payments and refunds due		2				5a - 5c, 5x	publication by 9/10
All Business Entities	V		None	None	3/10 as of 12/31		
Amounts owed on securities		3				3a - 3d, 3x	
Wages payable		3				8a	
Securities issued but held		3				3c - 3d, 3x	
Brokers/Dealers	V-A		None	None	3/10 as of 12/31		
Securities, dividends & interest owed on securities		3				1i, 4a - 4e, 8f	
Wages payable		3				8a	
Court funds	VI	5(See Note 1)	None	2/1 as of 1/1	4/10 as of 1/1	7a - 7x	Proof of 2/1 publication by 2/10
Life Insurance Companies	VII			5/1	9/10		Proof of 5/1
Amounts held or owing on matured life policies		3	4/1 as of 1/1			6b	publication by 5/10
Amounts held or owing on superannuated life policies		None	4/1 as of 12/31			6a	
Unclaimed death benefits		3	4/1 as of 1/1			6c	
Unclaimed refunds (dividends) on life policies		3	4/1 as of 1/1			5d, 6e, 6x	
Condemnation awards	X	5	10/1 as of 7/1	10/30	2/10	7d	Proof of 10/31

United States of America	XII-A	(See Note 3)	Upon special proceedings by Attorney General.			7a - 7x	
Miscellaneous Property	XIII						
Pledged property	1300	6	None	None	6/1 as of 1/1	8x	
Pledged property (Collateral Loan Broker)	1301	1	None	None	7/10 as of 6/30	8d	
Property in state institutions	1304	None	Moneys, intangibles, proceeds of sale of tangibles paid immediately to Comptroller.			7x	
Public assistance	1305	4	None	None	9/10 as of 6/30	7x	
Vehicle & Traffic Law	1306	None	None	None	7/1 as of 1/1	7x	
Wrecked property proceeds	1307	(See Note 4)	Paid immediately to Comptroller.			7x	
Unclaimed wages - Dept. of Labor	1308	(See Note 5)	None	None	5/1 as of 4/1	8a	
Travelers checks (non bank)	1309(1)	15	None	None	6/1 as of 1/1	2h	
Money orders (non bank)	1309(2)	7	None	None	6/1 as of 1/1	2i	
Miscellaneous property	1310	2	Upon application to Supreme Court & election by Comptroller.			8x	
Utility Co. collection of taxes	1311	1	8/1 as of 7/1	None	10/10	8x	
Unauthorized foreign corp. prop.	1312	5	None	None	10/10	3a - 3e, 3x	
Sales finance co. properties	1313	3	None	None	10/10 as of 6/30	8c	
Consumer credit balances (See Note 6)	1314	3	None	None	2/15 as of 12/31	1h	
Vendor payments, outstanding checks and escrow amounts, gift certificates	1315	5	None	None	3/10 as of 12/31	1f, 2g, 5e, 8b	
Insurance proceeds other than life insurance	1316	3	4/1 as of 1/1	5/1	9/10	6d, 6e	Proof of 5/1 publication by 5/10
Corporate dissolution proceeds	(See Note 7)					3x	

The reportable types listed represent a summary of classifications and are not intended to restrict statutory coverage.

NOTES TO CALENDAR OF ABANDONED PROPERTY REPORTS AND PAYMENTS STATE OF NEW YORK

NOTE 1:

Court Funds: The monetary proceeds of any legacy or distribution share to which an unknown person is entitled pursuant to Section 2222 of the Surrogate's Court Procedure Act shall within 30 days after a decree pursuant to Section 2222 of that act be paid to the Comptroller by the executor, administrator, guardian or testamentary trustee.

NOTE 2:

Property In Federal Courts: The dormancy period is ten years in cases in which the rightful owners are unknown. If the rightful owners have died without heirs or abandoned the property pursuant to Section 1201 of the Abandoned Property Law, there is no dormancy period.

NOTE 3:

Property in Custody of the United States Government: The dormancy period is seven years in cases in which the rightful owners are unknown. If the rightful owners have died without heirs or abandoned the property pursuant to Section 1216 of the Abandoned Property Law, there is no dormancy period.

NOTE 4:

Wrecked Property Proceeds: The dormancy period for proceeds of the sale of perishable goods is one year. There is no dormancy period for proceeds of sale of nonperishable goods.

NOTE 5:

Unclaimed Wages: The dormancy period is one year from the date the wages are received by the Department of Labor. (Refers to underpayment of minimum wages only).

NOTE 6:

Consumer Credit Balances: The requirements for reporting and paying unclaimed credit balances are contained in Article 34-A of the General Business Law and relate only to credit card balances.

NOTE 7:

Corporate Dissolution Proceeds: Applies to assets distributed to a creditor or shareholder of business corporations upon non-judicial dissolution (Business Corp. Law, Section 1005(c)) or judicial dissolution (Business Corp. Law, Section 1117(a)) and non-judicial dissolution of not-for-profit corporations (Not-For-Profit Corp. Law, Section 1005(a)(4)) or judicial dissolution (Not-For-Profit Corp. Law, Section 1115(a)). Such proceeds are payable as abandoned property within six months of the date fixed for payment of the final liquidating distribution, unless otherwise specified by court order in cases of judicial dissolution.

V. SPECIFIC REPORTING INSTRUCTIONS

FORM AC 2709 - VERIFICATION AND CHECKLIST

A samle completed copy of Form AC 2709 - Verfication and Checklist is included in the section entitled Report Illustrations. The following significant points should be noted:

- Cash and securities should not be reported together in a single filing. A separate report and separate Form AC 2709 should be prepared for each.

- Correct property types as listed on the back of Form AC 2709 must be used. For example, the correct property type for Cashier or Tellers Checks is 2B.

- On supplemental abandoned property reports, **Verification for the Period Ended** should reflect the statutory year end cut-off for which the reporting organization was last required to file. For example, a banking institution filing a supplemental report in April 1988, would use June 30, 1987 as the **Period Ended** date.

- Organizations reporting on behalf of others, such as data processing corporations which file at the direction of their corporate clients, should enter the names of both organizations as follows:

  XYZ Corp. as Reporter for ABC Corp.

  In such cases, the **Federal Employer ID number** as well as the question **"Are you Authorized to do Business In NYS?"** should be answered based upon the corporate status of the client corporation on whose behalf the property is being filed and not the status of the preparer.

- Organizations which underwent a name change during the year should enter the name of reporting organization as follows:

  XYZ Corp. formerly ABC Corp.

- Banking institutions should substitute **State Chartered** and **Date Chartered** for **State of Incorporation and Date of Incorporation.**

- The Item and Record count may differ, since a multiple entitlement account or item results in more than one record. For example, a joint savings account would comprise one item but two records.

- Late filing interest charges are to be reflected on the Verification and Checklist as property type 8X and labeled as such.

UNIFORM REPORTING INSTRUCTIONS FOR FORM AC 2686 - REPORT OF ABANDONED PROPERTY AND MAGNETIC TAPE

Sample Forms AC 2686 Report of Abandoned Property are reflected in the section entitled Report Illustrations. Due to a recent enhancement of our system, the instructions on the back of the form are obsolete. Accordingly, regardless of whether filing a report on Form AC 2686, or on magnetic tape, reporters must comply with the following instructions. Additional instructions starting on page 16 relate exclusively to **tape reporting**.

OWNER INFORMATION

These fields will identify the person(s) or entity entitled to the property as they appear on the records of the reporting organization. Accordingly, reporters should carefully examine their records in order to report complete and accurate information. Data should be entered as described below. If owner name data is unavailable, enter the word "UNKNOWN" in the owner last name field. This field is the only field in which the word "UNKNOWN" is acceptable. Do not abbreviate the word "UNKNOWN" or use any other descriptive entry to indicate that the data is unavailable. If other owner information is unavailable, leave the appropriate field blank.

OWNER NAME (Person):

LAST NAME - Last name of the owner must be listed first.
FIRST NAME - First name, if available.
MIDDLE INITIAL - Middle initial, if available.
SUFFIX - Suffixes as shown on the records of the reporting organization (e.g., Jr., Sr., III, etc.)

Note: Punctuation and/or spaces should <u>not</u> be entered in the name data fields (e.g., the name O'Connor is to be entered as OConnor; the name O Brien is to be entered as OBrien; and the name Smith-Jones is to be entered as SmithJones).

OWNER NAME (Entity):

LAST NAME -Enter corporate or entity names except that the word "THE" must be omitted when it is the first word of the name. The name may continue into the FIRST NAME field.
SUFFIX - Enter "ENT" in the SUFFIX field.

ADDRESS:

STREET 1, STREET 2 - Use the address last known to the reporting organization.
CITY - City; if unknown, leave blank.
STATE - State code, as used by postal authorities; if unknown or foreign, leave blank.
ZIP CODE - Enter 5 digit zip code. Include 4 digit supplementary zip code. If unknown, leave blank.
COUNTRY - Enter name of foreign country of addressee. If address is in the USA, leave blank.

SOCIAL SECURITY NUMBER:

For individuals, enter SSN if known. If the owner is not an individual, enter Federal Employer ID Number if known.

ACCOUNT TITLE:

Enter the names and relationships of all owners and beneficiaries as reflected on the records of the reporting organization. Where the ACCOUNT TITLE and NAME are the same, the OWNER NAME should be repeated in the ACCOUNT TITLE data field. Examples of account titles are:

John Doe and Mary Doe, JT
Jane Powell I/T/F Joseph Powell
Margaret Rice as Custodian For
Jean Rice, UGMA
John Doe (Payee), Jane Doe (Maker)

Descriptions such as Unclaimed Dividends, Bond Interest or Outstanding Checks should <u>not</u> be entered in the Account Title data field. Use of the correct Property Type ID will provide us with this information.

<u>NOTE:</u> Whenever amounts or securities held for UNKNOWN parties in nominee name are reported, enter UNKNOWN in the Owner Last Name field. Nominee name should not appear in this field, but should be included in Description of Securities e.g.,

XYZ Corp. Div. on 100 shares n/o Cede

PROPERTY INFORMATION

PROPERTY TYPE:

This field identifies the type of property reported, (i.e., checks, insurance proceeds, securities, customer accounts, etc.) and is to be coded with a two-digit alphanumeric code as indicated in the Property Type Table on the back of Form AC 2709, Verification and Checklist. For example, a savings account is coded '1B', Lost Property is coded '8E'. (Note: The Property Type Table is provided as a guideline and does not affect or restrict statutory coverage of the unclaimed item your organization may hold.)

PROPERTY ID NUMBER:

Use the number by which the reporting organization identifies the property, for example:

Security certificate number
Customer account number
Insurance policy number
Check number

DATE (MMDDYY):

Use date dormancy period begins, for example:

Date of last activity
Payable Date (end of quarter date is acceptable)
Date of Death
Date of Check

NOTE: no hyphens, dashes, or slashes should appear in this field. For example, December 9, 1983 should be entered as 120983

AMOUNT INFORMATION

INITIAL AMOUNT:

This data field must always be completed. Enter amount as shown on the books as of abandonment date. (If amount is removed from the final report by reason of claim, contact or other, see REMOVAL INDICATOR described below).

ESCHEATED AMOUNT:

Enter amount paid to the State. (If this dollar amount reflects dividends, interest, proceeds of sale or cash-in-lieu of securities, the SECURITIES INFORMATION below must also be entered).

REMOVAL INDICATOR:	If paid to owner or contact with owner was established enter "P" in "Owner Claimed" box. If "Otherwise Reduced to Zero" (e.g., amount originally included in error) enter "R" in appropriate box. The presence of an entry in the REMOVAL INDICATOR field on the final report indicates that an item was included on the preliminary report but is not being reported. Improper usage of these codes can prevent a report from balancing with the payment.

SECURITIES INFORMATION

This information must be entered for securities escheated to the State whether in the form of physical delivery or by DTC transfer.

DESCRIPTION OF SECURITY:	Enter standard description of the issue as used by the financial community.
CUSIP NUMBER:	Enter number as assigned by CUSIP.
NUMBER OF SHARES OR DENOMINATION:	Enter number of shares or denominations to be reported to the State.
METHOD OF TRANSFER:	Use the appropriate code: "D" for DTC Deliveries, "P" for Physical Deliveries or "T" for Securities Reported But to be Delivered at a Later Date.

NOTE: When cash proceeds on securities such as proceeds of sale, cash-in-lieu, dividends, bond interest, over receipts, overages, etc., are reported, the only securities data field to be completed is DESCRIPTION OF SECURITIES e.g., XYZ Corp. - Div. on 100 sh. The CUSIP NUMBER, No. of SHARES OR DENOMINATION and METHOD OF TRANSFER fields should remain blank.

AGGREGATE INFORMATION

Whenever items under $3.01 are reported, the individual items should be grouped into one aggregate amount for each **property type**. This type of record should contain data as follows:

OWNER LAST NAME:	Enter the word "AGGREGATE".
OWNER FIRST NAME:	Enter the number of items comprising the aggregate (numeric characters only, e.g., 10).

NOTE: For tape reporting only, all aggregate records must additionally contain the fields RECORD IDENTIFIER, UNIQUE REFERENCE NUMBER and FEDERAL ID of the reporter.

PROPERTY TYPE:	Should contain the appropriate code from the Property Type Table.
ESCHEATED AMOUNT:	Should contain the aggregate sum.

NOTE: Amounts greater than $3.00 should not be aggregated. However, reporters have the option to combine amounts under $3.01 payable to an owner in a given year and reportable under the same property type (e.g., quarterly dividend checks).

MULTIPLE ENTITLEMENT INFORMATION

Whenever a reported item is subject to multiple entitlement, i.e., two or more owners are associated with the same property:

- A separate record must be created for each owner associated with the property (with MULTIPLE OWNERS coded "X" in each record).
- The first (primary) record must have data entered in **all** applicable fields.
- Subsequent records should contain data in the following fields only: OWNER NAME, ACCOUNT TITLE, ADDRESS, SOCIAL SECURITY NUMBER, PROPERTY TYPE, PROPERTY ID NUMBER, DATE, MULTIPLE OWNERS INDICATOR, and REMOVAL INDICATOR, where applicable.
- The ACCOUNT TITLE, PROPERTY TYPE, PROPERTY ID NUMBER, DATE and MULTIPLE OWNERS INDICATOR on subsequent records should be the same as in the primary record. ACCOUNT TITLE should reflect all owners and beneficiaries as reflected in the primary record.
- Examples of account titles for which multiple entitlement information must be provided are:

John Doe & Mary Doe Joint Tenants
John Doe I/T/F Mary Doe
John Doe as Guardian for Mary Doe
John Doe Custodian for Mary Doe U/G/M/A
Estate of John Doe, Mary Doe Executrix
John Doe (Maker), Mary Doe (Payee)
John Doe (Insured), Mary Doe (Beneficiary)

NOTE: For tape reporting only, all multiple entitlement records must additionally contain the fields RECORD IDENTIFIER, UNIQUE REFERENCE NUMBER and FEDERAL ID of the reporter.

MAGNETIC TAPE REPORTING INSTRUCTIONS

The following specifications and instructions are unique to Magnetic Tape Reporting.

MAGNETIC TAPE SPECIFICATIONS

All types of reportable abandoned property may be reported in one tape file. The tape itself must be 9-track, 1600 or 6250 BPI density; data format must be EBCDIC to be IBM-compatible. Diskette reporting is not acceptable at this time.

Except for tapes created on Burroughs equipment, internal tape labels must not be present. To aid us in returning the tapes, they must have appropriate external labels which identify the sending organization's name and address, **and** the reporting organization's name. If reports for more than one organization are on a tape, they should also be listed on an external label in the order they appear on the tape. A report will consist of one HEADER RECORD for each organization reporting, its associated DETAIL-RECORDS and its TRAILER RECORD. The recordlength is 384 characters, the record format is fixed-length, blocked 20 records to a block for a block length of 7680 characters. It is recommended that a dump of the tape be retained by the reporter on fiche, film or hard copy. We also recommend that a dump of the tape be given to whatever staff will be filing claims with New York State for the return of accounts.

RECORD IDENTIFIER

All records reported on tape must contain a record identifier in position **1**: **H, D** or **T** for **H**eader, **D**etail or **T**railer record. All records must contain the Federal ID number of the Reporter in positions 2-10.

UNIQUE REFERENCE NUMBER

All detail records for any item reported on tape must contain a Unique Reference Number which may be referred to by the reporting organization when making inquiries or claims to the State. If multiple reels of tape are submitted as one report, the Unique Reference Number must not be duplicated.

NOTE: Aggregate records and multiple entitlement records must contain a Unique Reference Number.

TAPE RECORD SPECIFICATIONS

Header Record (Organization Header):

Positions	Field	Length	Remarks
1	Record identifier	1	Constant "**H**"
2-10	Federal ID no. of **Reporter**	9	As used for IRS
11-40	Business name 1	30	Alpha
41-70	Business name 2	30	Alpha
71-100	Address block 1	30	Alpha
101-130	Address block 2	30	Alpha
131-150	City	20	Alpha
151-152	State	2	Alpha postal abbreviation
153-157	Primary Zip Code	5	Alpha
158-161	Supplemental Zip Code	4	Alpha
162-171	Country, if not USA	10	Alpha
172-173	State of incorporation	2	Alpha postal abbreviation
174-177	Month and year report is filed	4	Numeric, (MMYY)
178-183	Date report produced	6	Numeric, (MMDDYY)
184-384	Blank	201	Blank

Detail Record (See Data Field Specifications on pages 10-16)

Positions	Field	Length	Remarks
1	Record identifier	1	Constant "D" *
2-10	Federal ID No. of **Reporter**	9	As used for IRS *
11-12	Property type	2	From Property Type Table *
13-18	Unique reference number	6	Numeric *
19	Multiple Owners Indicator	1	"X" if 2 or more are associated with the same property. See Multiple Entitlement Information on page 15.
20-39	Last name	20	Alpha
40-49	First name	10	Alpha
50	Middle initial	1	Alpha
51-53	Suffix	3	Alpha
54-83	Street 1	30	Alpha
84-113	Street 2	30	Alpha
114-133	City	20	Alpha
134-135	State	2	Alpha postal abbr.
136-140	Primary Zip Code	5	Alpha
141-144	Supplemental Zip Code	4	Alpha
145-154	Country, if not USA	10	Alpha
155-163	SSA or Employer ID of owner	9	Alpha
164-183	Property ID number	20	Alpha
184-253	Account title of property	70	Alpha
254-259	Date dormancy began	6	Numeric, (MMDDYY)
260-268	Initial amount	9	Numeric, dollars and cents, no decimal point
269-277	Escheated amount	9	Numeric, dollars and cents, no decimal point
278	Removal indicator	1	Blank, "P", "R"
279-348	Description of security	70	Alpha
349-357	CUSIP number	9	Alpha
358-361	Blank	4	Blank
362-374	Number of shares or demomination	13	Numeric, 9 whole numbers and 4 decimal places, no decimal point
375	Method of transfer of security	1	Blank, "D","P","T"
376-384	Blank	9	Blank

* Represents control data and must be present on every detailed record appearing on the tape.

Trailer Record (Organization Trailer)

Positions	Field	Length	Remarks
1	Record identifier	1	Constant "T"
2-10	Federal ID number of Reporter	9	As used for IRS
11-40	Business name 1	30	Alpha
41-70	Business name 2	30	Alpha
71-100	Address block 1	30	Alpha
101-130	Address block 2	30	Alpha
131-150	City	20	Alpha
151-152	State	2	Alpha postal abbr.
153-157	Primary Zip Code	5	Alpha
158-161	Supplemental Zip Code	4	Alpha
162-171	Country, if not USA	10	Alpha
172-173	State of incorporation	2	Alpha postal abbr.
174-177	Month and year report is filed	4	Numeric, (MMYY)
178-183	Date report produced	6	Numeric, (MMDDYY)
184-193	Total escheated cash in report	10	Numeric, dollars and cents, no decimal point
194-200	Total certificates	7	Numeric
201-205	Total items	5	Numeric
206-210	Total records	5	Numeric
211-384	Blank	174	Blank

NOTE: Zip codes are Alpha rather than numeric which will ensure that the data is left justified.

VI. DELIVERY OF SECURITIES

All reported positions must be delivered at the time the abandoned property reports are filed. It is recommended that, where possible, the delivery of abandoned securities to the State Comptroller be made by means of book entries via the Depository Trust Company (DTC).

The following instructions relate to the reporting of abandoned securities regardless of whether the report is on Magnetic Tape or on paper Form AC 2686.

DTC WIRE TRANSFER

1. All required securities information must be completed according to the Specific Instructions.

2. Place the letter "D" in the method of transfer field if securities are being delivered via DTC.

3. In addition to the regular security information all DTC wire transfers must contain the following delivery instructions:

   a. Deliver to NB Clearing Corporation, Clearing #108.

   b. New York State Account #_____. (For NYS Account number contact the Securities Liquidation Unit at (518) 474-6049.

4. Send all DTC wire notices with your abandoned property report.

PHYSICAL DELIVERY OF SECURITIES

1. All required securities information must be completed according to the Specific Instructions.

2. Place the letter "P" in the method of transfer field if securities are being physically delivered.

3. We recommend that physical deliveries be made by Registered Mail.

SPECIAL INSTRUCTIONS

1. If you are reporting on Form AC 2686, Report of Abandoned Property, and your organization is reporting both DTC eligible and non-eligible (physical delivery) abandoned securities, the two categories must be separated so that all DTC transfers and all physical deliveries will be sequential. The physically delivered securities must be listed on Forms AC 2686 separate from those used for DTC.

2. Securities being physically delivered to the State Comptroller may be left in their existing registration. However, where feasible, it is preferred that physical securities be transferred into the name **Comptroller State of New York** prior to remittance to NYS. One master certificate should then be issued for each company, while the report would reflect individual shareholder data.

3. When securities are reported in the form of a master certificate, the PROPERTY IDENTIFICATION data field should reflect the certificate number of the original unclaimed certificate. The DESCRIPTION OF SECURITY field should indicate that a master certificate was filed, its number, and the total number of shares it represents (e.g., XYZ Corp - MASTER CERTIFICATE #XYZ100A, 1000 sh.)

4. **Nontransferable** unclaimed security positions should not be included in abandoned property reports until they are deliverable. These securities should be disclosed in a separate letter submitted along with the report. In addition, the positions should be transferred to an internal general ledger account titled **Abandoned Securities - State of New York - Reportable Year 19__**. Our office will provide instruction for disposition of these securities at a later date.

VII. REPORT ILLUSTRATIONS

The following sample Forms AC 2709 and AC 2686 are exclusive of each other and are designed to assist reporters in completing their abandoned property reports and apply to both paper and tape reports. Special reporting instructions applicable to Court Funds, Condemnation Awards, and Safe Deposit Boxes will be provided in the annual abandoned property circular.

The samples that follow illustrate primary requirements of the reporting format. For brevity and clarity, we have chosen not to present an example of each Property Type.

- Figure 1 reflects a typical demand deposit or checking account item, Property Type 1A. Note the difference between the figures reported for Initial Amount and Escheated Amount. The former would be entered on a preliminary report; the reduced figure in the field Escheated Amount would be added to the final report. The reduction represents the reporter's recovery of lawful advertising charges.

- Figure 2 indicates that the owner has claimed his property or reactivated his account prior to the filing of the final report. The escheated amount is equal to zero, and a Removal Indicator has been entered.

- Figure 3 shows the proper handling of an item subject to multiple entitlement, regardless of Property Type. There is a separate Record for each owner, but the Account Title, as it appears on the reporter's records, is shown in the Records for all owners.

- Figure 4 represents 58 individual items of Property Type 1B, each of which was less than $3.01. "Aggregate" appears in the field for Owner Last Name; the item count is given in the field for First Name. Aggregates are segregated by Property Type; had there also been demand deposits valued at less than $3.01, there would have been an additional Aggregate entry under 1A.

- Figure 5, reflecting Negotiable Instruments, provides further examples of multiple entitlement. The names of corporate entities begin in the field for Owner Last Name (see the entry for Allied Trucking Service, longer than the 20 spaces provided for Owner Last Name). For these corporate entities, "ENT" is entered in the Suffix field (this cues our system to alphabetize the record correctly).

- Figure 6 represents a Money Order. Due to the nature of the transaction, the owner's name is often not known. Therefore, "Unknown" is entered for Owner Last Name, which is the only field in which "Unknown" should appear.

- Figure 7 illustrates an uncashed vendor payment issued to Northeast Tool, and now being reported by the issuer.

- Figure 8 reflects an uncashed corporate dividend check. The corporate issuer declaring the dividend, North American Electric and Gas Co., is indicated in the field for Description of Security. Note, the paying agent's name should not be used in this field. Further note, the escheated amount for this example should only be reduced by the cost of advertising.

- Figure 9 reflects the physical reporting of an actual security, a stock dividend in this case. When comparing this entry to Figure 8, note that the CUSIP Number and Method of Transfer are provided.

- Figure 10 reflects the reporting of unknown cash (line 4) and securities (line 5) within Property Types 4A through 4X. These items usually appear on the report of a broker-dealer or bank trust department. Note when the security is reported via DTC, the Method of Transfer is coded "D".

As you review the examples, consider that the principles shown extend to other Property Types as well. Our examples for "Amounts on Deposit" are made up of bank items. However, with the exception of a change in Property Type, a Utility service Deposit would be reported the same. Similarly, the Negotiable Instrument sample would apply to insurance refunds by merely changing the Property Type to 5D or 6E. If you have further questions on preparing your entries or on the correct Property Type to use, please contact us. See the directory on page 2.

AC 2709 (Rev. 11/85)
15

New York State Comptroller
OFFICE OF UNCLAIMED FUNDS
Capitol Station Annex
PO Box 7009
Albany, New York 12225

VERIFICATION AND CHECKLIST FOR UNCLAIMED PROPERTY

11/07/88
Date

REPORTING ORGANIZATION

AMERICAN BANK OF ANYWHERE
(name of business)
123 BROADWAY
(street address)
(street address)
ANYWHERE NY 10000
(city, state, zip code)

VERIFICATION FOR PERIOD ENDED June 30, 19 88

STATE OF INCORPORATION NEW YORK

DATE OF INCORPORATION 01/01/65

ARE YOU AUTHORIZED TO DO BUSINESS IN NYS? YES

FEDERAL EMPL. ID NO. 11-111111

CONTACT PERSON Steven George
CONTACT TITLE Sr. Escheat Officer
CONTACT PHONE (307) 555-1111
ADDRESS 123 Broadway
Anywhere NY 10000

State of New York
County of } ss:

JEANE SMYTHE, being duly sworn, deposes and says: that he/she is the

VICE PRESIDENT of the

AMERICAN BANK OF ANYWHERE

by which this report of abandoned property is made pursuant to Section III of the Abandoned Property Law; and that to the best of his/her knowledge and belief, such report, consisting of computer tape and/or 6 pages, exclusive of Verification and Checklist, is a true and complete statement of all abandoned property held by or owing by the said organization at the close of business June 30, 1988 (date), excepting such property as has since said date ceased to be abandoned.

Jeane Smythe (facsimile)
Signature

Subscribed and sworn before
me, this 7th day of November 19 88

Signature of Notary Public or Commissioner of Deeds
GRACE SHANAHAN
Notary Public, State of New York
Qualified in Rensselaer County
No. 4769396
Commission Expires , 19....

TOTALS:		
Cash	1576.50	
Certificates	9	(552 Shs)
Items	17	
Records	26	

RESERVED FOR USE OF STATE COMPTROLLER

Amount Received	Date Received	Ack. Number		Date	By
			Verified		
			Coded		
			Edited		

Securities Received:	Date Reg: ___/___/___	Class	Organization	Unique Code	Year	RPT No.
Publication: Letter Sent ___/___/___	Waived: ___/___/___					
Pages _____ thru _____	Item Count:					
Newspapers Designated:						

INSTRUCTIONS: Please complete the checklist on the back of this sheet indicating which types of property are being reported. Include the amount reported for each property type in the appropriate column; for securities, put the number of certificates in CERTIFICATES column or cash-in-lieu in the Cash column. Place the total amount of cash, number of certificates, number of items, and number of records in the Totals box located above. If negative report if being filed, enter "None" in the TOTALS box. Detailed instructions on how to complete this form are available in the handbook.

	Cash	Certificates
1. Account Balances (5 years unless otherwise indicated)		
A. Demand Deposit Account(s)	$ 900.00	
B. Savings Accounts (includes Club Accounts, Security Deposit and Retirement Accounts)	600.00	
C. Time Accounts		
D. Money on Deposits to Secure Funds (If separate from A and B)		
E. Unidentified Deposit (If separate from A and B) and Suspense Accounts		
F. Escrow Funds (Mortgages, Performance Guarantee, Surety Bonds, etc.)		
G. Credit Balances Arising From Loans (Includes Liquidated Mortgages, Consumer Loans, Remainder of Collateral Amounts, etc.)		
H. Credit Balances; Consumer Credit Accounts (3 years)		
I. Credit Balances in Trading and Investment Accounts with Trusts, Brokers, Investment Firms, etc. (including o/s checks issued to customers) (3 years)		
J. Credit Balances or Cash Due Renters of Safe Deposit Boxes (3 years)		
X. Other		
2. Negotiable Instruments (5 years unless otherwise indicated)		
A. Certified Checks	60.00	
B. Cashier, Teller Checks		
C. Bank Money Order		
D. Treasurer and Registered Checks		
E. Drafts and Bank Traveler's Checks		
F. Warrants		
G. Oustanding Checks Issued to Vendors (Accounts Payable)		
H. Travelers Checks (non-bank) (15 years)		
I. Licensed Money Transmitter Receipts and Money Orders (non-bank) (7 years)		
X. Other		
3. Paying Agents, Fiduciary, American Depository Receipt Accounts and Corporations Disbursing Directly to Their Own Shareholders (3 years)		
A. Cash Dividends (other than ADR)		
B. Bond Interest (other than ADR)		
C. Stock Dividends (other than ADR)	16.50	2
D. Other Distributions Resulting From Ownership of Interest (other than ADR), Includes Liquidating Dividends, Redemption Values, Warrants, etc.		
E. Cash Dividends (ADR)		
F. Stock Dividends (ADR)		
G. Other Distributions Resulting From Ownership of Interest (ADR)		
X. Other		
4. Investments, Trading (Broker/Dealer) and Bank Trust Department Accounts Representing Distributions Received for Known and Unknown Owners (3 years)		
A. Cash Over Receipts (Dividends and Other)		
B. Bond Interest Over Receipts		
C. Stock Over Receipts (Dividends and Other)		
D. Other Over Receipts		
E. Unidentified Overages		
F. Other Distributions Resulting from Ownership Interest or Debt Obligation		
X. Other		
5. Refunds (Dormancy as Indicated)		
A. Utility Service Deposit (2 years)		
B. Advance Payments for Utility Services Not Furnished (2 years)		
C. Refunds Due on Overcharges by Utility Companies (2 years)		
D. Refunds Due by Insurance Companies (3 years)		
E. Amounts Due for Undelivered Goods and/or Services (5 years)		
F. Rebates		
X. Other		
6. Insurance Proceeds (3 years unless otherwise indicated)		
A. Limiting Age (Superannuated) Contracts (No dormancy period)		
B. Matured Endowments		
C. Death Claims		
D. Amounts Due Under Policies of Insurance Other than Life		
E. Refunds and Other Amounts Due Under Policy Terms		
X. Other		
7. Funds Owing by Courts and Governmental Units (5 years)		
A. Trust Funds		
B. Bail Funds		
C. Funds for Support of Spouse or Child		
D. Condemnation Awards		
X. Other		
8. Other Amounts and Securities (Dormancy as Indicated)		
A. Wages, Payroll, Salaries, Commissions (3 years)		
B. Unredeemed Gift Certificates (5 years)		
C. Amounts Owed by Sales and Insurance Finance Companies (3 years)		
D. Surplus from Sale of Pledged Property (1 year)		
E. Lost Property (5 years)		
F. Securities Long in Customers' Trading, Investment, Trust Accounts (3 years)		5
G. Securities Held as Transfer Agent (3 years)		
H. Securites Held in a Vault or Storage Area of a Bank (3 years)		
I. Securities Lost and Held by a Safe Deposit Company or Bank (5 years)		
J. Securities Found in a Safe Deposit Box (3 years)		2
K. Other Securities Owed (3 years)		
X. Other miscellaneous property		

AMOUNTS ON DEPOSIT

FIGURE 1 — Lot No. — Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
APPLEGATE	Gerald	T		GERALD T APPLEGATE

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
47 Elm Avenue		Riverview	NY	12182	

	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
1	002994321	1A	40906-2	011583	$ 67.29	$ 63.82	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

FIGURE 2 — Lot No. — Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
BURNS	Mark	A		Mark A Burns

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
129 Laurel Avenue		Fairmont	NY	12184	

	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
2	003973214	1C	26734-3	060183	$ 1457.63	$ -0-	P Owner Claimed [P] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

FIGURE 3 — Lot No. — Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
CHILDS	Dorothy	M		Dorothy M Childs ITF John J Childs

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
17 River Road		Riverview	NY	12182	

	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
3	004981243	1B	10624-1	031083	$ 419.62	$ 416.15	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

Lot No. — Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
CHILDS	John	J		Dorothy M Childs ITF John J Childs

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
17 River Road		Riverview	NY	12182	

	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
4		1B	10624-1	031083	$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

FIGURE 4 — Lot No. — Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
AGGREGATE	58			

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
5		1B			$ 103.82	$ 103.82	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

SEE INSTRUCTIONS ON REVERSE OF LAST COPY

*Method of Transfer Codes:
D = DTC
P = Physical
T = To Be Sent

NEGOTIABLE INSTRUMENTS
(INCL. VENDOR PAYMENTS)

FIGURE 5

Lot No.

Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
MODERN DECORATORS			ENT	Modern Decorators (Drawer) Allied Trucking Service (Payee)

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
34 Main Street		Riverview	NY	12182	

1	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
		2A	2964	031083	$ 20.45	$ 20.45	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
ALLIED TRUCKING SERVICE			ENT	Modern Decorators (Drawer) Allied Trucking Service (Payee)

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

2	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
		2A	2964	031083	$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

FIGURE 6

Lot No.

Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
UNKNOWN				

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

3	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
		2C	4346	071182	$ 10.00	$ 10.00	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

FIGURE 7

Lot No.

Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
NORTHEAST TOOL CO			ENT	Northeast Tool Co.

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

4	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
		2G	245348	021783	$ 55.27	$ 55.27	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

Lot No.

Reg.

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

5	Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
					$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer (Insert Appropriate Code*)

SEE INSTRUCTIONS ON REVERSE OF LAST COPY

*Method of Transfer Codes:
D = DTC
P = Physical
T = To Be Sent

o P A Y I N G A G E N T S , C O R P S

o B R O K E R - D E A L E R S , B A N K T R U S T D E P T S .

FIGURE 8

Lot No.

Reg.

1

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
SMITH	Charles	F		Charles F and Mary A Smith Jt Ten

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
12 Oak Street	Apartment 30	Oakville	NY	12369	

Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
	3A	21940	121584	$ 250.00	$ 243.47	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer Insert Appropriate Code*
North American Electric & Gas Co.			

2

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
SMITH	Mary	A		Charles F and Mary A Smith Jt Ten

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
12 Oak Street	Apartment 30	Oakville	NY	12369	

Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
	3A	21940	121584	$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [X]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer Insert Appropriate Code*
North American Electric & Gas Co.			

FIGURE 9

Lot No.

Reg.

3

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
WARREN	Arthur	P	Jr	Arthur P Warren Jr

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)
RD2		Freemont	NY	13254	

Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
	3C	63925X	031085	$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer Insert Appropriate Code*
Allied Trucking 2% PFD Stk	723622107	5	P

FIGURE 10

Lot No.

Reg.

4

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
UNKNOWN				

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
	4A	145692	031585	$ 40.00	$ 40.00	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer Insert Appropriate Code*
Colonial Window Co			

Lot No.

Reg.

5

Owner Last Name (20)	First Name (10)	M.I.	Suffix (3)	Account Title (70)
UNKNOWN				

Owner Address Street 1 (30)	Owner Address Street 2 (30)	Owner City (20)	State (2)	Zip (9)	Country if Not USA (10)

Soc. Sec. No./ Empl. ID No.	Property Type (2)	Property ID Number (20)	Date (MMDDYY)	Initial Amount	Escheated Amount	Removal Indicator (If Applicable, Enter "P" or "R")	Multiple Owners
	4C	AB12757	032085	$	$	P Owner Claimed [ ] Otherwise R Reduced to Zero [ ]	Yes [ ]

Description of Security (70)	CUSIP Number of Security	No. of Shares or Denomination	Method of Transfer Insert Appropriate Code*
Hudson Forge	125444039	25	P

SEE INSTRUCTIONS ON REVERSE OF LAST COPY

*Method of Transfer Codes:
D = DTC
P = Physical
T = To Be Sent

VIII. RECIPROCAL REPORTING

Chapter 501 Sec.2 of the Laws of 1985 permits the State Comptroller to enter into reciprocal agreements with appropriate officers or agencies of other states. The Comptroller has begun entering into these agreements for the purpose of easing the burden of reporting abandoned funds by the reporting organizations.

Organizations now have the option of reporting unclaimed funds which are payable to several states to the state where the principal place of business is located. The state which receives the funds would then transfer the funds to the reciprocal state.

If an organization wishes to report property owed New York State to another state, prior permission must be obtained from our office. In addition, we recommend that written permission be obtained from any other state before reporting funds due that state to New York. All questions regarding reciprocity including inquiries as to those states which have reciprocal agreements with New York should be addressed to the Director of Audits in our New York City office.

IX. CLAIMS

Pursuant to Section 1406 of the Abandoned Property Law, claims may be filed with the State Comptroller for any abandoned property over three dollars. There is no statute of limitations and all inquiries are researched free of charge.

Refunds of abandoned property made by the State Comptroller's office are to:

- Individual owners of record, their legal heirs, or duly retained attorney at law.
- Reporting organizations on behalf of the owners of record.
- Organizations which are the owners of record when such property is turned over to the State by another reporting organization.

When providing assistance to, or initiating a claim on behalf of a claimant, reporting organizations should always indicate the year, page and line number or unique reference number (tape reports) associated with the item being claimed.

In addition to the above, the State Comptroller is empowered to return property within six years after receipt to any organization who because of a mistake, error in calculation or misinterpretation of the statute, had paid such property to the State Comptroller. Property erroneously paid is considered to be abandoned property until refunded or returned by the State Comptroller, and no liability attaches to an organization which makes such an erroneous payment.

Over the past few years, an extensive Outreach Program including television and radio public service announcements, site visits, direct mailings, posters and our toll-free telephone number has generated a growing number of claims and inquiries. In fiscal year 1986 alone, over 40,000 claims were paid by this office.

As part of our Corporate Outreach Program, reporters wishing to determine whether unclaimed funds are being held on behalf of the organization should contact the Corporate Claims Unit in writing and provide a list of all corporate names and/or branch offices and addresses for which a search of our records is requested.

In addition, as part of our effort to generate public awareness about unclaimed funds, we offer articles about our office which may be included in corporate newsletters, as well as brochures in English and Spanish which may be distributed to employees of your company. This information is obtainable by calling our toll free number. Our office would also be happy to arrange for a speaker or on-site outreach program for your organization or civic group. For additional information contact our outreach specialist.

REPORTING ORGANIZATIONS NOT LIABLE AFTER PAYMENT TO THE STATE

Section 1404 of the Abandoned Property Law provides that the State assumes liability for the payment of all claims for abandoned property paid to the State and that the organization making a payment of abandoned property to the State Comptroller shall not be held liable for any claims in respect to such property. It further provides that no action shall be maintained against an organization for the recovery of abandoned property paid to the State Comptroller, or interest thereon, or for damages alleged to have resulted from any such payment.

INTEREST PAID ON AMOUNTS REPORTED TO NEW YORK STATE

In accordance with Section 1405 of the Abandoned Property Law, interest will accrue on the following types of property for the first five years that such property is held by the Comptroller's office:

Type of Property	Statutory Coverage
Bank Account Balances	300.1(a) APL
Court Funds	600.1(a) APL
Condemnation Awards	1000.1APL
Utility Deposits	400.1APL

The annual rate of interest is based upon the rate set by the NYS Tax Commission.

X. CLARIFICATION OF ISSUES MOST FREQUENTLY RAISED BY REPORTING ORGANIZATIONS

BANKING INSTITUTIONS
ARTICLE III

BANK ACCOUNTS

CUSTODIAN ACCOUNTS - The dormancy period on New York Uniform Gifts to Minors Act or any other custodian or In Trust For account not subject to a court order is five years from the date of last customer contact, as with regular savings and checking accounts.

COURT ORDERED GUARDIAN ACCOUNTS - The five-year dormancy period on court ordered guardian accounts commences at age 18 or at the death of the infant, whichever occurs first, pursuant to Sec. 300.3 of the Abandoned Property Law. This applies even if the court order specifies that the infant reaches majority at age 21. If the bank does not know the infant's date of birth, an attempt to obtain this information from the court should be made, and in the absence of such information, it should be assumed for reporting purposes that the infant was born on the date the account was opened.

IRA'S AND KEOGH'S - An individual retirement account (i.e., Keogh or IRA) is considered a deposit account subject to certain restrictions as to withdrawal by the depositor and to penalties for premature withdrawal prior to age 59 1/2. Accordingly, the five-year dormancy period on these accounts commences at age 59 1/2. However, where such accounts are in the form of a time or certificate of deposit, the dormancy period commences at the first renewal date after age 59 1/2.

TIME ACCOUNTS - The five year dormancy period on time deposits (including automatically renewed accounts) commences at the first maturity in the absence of depositor contact. However, a time deposit should not be interrupted in the middle of a term in order to be reported to New York State. For example, in the absence of depositor contact, the dormancy period of an automatically renewable 2 year account issued in April 1980 would commence in April 1982 at maturity. Ordinarily, the dormancy period would expire in April 1987 and the account would be deemed abandoned as of June 30 of that year. However, because of the automatic renewal provision, the account would be renewed for 2 years in April 1982, and again in April 1984. Since the five-year dormancy period had not yet expired, the account would be renewed for a third time in April 1986 and be reported to New York State as of June 30, 1988. If depositor contact is established during a renewal term, however, the dormancy period will run from the date of such contact.

As a basis for identifying dormant time accounts, banks should maintain on the system the original issue or maturity date which should only be changed by a customer generated roll over and a valid date of last customer contact.

PASSBOOKS IN SAFEKEEPING - Passbooks other than those held as collateral for loans which have not yet matured are reportable as any other bank account on a five year basis. These passbooks should not be updated by bank personnel in the absence of depositor contact.

ACCOUNTS NOT REPORTABLE - Deposits held at a foreign or out of state branch of a New York bank are not subject to the Abandoned Property Law. However, funds held at an International Banking Facility (IBF) established in New York are subject to the statute.

CUSTOMER CONTACT

1. If the banking institution has the ability to link several accounts of a single customer through various computer programs, it is our opinion that an exclusionary action on any of a single customer's accounts (e.g., savings, checking, IRA, personal trust, loan payment, etc.) may be treated as an exclusionary action for all of such customer's accounts, notwithstanding that not all such accounts are "active." However, the bank should notify the customer of any dormant account and instruct the customer to reactivate the account.

2. Automatic direct deposits from an external authorized source such as Social Security checks constitute depositor contact. However, where such external source is the sole contact, the bank should periodically verify that the customer has knowledge of his account.

3. Written customer contact includes a positive bank or auditing confirmation as well as a W-9 signed by the depositor and maintained on file for a period of five years.

4. The following are **insufficient** to preclude an account from being reported to New York State:

a. Telephone or verbal contact

b. Internal activity such as service charges or automatic withdrawal of safe deposit fees.

c. The fact that statements mailed to the depositor are not returned as undeliverable.

d. Automatic deposit of interest from a time account into another dormant account.

NEGOTIABLE INSTRUMENTS

1. Amounts held for the payment of negotiable instruments are subject to the dormancy rules applicable to the underlying obligation for which such instruments were issued (e.g., checks issued in payment of interest and dividends are subject to a three-year dormancy rule).

2. Service charges may not be levied against negotiable instruments, unless there is a specific contract with the customer authorizing such charge.

3. Negotiable instruments may be deemed outstanding in error and excluded from an abandoned property report, where the reporting organization has a written statement from both the payee and the drawer acknowledging that the obligation has been satisfied and disclaiming any entitlement to the funds, or from either party documenting receipt of the funds.

4. A banking institution's own payroll or vendor checks are reportable as negotiable instruments pursuant to Section 300.1(c) of the Abandoned Property Law.

SAFE DEPOSIT

1. The procedures to be followed in the opening of safe deposit boxes for nonpayment of rent are set forth in Section 335 of the NYS Banking Law.

2. Cash, including the net proceeds of an auction, and securities are reportable three years from the date of opening. The proceeds resulting from an auction of property held in excess of three years would be reportable as of June 30 of the year in which the proceeds were received by the bank as a result of the auction.

3. A banking institution is not required to hold an auction, but if an auction is held, the net proceeds are reportable (after subtracting the auctioneer's expenses and reasonable bank fees) on a box by box basis.

4. Coins (including U.S. coins such as silver dollars) with an apparent market value in excess of face value should not be offset against bank fees, but rather retained and auctioned.

5. Series E bonds should not be reported to NYS. They may be retained by the bank or forwarded to:

Department of the Treasury
Fiscal Service
Parkersburg, WV 26101

6. Papers and property of no apparent value must be retained in safekeeping for a period of at least ten years, in accordance with Section 335.1(f) of the NYS Banking Law.

UNCLAIMED OVERPAYMENT DIVIDENDS - INTEREST & SECURITIES (TRUST DEPARTMENT)

1. A 1987 revision to Article III Sections 300.1(e) and (f) of the Abandoned Property Law extended statutory coverage to unclaimed overpayment amounts or securities received by a banking organization's trust department on governmental or quasi-governmental issues. This revision is effective commencing with the 1988 report and applies to items received on or subsequent to July 1, 1984.

2. Unclaimed overpayment dividends or interest received in a foreign currency are subject to the APL.

CASH AND SECURITIES HELD BY PAYING AGENTS

1. For the types of property subject to New York State statute, reporting requirements and related issues, see Section on General Corporations, page 38 of this handbook.

2. New York banks acting as paying agents are responsible for filing on behalf of corporate clients, unless the funds are returned to the corporations prior to July 1 of the reportable year.

3. Successor agents are required to report abandoned property applying a three year dormancy period from the original issue date rather than three years from the date received.

4. Amounts held by a New York State Paying Agent on corporations which have discontinued business without the right to receive such amounts having passed to a successor are reportable to New York State regardless of whether the corporation was authorized to do business in this State. There is no payee residency requirement.

SAVINGS BANK LIFE INSURANCE

See Section on Insurance Companies, page 41 of this handbook.

UTILITY COMPANIES
(ARTICLE IV)

1. Utility deposits accrue interest at a rate approved by the Public Service Commission from the date the deposit was received until the date the check was issued.

2. Handling and/or advertising charges may not be deducted from amounts reported to New York State.

3. In addition to the statutory requirements of Article IV of the Abandoned Property Law, utilities are also subject to the reporting requirements of Article V and Section 1315 of the statute. Refunds of excess taxes are reportable pursuant to Section 1311 of the statute.

4. In addition to those items specifically covered under Article V, unidentified remittances from customers, customer overpayments (e.g., for appliance purchases) and unclaimed outstanding vendor checks are subject to Section 1315 of the Abandoned Property Law. The statutory floor date as it applies to utilities is July 1, 1980. Accordingly, the first report on these items was due March 10, 1986.

GENERAL CORPORATIONS
(ARTICLE V & SECTION 1315)

UNCLAIMED CASH AND SECURITIES HELD ON DEBT AND EQUITY ISSUES

1. The types of property subject to the Abandoned Property Law include cash and stock dividends, bond interest and principal, accrued cash dividends and cash in lieu of fractional shares. The statutory coverage on mutual funds is complex. Accordingly, all questions should be directed to our legal staff.

2. The following criteria should be applied in determining amounts to be reported (January 1, 1947 floor date):

a. New York incorporated entities must report amounts payable to New York residents, foreign and unknown payees including APO's & FPO's. Unknown includes c/o the company or its agent where the address cannot be determined.

b. Authorized corporations or corporations incorporated out of state but doing business in New York State must report amounts payable to New York residents only.

c. Unauthorized corporations or corporations not doing business in NYS, are not required to report abandoned property. (Voluntary under Section 1312, 5 year dormancy).

d. Unexchanged shares as well as underlying shares are <u>not</u> reportable pursuant to the New York State Abandoned Property Law.

3. New York paying agent banking institutions are responsible for reporting the aforementioned property using the criteria as set forth in 2 above, unless requested and returned to the issuing corporation prior to July 1 of the report year. Only New York paying agent banking institutions are subject to the New York State Abandoned Property Law. Accordingly, corporations utilizing non-New York paying agents are responsible for filing their own abandoned property reports.

4. An administrative judge has ruled that cash redemption proceeds resulting from a corporate merger or acquisition may not be subject to the Abandoned Property Law in cases where the merger or acquisition agreement specifically requires that outstanding stock certificates be surrendered before the certificate holder is vested with ownership rights in such proceeds. Entities holding these funds should review the applicable agreements, and contact the legal staff of the Office of Unclaimed Funds, in order to determine their responsibility for reporting the funds as abandoned property. The aforementioned opinion does not apply to bond redemptions or the redemption by the issuing corporation of a stock series.

5. The fact that a dividend check is mailed out and not returned by the postal authorities as undeliverable or that a shareholder has cashed subsequent dividend checks does not constitute valid contact with the payee for the purpose of precluding reporting of an uncashed check as abandoned property. The firm must have on record written communication from the payee within the past three years regarding the check in question.

UNCLAIMED WAGES

1. For reporting criteria, see 2a-2c above (no voluntary reporting).

2. The mailing of a notice is not a prerequisite for determining abandonment.

SECTION 1315

Corporations are required to report outstanding checks issued for goods or services and unclaimed amounts issued for services not rendered or goods not delivered, pursuant to Section 1315 of the Abandoned Property Law. In addition, retailers are required to report unclaimed amounts representing unclaimed gift certificates pursuant to this Section of the statute. Unknown amounts are reportable if held by a New York corporation. There is a five-year dormancy period. The floor date for outstanding checks and amounts received for services not rendered or goods not delivered is July 1, 1974. However, in the case of a public utility company, as that term is defined in subdivision 23 of Section 2 of the Public Service Law, the floor date is July 1, 1980. For amounts representing unclaimed gift certificates, the floor date is January 1, 1984. There is no statutory floor date for amounts held in escrow.

STOCKBROKERS
(ARTICLE V-A)

1. Unclaimed amounts received in this state and securities held in this state for unknown parties or addressee unknown are subject to Article V-A of the New York State Abandoned Property Law regardless of whether or not the broker is incorporated in New York.

2. Dormant customer accounts are reportable to New York State if payable to a resident of this state. Dormant accounts held for non- New York residents may be subject to the abandoned property laws of other states.

3. Uncashed checks issued by stockbrokers to their customers or other stockbrokers in payment of dividends, bond interest, principal, or other customer credit balances are reportable to New York State if payable to a resident of this state. Since the funds represent amounts due customers, Article V-A and the three year dormancy period set forth therein applies.

4. Unclaimed wages held by a brokerage firm are reportable under Article V-A of the statute.

5. In addition to the reporting requirements of Article V-A, stockbrokers are also subject to the reporting requirements of Article V and Section 1315 of the Abandoned Property Law.

INSURANCE COMPANIES
(ARTICLE VII & SECTION 1316)

1. Article VII of the Abandoned Property Law applies to unclaimed life insurance proceeds. Section 1316 is applicable to other than life insurance and includes amounts on health, casualty, fire, home and liability insurance. An unclaimed deposit made in anticipation of issuance of a policy which is subsequently not issued is also subject to Article VII and Section 1316.

2. The statutory requirements of Article VII and Section 1316 apply to both insurance companies organized under the Laws of New York State and those incorporated in other states doing business in this state. Foreign insurers not authorized to do business in this state are not subject to the statutory requirements.

3. Reinsurers are subject to the same statutory requirements as insurers.

4. Unclaimed amounts on group plans established as employee benefits are subject to Article VII and Section 1316 and are not subject to the preemption provision of EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA).

5. Article VII and Section 1316 require the reporting of amounts owed to New York residents. Pursuant to Article VII, only items which can be established as owing to New York residents are reportable. If the address of the person apparently entitled to proceeds under Article VII cannot be ascertained or if it is uncertain as to which person is entitled to the funds, it is presumed that the last known address of the entitled person is the same as the last known address of the insured according to the records of the insurance company. Under the provisions of Section 1316, amounts held by a domestic (New York incorporated) insurance company for individuals whose last known address is unknown are reportable to New York as well.

6. Amounts reportable as abandoned property pursuant to Section 700.1(a) (matured endowments) and Section 700.1(c) (proceeds of death claims) include statutory interest payable on matured endowments and death claims as provided in Section 3214 of the New York State Insurance Law. Interest pursuant to Section 3214 is to be credited from the date of maturity of an endowment contract, or from the date of death of an insured, until the date that the proceeds of such matured endowment or death claims are deemed abandoned and reported as abandoned property together with the principal amounts.

7. Unclaimed insurance benefits paid to employees by companies not engaged in the insurance business are not subject to the Abandoned Property Law.

8. Article VII and Section 1316 do not apply to:

- annuity payments
- pension payments
- benefits due survivors under an annuity contract
- proceeds of insurance (non-life) payable to the insured and another person who is not insured under the policy. (Example, a check issued to John Doe and Paul Smith, his Attorney is not reportable, but a check payable to John and Mary Doe who jointly own a policy on their home is reportable).
- amounts that have been offered by the insurance company in settlement of a claim but may not have been accepted by the payee (liability is not "Liquidated"). The issue of "acceptance drafts" is complex and our legal staff should be consulted.

9. In addition to Article VII and Section 1316 insurance companies are subject to the statutory requirements of Article V and Section 1315.

AICPA

American Institute of Certified Public Accountants

INDUSTRY AUDIT GUIDE

AUDITS OF BROKERS AND DEALERS IN SECURITIES

PREPARED BY THE COMMITTEE ON STOCKBROKERAGE AUDITING

AUDITS OF BROKERS AND DEALERS IN SECURITIES

PREPARED BY THE COMMITTEE ON STOCKBROKERAGE AUDITING

American Institute of Certified Public Accountants
666 Fifth Avenue, New York, N.Y. 10019

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O. Stand

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Preface

This audit guide has been prepared to assist the independent public accountant in conducting examinations of financial statements of securities brokers and dealers by describing those conditions or procedures unique to the industry and by illustrating the form and content of broker-dealer financial statements and informative disclosures pertaining thereto. The guide includes a discussion of brokerage transactions, accounting records, internal accounting controls and procedures for safeguarding securities, unique aspects of the examination, and illustrations of Answers to Financial Questionnaire and other financial statements.

The forms of financial reporting of broker-dealers, in accordance with requirements established by the regulatory or self-regulatory bodies, are intended to meet the needs of customers who do business with these securities concerns, the regulatory bodies and, in the case of firms with public ownership, the needs of stockholders.

Substantially all brokers and dealers in securities are subject to regulation under the Securities Exchange Act of 1934. Those that are members of the National Association of Securities Dealers, Inc., are subject to the rules of that Association and those that are members of securities or commodities exchanges are also subject to the rules of such exchanges. Some of these rules, as currently in effect, are discussed herein. However, changes in the rules, regulations, practices, and procedures of the securities industry have been frequent and extensive in recent years. Still further

changes are under consideration as this guide goes to press and *it is imperative that the independent public accountant keep abreast of these changes.*

This publication is only a guide in determining the scope of the work for each individual audit. It is not intended to limit or supplant individual judgment, initiative, imagination, and vigilance. Programs for each audit should be designed to meet the requirements of the particular situation, giving careful consideration to the size and type of organization and the adequacy of internal control; this is a matter which can be determined only by the exercise of professional judgment in the light of circumstances present in a particular case.

The accounting practices recommended in the guide differ, in some instances, from those presently followed by the industry. In this connection, it is the considered opinion of the Committee that the financial statements of brokers and dealers, for fiscal periods ending after March 31, 1973, should conform to the recommended accounting practices as set forth herein.

This audit guide has been prepared under the auspices of the AICPA Committee on Stockbrokerage Auditing, and important contributions have been made by members of prior committees. The Committee wishes to acknowledge in particular the efforts of Carroll F. Davis, a retired practitioner, who has given unstintingly of his time and effort to this endeavor.

Committee on Stockbrokerage Auditing

February 1973

Section 1

General

Introduction

A securities broker or dealer engages in two major activities. As a broker (in an agency capacity) it buys and sells securities or commodities for its customers charging a commission, and as a dealer or trader (in a principal capacity) it buys and sells for its own account (trading with customers or other dealers) for whatever profit or loss is made on the transaction.

While buying, selling, and settlement of accounts in industry are usually relatively simple, these same functions by brokers and dealers in securities are complicated by the many intermediate steps which occur between the execution and completion of a buy or sell transaction. These intermediate steps are graphically illustrated in the "System Level Flow of Security Transaction" which is shown on the following page. This illustration is subject to "Copyright American Stock Exchange 1969" and is reproduced with permission of that Exchange.

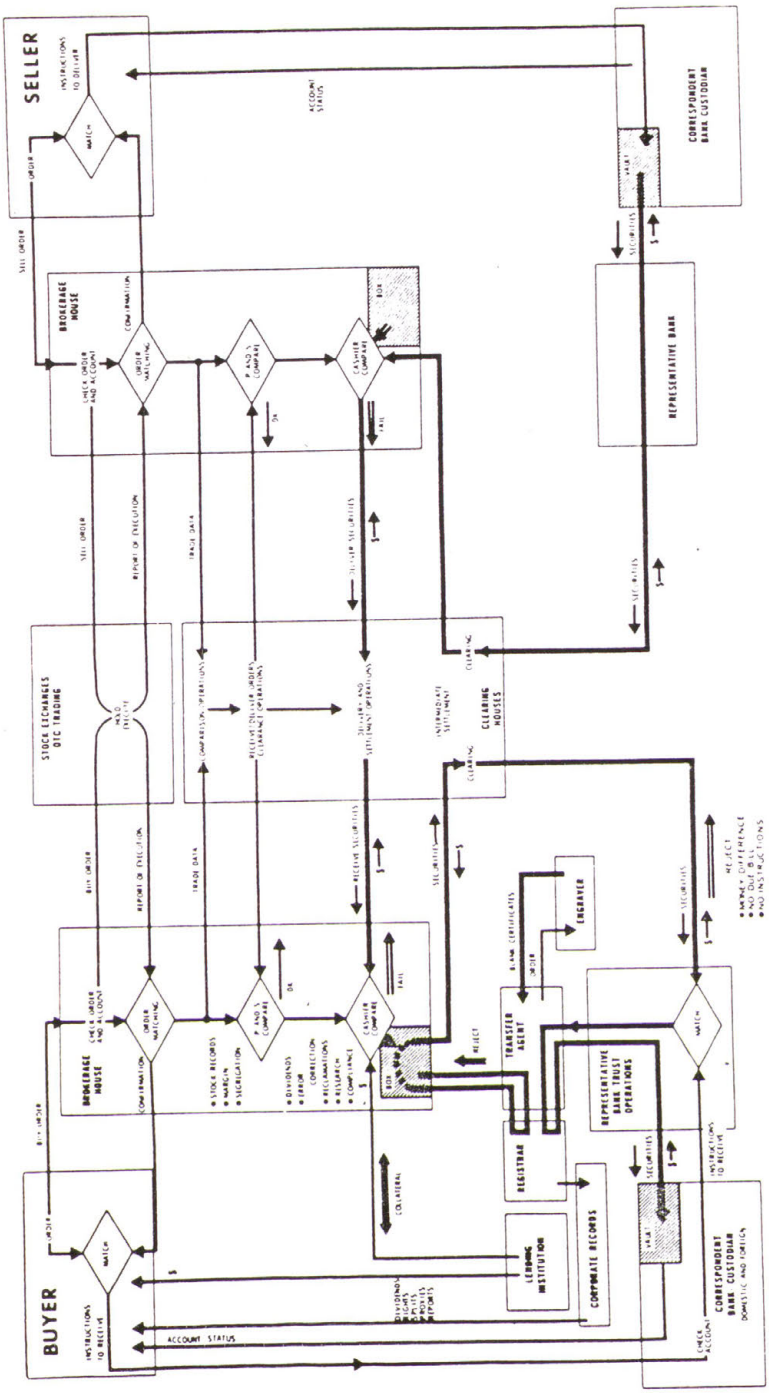


FIGURE 2—SYSTEM LEVEL FLOW OF SECURITY TRANSACTION

In addition to the major activities of buying and selling securities and commodities, a securities broker or dealer may underwrite or participate in group underwritings of new issues of securities. It may assist in the private placement of securities, offer investment advisory services, extend credit to customers who have purchased securities on margin, and act as a depository in holding large quantities of securities owned by its customers. Further, a securities broker or dealer may market oil and gas participations, real estate participations, cattle programs, etc., which are highly specialized activities and, except for the accounting principles pertaining to investments by brokers and dealers in such activities, are not covered in this guide.

Brokers and dealers in securities are regulated primarily by the Securities Exchange Act of 1934. The purpose of this Act is to provide for the regulation of securities exchanges and over-the-counter markets operating in interstate and foreign commerce and through the mails to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.

The Securities and Exchange Commission has promulgated certain rules under the aforementioned Act. Some of the more important of these rules with which the independent public accountant should be familiar include 8c-1 and 15c2-1 regarding fraudulent practices and hypothecation of customers' securities, 15c3-1 regarding net capital requirements, 15c3-3 regarding maintenance of reserves with respect to customers' cash and standards concerning the physical possession or control of fully paid and excess margin securities of customers, 17a-3 regarding records to be maintained, 17a-4 regarding retention of records, 17a-5, 17a-10 and 17a-11 regarding reports to be filed with the Commission, and 17a-13 regarding quarterly security counts, verifications and comparisons.

In addition to a familiarity with the above rules of the Securities and Exchange Commission, it is necessary for the independent public accountant to have a working knowledge of Regulations T and U of the Board of Governors of the Federal Reserve System, and, if his client is a member of a stock exchange or the National Association of Securities Dealers, Inc., he should be familiar with the pertinent rules of those organizations. It is also considered advisable to review the applicable Accounting Series and other releases which are published from time to time by the Securities and Exchange Commission.

The report required under Rule 17a-5 is a response (Answers) to a Financial Questionnaire to be prepared in accordance with the instructions set forth in Form X-17A-5. This response is, in effect, an expanded statement of financial condition containing ledger balances, security valuations, and commodity gains and losses. Form X-17A-5, which sets forth the audit requirements, information required, and order of presentation, may be obtained from a local office of the Securities and Exchange Commission.

In addition to the Securities and Exchange Commission, national securities exchanges of which the broker or dealer is a member and, in some instances, state security commissions and other regulatory bodies also require the filing of financial information in the form of Answers to Questionnaires. In most instances an exchange will accept Answers to a Financial Questionnaire of a larger exchange with whom a broker or dealer may also have to file. The Securities and Exchange Commission will accept the Answers to a Financial Questionnaire filed with the principal national securities exchange of which the broker or dealer is a member provided such Answers meet the requirement of its Rule 17a-5.

In substance, the format of each questionnaire is similar to that of the Securities and Exchange Commission. However, each regulatory body in its individual questionnaire may have one or more additional parts, reporting requirements, etc., that would have to be complied with if the questionnaire being filed were the principal one for the particular broker or dealer.

Since the securities broker or dealer operates in a fiduciary capacity, financial strength is considered to be of utmost importance. For this reason emphasis is placed on the amount of protection afforded its customers who entrust it with large sums of money and securities. The Securities and Exchange Commission, national securities exchanges, and other regulatory bodies prescribe minimum capital requirements which limit aggregate indebtedness of the broker or dealer in securities to a specified percentage of net capital. As a means of increasing net capital, the brokerage concerns frequently borrow cash, and/or securities, under agreements which subordinate such borrowings to claims of general creditors. Such subordinated borrowings, if approved by the applicable regulatory authority are includable as capital under the capital rules.

On December 30, 1970, the Securities Investors Protection Act

of 1970 was signed into law. The Act, which established the Securities Investor Protection Corporation (SIPC), requires registered broker-dealers, with few exceptions, to become members of SIPC and become subject to a fee assessment based upon annual gross revenues from the securities business beginning with the calendar year 1969. The Act, in effect, represents an amendment to the Securities Exchange Act of 1934. It provides the Securities and Exchange Commission with rulemaking authority relating to the custody and use of customers' securities, carrying and use of customers' deposits and credit balances and requires establishment of rules regarding the maintenance of reserves relating to customer deposits and credit balances.

The language of the securities industry includes many specialized terms and this guide contains a glossary of some of those most frequently encountered. A familiarity with these terms is essential to the independent public accountant contemplating an examination of a brokerage concern.

Brokerage Transactions

Transactions in Listed Securities. Transactions in listed securities may be in round lots (unit of trading specified by the exchange on which the security is listed, usually 100 shares) or in odd lots (quantities less than the unit of trading).

Transactions in securities listed on an exchange are usually initiated by a customer calling or otherwise communicating with a registered representative (salesman, customer's man or account executive) and requesting that a specified number of shares of particular securities be bought or sold at a stated price or at the market. This order is then communicated by the order room of the brokerage concern to its clerk who is stationed at the exchange where the security is traded. If the brokerage concern is not a member of the particular exchange, or has no member on the floor, the order is relayed to a correspondent broker who executes the trade.

In either case the order, once conveyed to the floor of the exchange, is given by the order clerk to the representative on the floor of the exchange who will attempt to execute it. Once executed, the details of the transaction (price, quantity, other broker with whom the transaction was consummated, etc.) are reported back to the order room of the brokerage concern which, in turn,

transmits the data to its purchase and sale department. A confirmation of the trade is then prepared and sent to the customer.

Orders for a quantity less than the normal trading unit specified by the particular exchange may or may not be handled differently from round lot transactions. Where the exchange has no odd-lot dealers, as is the case on the American Stock Exchange, the procedures followed are the same as for round lots. Where there are odd-lot dealers, as is the case on the New York Stock Exchange, the transaction is executed and settled directly with one of them. Their compensation is the odd-lot differential which is included in the execution price. The odd-lot broker offsets these transactions by buying and selling round lots.

Most of the exchanges have related clearing organizations. For brokerage concerns who are members, deliveries (or receipts) of securities and the related cash settlements are made through these clearing organizations. The clearing organization usually offsets transactions between members so that only the net transactions for each day by each member require physical movement of securities. Brokers or dealers in securities operating through correspondent brokers settle their transactions through these correspondent (clearing) brokers who in turn settle the transactions through the clearing organizations.

Transactions in Unlisted (Over-the-Counter) Securities. A customer's order involving an unlisted security is filled by his broker or dealer locating and entering into a transaction with another broker or dealer who can make the security available. Such transactions are executed and settled directly between the respective brokers or dealers or cleared through the National Clearing Corporation.

At times, usually in the case of new issues and unlisted securities, the broker or dealer may act for his own account in a purchase or sale transaction with a customer or with another broker or dealer. On this type of transaction there is, of course, no commission but, instead, a profit or loss on the purchase or sale.

Cash Transactions. Cash account transactions are transactions for the purchase or sale of securities which are expected to be settled within the time limit prescribed by the Board of Governors of the Federal Reserve System in its Regulation T.

Margin Transactions. Margin account transactions are transactions for the purchase or sale of securities by customers on other than the regular cash settlement terms. A purchase on margin contemplates an extension of credit to the customer by the brokerage concern; the maximum amount of such credit is regulated by the Board of Governors of the Federal Reserve System through Regulation T. The brokerage concern, acting as agent for the customer, buys the securities ordered by the customer and borrows, if necessary, the additional funds from a bank to make payment. In so doing, the brokerage concern may pledge as collateral against the loan the securities so purchased or any other securities which it may rightfully hypothecate.

Additional margin deposits may be required (maintenance margin) if market fluctuations adversely affect the equity in the customer's account. Maintenance margin ordinarily is governed by the rules of the exchange of which the brokerage concern is a member rather than by Regulation T.

Commodity Transactions. Transactions in commodities are usually confined to one of the following three types:

1. *A spot transaction.* This involves the delivery of the commodity (usually accomplished by a warehouse receipt).
2. *A futures contract.* This is an agreement (executed on a commodity exchange) to buy or sell a definite quantity of a specified commodity of a certain grade in the future.
3. *A forward contract.* A contract for purchase or sale of a spot (cash) commodity for future delivery.

Customers of a brokerage concern are generally not interested in making or accepting delivery of the commodity itself; instead, they wish to trade in futures contracts only. Accordingly, on or before the delivery date specified in the futures contract, settlement generally is made by buying or selling an offsetting futures contract. Most commodity dealers and many processors have their own representatives on the floor of an exchange to enter into futures transactions.

When a customer places an order for a futures contract with a brokerage concern, he is required to provide a margin deposit which is credited to his account. Additional margin deposits may be required (maintenance margin) if the price of the commod-

ity fluctuates adversely to the customer's financial interest. Commodity exchange rules require that, in addition to general guaranty funds, the brokerage concern must deposit margin with the clearing association of the exchange.

A brokerage concern, other than one which places its commodity transactions through a correspondent broker, actually deals with a clearing association when it buys and sells futures contracts for the account of its customers. Commodity transactions are generally executed between two brokers but are settled by each with the clearing association. As a result, offsetting transactions entered into by the same brokerage concern are immediately balanced against one another by the clearing association.

A commodity exchange establishes at the close of business each day a settlement price to which all contracts are to be adjusted, that is, marked-to-the-market. Each day all open contracts are listed, together with the quantity, contract price, and settlement price. The net difference is determined and settled in cash with the clearing association each day. The brokerage concern records the amount of the daily settlements in contract difference accounts from which gains and losses are transferred to the customers' accounts when final settlements are made.

The brokerage concern notifies the customer of the date for completing the futures contract as it nears so that the customer can complete the transaction, generally with the purchase or sale of an offsetting futures contract. When a "round turn" (offsetting purchase and sale) has been completed for the customer, the gain or loss can be determined and recorded in the customer's account.

For a more complete discussion of commodity transactions refer to the section "Commodity Transactions," elsewhere in this guide.

Option Transactions. Options (referred to in the trade as "puts" and "calls") give the holder the right to sell or buy a specified number of shares of stock at a specified price within a specified time. A put option gives the holder the right to sell the stock; a call option the right to buy the stock. A put option obligates the seller of the contract to take delivery of the stock and pay the specified price to the owner of the option within the

time limit of the contract. A call option obligates the seller of the option to deliver the stock to the buyer of the contract at the specified price within the time limit of the contract. The price specified in a put or call option is usually close to the market price of the stock at the time the contract is made. Put and call options are written for 30, 60, 90 days, or longer. If the purchaser of a put or call option does not wish to exercise the option the price he paid for the option becomes a loss.

Options sold through the auspices of the National Put and Call Association bear the endorsement of a New York Stock Exchange member firm. Such endorsements constitute a guarantee of performance and, consequently, a contingent liability for the contract.

There are several variations of put and call options which are referred to as "straddles," "spreads," "strips," and "straps." For a description of these terms as well as more complete discussion of option transactions refer to the section "Option (Put and Call) Transactions," elsewhere in this guide.

Arbitrage Transactions. Arbitrage is (1) the buying of a security in one market and selling it in another, or (2) buying and selling of securities which are exchangeable, for the purpose of taking advantage of any price disparity that may exist between the markets of the exchangeable securities.

Opportunities for arbitrage exist in the following principal areas:

1. Securities which are traded on more than one exchange.
2. Securities which are traded in more than one country—called International Arbitrage.
3. Securities which are convertible. The arbitrage procedure involves purchasing the convertible security and selling "short" the appropriate amount of the security into which it is convertible. Delivery of the securities sold short is effected upon conversion. Similar procedures can be followed with rights and warrants.
4. Securities of companies which are merging or which are involved in reorganizations. The arbitrage procedure followed is similar to that of convertible securities described above.

Underwriting Transactions. Corporations and political subdivisions desiring to raise funds for various purposes through the sale of securities usually engage securities brokers or dealers to underwrite the security issues. Unless the transaction is on a "best efforts" basis the underwriter, or underwriters, agree to purchase the entire security issue from the issuer for a specified price and then proceed to sell the securities to the public at a slightly higher price.

Since the value of most new issues of securities and the consequent liability for successful marketing thereof is normally too great for any one brokerage concern to assume, group accounts, or syndicates, are formed in order to spread the risk. Additionally, selling groups, which may include brokerage concerns other than members of the underwriting group, are sometimes formed in order to obtain wider geographical distribution of the new issue.

The liability of the underwriting group may be divided or undivided. If the liability is divided, each member of the group has a specified maximum liability to take down a certain number of shares of stock or principal amounts of bonds. If the liability is undivided (usually in connection with security issues of political subdivisions), each member of the underwriting group has a designated percentage liability with respect to unsold securities in the underwriting account regardless of how many securities he has taken down and sold.

"When Issued" Transactions. Pending issuance of new securities which may arise through underwritings, exchanges, mergers, etc., brokerage concerns may enter into purchase and sale transactions after agreement to issue the securities has been effected but prior to the setting of a date for settlement. These purchase and sale transactions are made on an open contract basis referred to as "when issued" transactions, meaning that the contract is exercisable only when, as, and if the new securities are issued.

"Delayed Delivery" Transactions. "Delayed delivery" transactions are transactions for the sale by the brokerage concern of securities which are similar in all respects to regular-way transactions except that, by agreement, the date of consummation or settlement is extended.

Repurchase Transactions. Transactions of this type involve the sale and delivery of securities with a simultaneous agreement to repurchase them, with delivery and payment to be made at either a fixed or variable time in the future. As a rule, these transactions are in exempt securities and are another means of borrowing money.

Accounting Records

Many brokerage concerns, particularly those concerns having operations in the New York area, record securities transactions in the financial accounts on settlement date rather than on the transaction (trade) date. This practice, which varies from the practice followed by other industries of recording transactions on the date of occurrence, is not in accordance with generally accepted accounting principles; however, this departure from generally accepted accounting principles is usually not material and is occasioned by the practical necessity of providing time for the orderly settlement of the transactions, including confirmation with the customer, comparison with the brokerage concern on the other side of the transaction, and for delivery of the securities. The effect of this departure on financial statements and the audit procedures relating thereto are discussed elsewhere in this audit guide.

Record keeping by securities brokers or dealers may be accomplished in a variety of ways ranging from completely hand prepared records to sophisticated electronic data processing systems, depending on the size of the brokerage concern's operations.

Under the manual system, trade confirmations may be prepared on bookkeeping machines or on typewriters and the information transcribed, together with other transactions, on hand-posted blotters. The stock record is usually in the form of a handwritten card for each security. Customer statements may be prepared by hand, on bookkeeping machines, or typewriters, and margin records may be in the form of hand-posted cards which are regularly updated by erasing and writing over, similar to "slate" records.

A manual system requires separate postings of each transaction to blotters, customer statements, margin records, stock records, etc., which increases the possibility of posting errors; whereas,

mechanized systems usually provide only one posting or entry to the system which is then used to prepare all records.

In recent years, many brokerage concerns have adopted automated methods of recording transactions. One of the first steps toward automation was the introduction of punch card or "unit" record keeping. The unit record method utilizes punch cards and mechanical processing equipment in the preparation of records. The stock record, together with certain detail transaction data, is represented by files of punch cards which may be tabulated and printed. In addition, there is sometimes a duplicate file of cards in customer account order sequence called a "holder's file." Under this method daily blotters, stock records, customer statements, and various other reports are prepared mechanically and require minimal manual effort.

Most of the medium and large brokerage concerns have adopted computerized processing in various degrees of sophistication as a method of record keeping. In the more sophisticated systems, the stock record, details of customer transactions, margin records and, in many cases, the general ledger are placed on magnetic tape, discs, or other storage media until they are ready to be used in the production of reports. In computerized operations there are certain master files (principally security files and customer files) that are used in processing most of the work, together with programs for each operation. The security file includes code numbers to identify the security for machine processing, a sufficient description of the security to properly identify it in printed reports, and possibly its ticker symbol if it is a listed security. The customer file normally includes the customer account number, a number to identify the salesman that handles the account, the name and address of the customer, and, where desired, delivery instructions and possibly an indication to whom additional copies of confirmations or statements should be sent.

Some brokerage concerns using fully automated record keeping techniques have acquired their own electronic data processing equipment for "in-house" operations, thus necessitating the organization of an operations center and a systems department. Other firms use computer service bureaus such as those organized by stock exchanges, equipment manufacturers, and others.

Records Retention SEC Rule 17a-3 et seq.

Virtually all brokers or dealers in securities are governed by the rules and regulations of the Securities and Exchange Commission. Rule 17a-3 specifies those books and records which must be

maintained and kept current. Rule 17a-4 specifies the period of time that the books and records under Rule 17a-3, as well as certain additional records, must be preserved. Also, the National Association of Securities Dealers, Inc., and many securities exchanges including the New York and American Stock Exchanges, in their constitutions and rules prescribe that members are required to keep certain books and records. There are, however, depending on the needs of the individual business, situations which may warrant the maintenance of certain additional records not specifically required under the rules of the various regulatory bodies. The prescribed records do not constitute an accounting system, but all accounting systems must include such records and they must be maintained on a current basis.

In instances where a broker-dealer operates as a sole proprietor, records must also be maintained of all assets and liabilities of the proprietor which are not related to the brokerage operation. Such records are necessary to permit determination of compliance with net capital requirements. In this connection reference should be made to Accounting Series Release No. 107 of the Securities and Exchange Commission.

Listed below are brief descriptions of the more important records which are incorporated in the accounting system of many brokerage concerns. The independent public accountant should recognize that the nomenclature as well as the form of these records may vary from concern to concern as in the case of computer-produced or hand-produced records.

Blotter Records. The basic records of original entry maintained by a broker or dealer in securities are known as "blotters." While the term "blotter" is used in the securities industry it is similar to a "journal" used in other businesses. Specifically, the blotters serve to record the details of cash receipts and disbursements, purchases and sales of securities (by market), receipts and deliveries of securities, and other appropriate debits and credits, such as a listing of floor brokerage receivables or payables, mutual fund commissions earned, and investment counseling fees. Blotters and related records of receipts and deliveries of securities generally indicate the quantity, description, and certificate numbers.

Stock Record. The stock record provides a composite listing of the long and short positions for each security for which the

brokerage concern is responsible. A long position in the stock record indicates ownership of the security or the right to possession. The position sheet for each security shows the identity of each owner. These may be customers, brokerage concerns to or through whom a sale of securities but not delivery has been made, brokerage concerns or others from whom securities have been borrowed, or the brokerage concern itself if it has purchased securities for its own account.

Short positions in the stock record indicate either the location of the securities or the responsibility of other parties to deliver them to the brokerage concern. Every security owned or held by the brokerage concern must be accounted for as being in such locations as the active box, the safekeeping or segregation box, a branch office box, out with a transfer agent, in transit between offices of the brokerage concern, held by a bank as collateral to a loan, or due from other parties as indicated in the preceding sentence.

The long and short positions for each security should be in balance. In the event the total long and total short positions for a security are not equal, the amount required to balance is recorded in a difference account. Examples of some of the causes of out-of-balance positions would be a lag in processing the offset transaction, miscoding the transaction or the offset transaction, or misfiling of a security movement ticket. The use of difference accounts is an aid to brokerage concerns in isolating problems for subsequent investigation. In line with this, EDP (electronic data processing) programs for the preparation of stock record reports are frequently designed to record automatically any differences in difference accounts.

The speed and accuracy required in the maintenance of comprehensive listings, such as the stock record, has led to the widespread use of EDP equipment. Moreover, EDP equipment has provided a greater latitude and versatility in obtaining information and recasting it in various formats. For example, data as to securities held in segregation or safekeeping may be shown on the same stock record, through the use of an additional column or memo field beyond the original long and short positions, thus eliminating the need for a separate listing or summary. The entire stock record tabulation is generally prepared on a weekly basis with a tabulation of changes produced on a daily basis.

Example of an EDP Produced Stock Record

Account *XYZ Corp.—Common Stock*

Example of an EDP Produced Stock Record

Account			XYZ Corp.—Common Stock			
Description*	Number	Date of Last Activity	Long	Short	Seg	SK
Active box	0-00001-8-0	4/28		890		
Transfer	0-00003-4-0	4/28		42		
Segregated box	0-00005-9-0	2/17		100	100CR	
SK box (customer name)	0-00006-7-0	1/17		250		250CR
Central Certificate Service	0-00007-6-0	4/28		100		
Fail to deliver	0-00009-0-0	4/28	1880			
Fail to receive	0-00011-7-0	4/28		959		
Customer and partner accounts	1-05451-6-1	4/25	100			
	1-10476-9-1	3/28		275		
	1-41200-6-1	2/01	100		100	
	1-52720-9-1	12/14	250			250
	5-84438-6-1	4/26	20			
	6-11002-7-0	3/21	15			
	6-15511-1-0	4/22	15			
	6-23002-5-0	4/25	226			
Difference account	9-99999-6-1	4/25	10			
Total			2616	2616	0	0

* In most systems the account description is not printed out.

In firms that use a manually prepared stock record the usual type of record is a large card for each security which is filed in alphabetical order in metal trays or binders. The card generally has a section at the top which is used to post long positions and a section at the bottom which is used to post short positions. The cards usually have lines running across and down resulting in spaces somewhat like boxes. Each column running across the card is used to record the date and the new balance for each account affected. Only the new balance is recorded, not the entry. Such card must be analyzed to determine the actual, by line, positions at any point in time, since usually at the time of an entry the unchanged balances are not brought forward as only the balance of the changed positions are entered.

In manual systems, the total long and total short positions should be checked periodically to make certain that they are equal. Out-of-balance differences are not usually set up in a separate account in a manual system, whereas procedures in most mechanized systems result in a balanced record.

In some firms, a separate stock record is maintained for securities held in safekeeping for customers. Under such a system the regular stock record is reduced in size with the elimination of these accounts. The safekeeping stock record sets forth positions only in customers' accounts (long) and in the safekeeping box (short).

Failed to Receive and Failed to Deliver Records. A "fail to receive" is a buy transaction where the security has not been received from the broker on the other side of the transaction by or on the settlement date and shows "short" on the stock record. A "fail to deliver" is a sale where delivery of the security has not been made to the broker on the other side of the transaction by or on the settlement date and shows "long" on the stock record.

Generally the cashier's department is responsible for keeping track of all unsettled security transactions with other brokerage concerns. One method of accomplishing this record keeping under manual systems is to have the P & S department send copies of the trade confirmation tickets to the cashier's department. These tickets are filed in alphabetical order by settlement date. If the security is not received in or delivered out by the

Example of a Manually Prepared Stock Record
XYZ Corp.—Common Stock

19X1
FWD

Example of a Manually Prepared Stock Record
XYZ Corp.—Common Stock

19X1 FWD 1/27	1/31	2/1	2/6	2/8	2/10	LONG						
200						John Doe						
	500					Richard Roe						
		100				Henry Hoe						
			300		200	Failed to Deliver						
					100	Stock Borrowed						
				100		Firm Accounts						
200						Total						
						SHORT						
			300	200	100	James Smith						
	500	0		100		Active Box						
100						Safekeeping Box						
100						Segregation Box						
		500				Bank Loans						
		100		200	300	Transfer						
200						Total						

settlement date, the open tickets are transferred to the fail to receive or deliver files. When the security is delivered out or received in, a copy of the confirmation ticket is sent to the accounting department as the basic bookkeeping entry to record the security movement.

Some brokerage concerns develop "fail" items through a daily check of the various blotters to determine which items are fails. Under this system, for each such item the fail clerk prepares a memo slip indicating the date of the fail, the broker on the other side of the transaction, the number of shares and the description of the security, the unit price of the security, and the total dollar value of the transaction. The fail clerks usually keep a file of fail slips in alphabetical order by security and by date of the fail, within each security. The securities and money balances listed on these slips or punch cards, as explained below, provide the supporting detail for the brokerage concern's stock record fail security positions and the general ledger fail money balance controls.

In brokerage concerns using electronic data processing systems, a copy of the fail slip is usually sent to the data processing department for recording the fail in the mechanized records. The data processing department may then prepare a punch card for each fail with all the applicable details on the transaction keypunched into the card and then route the card back to the fail clerk. The fail clerk will then maintain a punch card file of all open fail items for utilization as an "out-of-fail" entry.

In other data processing systems, a punch card is prepared in advance for each transaction and is sent to the fail clerk. The cards for transactions which clear on the settlement date are destroyed. The remaining cards, representing fails, are returned to the data processing department for entry in the stock record (securities) and general ledger (money). The data processing department usually reproduces the fail cards and returns the reproduced cards to the fail clerk for filing in the open fail card file. When the fail is cleared (securities having been either received or delivered versus payment), the fail clerk notes the date of the clearance and then routes the applicable punch card to the data processing department so that the fail position may be cleared from the brokerage concern's records.

Where punch cards comprise the details of open fails, these cards can also be used to compare the cashier's department de-

tailed records to related stock record positions and general ledger money balances.

Brokers or dealers clearing transactions through correspondent brokers located in exchange centers usually maintain fail to receive and fail to deliver records only in connection with transactions initiated by their trading departments with over-the-counter brokers or dealers. In some instances these records are maintained as ledger accounts in the same form as the accounts maintained for customers.

Securities Borrowed and Securities Loaned Records. Generally, details of securities borrowed from or loaned to brokers and others are recorded in a stocks borrowed and loaned ledger or on individual borrowed and loaned information sheets. The cashier's department records will contain all applicable details of the borrowed and loaned transactions, such as date, description of the security, quantity, total amount of the deposit made (stocks borrowed) or received (stocks loaned) and from whom borrowed or to whom loaned. As with fails to receive and deliver items, these records will provide the supporting details for the stock record borrowed and loaned security positions and the general ledger money control of amounts due to and from others with respect to these transactions.

In electronic data processing systems, a punch card may be prepared for each loaned and borrowed position and retained in the cashier's department for utilization as an "out-of-loaned" or "out-of-borrowed" entry and in the comparison of cashier's department records with the stock record and general ledger.

Collateral Loan Records. A separate record should be maintained in the cashier's department for each bank loan. This record should indicate the name of the bank, the dollar amount of the loan, the interest rate and the quantity, description, and market value of securities held by the bank as collateral. In certain data processing systems a separate punch card file of securities out as collateral may be maintained in the cashier's department. The loan records or, where applicable, the punch card file represent the supporting detail for the general ledger dollar amounts and the stock record collateral loan security positions.

When collateral loan securities are recalled from the bank or when additional securities are forwarded to the bank, either in substitution for securities recalled or as additional collateral, entries are prepared by the cashier's department and forwarded to the bookkeeping or data processing department for entry in the stock record.

In some systems, particularly electronic data processing systems, separate accounts are maintained in the general ledger for each loan with separate positions being maintained in the stock record for the securities collateral to each loan. In other systems, usually manual systems, the stock record may contain only one collateral loan position for each security instead of a separate position for each loan.

Transfer Records. The margin department of a brokerage concern usually prepares and forwards to the transfer department written security transfer instructions on a multipart form which includes the following information:

1. Name in which the new certificates are to be registered and the customer's mailing address for securities to be registered in a customer's name.
2. Customer's name and/or account number.
3. Number of shares or principal amount and description of the securities, and
4. Instructions indicating whether the new certificates are to be sent to the customer or held by the broker for the customer's account.

Generally, the instructions are separated between those covering securities to be transferred into the brokerage concern's name or that of its nominee and those to be transferred into the customer's name. In addition, instructions for securities sent out of town for transfer sometimes are filed separately.

The transfer clerk records on the instruction ticket the date the security was received in the transfer department and the certificate numbers of the securities to be submitted to the transfer agent for transfer. Also, the transfer department may record on the instruction form, or on a separate information slip, the name and address of the transfer agent to whom the securities are sent.

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A copy of the instruction ticket is sent to the stock record department or, where applicable, to the data processing department for recording the security as in transfer on the stock record.

The transfer department usually keeps one copy of its instruction form in an open transfer ticket file which constitutes the supporting detail for the stock record transfer position. At least one additional copy of the instruction form is sent to the transfer agent with the securities to be transferred. In exchange centers such as New York, the brokerage concern usually prepares so-called "broker originated window tickets" for securities going into transfer. These tickets are numbered and are generally in triplicate. Two copies accompany the security going to transfer and the other is retained by the brokerage concern. The agent returns one with the security and retains the other for reference purposes. The use of these tickets facilitates the proper identification of transfer items received from the transfer agents and permits the brokerage concern to question the transfer agent regarding specific items.

Under manual accounting systems, the security received from transfer is matched against the applicable open transfer instruction and a copy of the instruction sent to the stock record department to be used as the basis for removing the open transfer position from the stock record.

In data processing systems multipart transfer instruction forms which set forth all information required by the transfer department and the transfer agent are sometimes prepared. At the same time, punch cards may be produced for each security going into transfer. Such cards are maintained in the transfer department as an open card file in security and date order. As securities are received from transfer agents, they are matched against the applicable punch cards on file and the cards used as out-of-transfer entries to be sent to the data processing department for removal of the open transfer positions from the brokerage concern's stock record. At any time the remaining cards in the transfer department should represent the detail in support of the transfer positions in the stock record.

Active Securities Records. Active securities are those that are used by the brokerage concern in carrying out its daily business. These include customers' securities not paid for, securities purchased by customers on margin which collateralize funds ad-

vanced against the purchase price, securities owned by the brokerage concern, and other proprietary securities.

In some brokerage concerns the cage personnel prepare records showing the daily movements in and out of the active box. Forms used for recording daily activity are normally referred to as "in-box" sheets and "out-box" sheets. At the end of each day, copies of these sheets are sent to the stock record department or to the data processing department (where applicable) in order that entries can be made reflecting the security movement in the brokerage concern's records.

Some brokerage concerns, however, use copies of the receipt and delivery tickets, in lieu of the "in-box" and "out-box" sheets referred to above, as instructions to notify the stock record department of the security movement.

Safekeeping and Segregation Securities Records. Safekeeping securities are customers' securities which are fully paid for and held in custody by the firm for the accounts of customers. Safekeeping securities are usually registered in the name of the customer.

Segregation securities are securities registered in the name of the brokerage concern and which are set aside for customers who have fully paid for such securities, or which represent securities of margin customers in excess of those required as margin. Segregated securities may be specifically identified as to customers but in most cases they are segregated in bulk on a fungible basis.

Normally, securities are placed into or removed from safekeeping and segregation on the basis of instructions prepared by the margin department. The margin department records on an instruction ticket the customer's name, the quantity and description of the security, the date of the preparation of the instructions and, if applicable, the customer's account number. A multipart form may be used as the instruction ticket with one copy being retained by the margin department and a copy being sent to the cashier's department. Additional copies may be provided for other uses depending upon the system in use. For example, a copy may be forwarded to the stock record department or to the data processing department to record the security movement when changes take place in safekeeping or segregation securities.

Under a non-bulk (specifically identified) segregation system, the margin department instruction ticket is usually maintained in an open or pending file in the cage awaiting the receipt of the security in proper form for placing in the vault. When the securities are received and placed in the vault, the pending segregation instruction ticket is pulled from the open file and the certificate numbers and the date the securities were actually placed in the vault are recorded on the instruction ticket. Securities pending safekeeping or segregation (securities for which the margin department has issued instructions that such securities are to be placed in safekeeping or segregation) are securities which may currently be fail to receive items, transfer items, or items located elsewhere, such as in the active box, out on loan to another broker, or collateral for bank loans.

In some EDP systems, the data processing department prepares punch cards as instructions to the cashier's department on the basis of the "into-segregation" or "into-safekeeping" instructions prepared by the margin department. The cards are reproduced; one set of the cards is sent to, and retained by, the margin department for use as release instructions and the other set is sent to and used by the cage as the instruction to "lock up" the security. A copy of the original instruction is filed by the margin department and an additional copy may be sent to the cashier's department, with the punch card instructions, to be attached to the securities as the customer identification for safekeeping and non-bulk (specifically identified) segregation.

In manually operated systems of bulk segregation, the ownership of the segregated securities is usually shown by copies of the into-segregation instructions which are filed in security order sequence, by customer. A separate record is sometimes maintained for each security showing the total number of shares or principal amount of bonds in bulk segregation which should agree with the total quantities shown on the copies of the into-segregation instructions and the segregation position in the stock record. Under EDP systems the ownership of bulk segregation is usually indicated by means of additional columns in the stock record. (See example of an EDP produced stock record elsewhere in this guide.)

Another method of bulk segregation is sometimes utilized by brokerage concerns operating EDP equipment. Under this

method, instructions for the segregation or the release of segregation securities are likewise issued by the margin department. These instructions are processed into the brokerage concern's stock record and a comparison of customer segregation requirements is made with the quantity of specific securities presently in segregation. This comparison generates a report to the cashier's department indicating, by issue, the number of shares pending (which must be placed in segregation by the cashier) and the number of shares in excess of requirement (which may be removed from segregation by the cashier). The cashier's department then concentrates on accomplishing the instructions generated by this comparison which is usually produced on a daily basis by the EDP department. Since this bulk system does not relate certificates to specific customers, it is not feasible to determine in the case of a pending segregation condition the particular customer for whom segregation has not been accomplished.

Security Difference Records. Securities differences may result from a number of factors, including inaccurate record keeping on the part of a brokerage concern and errors in receipt and delivery of securities. Such differences are generally disclosed through periodic counts of securities on hand and examination or confirmation of items such as transfers, fails, etc.

When a security difference is discovered, it should be recorded in a security difference account, pending research as to the cause of the difference. When the difference is resolved, entries are made clearing the difference position from the stock record. If the difference is not resolved after appropriate research, the brokerage concern may, subject to any legal requirements, buy in the shortages and sell the overages.

Rule 17a-13 under the Securities Exchange Act of 1934 (effective January 1, 1972) requires, among other things, that brokerage concerns subject to the rule shall, at least once in each calendar quarter (other than the calendar quarter during which the date of its annual report of financial condition pursuant to Rule 17a-5 falls),

1. physically examine and count all securities held;
2. account for all securities subject to its control and direction, but not in its possession, by examination and comparison of

the supporting detail records with the appropriate ledger accounts;

3. verify all items described in (2) above which have been in said status for longer than 30 days;
4. compare the results of the count and verification with its records; and
5. within seven business days after each required quarterly security examination, count and verification, record in a security difference account all unresolved differences setting forth the security involved and the date of comparison.

Related reporting requirements of Form X-17A-5 provide that the valuations of security differences bought and sold since the previous X-17A-5 filing are to be stated in a footnote; therefore, appropriate accounting records must be maintained to provide such information.

Cash Receipts and Disbursements Records. Checks or cash are received from customers, brokers and banks through the "window" by messengers or by mail. In some brokerage concerns, cash receipts are entered by hand on the daily cash blotter. In others, a cash receipts journal is prepared on a bookkeeping machine. In still other concerns, a receipt form is typed, and, as part of the output, a paper punch tape is prepared which is later used to produce, among other things, a daily cash receipts blotter.

Disbursements are made almost exclusively by check or draft. Checks to customers are prepared on the basis of check requests received from the margin department. The cash disbursements journal, or blotter on which the transactions have been entered, is sent to the data processing, bookkeeping, or controller's department for entry.

Receipts and disbursements for the day are totaled on the journals or blotters and the closing balance for each bank account is determined. A summary of the postings is prepared showing the distribution to the control accounts in the general ledger. The summary is agreed with the totals of the various source documents and related items in the summaries prepared by the receive and deliver departments. In addition to the settlement and cash journal summaries, some brokerage concerns prepare an overall summary of cash transactions processed by the cashier's depart-

ment. Generally, this cash summary sheet contains numerous descriptive categories and columns to which the cash movements (totals) and settlement values of all security movements are posted. Entries are compiled by summarizing appropriate working documents, i.e., blotters, journals, drafts, and various miscellaneous receive and deliver and receipt and disbursement forms. The totals of all cash debits and credits on this cash balancing sheet must equal in order to balance.

Central Certificate Service (CCS) Records. The Central Certificate Service is a custodian operation of the Stock Clearing Corporation, a subsidiary of the New York Stock Exchange, Inc., whose facilities are available to member organizations. It provides for physical custody of certain securities and settlement of security transactions without the physical movement of securities. Securities on deposit at CCS may be pledged to banks as loan collateral without the physical transfer of certificates.

CCS prepares daily reports for member organizations showing activity by security and the balance on deposit. Monthly, a statement is sent to each member showing the entire CCS security positions of such member. In connection with security movements at CCS, member organizations use specific forms to make deposits or authorize withdrawals. If regular security settlements are made through CCS, a settlement sheet is provided each member.

It is the responsibility of the brokerage concern to disclose on its records whether the securities held at CCS are available for use as collateral or should be held in segregation. The disclosure of the status of CCS-held securities may be indicated on the records of the brokerage concern in the detail information shown on a computer-maintained stock record or in separate records kept to support the total stock record position shown for CCS.

Margin Department Records. The margin department usually has the overall responsibility for the proper maintenance of customer accounts and control of the extension of credit. Although the form of their records will vary depending upon whether the accounts are maintained manually or on mechanized accounting systems, the information contained in margin department records is generally the same. At all times the margin department records should indicate the complete status of the customer's account on a trade date basis. The margin department's records are posted

from copies of transaction tickets received from the purchase and sale, cashier, dividend and accounting departments.

The margin card, or supplementary records in the margin department, will ordinarily indicate as to each margin customer the market value of the securities, the money balance of the account, excess or deficient margin, transfer, safekeeping and segregation instructions, and the special miscellaneous account balance of the customer calculated in accordance with Regulation T.

Since the margin department's main function is checking the credit status of customers, it is responsible for initiating margin calls, maintenance margin calls, extensions of time for cash account customers to pay for securities purchased, and instructions for placing securities into or taking them out of safekeeping or segregation. Copies of documents relating to these transactions are maintained in the margin department.

Other records and information which may be maintained by the margin department are standing customer instructions regarding the delivery of securities, the disposition of cash from the sale of securities or the receipt of dividends and interest, and guarantees of customers' accounts.

Dividend Department Records. The dividend department has the responsibility for records relating to all types of distributions made on securities including cash dividends, stock dividends, rights, splits, etc. It may also handle proxy material for customers.

Listings are supplied to the dividend department showing registered holder and location of each security on the dividend record date. The record will indicate how the securities are registered, i.e., in the name of the brokerage concern, its customers, or in the name of another brokerage concern or individual from whom claim for the dividend must be made. In order to reduce the number of dividend claims, it is normal procedure for the dividend department to notify the cashier's department on a daily basis as to securities approaching dividend record dates a few days hence. The cashier's department of the brokerage concern will then check for securities on hand that are registered in a name other than its own and will attempt to deliver such securities to the transfer agent so that the registration may be transferred to its own name as of the record date. Frequently, brokerage concerns with EDP systems use magnetic tapes or

punch cards provided by dividend reporting services to disseminate record date information.

For each dividend distribution, the dividend department prepares a memo proof to ascertain the total receipts and disbursements which it will process for that distribution.

Prior to payable date, the dividend department instructs the accounting department or the data processing department as to who should be credited or charged for the dividend on the payable date. The offsetting entry is made to a dividend receivable or payable account. When the money or stock certificates are received or paid, the dividend accounts are offset. Differences between the amount received and the amount receivable represent items which must be investigated by the dividend department. Dividends received by a brokerage concern for securities registered in a customer's name at the brokerage concern's address are generally credited directly to the customer's account upon receipt.

The dividend department also maintains a record of securities which the firm is failing to receive or deliver on the dividend record date. Securities received or delivered against "fails" which were open on the ex-dividend date should be accompanied by due bills. It is usually the responsibility of the dividend department to effect collection or authorize payments for transactions of this nature. Brokerage concerns should maintain dividend records for each security by individual declaration date and not combine all dividends received for each security over a period of time. For example, Company X declares a dividend on its stock to holders of record January 2 and later declares another dividend to holders of record on April 1. The brokerage concern might have a receivable of $5,000 for the January 2 dividend, but received $5,500. This would normally indicate that the brokerage concern was failing to deliver and owes brokers $500. For the April 1 dividend the brokerage concern might have had a receivable of $6,000, but received only $5,200. The dividend department would have to determine which brokers owed them $800 on securities which the brokerage concern was failing to receive and seek collection. The dividend record would show a payable of $500 for the January 2 item and a receivable of $800 for the April 1 dividend.

Dividends which are not paid or credited on the payable date are considered to be unclaimed dividends and are normally paid

only upon receipt of valid claims. Balances remaining in dividends payable may be subject to abandoned property laws.

Customers' Securities Account Records. A separate account must be maintained for each customer and a statement of the account should be sent to the customer, at least quarterly, as required by the regulatory bodies. Transactions in the account cover both money and securities, with the security transaction generally recorded on the settlement date. The account should itemize all purchases, sales, receipts and deliveries of securities and all other debits and credits, including dividends and interest received or charged, investment counseling fees, etc. The accounts are generally maintained so that money and security balances are clearly indicated.

A customer may have many different accounts. Those most commonly encountered are as follows:

1. *Cash account.* The special cash account is used to record cash transactions expected to be cleared within the time limit prescribed by Regulation T of the Board of Governors of the Federal Reserve System. Cash account purchases are limited by Regulation T to those situations in which sufficient funds are already held in the account, or in reliance upon an agreement that the customer will promptly make full cash payment for the security, and that the customer does not contemplate selling the security prior to making such payment. Cash account sales are similarly limited to those situations in which the security is held in the account or in reliance upon an agreement that the customer owns the security and will make prompt delivery.

   As a general rule, full cash payment must be made within seven business days after the date on which the security is purchased. Thus, assuming a five-day settlement period, full cash payment must be made no later than two business days after settlement date. However, if a customer purchases a security with the understanding that the security will be promptly delivered and that the full cash payment will be made promptly against such delivery, the time period for making payment is not to exceed thirty-five calendar days. Failure to make timely payment would ordinarily require the prompt cancellation or liquidation of the transaction. In ex-

ceptional cases, the seven-day and thirty-five day periods may be extended for one or more limited periods upon application to a committee of a national securities exchange or to the National Association of Securities Dealers, Inc.

It is important to note that certain of the regulatory agencies restrict the acceptance of sales orders, other than short sales, unless there is a reasonable prospect of making prompt delivery (not defined in Regulation T) of securities against the sale. It is presumed that a brokerage concern will cancel or liquidate the transaction in the event that the customer fails to make the securities available within a reasonable period of time.

2. *Margin account.* The margin account is used to record transactions which result in a borrowing by the customer from the brokerage concern. Thus, for a purchase transaction the brokerage concern is expected to extend credit. The amount of credit extended on a purchase transaction is subject to the limits prescribed by Regulation T of the Board of Governors of the Federal Reserve System. This regulation establishes the maximum loan value of the securities in the account and requires the brokerage concern to obtain, as promptly as possible, and in any event, before the expiration of five full business days following the date of the transaction, a deposit into the account of cash or securities necessary to eliminate any deficiency. Assuming a five-day settlement period, the deposit would thus be required no later than the settlement date. In exceptional cases, the five-day period may be extended for one or more limited periods upon application to a committee of a national securities exchange or to the National Association of Securities Dealers, Inc. Maximum loan values for securities are prescribed from time to time by means of a supplement to Regulation T. In addition, certain securities exchanges have rules establishing minimum maintenance margin requirements. A brokerage concern may establish initial or maintenance margin requirements which are greater than those required by the rules and regulations of the regulatory bodies.

3. *Income account.* The income account is sometimes utilized to accumulate the interest and dividends received on securities maintained in other accounts.

4. *Short sale account.* The "short" sale account is used to record

transactions in securities sold "short." Such transactions are also governed by the margin requirements of Regulation T of the Board of Governors of the Federal Reserve System. On a short sale transaction, the brokerage concern is expected to lend or arrange for the lending of the security to the customer for the purpose of effecting delivery.

5. *Other accounts.* Other special accounts are provided for (a) the purchase of securities through the exercise of a right evidenced by a warrant, (b) bond transactions in exempted and registered nonequity securities purchased on margin, and (c) transactions in convertible debt securities purchased on margin which are convertible into margin stock or carrying a right to subscribe to or purchase such stock. Regulation T prescribes different loan values and the length of time on which credit can be extended in these accounts.

Commodity Department Records. A description of certain of the books and records maintained by brokerage concerns dealing in commodities is set forth below:

1. *Commodity contract book.* At the time a customer enters into a futures commodity contract, which is an agreement to buy or sell at some future date, no entries are made in the brokerage concern's general ledger accounts other than to record the amount of any margin deposit made by the customer. Nevertheless, a record in the form of a contract book is maintained by commodity and by maturity date. When an offsetting purchase or sale contract is made, the open trade in the contract book is so noted and an account purchase-and-sales form is prepared and sent to the customer.

   In manual systems, there is usually a separate page in the contract book for each delivery month and space to note the completion of the transaction. In mechanized systems listings can be made in chronological order periodically, and posting space and order requirements are rather flexible.

2. *Commodity blotter.* This is a record in which the actual purchase or sale at the completion of what is called a "round turn," i.e., a purchase or sale offsetting an existing open contract, is entered. In addition to entering a description of the transaction, the amount of the resulting gain or loss to the customer is also recorded.

3. *Open contract position record.* This record is maintained separately on the basis of up-to-date information concerning the positions in each commodity carried for a brokerage concern's customers or for its own account. It shows an up-to-date balancing of futures contracts by customers offset by the net position with the carrying broker or with the clearing association.
4. *Customers' commodity ledger.* This ledger is used to record commodity transactions for each customer and carrying broker. Completed transactions are posted daily, both as to money and contracts, from the regular blotter record of cash receipts and disbursements and from the commodity blotter as to gains and losses and commissions.

Interest Records. Brokerage concerns charge their margin customers with interest on unpaid balances and some brokerage concerns pay customers interest on credit balances under certain conditions. In a manual operation, an interest sheet is prepared periodically for each customer's margin or short sale account resulting in a net debit balance during the period. The interest sheet becomes the basis for computing the amounts to be taken into interest income and interest expense, if any, of the brokerage concern by charges or credits to its customers' accounts.

In an automated operation the computation of interest is usually made by utilizing data processing equipment specifically programmed to perform the computations.

Trading and Investment Account Records. Securities are often purchased and sold for the account of the brokerage concern. Trading securities are considered as inventory or stock-in-trade, whereas investment securities are purchased or sold with the expectation of capital gain. To qualify for capital gain treatment under the present Internal Revenue Code, the brokerage concern's records must clearly indicate, before the expiration of the 30th day after purchase, that the security is held for investment and not for trading purposes.

Brokerage concerns may purchase securities for investment which are not readily marketable or which are restricted as to sale by the purchase terms. These securities should be recorded separately in the accounts of a brokerage concern and clearly designated.

The trading department maintains separate records on a trade date basis. It is extremely important that the brokerage concern reconcile these records periodically with the accounting department records and the stock record.

Underwriting Department Records. A brokerage concern which participates in underwriting activities will normally function as either the managing underwriter or a participating underwriter. A managing underwriter, in addition to being a participating underwriter, usually negotiates the transaction with the issuer of the security and maintains the records of the underwriting group.

The managing underwriter maintains daily position listings of the entire issue and ascertains the status of securities subscribed to and whether they have been delivered to the participating underwriters. Expenses associated with each underwriting are accumulated in the general ledger in separate accounts. When the underwriting is completed, the profit or loss on the particular underwriting is determined and distribution made to the participating underwriters.

The participating underwriters will maintain records of each underwriting participation but are concerned only with their portion of the total underwriting.

Other Records. The brokerage concern is also required to make a record of each brokerage order, each purchase and sale of securities, each cash and margin account, and proofs of ledger accounts in the form of trial balances, as well as certain other records as set forth in Rule 17a-3 of the Securities Exchange Act.

General Ledger. The general ledger of a brokerage concern is not significantly different, as to form and principal purpose, from the general ledger of any other business concern. For purposes of illustration, the following is a listing of the accounts which may appear in the general ledger. All of the account titles may not appear in the general ledger of every brokerage concern and the general ledger of others may include accounts not shown in the list. Certain accounts listed as assets may, on occasion, be liability accounts or vice versa, i.e., customers' accounts or accounts carried by other brokerage concerns may contain either debit or credit balances at any given time.

Assets

- Cash in banks—general funds
- Petty cash
- Cash in transit
- Cash in bank—segregated pursuant to Commodity Exchange Act requirements
- Cash in bank—segregated for exclusive benefit of customers
- Commodity margins:
  - Regulated commodities
  - Non-regulated commodities
- Guaranty funds, deposits and contributions to clearing associations
- Deposits with clearing associations—account of intermediate clearances
- Good faith deposits
- Settlement balances receivable:
  - Commodities:
    - Regulated commodities
    - Non-regulated commodities
  - Security clearing associations
- Failed to deliver
- Securities borrowed
- Accounts receivable—securities shipped draft attached
- Accounts receivable—securities shipped free
- Customers' accounts:
  - Securities
  - Regulated commodities
  - Non-regulated commodities
  - Spot commodities
- Partners' and/or officers' and directors' accounts:
  - Securities
  - Regulated commodities
  - Non-regulated commodities
  - Spot commodities
  - Personal and/or drawing accounts
- Joint trading accounts
- Margin deposits with others—joint trading accounts
- Firm accounts:
  - Investment securities
  - Trading securities

Trading c
Trading s
Underwriti
Managers
Managed
Clearing ass
Commission
Commodity
Coupons rec
Dividends r
Accrued int
Floor broke
Capital dem
Cash value
Advances to
Miscellaneo
Tax stamp a
Prepaid exp
Exchange m
Furniture a
Allowance
Leasehold i
Allowance
Investments

Liabilities

Money borr
Secured b
Secured b
Accounts ca
ent broker
Securities:
Custom
Transac
Regulated
Custom
Transac
Non-regul
Custom
Transac
Failed to rec

Trading commodities futures
Trading spot commodities
Underwriting—syndicate accounts:
Managers' accounts
Managed by other brokerage concerns
Clearing association stock
Commissions receivable
Commodity difference accounts
Coupons receivable
Dividends receivable
Accrued interest receivable
Floor brokerage receivable
Capital demand notes
Cash value of life insurance policies
Advances to employees
Miscellaneous accounts receivable
Tax stamp accounts
Prepaid expenses
Exchange memberships
Furniture and equipment
Allowance for depreciation of furniture and equipment
Leasehold improvements
Allowance for amortization of leasehold improvements
Investments and advances—subsidiary companies

Liabilities

Money borrowed from banks:
Secured by customers' collateral
Secured by collateral belonging to firm and/or partners
Accounts carried by other brokerage concerns (correspondent brokers):
Securities:
Customers' transactions
Transactions of firm and/or partners
Regulated commodities:
Customers' transactions
Transactions of firm and/or partners
Non-regulated commodities:
Customers' transactions
Transactions of firm and/or partners
Failed to receive

Securities loaned
Unclaimed coupons
Unclaimed dividends
Underwriting—syndicate accounts payable
Commissions payable
Floor brokerage payable
Margin deposits by others—joint trading accounts
Good faith deposits by others—syndicates
Taxes withheld on dividends
Social security taxes withheld
Federal, state and/or city income taxes withheld
Federal income taxes payable (corporation)
State and local income and franchise taxes payable
Accrued commissions
Accrued payroll
Accrued property taxes
Miscellaneous accrued expenses
Subordinated borrowings:
Cash
Securities

Capital
Capital accounts:
Partnership or proprietorship:
Cash
Securities
Corporations:
Capital stock:
Common
Preferred
Capital in excess of par value of capital stock (capital surplus)
Retained earnings
Undistributed profit and loss

Income
Exchange commissions earned:
Securities
Commodities
Over-the-counter commissions earned
Floor brokerage received
Clearance fees received

Trading
Underwr
Investme
Income f
Interest
Custor
Tradi
Exe
Nor
Dividen
Tradi
Invest
Investm
Proxy sc
Miscella
Service
Postage
Miscella

Expense
Adverti
Amortiz
Bad del
Charita
Clearan
Commi
Commi
Commi
Dues
Enterta
Errors
Exchar
Floor l
Group
Insura
Interes
Bank
C
Fi

Trading profits
Underwriting and selling group profits
Investment profits
Income from mutual funds
Interest received:
Customers' accounts
Trading and investment accounts:
Exempted
Non-exempted
Dividends received:
Trading accounts
Investment accounts
Investment advisory fees
Proxy solicitation fees
Miscellaneous fees
Service charges
Postage and registered mail charged to customers
Miscellaneous

Expense
Advertising
Amortization of leasehold improvements
Bad debts
Charitable contributions
Clearance fees paid
Commissions paid to other brokerage concerns
Commissions paid to registered representatives
Commission fees paid to exchanges
Dues
Entertainment
Errors
Exchange dues and assessments
Floor brokerage paid
Group insurance
Insurance—general
Interest paid:
Bank loans:
Customers' collateral
Firm collateral:
Exempted
Non-exempted

Omnibus accounts carried by other brokers (correspondents)
Partners' capital
Subordinated loans
Leased wires
Licenses and taxes
Life insurance premiums—officers' (or partners')
Payroll:
Office salaries
Officers' (or partners') salaries
Payroll taxes
Postage and registered mail insurance
Professional fees
Profit sharing and retirement
Provision for depreciation
Quotation boards
Rent of premises
Rent of equipment
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Section 2

Financial Statements and Reports

Report of Financial Condition—(Questionnaire)

A report of financial condition, referred to as a questionnaire, containing information requested in Form X-17A-5, Parts I and II, is required to be filed with the Securities and Exchange Commission by each brokerage concern described in the following sentence, as of a date during each calendar year. The report must be filed by every member of a national securities exchange who transacts a business in securities directly with or for other than members of a national securities exchange, by every broker or dealer (other than a member) who transacts a business in securities through a medium of any member of a national securities exchange, and by every broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934. The report is due to be filed within 60 days (effective December 31, 1972, pursuant to Release No. 9658 of the Securities and Exchange Commission) after the date of the report of financial condition and the reports for two consecutive years shall not be as of dates within four months of each other.

Reports on financial condition required of members of national securities exchanges and other regulatory bodies generally conform in all material respects with Form X-17A-5 and may be filed with the Securities and Exchange Commission in lieu of Form X-17A-5 provided they meet the requirements of its Rule 17a-5.

Questionnaire answers are to be submitted on an unconsoli-

dated basis in order to present proper information for the computation of net capital.

Since the information presented in the answer to Part I must be sufficient to permit determination of the financial condition of the respondent, all footnotes, valuations, and classification of data deemed necessary to a fair presentation of financial condition must be included. Footnotes and classification of data in Part II must also be included in Part I if their inclusion is deemed necessary to a fair presentation of financial condition. This must be done whether or not the respondent elects to have the information in Part II accorded confidential treatment by having such Part II bound separately as provided in Section (b) (3) of Rule 17a-5 of the Securities and Exchange Commission.

Part I—(Financial Questionnaire)

The response (Answers) to Financial Questionnaire is prepared in columnar form as required by the general instructions. Replies to Questions 14, 15, and 16 are not included in the totals. The questions should be numbered as set forth in the form except that no caption need be shown for items and conditions which are not present. If no answer is made to a question or subdivision thereof, it shall constitute a representation that the respondent has nothing to report. See Exhibit B of this guide for an example of Answers to Financial Questionnaire and Exhibit A for examples of the independent public accountant's report which is to be submitted therewith.

Submitted below are comments relative to the various questions comprising Part I.

1. *Bank Balances and Other Deposits.* Each kind of deposit (cash and/or market value of securities) is to be separately stated under this question with adequate description. Included are cash on hand; cash in banks representing general funds subject to immediate withdrawal; cash in banks subject to withdrawal restrictions; funds segregated pursuant to regulations of any agency of the federal government, any state, any national securities exchange or national securities association; contributions to clearing organizations incident to membership; deposits with clearing organizations in connection with commitments; guaranty and margin deposits; good faith deposits; drafts with securities attached deposited for collection.

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Deposits not connected with security or commodity transactions, such as airline, lease, and utility deposits, are reported in Question 13, "Other Accounts."

If cash in banks contains uncollected funds resulting from immediate credit received for drafts deposited for collection with securities attached, the amount should be disclosed as a contingent liability under Question 16 with a notation as to collections subsequent to the audit date.

Bank overdrafts should not be offset against bank balances in other banks or restricted deposits in the same bank but should be reported under Question 13 since the credit balances in these accounts are considered a part of "aggregate indebtedness" for purposes of computing capital requirements.

Good faith deposits are sometimes outstanding after the related syndicate or underwriting account has been closed. Since good faith deposits are required to be identified with commitments shown in Question 14, those relating to closed accounts should be stated separately.

2. *Money Borrowed, and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured by or Containing Customers' Collateral.* The amount of money borrowed is reported as a ledger credit balance. The market value of the securities and warehouse receipts (supporting "spot" commodities) pledged as collateral will appear in the "short" valuation column.

   Accounts carried by other banking or brokerage houses may contain either debit or credit ledger balances and either or both long and short security valuations.

   Accounts carried by a regional clearing house under continuous net settlement arrangements may contain either net debit or net credit ledger balances and long or short security positions. The amounts may be reported under a separate subcaption in either Question 2, 3 or 4 as "Settlement Balances with Clearing Organizations."

3. *Money Borrowed, and Accounts Carried for Respondent by Other Banking and Brokerage Houses, Unsecured, or Secured Entirely by Collateral Owned by Respondent and Its Partners or Officers and Directors or by Securities Covered by "Satisfactory Subordination Agreements."* The amount of money borrowed is reported as a ledger credit balance. The market value

of the securities and warehouse receipts (supporting "spot" commodities) pledged as collateral will appear in the short valuation column.

Accounts carried by other banking or brokerage houses may contain either debit or credit ledger balances and either or both long and short security valuations.

Separation of borrowings secured by customers' collateral (Question 2) and by respondent's collateral (Question 3) is necessary since borrowings in the latter category are not considered "aggregate indebtedness" in computing capital requirements. However, unsecured borrowings, borrowings secured in whole or in part by non-exempted collateral owned by officers or directors (Question 8) and borrowings not adequately collateralized are considered part of "aggregate indebtedness."

Note particularly the word "entirely" in the Question 3 caption. If any portion of the collateral in a borrowing reported under this question is owned by customers, the whole borrowing will be classified as a Question 2 borrowing and, unless the borrowing is collateralized entirely by exempted securities, will constitute a part of "aggregate indebtedness." Reference is made to Rule 15c2-1 of the Securities Exchange Act of 1934 relating to hypothecation and commingling of customers' securities.

It should be noted that for purposes of the financial questionnaire, securities sold by the respondent as principal under a repurchase agreement are deemed to be securities owned by the respondent and are required to be reported separately and clearly under Question 10. In such instances the offsetting credit and short valuation are reportable separately in response to Question 3.

4. *Other Open Items With Brokers and Dealers.*

   a. *Securities borrowed*—The ledger debit balance represents the amount advanced to lending brokers or dealers as collateral for the borrowed securities (market value of security at time of transaction plus or minus subsequent marks-to-market) and thus the amount to be received when the borrowed security

is returned. The related long value represents the current market value of the securities borrowed.

b. *Securities failed to deliver*—The ledger debit balance represents amounts receivable from buying brokers or dealers covering the purchase price of securities sold but not yet delivered. The related long value represents the market value of the securities which the brokerage concern is obliged to deliver.

Data concerning age of fail to deliver transactions must be disclosed in accordance with applicable rules.

c. *Securities loaned*—The ledger credit balance represents the cash collateral advanced by the borrowing brokers or dealers (market value of securities at time of transaction plus or minus subsequent marks-to-market) and thus the amount to be repaid upon return of the securities loaned. The related short value represents the current market value of the securities loaned to the borrowing broker.

Loaning securities to other brokers or dealers provides, in most instances, an interest-free loan.

Customers' securities may not be used for lending purposes unless specific written consent is obtained from the customer. The consent to lend securities held for margin is generally included in margin account agreements; however, in order to lend excess margin or fully-paid-for securities a specific written agreement designating the particular securities to be loaned must be obtained.

d. *Securities failed to receive*—The ledger credit balance represents the amount payable to selling brokers or dealers for securities purchased by the brokerage concern but which have not yet been received. The related short value represents the current market value of the securities which the selling broker or dealer is obliged to deliver. The form requires failed to receive items for proprietary accounts to be shown as either sold or unsold at the date of the report to obtain proper treatment under capital Rule 15c3-1.

Failed to receive items classified as unsold in pro-

prietary accounts of the respondent are excluded from "aggregate indebtedness."

Data concerning age of fail to receive transactions must be disclosed in accordance with the applicable rules.

5. *Valuation of Securities and Spot (Cash) Commodities in Box, Transfer and Transit.* The valuation of fully-paid-for securities in safekeeping and segregation or in transfer (specifically identified to customers) may be, and usually are, omitted in the Answers to Financial Questionnaire. The valuations included in the answer to this question relate to negotiable securities in the box or which will find their way into the box when received from transfer or transit and to securities not segregated which are held by Central Certificate Service or other depositories.

   In-transit items are those which have been shipped from or to the respondent's offices and which have not yet reached their destination.

6. *Customers' Security Accounts.* After equity statements have been prepared, as described elsewhere in this guide, the accounts of customers are summarized into the various classifications set forth in this question.

   For the purpose of classification under Question 6, all accounts of any one customer (other than regulated commodity accounts) may be combined and reported under any appropriate section other than Section A. Customers' accounts related by bona fide written guarantees may also be combined.

   Accounts reportable in Section A are "bona fide cash accounts," defined in Form X-17A-5 as accounts having both unsettled money balances and positions in securities which are current items within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System. The form also provides that cash accounts which are not "bona fide cash accounts" shall be reported under Sections B, C or D, as appropriate.

   Present practices of the brokerage industry provide for the maintenance of customers' accounts on the "net balance forward" basis which does not provide details of the individual open items comprising such balance in a form through which

all transactions can be readily aged and summarized at a given point in time for classification purposes. Accordingly, it may be time-consuming and costly for the brokerage concern to comply with this classification requirement and extremely difficult for the independent accountant to ascertain that "all" transactions included in accounts which are classified as "bona fide" cash accounts are current.

Secured accounts reportable under Section B are accounts which liquidate to an equity and are for the most part margin accounts. To qualify as a secured account, one of the following conditions must exist:

a. The valuation of securities "long" in the account must be equal to or greater than the debit balance.
b. The valuation of securities "short" in the account must be equal to or less than the credit balance.
c. If the account contains both "long" and "short" securities:
    1. The valuation of the long securities must be equal to or greater than the debit balance plus the valuation of the short securities.
    2. The valuation of the long securities plus the credit balance must be equal to or greater than the valuation of the short securities.

In determining whether an account is secured, consideration may be given, if necessary, to the valuation of securities in segregation, if any, for the account of the specific customer provided such securities are in negotiable form.

Partly secured accounts reportable under Section C are accounts, other than those reportable under Section A, which liquidate to a deficit; i.e., opposite the conditions of equity set forth above for secured accounts.

Unsecured accounts reportable under Section D are accounts having only debit balances and/or short security positions.

Accounts with credit balances which contain open contractual commitments are reportable under Section E. The credit balance may or may not constitute a specific deposit against the commitment or commitments.

Free credit balance accounts reportable under Section F are accounts subject to payment on demand. If such accounts

contain "long" securities which are not segregated, the valuation of such securities are to be reported in Section G.

Fully paid securities not segregated which are reportable under Section G include, in addition to those in accounts with free credit balances as indicated above, long securities positions in accounts with no debit balance, no short securities positions and no open contractual commitments. The valuation reported in this section may also include securities for which instructions to segregate have been issued but which have not been accomplished as of the financial questionnaire date. This portion of such valuation may be separately disclosed.

Upon review of the Answers to Financial Questionnaires, exchange member organizations are often asked to explain the reason for unsegregated securities and to indicate the location of such securities in the Answers to Financial Questionnaire. It should be noted that it is not possible to specifically identify the location of the unsegregated securities unless the brokerage concern's record keeping procedures provide for such identification, a condition rarely encountered. Under these conditions, and because there are no established rules in this area, location allocation is arbitrary, and it is suggested that such information not be included in the questionnaire answers. If this information is requested by a regulatory agency of a respondent, consideration should be given to providing such information in a letter to the respondent, clearly describing the location priority used (to be furnished by respondent), the arbitrary nature of such location priority, and the limited reliance that should be placed thereon.

Significant changes may be made in the reporting requirements relating to fully paid securities not segregated as a result of the adoption of Rule 15c3-3 announced on November 10, 1972 which became effective January 15, 1973.

Joint accounts which are carried by the respondent and in which the respondent has an interest, including deposits received by the respondent from other members of the joint account, are reportable under this question. Attention is directed to note 3 of this question, as to the proper method of reporting such accounts.

Attention is also directed to notes 4 and 5 of this question regarding open contractual commitments carried for accounts

reportable under Section B, C, D, and E. This information is necessary for the purpose of determining net capital under the capital requirement rules.

7. *Customers' Commodity Accounts.* Customers' commodities accounts are classified either as regulated commodities accounts (regulated under the Commodity Exchange Act) or non-regulated commodities accounts. Valuations of "spot" (cash) commodities are entered in the long and short valuation columns as the case may be, whereas gains and losses on future commodity contracts are entered in the gain and loss columns. Valuations of future commodity contracts are not entered in Part I of the financial questionnaire.

   Separation of regulated and non-regulated accounts is important as liabilities arising from regulated accounts for which funds have been properly segregated are excluded from "aggregate indebtedness" in computing capital requirements. The independent public accountant should, therefore, establish that the aggregate of the segregated amounts consisting of cash or qualified securities deposited in segregated bank accounts or with clearing organizations, and equities with other brokers who carry customer trades on an omnibus basis (see Question 2B), are sufficient to cover the equities in regulated commodity accounts. Equities (liabilities) or deficits (receivables) in commodity accounts are determined by applying the unrealized gains or losses on open contracts to the ledger balances in each account.

8. *Accounts of Officers and Directors.* Accounts of officers and directors are classified in the same manner as customers' accounts. The account of an officer who is also a director should be classified as that of an officer.

9. *General Partners' Individual Accounts.* Accounts of general partners are on occasion covered by agreements which provide that cash, securities, commodities or equities recorded in the accounts are to be included as partnership property and may be included as capital under the capital rules provided that such agreements are acceptable to the applicable regulatory bodies. Such accounts are reported separately in an-

swer to Question 9A. The total valuations of "exempted securities" (securities exempted from registration under the Securities Exchange Act of 1934, otherwise than by specific action of the Securities and Exchange Commission) are to be stated separately. This information may be reported parenthetically. Non-capital accounts are classified in Question 9B in the same manner as customers' accounts.

The non-capital accounts of limited or special partners are to be included with customers' accounts.

10. *Trading and Investment Accounts of Respondent.* Long and short positions are both reportable under this question. The ledger balances with respect to all security accounts and "spot" (cash) commodities may be combined. Short positions of unlike securities, however, should not be netted against long positions and the valuations of each should be shown separately.

Securities sold by the respondent as principal under a repurchase agreement are deemed to be securities owned by the respondent and are to be separately and clearly shown as such under this question with the offsetting credits and security valuations reported under Question 3A. In submitting this information the cost to repurchase should be shown as the ledger debit and the market value of the securities should be shown as the long valuation.

Long and short positions which are exchangeable within thirty days may be reported separately under this question in order to minimize the capital charge effect of the respondent's securities.

11. *Capital Accounts.* In partnerships it is not unusual for partners to contribute securities as capital. In most instances, however, it is only the use of the securities that is contributed and the partner retains the right to receive the dividends and interest, the gains and losses on sales, and the right to substitute other securities. Also, it is not unusual in such instances for the partner to set a limit on the value of the securities to be considered as capital. If the market value of the securities exceeds the limitation, this condition must be reported in the answer to this question.

As indicated in the note to this question, the valuation

of "exempted securities" should be stated separately. This information may be reported parenthetically.

12. *Subordinated Accounts and Borrowings.* Any subordinated account reported under Question 12 must be subject to an agreement which complies with the requirements of Rule 15c3-1 (c)(7) under the Securities Exchange Act of 1934 or, if the respondent is a member of an exchange whose members are exempt from Rule 15c3-1 by subparagraph (b)(2) thereof, complies with the rules regarding subordination agreements of all the exchanges therein listed of which respondent is a member.

    Note 1 to this question states that the valuation of "exempted securities" shall be stated separately. As in the case of a similar requirement with respect to other questions, this information may be reported parenthetically. With respect to answers submitted by a member of the New York Stock Exchange, subordinated borrowings under agreements which have not been filed with and approved by the exchange are not reported under this question but must be reported separately in the answers to other questions.

13. *Other Accounts.* The types of accounts to be included under this caption are set forth in the printed instructions. Accounts which cannot be classified under Questions 1 through 12 are reported under this question.

    The market value of security differences, overages (long) and shortages (short) are reported in the security value columns under this question giving the details specified by the Questionnaire. Adequate provision should be made for possible losses in connection with security differences. Adequate provision should also be made for possible losses in connection with uncollected dividend and interest claims, unsecured and partly secured customer accounts, unverified transfer items, market exposure on aged fails, items in suspense accounts, aged items on bank reconciliations, and any other items the collectibility of which is in doubt.

    The commodity difference account, if any, is reported in the commodity gain or loss column, as the case may be, of this question and should result in balancing the gains or losses reported in response to the previous questions.

The note to this question requires that any liability reported under this question which is secured by collateral in any form shall be identified by reference to the related collateral.

14. *Contractual Commitments That Are Not Recorded in a Ledger Account for Money.* Contractual commitments to be reported in this question are defined in General Instruction B .11 of Form X-17A-5. The instructions do not specify the form which the answer is to take, but any presentation that clearly discloses the information requested is acceptable. A form of presentation will be found in Exhibit B of this guide.

In reporting the respondent's underwriting commitments under this question, care must be exercised in reporting the entire commitment. In some underwritings, particularly tax-exempt issues, the respondent's liability is undivided, which means that the member is responsible for his proportionate share of any unsold securities in the underwriting account regardless of the amount of the securities which he has taken down or sold. This information can be obtained from the syndicate managers. Likewise, in the case of divided accounts, the syndicate managers may reserve part of the respondent's commitments for sales to selected dealers or may enter into directed sales for the account of the respondent. In such instances, the reporting of the respondent's interest in the entire account would include these amounts. In other instances where the settlement date has been fixed and bridges the audit date, the transactions may have been entered on settlement blotters for entry after the audit date. These items are not "regular way" transactions and should also be reported as a part of the respondent's entire commitment.

In many instances, brokerage concerns which may or may not be members of underwriting groups enter into buy and sell transactions in "when issued" securities on a principal basis with other brokerage concerns which may or may not be members of the underwriting groups. Such transactions should be stated separately as "when issued" transactions and not included as purchases and sales affecting the "underwriting" commitment.

The respondent may enter into contracts to buy or sell on a "delayed delivery" basis securities which may be either short or long in the trading and investment accounts. This information should be reported as respondent's transactions under the caption delayed delivery contracts under this question and, if the offsetting position is either "long" or "short" in the trading and investment accounts, this fact should be noted in the answer to this question and in the detail supporting Question 10 in Part II of the financial questionnaire.

If the respondent is acting as syndicate manager of an underwriting group in unissued securities, only the respondent's portion of the commitment should be reported in the answer to this question.

Information reported in answer to this question may be presented in summary form or in detail. If a summary is presented, the details must be reported in Part II of the financial questionnaire.

15. *Participations of the Respondent in Joint Trading and Investment Accounts Carried by Others That Are Not Recorded in a Ledger Account for Money.* Items reportable under this question deal with joint accounts in *issued* rather than "when issued" securities.

Two or more brokerage concerns may enter into joint account arrangements whereby each member will carry specified securities for the joint account. In such instances consolidation of the information carried in the records of each member of the joint account is necessary to construct the entire account. The portion carried by the other brokerage concern is reported under this question. The portion of the joint account carried by the respondent, if any, appears under the proper classification in Questions 6 and 7 and, together with the information reported under this question, should constitute the entire account.

The answer to this question is usually in summary form with the details reported in Part II of the financial questionnaire.

16. *Unrecorded Assets, Liabilities, and Accountabilities.* The answer to this question requires the submission of a separate schedule containing a description of any assets, liabilities and accountabilities of the respondent, actual or contingent, which are not included in a ledger account or reported in answer to Questions 14 and 15. Only such items which in the aggregate are material in relation to net capital need be reported. Accountabilities shall include cash and/or other property, including securities held for customers by or on behalf of respondent, which are not included in a ledger account. Contingent liabilities may include lawsuits pending against the respondent, accommodation endorsements, rediscounted notes, guarantees of accounts of others, lease obligations, and uncollected funds included in cash in bank as a result of immediate credit given for securities shipped draft attached. The information furnished in response to this question should be sufficient to permit determination of appropriate treatment in the net capital computation.

Part II—(Supplementary Information)

Items (a), (b), and (c) of Part II of the financial questionnaire call for the details supporting various questions in Part I. Item (d) requests information with respect to amounts authorized or proposed to be distributed or withdrawn from the proprietary accounts reported in Question 11 of Part I within six months following the questionnaire date. If the amount is material, the information must also be reported in Part I, either as a separately identified amount or as a footnote. Item (e) requests information concerning liabilities of a sole proprietor which are not reflected in the answers to Part I which would materially affect net worth as reported. Here again, this information must also be set forth as a footnote to Part I.

Since the respondent may not want to divulge certain details submitted in Part II by including them with Part I (a public document which is available for inspection at the Securities and Exchange Commission and the principal office of the brokerage concern) confidential treatment will be accorded to the schedules furnished pursuant to the requirements of items (a), (b), and (c) of Part II in those instances where such data is bound separately.

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Part III—(Supplementary Information Required by National Securities Exchanges for Computation of Net Capital Under Capital Requirement Rules)

Most national securities exchanges require information in addition to that provided in Parts I and II of Form X-17A-5 for use in connection with computations of net capital under capital requirement rules. The information is usually submitted as a separate section of the Answers to Financial Questionnaire. An example of the type of information required is to be found in Part III of the financial questionnaire of the New York Stock Exchange, Inc. Brokerage concerns reporting only to the Securities and Exchange Commission are not required to supply the information required in Part III.

Statement of Financial Condition

Most national securities exchanges[1] require that their members make available to customers a statement of financial condition. In the majority of cases this statement is as of the date of its most recent Answers to Financial Questionnaire. If it is as of the date of the audited Answers to Financial Questionnaire pursuant to Rule 17a-5 of the Securities and Exchange Commission or the equivalent rule of the national securities exchange of which the brokerage concern is a member, the statement is accompanied by the usual short-form report of the independent public accountant. If the financial statement is as of the date subsequent to the date of the audited Answers to Financial Questionnaire, it shall be one which, in the opinion of the organization, presents fairly the financial condition of such organization. If the organization is a member of the national securities exchange, an exact copy of the financial statement which the organization intends to submit to its customers is usually required to be filed with the exchange.

Examples of statements of financial condition (corporate and partnership forms) are shown in Exhibits E and K, respectively, of this guide. Accompanying notes to statement of financial con-

[1] The Securities and Exchange Commission has adopted an amendment to Rule 17a-5 (SEC Release No. 9658) effective for quarters ending on and after September 30, 1972, requiring brokerage concerns to furnish statements to their customers on a quarterly basis.

dition (corporate and partnership forms) and accountant's report are shown in Exhibits I, O, D, J, and P, respectively.

It should be noted that in Exhibits E and K no separation of assets and liabilities as between current and non-current is made. For the typical brokerage concern, such a distinction has little meaning and requires arbitrary decisions which might be misleading. For example, margin debit balances while subject to demand for payment by the broker, and thus theoretically current, are generally sought to be maintained (as long as properly margined) on a long term basis. Similarly, bank loans, payable on demand, are usually collateralized by securities purchased in margin accounts by customers and may be virtually long term in substance. Investments in marketable securities may be long or short term but the factors influencing the sell or hold decision, such as alternative investment opportunities, change frequently. Some confusion as to current or non-current status could result also from the customary application of the net capital rules where concepts such as "immediate convertibility into cash," "collectible within 30 or 45 days," etc., have evolved.

Thus, for the typical brokerage concern, it is believed that appropriate description of the assets (such as distinguishing clearly between marketable and not readily marketable investments) and liabilities without arbitrary distinction between current and non-current is the most meaningful presentation. However, if the brokerage concern diversifies to a substantial degree into non-financial businesses, such a distinction may be appropriate.

Most of the items set forth in the exhibited statements of financial condition are self-explanatory and those relating to corporate form (Exhibit E) are cross-referenced to the items appearing in the Answers to Part I of the Financial Questionnaire (Exhibit B). Several items, however, require special comment, as follows:

Receivable From Brokers or Dealers. This classification includes primarily failed to deliver and securities borrowed items.

Where the brokerage concern deals through correspondents, there may be debit balances in the "omnibus" accounts of one or more of the correspondents. In such instances, if the amounts are insignificant, they may be included under this classification. If the amounts are significant, a separate caption, "Due from correspondent brokers," may be appropriate.

Customers' Partly Secured and Unsecured Accounts. The suggested financial statement presentation of customers' partly secured and unsecured accounts is to classify them as receivables due from customers. Where losses in such accounts can be reasonably anticipated, an asset valuation allowance should be established. The disclosure and classification of such an allowance in the financial statements should be in accordance with the applicable Accounting Principles Board Opinion.

Trading and Investment Accounts. Trading and investment accounts of a brokerage concern generally are of two types:

1. *Trading accounts.* Generally marketable securities (stocks, corporate bonds, United States Government securities, state and municipal bonds, commercial paper, etc., or commodities) carried in inventory and held for sale in the ordinary course of business.
2. *Investment accounts.* Investments of all types other than those carried in trading accounts (including venture capital investments in securities, oil and gas leases, and real estate) both marketable and not readily marketable.

While the general practice in the past has been to reflect marketable securities in trading accounts at market value in the interim date balance sheets of brokers who are members of national securities exchanges, securities, etc., in investment accounts have been carried at cost and, in some instances, at market. In any event, because of the historical requirement to issue only a statement of financial condition (balance sheet) in connection with the surprise examinations of members of national exchanges, very few individuals focused on the cost versus market value implications in brokerage concerns' income statements (see discussion on income statements following).

In considering the issues involved, it is appropriate to classify investment accounts into two categories: (1) marketable, and (2) not readily marketable. "Not readily marketable" investments include (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 (or the condi-

tions of an exemption, such as Regulation A, under Section 3 (b) of such Act have been complied with); (c) securities which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities or to the company; and (d) most investments in oil, gas and real estate.

Trading and investment positions should be valued for financial statement purposes as follows:

1. Marketable securities at current market value.
2. Not readily marketable securities and other investments at fair value as determined by the brokerage concerns' management, with cost disclosed.[2]
3. The increase or decrease in unrealized appreciation or depreciation resulting from the foregoing treatment should be included in the income statement.
4. Differences between accounting and tax treatment will, in the case of corporations, require appropriate tax allocation.

The market and fair value concept recognizes that trading and investment securities and other investments, whether readily marketable or not, appreciate or depreciate as the earnings records of the companies themselves and market or other economic conditions dictate. Accordingly, the investing brokerage concern should account for its decisions to purchase, hold or sell a particular investment during the period under review. The market and fair value concept provides the most effective means of measuring the trading and investment decisions of the brokerage concern's management.

The difficulties in determining the fair value of not readily marketable investments are recognized. In this connection it is suggested that reference be made to SEC Accounting Series Release No. 118 relating to not readily marketable investments of investment companies.

[2] Investments which meet the criteria of APB Opinion No. 18, *and* which are made for long-term *operating* purposes, should ordinarily be carried on the equity basis. Investments of this type are usually made to provide facilities or services to the brokerage concern. The emphasis here is on the long-term operating nature of this type of investment.

The brokerage concern's interest (assuming such interest is not merely contingent) in underwriting or joint accounts with others for issued securities is includable with the trading and investment account. Where parts of the joint accounts are carried by other brokerage concerns (as set forth in Question 15 of Answers to Financial Questionnaire), the interest of the brokerage concern being reported upon should be determined and classified as above with a contra liability to the carrying brokerage concern.

Many brokerage concerns acting as principal have contractual commitments, including underwriting, when issued, when distributed and delayed delivery contracts. Appropriate footnote disclosure should be made of these commitments when deemed significant and provision should be reflected in the financial statements for inherent losses, if any.

Securities sold by the brokerage concern under repurchase agreements are required to be set forth in Questions 3 and 10 of Answers to Financial Questionnaire. These securities should be reported with trading and investment accounts, at market value, in the statement of financial condition with the repurchase cost reflected as a liability.

In some instances brokerage concerns sell call options against long security positions in trading and investment accounts. If material, it is necessary to separate such securities from the regular trading and investment securities, describe them as "securities for which endorsed calls are outstanding," and value them on an individual security basis at the lower of market value or contract value of calls outstanding.

In other instances, brokerage concerns operate "conversion accounts" for put and call brokers. These accounts are hedged as far as the securities broker is concerned. If material, the long securities must be likewise separated from the regular trading and investment securities, described as "securities for which endorsed calls are outstanding and puts for like amounts are held." For purposes of valuation in the statement of financial condition, a determination must be made as to the present realizable value of the security, considering the existing relationship between the put price, the call price and the current market price (see accounting for option premiums elsewhere in this guide). Because of the complexity of these relationships they are illustrated in the table on the following page.

If "put" price is above "call" price—

	Long Put	*Short Call*	*Market*	*Realizable Value (for statement of financial condition)*
and market is:				
Above put	$100	$ 98	$101	$ 98 (Call)
Same as put	100	98	100	98 (Call)
Below put, above call	100	98	99	99 (Market)
Same as call	100	98	98	100 (Put)
Below call	100	98	97	100 (Put)

If "call" price is above "put" price—

and market is:				
Above call	$ 98	$100	$101	$100 (Call)
Same as call	98	100	100	100 (Market)
Below call, above put	98	100	99	99 (Market)
Same as put	98	100	98	98 (Put)
Below put	98	100	97	98 (Put)

Secured Demand Notes. Secured demand notes are usually found in brokerage concerns operating as corporations, although it is possible for such notes to be found in partnerships. The secured demand notes receivable have a contra on the liability side of the statement of financial condition under liabilities subordinated to claims of creditors. Where the note is payable solely from the proceeds of the collateral, care should be exercised to limit the stated value of the note to the lower of the market value of the collateral or the face amount of the note.

Memberships in Exchanges. Exchange memberships owned by the brokerage concern are generally acquired for operating purposes and should be valued at cost or at a lesser amount where there is an indication of permanent impairment in value of a material amount. Exchange memberships contributed for the use of the brokerage concern and subordinated to claims of general creditors should be carried at market value with an offsetting amount shown under liabilities subordinated to claims of general creditors.

Investment in Subsidiaries. Under certain circumstances, valid reasons may exist for omitting a subsidiary from consolidation. However, generally accepted accounting principles require that subsidiaries, when they meet certain criteria, be consolidated. Where the brokerage concern has such investments, presentation in the financial statements should be in accordance with the applicable Accounting Principles Board Opinions.

Payable to Brokers or Dealers. This classification includes primarily failed to receive and securities loaned items. Where the brokerage concern operates through correspondents the credit balances in "omnibus" accounts of correspondents may be included under this classification if the amounts are insignificant. If significant, however, such credit balances should be shown separately as "Due to correspondent brokers."

Footnotes. The fairness of financial statement presentation is dependent upon the adequacy of disclosures involving material matters. As in the case of financial statements generally, footnotes for such items as summary of accounting policies, changes in accounting principles, long-term lease obligations, maturity dates of subordinated borrowings, assets subject to lien, pension and retirement plans, contingent liabilities, depreciation policies, stock option and purchase plans, provisions under which the brokerage concern may be required to purchase its own capital stock, etc., are necessary and required for fair presentation. Such disclosures in the financial statements should be regarded as being reasonably adequate unless otherwise stated in the report. If matters which the independent auditor believes require disclosure are omitted from the financial statements, the matters should be included in his report and he should appropriately qualify his opinion.

Statement of Income

Until quite recently, substantially all brokerage concerns were privately owned and the distribution of financial information to the public generally was limited to statements of financial condition which were required by the national securities exchanges to be made available to customers. However, as brokerage concerns sold their equity securities to the public, they became

subject to the disclosure rules which apply to publicly held companies in general. Such rules require the dissemination of more comprehensive financial information to stockholders including statements of income and changes in financial position. While brokers and dealers, other than those with public ownership, are not presently required to publicly disclose their results of operations and changes in financial position, we believe they should be encouraged to do so.

Prior to the advent of public ownership of brokerage concerns and the adoption in 1972 of amendments to Rule 17a-5 (SEC Release No. 9658), the independent public accountant was not generally concerned with reporting upon results of operations of such concerns. With the recent emphasis on such reporting, however, a number of accounting matters have assumed added significance. Chief among these is the question of the most informative method of asset valuation and the resultant effect on operating results.

Brokerage concerns today are involved in a number of financial activities including the investment of substantial sums of money in both short-term and long-term investments of various types. As indicated previously in this guide, we have concluded that trading and investment accounts of brokerage concerns should be valued at market or fair value for financial reporting purposes and that unrealized as well as realized gains and losses be reflected in the statement of income. The increase or decrease in net unrealized appreciation or depreciation in investment accounts included in results of operations should be disclosed if significant. The aggregate effect on reported net income (net of taxes) should also be disclosed as well as the amount per share.

The statement of income should disclose separately the principal sources of the brokerage concern's revenues such as brokerage commissions, trading profits or losses, investment profits or losses, underwriting profits or losses, fee income, dividends and interest, etc. Expenses should be reported by major types such as employee compensation and benefits, communications, occupancy and equipment, interest, floor brokerage and clearance fees, promotion, etc.

Examples of statements of income and retained earnings (corporate form), statement of income and statement of changes in partnership capital (partnership form), and the accompanying

accountant's report submitted when operating results are included are shown in Exhibits F, L, D, and J, respectively.

Statement of Changes in Financial Position

The Statement of Changes in Financial Position, formerly referred to as Statement of Source and Application of Funds, is now required as a basic financial statement when financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued. Several regulatory agencies have acted recently to require such statements in certain reports filed with them.

Examples of Statement of Changes in Financial Position (corporate and partnership forms) are submitted as Exhibits H and N, respectively.

Statement of Changes in Subordinated Liabilities

This statement, examples of which are submitted as Exhibits G and M (corporate and partnership forms), is now required to be filed with the Securities and Exchange Commission and must be covered by the opinion of the independent public accountant.

Annual Report of Income and Expense

Effective January 1, 1969, the Securities and Exchange Commission adopted Rule 17a-10 and the related Form X-17A-10. Under the provision of Rule 17a-10, every member of a national securities exchange and every broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (other than members of a national securities exchange or a registered national securities association which maintains records containing the information required by Form X-17A-10 as to each of its members, and which transmits to the Commission a copy of the record as to each such member, pursuant to a plan the procedures and provisions of which have been submitted to and declared effective by the Commission) shall file a report of his income and expenses and related financial and other information for such calendar year on Form X-17A-10. The report is due to be filed not later than 90 days after the close of each calendar year and need not be certified.

The New York Stock Exchange requires its member organizations to file annual reports which meet the exemption requirements of Rule 17a-10. These reports, however, are more detailed than the report on Form X-17A-10 in that income and expenses must be further identified by functions, i.e., sales, execution, administration, research, other business, security commission income and other income.

Since the preparation of both Form X-17A-10 and the related exchange report requires considerable breakdown and classification of income and expense, the larger brokerage concerns have expanded their classification of accounts to collect certain of the information on a day-to-day basis. Smaller brokerage concerns can, of course, obtain the information by analysis of the accounts, but such analysis should be carried on periodically throughout the year rather than waiting until the year end.

Since reports pursuant to Rule 17a-10 of the Securities and Exchange Commission and comparable rules of the New York Stock Exchange do not require certification by an independent public accountant, neither the rules nor the forms are included in this guide.

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Section 3

Internal Accounting Control and Procedures for Safeguarding Securities

General

Statement on Auditing Procedure No. 54, issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants, describes accounting control as follows:

> *Accounting control* comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:
>
> a. Transactions are executed in accordance with management's general or specific authorization.
>
> b. Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets.
>
> c. Access to assets is permitted only in accordance with management's authorization.
>
> d. The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

The review of the accounting system, internal accounting control, and procedures for safeguarding securities required by the Audit Requirements of Form X-17A-5 recognizes the regulatory concern for safeguards over customers' property held by the broker-dealer in that the independent public accountant is required to report on any material inadequacies found to exist in the accounting system, internal accounting control and procedures for safeguarding securities.

While not unique to the industry, the importance of an effective internal audit group in the overall internal control system of a broker-dealer should be stressed. Such a group should conduct continuing tests and evaluations of the procedures and controls in effect, adherence to established policies, and make recommendations for improvement. The internal audit function should, of course, be carried out by personnel who are independent of the departments or functions subject to audit.

Procedurally, in reviewing the actual operation of the system of internal control, the reviewer should follow the documentation. Completeness in documentation, of course, does not necessarily imply satisfactory control. However, in reviewing what is done and evaluating the effectiveness of control, the principal point of reference should be the documentation.

Many activities of a broker or dealer in securities are unlike those of companies in other industries; consequently, many internal accounting controls are peculiar to this industry. Such controls are concerned primarily with the following categories of activity: receiving, delivering, pledging, borrowing, lending, transferring, and maintaining custody of securities; maintaining customers' accounts including extending credit under the regulations of the Board of Governors of the Federal Reserve System; and transactions with other brokers and dealers and organizations involved in clearing and/or settling securities transactions.

Specific Controls

The following are illustrative of some of the controls one would expect to find in operation in a brokerage concern. Excluded are those controls which have to do with the adequate separation of duties between individuals who initiate and record transactions; and the approval of transactions or journal entries by

individuals who do not initiate or record transactions and journal entries; these are characteristics of all good systems of internal control.

Securities. The controls over securities should be such as to provide compliance with regulatory requirements as well as providing for physical safeguards and integrity of the records.

1. Certificate numbers should be recorded for all securities received and delivered; this is sometimes accomplished by microfilming such securities.
2. Securities received should be checked for negotiability (endorsements, signature, guarantee, etc.) and for completeness (coupons, warrants, etc.) before they are placed in the active box or vault.
3. Securities received from customers registered in the name of a third party should be accepted only upon proof of ownership.
4. Adequate investigation should be made to determine that customers delivering securities registered in a "street name" have title to such securities.
5. A limited number of responsible employees should be authorized to execute or guarantee assignments and, if the brokerage concern is a member of the New York Stock Exchange, an appropriate resolution must be filed with that Exchange.
6. Facsimile signature devices, if used, should be adequately controlled.
7. When securities are shipped against payment, a designated employee who does not handle securities or cash should follow to a conclusion the receipt of payment.
8. Adequate physical controls should be maintained over securities on hand; access to areas containing securities should be restricted to authorized employees. Access to security vaults should require the presence of two or more authorized employees.
9. Customers' fully-paid-for securities and excess margin securities, should be properly noted in the records of the brokerage concern as securities requested to be segregated.

10. The detail records pertaining to securities in transfer and those pledged as collateral to borrowings from banks should be agreed periodically (at least quarterly) with the securities record.
11. Securities on hand should be counted periodically and any differences recorded and followed to a conclusion. Reference is made to Rule 17a-13 of the Securities and Exchange Commission and to similar rules of other regulatory authorities which make periodic counts mandatory.
12. Movements of securities should be balanced daily and the responsibility for the clearance of out-of-balance positions should be assigned to specific individuals who have no other duties with respect to securities handling or accounting.
13. Security positions (and related ledger amounts) in suspense accounts should be investigated and resolved on a timely basis.

Customers' Accounts. In order to provide effective control over the opening and maintaining of customers' security and commodity accounts, various procedures are followed by brokerage concerns, some of which are required by regulatory authorities. These procedures include the following:

1. New accounts should be approved by a partner or voting stockholder-officer before or immediately following the completion of the initial transaction in the account.
2. All accounts should be in the name of the customer unless a written statement signed by the customer attesting to his ownership of an account in any other name, symbol, or number has been received.
3. Letters should be mailed to customers requesting confirmation of changes in addresses. Some brokerage concerns mail confirmation requests to the customer's last known address as well as his new address.
4. Statements should be mailed to customers periodically (at least quarterly) unless a customer has specifically requested, in writing, that the statement be held.
5. Security positions as shown on customers' periodic statements should be compared to margin and security records.

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6. A signed, written authorization should be required from each customer for whom the brokerage concern carries a discretionary account. Every trade in the account should be approved by a partner or officer of the brokerage concern. An advice should be mailed to the customer on the date each trade is completed.
7. Separate ledgers should be maintained for the accounts of all employees and known relatives in order that transactions in such accounts can be reviewed more readily by an officer or partner of the brokerage concern.
8. Written approval for the opening of an account for an employee of another broker or dealer should be obtained from his employer.
9. Payment of funds or withdrawal of securities from customers' accounts should not be allowed without the written authorization of the margin department.
10. Margin records should be checked periodically by an employee who has no duties in connection therewith to determine that the minimum margin requirements of the firm are being maintained.
11. The margin department of a brokerage concern should provide a system to prevent violation of Regulation T of the Board of Governors of the Federal Reserve System and similar regulations dealing with the extension and maintenance of credit of other regulatory bodies. In that connection, procedures should be in effect to see that all necessary margin calls are made and followed up.
12. Bookkeepers and margin clerks should be rotated periodically so that they are not always servicing the same accounts.

Transactions With Other Brokers and Dealers.

1. The details of fails to receive, fails to deliver, securities loaned and securities borrowed should be agreed periodically with the securities record, and the respective amounts receivable or payable should be agreed with the related general ledger control accounts.
2. Aging schedules of fails to receive and fails to deliver transactions should be maintained on a current basis.

3. With respect to accounts carried by other brokers (omnibus accounts), the details of transactions should be agreed daily and responsibility for follow-up of any differences should be assigned.

Electronic Data Processing. Despite the high degree of reliability of the machines and the application of advanced techniques in developing computer programs, it should not be assumed that good internal control automatically carries over into an EDP system from a previously used system. While there is no reason why control should not be at least as effective in the EDP system as in any other, the changes that accompany an EDP installation may present control problems that do not exist in less sophisticated systems.

In an EDP system, as in any other system, there are four stages in the complete flow of data from origination to final recording and use. These are: data acquisition, data transmission, data processing, and data utilization. Internal controls relating to the first two stages are generally referred to as "input controls," those relating to the third stage, "processing controls," and those relating to the fourth stage, "output controls." "Security control" is another important aspect of an EDP system.

(a) *Input controls*—The purpose of input controls is to insure correctness in the initial accumulation of data and any preliminary operations that may be involved in presenting the information to the computer. Specifically, they regulate and monitor the following activities:

- The authorization of source documents.
- The handling of source documents.
- The conversion of data to machine language.

Controls with respect to these activities should be reviewed and tested in the same manner as that used for similar activities in manual systems.

(b) *Processing controls*—These controls, which are known also as programmed checks or programmed controls, are a part of the stored instructions that direct a computer's operations. To the extent that they are used, an EDP system becomes self-regulating, eliminating the need for clerical monitoring of results. This characteristic gives the computer a self-auditing capability which

is superior to that of any other processing system. The purposes of processing controls are to monitor the following:

- The adequacy of the programs.
- The quantity and quality of data.
- The correctness of human intervention.

There are numerous methods used to provide processing controls. Among the more common control methods are the following:

Quantitative controls:
Record counts
Control totals
Hash totals
Sequence checks

Qualitative controls:
Coding checks
Combination checks
Check digits
Matching checks
Composition checks
Posting checks
Limit checks
Crossfooting checks
Sign checks
Labels

(c) *Output controls*—These controls provide accountability over documents prepared by the computer. They regulate the assembly and distribution of reports and provide a means of comparing results with predetermined control information. Output controls are not concerned with the accuracy of processing as such, since this is a function of system controls in the input and processing stages.

(d) *Security controls*—These controls consist of policies and work rules governing the operation of electronic data processing equipment. They are provided to protect the equipment, data, and programs from known hazards. These include: fire, power loss, humidity extremes, excessive dust, wear and tear, and other physical hazards and inadvertent or deliberate destruction or alteration by the machine operators. Measures that provide con-

trol over the console and restrict access to program tapes and data tapes should be emphasized.

Review and Tests of Internal Accounting Controls By Independent Public Accountants

The principal purposes of the examination by independent public accountants required under Rule 17a-5 are to report to the jurisdictional agencies on financial condition (presented in such detail as to facilitate computation of the net capital ratio) and on any material inadequacies found to exist in the brokerage concern's accounting system, internal accounting control and procedures for safeguarding securities.

In his review of internal controls, the independent public accountant should first obtain information as to procedures purported to be in effect and make an evaluation as to their adequacy. After obtaining the information, he must make appropriate compliance tests to satisfy himself that the procedures are being carried out.

With reference to electronic data processing, the independent public accountant should review and test the input, processing and output controls. Additionally he should review procedures to ascertain that controls over report distribution are adequate and that reports showing errors or exceptions (based on processing controls) are properly distributed to those responsible for follow-up. The independent public accountant's principal interest in the so-called "security controls" relate to those measures that govern or limit the activities of machine room employees. In the system of internal control as a whole, the importance of measures that provide control over the console and restrict access to program tapes and data tapes should be emphasized.

In compliance with generally accepted auditing standards, as well as the rules of the Securities and Exchange Commission and the principal national securities exchanges, the independent public accountant is required to review and make appropriate tests of the accounting system, internal accounting control, and procedure for safeguarding securities for the period since the prior examination date. If, based on his review and tests of compliance, no material inadequacies are found to exist with respect to any of the foregoing matters, the independent public accountant should so state in his report on internal control. If, however,

material inadequacies are found to exist his report should disclose the nature of the inadequacies and the constructive action proposed to be taken or already taken by the brokerage concern. The supplementary report on internal control is now required to be filed as public information and therefore it is suggested that such report be included in Part I of Answers to Financial Questionnaire. Reference is made to Statement on Auditing Procedure No. 49, and an illustration of suggested language for such a report is presented in Exhibit C.

The evaluation of the adequacy of internal control, and the distinction between inadequacies considered to be material and those considered not material, is one of the more difficult problems the independent public accountant encounters in carrying out the audit requirements of the various regulatory agencies. A material inadequacy can be defined as a condition that would permit a person acting individually in the brokerage concern's organization to perpetrate errors or irregularities involving the accounting records, assets of the brokerage concern, and/or assets of customers that would not be detected through the internal control procedures in time to prevent material loss or misstatement of the concern's financial statements, or serious violation of rules of the regulatory agencies.

Section 4

Examinations

General

The first prerequisite for undertaking an examination (audit) of a broker or dealer in securities is to be knowledgeable of the Securities Exchange Act of 1934, particularly Rules 15c-3(1), and 17a-5.

Timing of Commencement of Examination. Certain major exchanges presently require that the examination by independent public accountants be made on a date previously unannounced to the broker or dealer. The Securities and Exchange Commission does not require that the examination be on a surprise basis. Elimination of the surprise audit requirement is currently under study.

Where the examination must be on a surprise basis, it is generally understood that it be commenced on the examination date so as to minimize the problem of controlling securities movements. However, the independent public accountant is not precluded from commencing the examination a few days prior thereto.

Audit Requirements. The Securities and Exchange Commission, as well as the principal stock exchanges and other regula-

tory bodies, have prescribed audit requirements (minimum) for the examination of brokers or dealers in securities by independent public accountants. It is incumbent upon the independent public accountant, however, to expand the scope of his examination if in his professional judgment such expansion is necessary in the circumstances.

The audit requirements prescribed pursuant to Rule 17a-5 of the Securities Exchange Act (which are the same as those set forth in audit requirements of the national securities exchanges) are set forth in Form X-17A-5 of the Securities and Exchange Commission. See Exhibit T.

Preliminary Considerations. Prior to undertaking the examination, the independent public accountant should make a study of the physical layout of the brokerage concern's principal office, the organization of the employees' duties and other similar factors. If the brokerage concern utilizes data processing, either on premises or through a service bureau, the independent public accountant should also make a review of the system, ascertain the extent to which the system can be utilized in the conduct of his examination, and arrange with the client to keep him promptly advised of subsequent system and program changes.

Regardless of the system in use by the brokerage concern, it is desirable for the independent public accountant to meet with his client's operating personnel well in advance of the examination date and develop an operating plan which may be described as "what to do when the auditors arrive" and to arrange for proper liaison between his staff and client's staff. This will avoid confusion at the start of the examination and will insure a minimum amount of inconvenience to his client.

Review of In-House Data Processing Operations. In audits of brokerage concerns which utilize in-house computer systems, the independent public accountant must evaluate the adequacy of internal controls. Selected basic administrative control areas may be reviewed on an annual basis. Major application controls should be reviewed on a rotating basis (except that all major application areas should be reviewed in a first-time-through situation). In conducting the review of controls over data processing, the independent public accountant should concern himself with administrative, processing, and input/output controls. It

is suggested that the independent public accountant refer to the American Institute of Certified Public Accountants' publication, *Auditing and EDP*, by Gordon Davis, when developing the program for this review. Many accountants will find it desirable to utilize the services of data processing specialists in this area.

Review of Data Processing Service Centers. The use of a data processing service center may to some degree improve the level of internal control due to the greater separation of responsibilities inherent in the "third party" status of the service organization. However, a service center often processes major applications such as purchase and sales, bookkeeping, margin, etc., for the brokerage concern and maintains important files at the center location. In such a case, the absence of good internal controls may be considered a material inadequacy due to the potential for interruption of the brokerage concern's day-to-day activities.

The work to be done by the independent public accountant in reviewing controls will depend on the facts and circumstances in each case. If, for example, the independent public accountant is able to audit the output of the service bureau and to satisfy himself that the brokerage concern has good controls and is able to check the daily output throughout the year, it may not be necessary to perform any further review of the processing controls in use at the service center. However, it would appear essential that the independent public accountant make inquiry as to the existence of any problems relating to system continuity or data file security due to inadequate equipment or program backup and/or poor administrative control at the service center.

If the independent public accountant determines that the controls of the brokerage concern are weak and that output cannot be checked daily, he should inquire whether the service center controls are adequate. He might choose to accept the report of the independent public accountant of the service center as to the above matters, but if not, and if the processing is considered significant in relation to the overall information processing of the brokerage concern, he should consider visiting the service center to perform the appropriate review. Again, in establishing a program for such a review, it is suggested that reference be made to the American Institute of Certified Public Accountants' publication, *Auditing and EDP*, referred to above.

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Initial Control of Data Processing Operations. After the data processing records (cards, tapes, or discs) have been updated on the audit date and the usual daily reports prepared, the closing stock record should be prepared. The data going into the preparation of the closing stock record should be utilized in the customers' statement run and in the preparation of the street side runs, i.e., boxes, transfers, bank loans, correspondent brokers, etc.

Some brokerage concerns maintain a subsidiary record known as a "holders' file" which is a duplicate of the customers' position in the stock record in account sequence. This record is updated each day and provides a current record of customers' positions. The record is also usually utilized in the preparation of customers' statements. In other brokerage concerns the stock record is maintained in account sequence and sorted into security sequence when a stock record is required. If the holders' file is a subsidiary record and if such record is utilized in the preparation of customers' statements, it should be compared mechanically or electronically, under control of the independent public accountant, with the customers' positions in the stock record.

Representatives of the independent public accountant should control or obtain duplicates of cards, tapes, and discs comprising the following input data:

1. Stock record (in account or security sequence, whichever is appropriate).
2. Closing money trial balance.
3. Name and address.
4. Holders' file (if any).

The independent public accountant's representatives should also be present to observe and control, to the extent required, the preparation of the customers' statements and the listings of other accounts such as trading and investment accounts, details of fails, transfers, boxes, etc. Such presence coupled with utilization of the controlled input data in the preparation of the reports and statements will eliminate the detailed checking otherwise necessary to ascertain agreement between the customer statements, position listings, and the stock record. Control in this context could include a requirement for review or test of certain computer programs of the brokerage concern.

In those instances where the brokerage concern utilizes off-premise service centers, the foregoing procedures may be deemed unnecessary where the independent public accountant has satisfied himself as to the internal controls and the independence of ownership, management, and operation of such facilities. If the independent public accountant utilizes special audit reports generated by a service bureau, he should take whatever steps he considers necessary to assure himself that the contents of the reports are appropriate and valid.

Some independent public accountants take control of the brokerage concern's data processing departments and use their own employees in the preparation of the statements and reports utilized in their examination. Others have devised sophisticated programs of their own, including conversion programs which convert the brokerage concern's data into input data acceptable to these special programs.

Fidelity Bonds. The independent public accountant should examine the fidelity bonds of the brokerage concern under examination, should note any special conditions and compliance therewith, and should ascertain that the amount of coverage is in compliance with recommendations of regulatory bodies.

Examination of or Accountability for Securities

Physical Inspection of Securities. Securities in physical possession may fall into several classes, depending upon the stage of the transaction with the customer, the characteristics of the customer's account, and other factors. Such securities are ordinarily placed in boxes, cabinets, or other storage devices. Apart from any physical form that such devices may have today, the custom persists of referring to any given class of securities in physical possession as being identified with a particular type of "box," such as "active box," "safekeeping box," "segregation box," "name of box," etc.

Inspection of securities should include positive identification of the classes or series such as, Class A or B common stock, preferred stock, prior preference stock, "old" or "new" stock and, with reference to bonds, the interest rate and maturity date. All

securities received while the count and inspection are in progress should be segregated from those under audit control, and the independent public accountant should have a record of securities which are removed from audit control to permit delivery.

Control of securities should be maintained until the inspection and count are completed and the results are compared with the records. If time does not permit such control, securities not yet compared with the records should be recounted before releasing control and such counts agreed to by appropriate personnel of the brokerage concern.

Any differences between the physical count and the records, as to either quantity or identification, should be reviewed with a responsible official of the brokerage concern who should, before control is released, concur with the differences.

The record of inspection may be in the form of listings prepared during the count or by checking the count to pre-listings which are usually obtained where electronic data processing systems are in use. If listings are prepared during the count, it is necessary to check the security count to the brokerage concern's stock record; whereas, if the pre-listing is prepared by utilizing controlled data in the preparation of the stock record, the two separate operations (listing and checking) are combined.

Securities in for Transfer, Exchange, or Redemption. The brokerage concern, particularly one which engages in a large number of transactions, probably will have a separate department or division to handle securities which are held for transfer, exchange, or redemption. The basic procedures for handling such securities, however, are the same in all brokerage concerns and do not vary materially with the size or plan of organization. Securities in this class consist of the following:

1. Securities on hand pending preparation of instructions for transfer of title, exchange, or redemption.
2. Securities on hand awaiting processing for delivery or routing to securities boxes.
3. Securities on hand which are not in negotiable form because of the absence of legal documents, such as those necessary to qualify one to act as an executor, administrator, or guard-

ian, or in some other similar capacity. These securities are frequently referred to as "legal" securities.

4. Securities delivered to local transfer agents for transfer of title, exchange, or redemption and for which window tickets or receipts are held.

5. Securities sent to out-of-town transfer agents or the corporate issuers for transfer of title, exchange, or redemption. Copies of transmittal correspondence should be available for inspection.

6. Securities receivable from other brokerage concerns which have initiated a transfer-of-title procedure. This situation occurs principally as a result of delivery to the receiving broker of a certificate or certificates for a greater number of shares than required and the receiving broker is having the excess shares transferred to the name of the sending broker.

7. Securities in process of being transferred through Central Certificate Service or any other depository service.

Securities in the first three of the foregoing groups should be counted and inspected in the same manner as the securities in any other box.

The location of the securities described in the last four of the foregoing groups should be accounted for by direct correspondence with the transfer agents, the corporate issuers, the other brokerage concern or should be examined upon return to the brokerage concern under examination.

Circumstances of internal control and/or the quality of audit evidence obtainable, may be such as to permit, as an alternative procedure, a combination of direct confirmation, inspection and control of outgoing mail on the audit date and inspection of incoming mail for several days subsequent to the audit date. Securities received in the incoming mail should be inspected at the time the mail is opened and should be traced to the record of securities sent to transfer agents. Dates appearing on stock certificates received from transfer subsequent to the audit date should be noted. Such information will be helpful to the independent public accountant in satisfying himself that the securities purported to have been delivered out for transfer were not actually on hand as of the audit date.

Securities Held by Branch Offices. Ordinarily, securities held by a branch office of the brokerage concern should be inspected in the same manner as those held at the main office, and simultaneously with the inspection at the main office. Only if such security holdings are small may it be appropriate to request that all securities on hand at the branch office at the audit date be submitted to a bank for inspection and for listing in detail in a written communication to the independent public accountant. Where this procedure is used, banks should be asked to hold securities overnight. As an alternative procedure, when the holdings are small, the branch office may be requested to mail all securities on hand to the head office of the brokerage concern in order that they may be counted and inspected by the independent public accountant.

Securities in Transit Between Offices. Description and quantities of all securities which were transmitted between offices (including correspondent brokers) during a period of several days immediately preceding the audit date should be noted and used in the reconcilement and accounting for securities in transit.

In those cases where outgoing mail on the audit date and incoming mail for several days after the audit date is controlled, securities in transit between offices may be examined and checked to the record of pre-audit-date shipments. Identification of securities by certificate number facilitates the audit of securities in transit.

If application of these procedures is impracticable, copies of receipt forms, correspondence, and any other pertinent evidence should be examined to the extent necessary to satisfy the independent public accountant that the securities were actually in transit on the audit date.

Free Shipments. In many instances, securities are shipped "free" to out-of-town brokerage concerns to avoid payment of collection charges. Requests for confirmation, prepared in sufficient detail to clearly identify the security, should be mailed to the respective brokerage concerns for all free shipments which are open at the audit date.

Other Accounts Containing Security Positions. Under the audit requirements prescribed by jurisdictional agencies "positive" con-

firmation requests are required to be sent with respect to all accounts containing security positions as of the audit date.

Count Differences. All differences disclosed, through the comparison of counts and confirmations, in the records of the brokerage concern should be corrected or should be considered as "differences" pending clearance.

Since many of the differences in security positions will be in the nature of offsetting items, i.e., between box and transfer, box and loans, etc., the recognition of these offsetting items is facilitated in large operations by use of a so-called "composite break sheet" such as that shown below.

Security Description	*ABC Corporation*		*Security Number 1013*
Account Number	*Stock Record*	*Count or Confirmation*	*Account Name*
99999-0-5	300	200	Active Box
99996-0-9	100	—0—	Branch Office
99997-0-7	—0—	100	Segregation Box
99995-0-9	200	300	Transfer
	600	600	

The responsibility for clearing security differences lies with the brokerage concern. At times, the independent public accountant may be requested to assist his client in researching the open items; however, subsequent adjusting entries should be initiated only by the brokerage concern under examination, and the role of the independent public accountant should be limited to controlling the open differences and satisfying himself as to the validity of subsequent adjustments.

Examination of Accounts

General. All jurisdictional agencies require that written positive confirmation requests be sent to all customers whose accounts show, as of the audit date, a balance due to or from, or a security or commodity position with, the brokerage concern. In addition to customers' accounts (including closed accounts discussed below) this requirement includes, but is not limited to, the following accounts:

Bank balances and other deposits
Deposits and open contractual positions with clearing corporations and associations
Money borrowed and details of collateral
Accounts carried for the broker or dealer by others
Securities borrowed
Securities loaned
Failed to deliver
Failed to receive
Accounts of partners, officers, or directors
Investment and trading accounts (confirmed with management)
Capital accounts
Borrowings and accounts covered by subordination agreements
Open contractual commitments (other than unsettled "regular way" purchases and sales of securities)
Guarantees in cases where required to protect customers' accounts guaranteed as of the audit date

In addition, the independent public accountant is required to obtain a written statement from the proprietor, partner (if a partnership), or officer (if a corporation) as to the assets, liabilities, and accountabilities, contingent or otherwise, not recorded on the books of the brokerage concern.

Compliance with requirements for obtaining written confirmation shall be deemed to have been made if such request has been mailed in an envelope by the independent public accountant, bearing his return address, and second requests are similarly mailed to those not replying to the first requests, together with such auditing procedures as may be necessary. With respect to customers' accounts closed since the last prior audit, the accountant may use either positive or negative confirmation requests. (Closed accounts for this purpose are those which, as of the audit date, reflected no money balances, open contractual commitments, or commodity or security positions and had no transactions during the period covered by the customers' statement.)

It is further provided that, with respect to periodic investment plans sponsored by member organizations of a national securities

exchange whose members are exempted from Rule 15c3-1 by paragraph (b)(2) thereof, the independent public accountant examining the financial statement of the originating member organization may omit direct written confirmation of such plan accounts with customers when, in his judgment, such procedures are not necessary, if (1) the originating member organization does not receive or hold funds for such accounts, except the initial payment which is promptly transmitted to the custodian; (2) the custodian is a member organization of such national securities exchange and files certified reports complying with Rule 17a-5 in connection with which the customers' accounts are confirmed by an independent public accountant; and (3) funds and securities held by the custodian for each such customer's account are reconciled with the records of the originating member organization as of the date of the most recent audit of the custodian.

The independent public accountant should usually deliver the request for confirmation directly to the postal authorities. However, under certain circumstances he may hand deliver requests for confirmation directly to the addressee through clearing-house facilities. The addressee should be requested to acknowledge in writing the accuracy of the statement of account which accompanies the request for confirmation and to return the request directly to the independent public accountant in a self-addressed envelope which has been enclosed for the convenience of the addressee. Accounts for which no current addresses are known and which have a money balance and/or security positions should be reviewed by the independent public accountant to determine that efforts are being made to locate the customers and that the accounts are under adequate supervision and control.

Unsatisfactory replies should be followed up by, or under the direction of, the independent public accountant. As to unanswered requests, while he is required by the jurisdictional agencies to make second requests, the independent public accountant may, if deemed appropriate, make further requests. Also, the independent public accountant may find it desirable to furnish a listing of unanswered requests to the brokerage concern at the conclusion of the examination.

Since positive confirmation requests are required by regulation

for 100% of the accounts, thus mandating a scope which is more comprehensive than the independent public accountant would ordinarily consider necessary for the expression of his opinion, it is appropriate to limit the application of alternative procedures relating to non-replies to those non-replies included in a selected sample. It is suggested that the sample be of sufficient size to provide satisfactory evidence to the independent public accountant as to the validity of the accounts as a whole as if confirmation had not been requested on a 100% basis. The alternate procedures to be applied may include a review of subsequent cash receipts or payments, delivery or receipt of securities, remittance advices, orders, correspondence, credit files, etc. The sampling technique does not, of course, relieve the independent public accountant of responsibility for follow-up of all significant exceptions received with respect to accounts not included in the sample.

While the examination of many of the accounts of a broker or dealer in securities does not differ materially from the examination of accounts of other types of businesses, a few special comments are presented, as follows:

Bank Balances and Other Deposits. In addition to confirming bank balances, the independent public accountant is required to reconcile balances shown by bank statements with balances recorded on the books. This requirement is deemed to be met where the reconciliation is prepared by personnel of the brokerage concern provided the independent public accountant satisfies himself with respect to the accuracy of the reconciliation. After allowing ample time for clearance of outstanding checks and transfers of funds, the independent public accountant is required to obtain from the depositories bank statements and paid checks and by appropriate audit procedures to substantiate the reconciliation as of the audit date.

Good-Faith Deposits. Generally good-faith deposits accompany bids to purchase new issues of securities. The deposit and the related commitment are normally confirmed at the same time. The brokerage concern may be acting as manager of a group making a bid for a new issue of securities and, in such cases, the other participating members usually deposit proportionate amounts of the required deposit with the managing concern. In these instances, the participants should be requested to confirm

in writing the amount of their deposit as well as their participation in the commitment.

Interest Accrued on Margin Account Balances. In order to reduce the month-end work peak, interest on customer accounts is ordinarily computed, and charged to customer accounts, up to a date within a week or ten days prior to the end of the regular statement period. Interest from such date to the end of the regular statement period is then estimated and accrued on the basis of the aggregate of all interest bearing accounts. The procedures followed in making such accruals should be reviewed to ascertain the reasonableness thereof.

Customers' Accounts. The brokerage concern usually prepares the statements of customers' accounts as of the audit date and under manual systems sometimes checks these statements to the margin department records or to the stock record before releasing them to the independent public accountant. Where in-house data processing systems are in use, the independent public accountant should be present during the time the statements are being prepared and should control the statements and the cards, tapes, or discs from which the statements were prepared. If the client wishes to review the statements prior to mailing, the review should be made from a copy released to the client and arrangements should be made for proper control of any statements released to the client for purposes of correction.

Copies of the customers' statements should be retained by the independent accountant as a part of his working papers, unless the security and commodity positions and the ledger balances in customers' accounts are retained in some other form. In cases where the brokerage concern utilizes data processing equipment this other form may be tapes, discs, cards, or print-outs thereof.

Requests for confirmation of customers' accounts are usually in the form of printed data processing type cards which are enclosed with the customers' statement. Where data processing systems are in use, the confirmation cards are prepared, usually in duplicate, by use of a simple program or routine. The duplicate card comprises a master deck which is utilized for the purpose of determining the unconfirmed accounts requiring second requests.

In examinations of very small brokers or dealers, it is not uncommon for the independent public accountant to prepare, or have the brokerage concern prepare for him, written or typed requests for confirmation of customers' accounts which show the money balance and details of the security position at the audit date.

Customers' accounts containing no money balance or security position as of the audit, but which have been closed during the current month (or during the most recent quarterly period in cases where statements are furnished to customers on a quarterly basis), are generally referred to as "flat accounts." Under data processing systems, statements for these accounts are usually produced during the statement run as of the audit date and can be confirmed in the same manner as open accounts. Customer accounts closed since the previous examination by the independent public accountant may be selected for confirmation on a test basis utilizing either positive or negative form requests.

Trading and Investment Accounts. In addition to obtaining written confirmation of trading and investment accounts from management, the independent public accountant should also ascertain that the trading department position records are in agreement with, or reconcilable to, the stock record.

Capital Accounts. With respect to partnerships, the independent public accountant should examine the partnership agreement and determine, among other things, the extent, if any, to which securities or equities in partners' security or commodity accounts may be included in net capital.

With respect to corporations, the independent public accountant should examine the charter, bylaws, and minutes of meetings of the Board of Directors and any committees thereof for the period since the last examination. Minutes subsequent to the audit date and up to the date of the accountant's report should also be examined for the purpose of determining subsequent events which may have a bearing on the financial position and results of operation as of the audit date.

The independent public accountant should also ascertain that the brokerage concern has obtained counsel's opinion to the effect that the issuance of secured demand notes, debentures, subordinated notes, voting and non-voting shares of capital stock or

any capital contribution by limited or general partners since the previous examination did not involve a public offering of securities within the meaning of Section 4(2) of the Securities Act of 1933 and therefore need not be registered under such Act.

Subordinated Accounts and Borrowings. The independent public accountant should examine subordination agreements and determine, preferably by direct confirmation, whether or not they have been approved by the regulatory bodies in the amounts reflected on the books. He should also determine the expiration dates of the agreements, the extent of the amounts subordinated, any limits as to those amounts, and the exact nature of the liability to the subordinating party. This information is necessary in order for him to determine the carrying value of these accounts and the effect that the liability to the subordinated lender may have under the "net capital" rules. Also, he should determine if the borrower has the right to sell or pledge the securities and the nature of the items to be returned to satisfy the subordinated debt.

Dividends Receivable or Payable. Dividends receivable in cash or securities should be analyzed and reviewed as to age and collectibility and, if material in amount, confirmation procedures should be applied. Some regulatory bodies consider age a factor when determining whether the cash or receivables are allowable in the computation of net capital.

Many brokerage concerns do not record dividends receivable or payable on stock positions "long" or "short" in trading or investment accounts until the payable date of the dividend, which can be from a few days to several weeks after the record date for the dividend. This practice may result in an understatement of assets and income, or liabilities and expense, when a dividend record date and payable date straddle the examination date. Under these circumstances the independent public accountant should review the procedures for recording dividends receivable and payable and should ascertain the materiality of any unrecorded amounts.

Exchange Memberships. The ownership of exchange memberships should be confirmed by direct correspondence with the applicable exchange. Although an exchange membership is usu-

ally registered in the name of an individual, it is ordinarily considered to be an asset of the brokerage concern if it is held by the brokerage concern under a so-called A-B-C agreement or if its use has been contributed to the brokerage concern under a subordination agreement. Also, it is not unusual for a broker or dealer to have more than one membership on a particular exchange.

Under an A-B-C agreement the member agrees that upon dissolution of the member organization or his ceasing to be a participant therein or upon his death or other contingencies, he or his legal representatives will comply with the terms of one of the following options:

(a) Retain his membership and pay to the member organization the amount necessary to purchase another membership

(b) Sell his membership and pay the proceeds over to the member organization, or

(c) Transfer his membership for a nominal consideration to a person designated by the member organization and satisfactory to the exchange.

The propriety of considering exchange memberships as assets of the brokerage concern should be ascertained by reference to partnership agreements or other applicable documents of the member organization.

Unclaimed Dividends, Coupons, and Securities. Procedures followed by the brokerage concern for recording transactions in accounts for unclaimed dividends, coupons, and securities should be reviewed. Detailed accounts maintained for unclaimed items should be agreed with related controlling accounts and particular attention given to accounts containing debit balances and/or short security positions. Charges against unclaimed items should be test checked to claims or applicable correspondence, giving particular attention to older items. Compliance with applicable state escheat laws should be reviewed.

Suspense Accounts. All suspense accounts should be analyzed to determine the nature of the items included therein, and the items should, if material, be reclassified to appropriate accounts.

Reserves and Allowances. The independent public accountant should analyze or obtain from the brokerage concern analyses of all liability and valuation reserve accounts. On a test basis he should examine documentary evidence supporting charges and credits to such accounts and indication of approval by authorized personnel. He should also ascertain the adequacy of allowances which are deductible from assets and investigate the reasonableness of reserves established for possible claims. If he believes provision for such allowances or reserves to be inadequate, he should evaluate the circumstances in relation to the type of opinion to be rendered covering the Answers to Financial Questionnaire and the financial statements.

Income, Expense, and Other Charges and Credits. The extent of the examination of income, expenses and other charges and credits is dependent upon the nature of the opinion to be expressed by the independent public accountant, the effectiveness of the system of internal control, and the degree of reliance that may be placed upon the classification of the income and expense accounts. Audits of brokers and dealers have traditionally placed primary emphasis on examination of the balance sheet, with usually only limited procedural testing being performed on the income and expense accounts. The responses (Answers) to Financial Questionnaires filed with the various regulatory authorities have been largely concerned with presentation of financial liquidity or detailed information necessary for the net capital computations. Recently, however, the income statements of brokers and dealers have received considerable attention because of the need to furnish financial information which is adequate for public investors. This presents a unique problem in that many brokers and dealers are subject to surprise examinations which rarely coincide with their fiscal year-ends. Furthermore, situations will undoubtedly occur where brokers and dealers will require their income statements to be audited retroactively so as to present comparative financial data for several prior years.

In order to render an opinion on income statements of the various fiscal years, the independent public accountant must do sufficient audit cut-off work as of the fiscal year-ends (assuming the regular audit does not coincide with the year-end) to satisfy

himself as to allocation of income and expense items between years, in addition to the testing of transactions during the years. Whether the independent public accountant can satisfy himself regarding the individual fiscal year results on a retroactive basis depends upon the quality of the brokerage concern's internal controls and the accuracy of its records. Under conditions where such items as stock record differences of material amounts may have gone unresolved for extended periods, determination of income on an annual basis may be impracticable.

As in other industries, the procedures followed in auditing the income and expense accounts will depend upon their relative importance and the internal control procedures in effect. Where the independent public accountant merely renders opinions on the Answers to Financial Questionnaire of the regulatory bodies and the statement of financial condition, work on the income and expense accounts may generally be limited to procedural tests and review of internal control. The audit procedures prescribed by the Securities and Exchange Commission and the stock exchanges relate only to the balance sheet accounts, are comprehensive and cover virtually all such accounts. Although retained earnings or undistributed profit and loss are *not* specifically covered in the prescribed audit requirements, these accounts must be reviewed in order to render an opinion on the overall fairness of the statement of financial condition and the Answers to Financial Questionnaire. Without a review of income and expense accounts there can be no reasonable assurance that the assets, liabilities, and capital accounts are fairly stated.

Depending upon the nature of the particular brokerage concern, such procedural tests, quite limited in scope, might include major elements of income and expense such as: commission income, trading profit or loss, underwriting income, interest and dividends, advisory fees, employee compensation, and interest expense. It is also desirable to compare current operating results with the prior period to ascertain that the variations are logical in light of the facts and circumstances. Here the independent public accountant should consider such matters as stock market volumes, the brokerage concern's share of the market, changed business conditions such as volume of new securities offerings, changes in character of the brokerage concern's business, trend of securities prices, etc. A comprehensive discussion of this com-

parative data with top management will often highlight areas where added audit emphasis should be directed.

If an opinion is to be rendered on the income statement, the above procedures would, of course, still apply. In addition, however, many transactions that heretofore did not fall within the scope of the procedural tests would have to be tested by examination of supporting records or documents. Particular attention should be given to the consistent classification of items so as to obtain meaningful trend comparisons.

Auditing for many of the income and expense items such as interest, dividends, employee compensation, occupancy, communications, promotion, and taxes is similar to other industries and need not be covered here. Tests should be made of trading and investment profit and loss and it should be ascertained on a test basis, where appropriate, that trading and investment inventories are marked-to-market and the market adjustment reflected in current earnings. Calculations of commission income should be tested and related to trading volumes and to compensation of registered representatives. Provisions for uncollectible accounts and for potential loss on aged fails, aged transfers, aged dividends receivable and security shortages should be analyzed and reflected in the proper period. Accounts reflecting losses or gains from closed out security differences should be reviewed and consideration given as to the effect of possible claims arising from closed out "long" differences (overages). Care should be exercised to determine that proper accruals are made in the appropriate period for such items as investment advisory fees, sums due to and from syndicate account managers, merger and professional fees, etc. If the accounting for securities transactions is on a "settlement date" basis, it is appropriate to accrue commission income on the unsettled trades and related expenses such as registered representatives' share of the commissions, floor brokerage, etc. Since the brokerage concern has performed all of the required services and incurred the costs of earning one-half of the "round-turn" commissions on open commodity positions, such commissions, if material, should be accrued even though they are not billed to customers until the position is closed.

If the examination is being made at a time other than at the time of the normal closing of the accounts of the brokerage concern, it is the practice to group all income and expense account

balances into one figure designated as "undistributed profit and loss." As brokerage partnerships frequently have limited partners who share in the profits in addition to receiving interest on their capital contributions, care should be exercised in classifying as a liability that portion of undistributed profits which is applicable to limited partners in accordance with the terms of the partnership agreement.

Open Contractual Commitments. Contractual commitments which are usually not recorded in money liability accounts include underwriting commitments, "when issued" contracts, "delayed delivery" contracts, endorsements of puts and calls, commitments in foreign currencies, etc.

Confirmation of all commitments of the type indicated, other than endorsed puts and calls (as to which the holder is unknown), should be requested, as well as the offsetting commitments of its customers. In most instances the commitments of customers will appear in the accounts of the customers and will be confirmed at the time the accounts are confirmed. In other instances, however, information as to purchases and sales of securities on a "when issued," "delayed delivery," or "when distributed" basis may not appear in the accounts of customers or others but may be represented by tickets in an open contract file. If so, these open contracts must be confirmed in the same manner as other accounts. In some instances where a settlement date (subsequent to the audit date) has been fixed for an open contract transaction, the broker or dealer will clear the open contract file and enter the transactions on the settlement blotter for the day of settlement. These transactions are not "regular way" transactions and should be confirmed and reported as "open contractual" commitments.

Another type of contract has to do with the brokerage concern's interest in joint accounts in issued securities carried by other brokerage concerns. In many instances the interest in these positions in securities is not recorded in the financial accounts of the non-carrying member of the joint account although, if material, they should be reflected in the financial statements. Regardless of whether or not the positions are reflected in the financial accounts of the brokerage concern under examination, all details of the joint accounts should be confirmed in writing

with the carrying brokers. If the brokerage concern under examination is the carrying broker, all details of the joint accounts should be confirmed with the participating brokers.

Contingent Items. Inquiry should be made as to the existence of contingent or unrecorded assets, liabilities and accountabilities, lawsuits or claims pending, accommodation endorsements, rediscounted notes, guarantees, and subsequent happenings. A representation should be obtained from an authorized representative of the brokerage concern as to unrecorded assets, liabilities, accountabilities, and any other matters which might influence the overall fairness of the financial statements.

Written statements should be obtained from outside legal counsel of the brokerage concern as to the status of lawsuits or claims pending and any other matters involving legal determination and as to the probable extent of any liability arising therefrom.

Unsettled Principal Transactions. Many brokerage concerns record transactions on a settlement date basis; however, particularly where brokers or dealers in securities maintain substantial positions in their inventory accounts, it may be necessary, where there has been a material change in the inventory value, to adjust such accounts to a trade date basis in order to present fairly the financial position and results of operation.

In cases where trades are recorded on the trade date basis, the offsetting entry on a sale of securities would be to the asset account "Receivable for securities sold for future settlement," and the offsetting entry on a purchase of securities would be to the liability account "Payable for securities purchased for future settlement." The receivable and payable accounts, including securities positions, should be confirmed, if practicable, or otherwise audited by alternative procedures. If confirmation is requested, the confirmation should identify the securities by quantity and description, trade date and settlement date, and should show the specific amount to be received or paid upon receipt or delivery, respectively, of the security.

Exclusion From Valuation of Segregated and Safekeeping Securities

Under Item B.2 of the general instructions to Form X-17A-5 the valuation of customers' securities in segregation or safekeeping need not be included in the answers. While the language indicates that the elimination is permissive, the valuations of segregated and safekeeping securities (including fully paid for securities in transfer into the name of the customer) are generally eliminated because the values have no financial significance and their elimination facilitates the interpretation of the Answers to Financial Questionnaire.

In brokerage concerns utilizing electronic data processing it is possible to develop programs which automatically eliminate from valuation the segregated and safekeeping securities. These programs are designed to cross-foot the quantities appearing in the "Seg" and "SK" columns (see example of EDP produced stock record elsewhere herein), to subtract the totals thus obtained from the quantities appearing in the "long" column (or in the "short" columns with respect to the box control accounts), and to determine the net quantities "long" and "short" which should be valued. Special program instructions may be provided to identify "over segregated" conditions, i.e., where the aggregate in segregation and safekeeping columns exceeds the position "long." (This indicates an error condition which should be corrected.) Items in process of being transferred into customer name are eliminated by special program instructions, or manually as if such securities were in segregation. This elimination is made because the securities, when returned to the brokerage concern in customer name, are generally no longer negotiable and are held for that particular customer.

In smaller brokerage concerns where the independent public accountant manually checks security counts and confirmations to copies of the brokerage concern's stock record, the elimination of segregation, safekeeping, and transfers to customers' names are performed manually. Where the independent public accountant checks his security count to copies of the stock record, the "Seg" or "SK" column may be posted opposite the customers' names simultaneously with the count check out. An example of this operation is shown on the following page.

SECURITY: X Y Z Corporation 6% Preferred

MARKET VALUE _____

SOURCE _____

LONG			
	Quantity Shs. or Par Fr.	SK. or SEG.	Value
Customers' Accounts:			
John Doe	200	100(1) 100(3)	
Richard Roe	500	100(2) 100(3)	
Henry Hoe	100	100(1)	
Failed to Deliver	200		
Stocks Borrowed	100		
Firm Accounts	100		
	1,200	500	

SHORT			
	Quantity Shs. or Par Fr.	SK. or SEG.	Value
Customers' Accounts:			
James Smith	100		
Firm Accounts	—		
Active Box	100		
Safekeeping Box	200	200(1)	
Segregation Box	100	100(2)	
Bank Loans	500		
Transfer	200	200(3)	
	1,200	500	

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After the segregation and safekeeping elimination has been completed, the balance of positions to be valued "long" should be in agreement with the balance of positions to be valued "short."

Valuation of Securities

Securities regularly traded are valued at the closing prices on the audit date or, in the event that no transactions occurred on that date, at the appropriate closing bid or ask prices. Fractions are generally eliminated unless their elimination would have a material effect on net capital.

Market prices for securities actively traded are obtained from financial journals or other reliable sources and the source indicated in the working papers. Quotations may not be available for exempted securities and securities not actively traded. In such cases, the independent public accountant may obtain prices for such securities from the trading department of the brokerage concern being examined, provided he checks all material items independently with some other brokerage concern having knowledge of the particular security and, for net capital computation purposes, that such securities meet the requirements of the applicable regulatory body.

In the case of securities for which market quotations cannot be obtained, fair values would ordinarily be determined by the management. The independent public accountant does not function as an appraiser and is not expected to substitute his judgment for that of the brokerage concern's management; rather he should review all information considered by management and ascertain that the procedures followed appear to be reasonable and adequate. Since the determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures, the accountant may find it appropriate to qualify his opinion where such valuation involves material amounts.

Reference is made to Accounting Series Releases No. 113 and No. 118 of the Securities and Exchange Commission as guides for the valuation of securities and the auditing thereof.

General instruction B.5 to Form X-17A-5 requires that securities not readily marketable shall be so designated in the Answers

to Financial Questionnaire. (Reference should be made to the rules and regulations of the applicable regulatory bodies for definitions of "not readily marketable.")

In brokerage concerns utilizing electronic data processing, special programs are often developed which associate pricing data with the stock record and perform the necessary computations automatically. The end result is what may be termed a "valued stock record."

In smaller brokerage concerns the security prices and source may be entered on a copy of the stock record and the necessary computations performed manually. The "valued stock record" would appear as follows:

SECURITY: X Y Z Corporation 6% Preferred

MARKET VALUE 46

SOURCE WN-1(*)

LONG								
		Quantity Shs. or Par Fr.		SK. or SEG.		Value		
Customers' Accounts:								
John Doe		200		100 100				
Richard Roe		500		100 100		13	800	
Henry Hoe		100		100				
Failed to Deliver		200				9	200	
Stocks Borrowed		100				4	600	
Firm Accounts		100				4	600	
		1,200		500		32	200	

SHORT				
	Quantity Shs. or Par Fr.	SK. or SEG.	Value	
Customers' Accounts:				
James Smith	100		4	600
Firm Accounts	—			
Active Box	100		4	600
Safekeeping Box	200	200		
Segregation Box	100	100		
Bank Loans	500		23	000
Transfer	200	200		
	1,200	500	32	200

(*) Wall Street Journal
New York Stock Exchange
Closing Sale

Review and Classification of Accounts in Response to Financial Questionnaire

At this point of the examination, securities valuations "long" and "short," by security, have been balanced and preliminary classification of the questionnaire answers for most of the general ledger accounts determined. However, certain accounts, such as those with customers and brokers, must be analyzed before it can be determined where they are to be reported in the questionnaire. In general, the accounts to be analyzed are those which contain, or may contain, security or commodity transactions and where the classification of the account may depend upon the relationship of security valuations to the net debit or credit balance in the account.

In manually operated accounting systems the valuation of each security position may be posted to the audit file copies of the statements of customers and brokers, bank loan confirmation requests, etc. This procedure may be accomplished at the same time the security positions, as shown on the stock record, are compared to those shown on the file copies of the statements. When all values have been posted, the valuations are totaled

separately by "long" and "short" on each file copy or listings such as those containing trading and investment accounts. The totals obtained are then compared to the appropriate totals mentioned in the following paragraph.

In turn, a summary analysis is made of the valued stock record which should show totals for each security valuation "long" and "short," summarized as follows:

Customers
Brokers
Trading and investment accounts
Other accounts
Bank and other loans
Box, transfer and transit

When complete, the summary is totaled, and the total of all valuations "long" must agree with the total of all valuations "short."

After posting of security valuations to copies of customer's statements the customer's equity in each account may be determined. Accordingly, all statements which show this information are commonly referred to as "equity statements."

In determining a customer's equity in an account, the value of securities "long" represent credits and the value of securities "short" represent debits. If the value of securities "long" exceeds the debit balance plus the value of securities "short," or if the credit balance plus the value of securities "long," exceeds the value of securities "short," such excess represents the customer's equity in the account and the account is secured. If the total of the debit balance and value of securities "short" is greater than the value of securities "long," or if the credit balance is less than the value of securities "short," the account is in deficit and is partly secured. If the account shows a debit balance and no long security values, or a short security value and no credit balance or long value, the account is unsecured.

In determining equity, all of a customer's accounts (including accounts related by bona fide written guarantees) other than regulated commodity accounts may be combined. Also, securities in negotiable form which were not valued, because held in segregation, may be considered (but need not be reported in the Answers) in determining the equity and status of an account. For

example, if the equity statement discloses the account to be unsecured, but the value of negotiable securities held in segregation is equal to or greater than the deficit, the account should be classified as secured.

Although the classification of customer accounts is primarily based on the equity or deficit in the account, there is an additional classification consideration with respect to customers' cash accounts. Form X-17A-5 provides that "bona fide cash accounts" (defined as accounts having both unsettled money balances and positions in securities which are current items within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System) are to be classified in Question 6A regardless of whether the account liquidates to an equity or a deficit. Therefore, in order to properly classify cash accounts, a determination must be made as to whether the open transactions included in each account are current. Cash accounts which contain one or more transactions which are not current within the meaning of Section 4(c) of Regulation T must be reclassified from Question 6A to Question 6B or 6C, based on the equity or deficit in the account. As indicated elsewhere in this audit guide, the present practices of the brokerage industry provide for the maintenance of customers' accounts on a "net balance forward" basis, which does not provide details of the individual open items comprising such balance in form through which open transactions can be readily aged and summarized at a given point in time for classification purposes. Accordingly, it may be time consuming and costly for the brokerage concern to comply with this classification requirement and extremely difficult for the independent accountant to ascertain that "all" transactions included in accounts which are classified as "bona fide" cash accounts are current.

The difficulty posed by the present requirements is under consideration by various regulatory agencies at this time.

After completing the analysis of customers' accounts a summary classification is prepared and may then be posted to the general ledger working trial balance. In addition, the values shown on the valued stock record covering securities in box, transfer, and transit may likewise be posted to the general ledger working trial balance.

The responses to Questions 14, 15, and 16 are not recorded in

ledger accounts for money, and the security values are not included with the totals reported in the columns for "long" and "short"; accordingly, responses to these questions are prepared independently of the responses to preceding questions.

In substance, similar steps are taken in order to classify the accounts, by type, when the brokerage concern utilizes EDP equipment. There are various methods that may be utilized in order to accomplish these objectives. Such methods vary depending upon the systems and procedures in effect.

Margining of Customers' Margin Security Accounts

Margining of customers' margin security accounts is not required for purposes of completing Form X-17A-5 of the Securities and Exchange Commission or Parts I and II of the financial questionnaires of the various regulatory bodies. However, for purposes of completing Part III of the financial questionnaire of the New York Stock Exchange (which part is also required by other exchanges) margining of all customers' margin security accounts is necessary. All security accounts of a customer may be combined for the purpose of determining adequacy of margin.

Federal regulations designate the amount of credit which a brokerage concern may extend to its customers on initial purchases of securities. The exchanges, on the other hand, designate in their rules the margins which their member organizations must maintain in the margin accounts of customers. Although it is maintenance margin that the independent public accountant is primarily concerned with in his examination of the Answers to Financial Questionnaire, he should also review and test procedures for compliance with federal regulations of initial margins.

Margining of customers' margin security accounts begins with the equity statements described elsewhere in this guide. In large brokerage concerns utilizing electronic data processing equipment, margining may be performed by use of special programs which are sometimes incorporated in the equity statement programs and performed simultaneously with the preparation of the equity statement. In small manually operated brokerage concerns and in some brokerage concerns with less sophisticated data processing equipment, the margining operation can be accomplished by performing the calculations manually on the equity statement (or on a copy of the customer's statement to which security

valuations have been entered from the valued stock record during the posting operation).

The following example, based on the present maintenance margin requirements of the New York Stock Exchange, illustrates a method used to determine the amount of cash required, if any, to margin an account. Such cash required (after application of current margin calls outstanding as of the audit date) must be reported in Part III of the Answers to Financial Questionnaire when reporting to the New York Stock Exchange.

Customer—John Doe:		
Ledger balance—debit		$ 6,800
Long security valuations:		
100 shs. A B C Corp. @ 75	$7,500	
200 shs. X Y Z Corp. @ 25	5,000	12,500
Short security valuation:		
100 shs. D E F Corp. @ 32		3,200
Computations		
Equity in account:		
Debit balance		6,800
Valuation of "short" securities		3,200
Total		10,000
Valuation of "long" securities		12,500
Equity		$ 2,500
Maintenance margin required:		
25% of valuation of "long" securities		$ 3,125
30% of valuation of "short" securities		960
Total		$ 4,085
Maintenance margin deficiency (cash basis) ($4,085-$2,500)		$ 1,585

If the customer corrects the maintenance margin deficiency by depositing additional securities, the valuation of such securities must be greater than the $1,585 cash deficiency shown in the above example since the additional securities are also subject to the 25% maintenance margin requirement. To determine the valuation of securities needed to correct the cash margin deficiency, the cash margin deficiency is divided by 75% which, in the above example, would result in $2,113.33.

If undermargined accounts are guaranteed and such guarantees are evidenced by approved written forms, the maintenance margin status is determined by combining the account with the account of the guarantor.

The margining of accounts contemplates that consideration be given to margin required with respect to contractual commitments such as "when issued," "when distributed," and "delayed delivery" transactions and put and call options.

Computation of Net Capital and Capital Ratio

Before completion of the examination of the Answers to Financial Questionnaire, the independent public accountant is required to verify the computation of net capital and the capital ratio of the respondent as of the audit date in accordance with the rules of the Securities and Exchange Commission or of the securities exchanges of which the respondent is a member. He is also required to review the procedures followed in making the periodic computations required under provisions of Rule 17a-3 (a)(11) of the Securities and Exchange Commission. The various net capital rules specify the maintenance of a minimum net capital and establish maximum permissible ratios of aggregate indebtedness to net capital.

Net capital is basically the net worth plus, where applicable, subordinated indebtedness of a broker or dealer less (1) assets which cannot be readily converted into cash and (2) certain percentage reductions, referred to as haircuts, in the market value of proprietary securities.

"Aggregate indebtedness" is the aggregate of certain liabilities as set forth in Rule 15c3-1 of the Securities Exchange Act of 1934 and may be defined generally as total money liabilities excluding amounts payable to general partners and excluding indebtedness (1) adequately collateralized by securities exempted from registration under the Securities Exchange Act of 1934 otherwise than by action of the Securities and Exchange Commission, (2) adequately collateralized entirely by proprietary securities, and (3) subordinated to claims of general creditors under approved agreements.

The rules, regulations, and instructions relating to the computation of net capital have been made quite extensive in an attempt to provide for the proper handling of a myriad of transactions. Since the number of situations a broker or dealer may engage in is limited to some extent only by his imagination, a standard form which may be used to insert figures to arrive at

net capital does not appear to be practical. However, examples of a computation are provided in Exhibit R and in the Securities Exchange Act (1934) Release No. 8024 (which is also identified as Accounting Series Release No. 107 of the Securities and Exchange Commission). Unfortunately, there are at present numerous variations in the capital rules of the regulatory and self-regulatory bodies. It is, therefore, extremely important that the independent public accountant ascertain (a) which rule is applicable in each case, and (b) that he is familiar with the current provisions and interpretations of such rule.

Computation of Formula for Determination Of Reserve Requirement

On November 10, 1972 the Securities and Exchange Commission adopted Rule 15c3-3, under the Securities Exchange Act of 1934, which became effective January 15, 1973. The Rule provides, among other things, that a brokerage concern must compute on a weekly basis the amount, if any, of customer funds held in excess of funds deployed in specific customer related activities and, further, that such amount must be on deposit in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" at all times. The computation is made in accordance with a detailed formula which is provided in the Rule. The Rule also requires a brokerage concern to promptly obtain physical possession or control of all fully-paid securities and excess margin securities carried for the account of customers and requires him to act within designated time frames where possession or control has not been established.

The independent public accountant should review the procedures and controls of the brokerage concern relating to this Rule and perform those tests which he considers necessary to satisfy himself that the procedures and controls in effect provide reasonable assurance of compliance with the Rule.

Report to Be Rendered on SIPC Annual Assessment

The Securities and Exchange Commission, in its Release No. 9766, amended Rule 17a-5 by the addition of paragraph (b)(4), effective October 15, 1972, which requires certain ex-

change members, brokers and dealers to file concurrently with the report filed pursuant to Rule 17a-5, a supplemental report, in letter form, addressed to the Commission, covering the SIPC annual general assessment reconciliation or exclusion from membership forms, not previously reported on under this subparagraph (b)(4). Attached to this supplemental report shall be an independent public accountant's report which shall state that in his opinion either the assessments were determined fairly in accordance with applicable instructions and forms, or that a claim for exclusion from membership was consistent with income reported. However, if his examination did not provide the basis for issuing such a report, the accountant shall state the extent of his review. Such review shall include as a minimum, certain procedures as detailed in the amendment.

Reporting

The independent public accountant's report covering the Answers to Financial Questionnaire must meet specified Securities and Exchange Commission and stock exchange requirements (see Exhibit A). Reports on statements of financial condition and related statements of income follow the standard short form (see Exhibits D and J), as does the report when reporting only on the statement of financial condition (Exhibit P).

There may be situations where it is appropriate for the independent public accountant to qualify or disclaim an opinion. Particularly troublesome areas include material amounts of unresolved security differences, suspense accounts, unverified transfer items and unverified dividends receivable. Situations may also be encountered where operational conditions and the status of the records are such that it would be inappropriate to report on financial statements prepared on a "going concern" basis.

A violation of the applicable net capital rules as of the audit date requires footnote disclosure and may require the independent public accountant to qualify his opinion because of "going concern" considerations. However, there may be situations in which the capital deficiency is corrected prior to the issuance of the independent public accountant's report. In these circumstances footnote disclosure may be adequate.

Section 5

Commodity Transactions

General

The commodity department usually functions as an independent unit with its own purchase and sales, bookkeeping, and margin departments. The commodity general ledger reflects all real and nominal accounts relevant to commodities and carries the net balancing figure thereof as an account in the general ledger.

Transactions in commodities involve either futures contracts or spot (cash) transactions. A futures contract is an agreement to buy or sell a definite quantity of a specified commodity of a certain grade at some later time. Settlement generally is made by an offsetting futures contract, either before or during the delivery month specified in the contract; this is known as a round-turn. A spot (cash) transaction involves delivery of the commodity. Customers of brokerage concerns generally are not interested in making or accepting delivery of a commodity; instead, they wish to trade in futures contracts only.

Security brokers and dealers who also deal in commodities generally engage in at least one of several activities. The larger brokerage concerns may act in the capacity of futures commission merchants, cash commission merchants, commodity merchandisers, and country and/or terminal grain elevator operators.

The number of brokerage concerns that engage in all of these activities is relatively few as commodity trading is a highly specialized activity.

Trading in futures is the most common type of commodity transaction and, accordingly, is the kind which will be most frequently encountered in examinations of brokerage concerns. While a direct relationship with futures trading exists, cash (spot) trading occurs much less frequently. Commodity merchandising and elevator operations often are conducted through subsidiary or affiliated companies because of capital requirements and other restrictions imposed upon brokerage concerns who are also members of national securities exchanges.

Commodities traded range from grains to cocoa, cotton, eggs, metals (lead, copper, etc.), and meats (turkeys, pork bellies, etc.). Commodities are susceptible to trading on a futures basis because of their generally fungible nature (that is, a particular lot or grade of the physical commodity loses its identity when commingled with quantities of the same commodity) and volatility of price fluctuations in periods of uncertainty (wartime conditions, crop failures, pestilence, drought).

In the absence of a futures market for these commodities, food processors, millers, farmers, and other users who must carry large physical quantities of these commodities in inventory would be subject to the risk of price changes. The futures market, however, affords these users a means of price protection by enabling them to hedge the physical quantities of commodities in inventory in either their raw or finished state.

In its simplest form, hedging involves the simultaneous purchase of the physical commodity to replenish inventory and entering into a contract for the sale of the same commodity for delivery at some future date. Theoretically, as physical (spot) inventory is accumulated, futures (sales) contracts are entered into to hedge against loss due to price fluctuations. As the physical inventory of the commodity is sold, the futures trade is closed by buying-in the previous sale. Any loss incurred on the futures transaction becomes part of the cost of sales and will be offset by a profit on the inventory liquidation, or vice versa.

Through continued application of futures transactions, commodity users can avoid a large part of the potential losses caused by fluctuations in market price of the commodity.

While price protection is the basic purpose of a futures market, the speculator plays a major role in making an effective market. The speculator assumes the risk of price changes, and it is these changes in price that provide the speculator an opportunity to profit, generally by assuming a position opposite to the hedger.

The federal government participates significantly in the regulation of commodity exchanges. Through the authority conferred upon it by the Commodity Exchange Act, the United States Department of Agriculture regulates the operation of certain commodity contract markets or exchanges. Some of the more important provisions of these regulations limit the quantities of speculative futures contracts in each commodity any one person may acquire, require daily reporting of trading activity by exchange members, and restrict use of customers' funds deposited with brokers as margin on futures contracts.

Federal authority over trading activity is confined only to certain commodities—commonly referred to as regulated commodities. These commodities are, however, often the most actively traded, and accordingly, Federal regulation is quite broad in scope. Regulated commodities are generally those domestically produced farm commodities controlled by regulations of the United States Secretary of Agriculture under the Commodities Exchange Act. These include grains, soybeans, cotton, butter, eggs, potatoes, etc. Commodities not covered by this legislation are classified as non-regulated commodities.

In a few instances, brokerage concerns also may be subject to the United States Public Warehouse Act governing the operation of public storage facilities. These situations are generally confined to concerns operating grain elevators.

In addition to federal government regulations, brokerage concerns must conform to the requirements of the various contract markets or exchanges and associated clearing organizations of which they are members. These self-policing organizations are similar in nature to security exchanges in that they maintain and provide a market place for buyers and sellers and establish standards for orderly trading. Moreover, initial and maintenance margin requirements have been established for each commodity. Unlike security exchanges, however, commodity exchanges have set maximum daily price fluctuations for certain commodities.

Rules and regulations of the various exchanges require mini-

mum initial margin deposits depending upon the commodity bought or sold. While the brokerage concern may establish its own requirements depending upon the financial ability of a particular customer, they must not be less than the minimums set by the exchanges. Margin rates differ for each commodity and for the purpose for which a futures trade is made, that is, hedging or speculating. In periods of high volume of activity, when excessive speculation prevails, the exchanges increase initial margin requirements. However, margin rates are subject to reduction or restoration to their previous level when conditions warrant a change.

In addition to initial margin requirements, maintenance margin requirements have also been prescribed by the exchanges. Any impairment of the initial margin deposit due to price fluctuation below the maintenance margin level set by the exchange must be met by margin calls to customers. In most cases, the call must be sufficient to restore the margin to the maintenance level which is usually lower than the initial margin, while for certain commodities the call must be sufficient to restore the margin to the original margin deposit. Obviously, if the call is not met within a reasonable number of days, the customer's open futures position must be liquidated to an extent that would bring his account back to a status of margin conformity.

Execution of orders for future commodity trades by brokerage concerns is somewhat similar to the handling of stock or bond orders. However, a brokerage concern, other than a brokerage concern which places its commodity transactions through a correspondent broker, actually deals with a clearing organization when it buys and sells futures contracts for the account of its customers. According to commodity exchanges rules, the clearing organization substitutes for the other broker that is a party to the transaction. As a result, offsetting transactions entered into by the same broker are immediately balanced against one another by the clearing organization.

Accounting for a future commodity contract transaction differs from that for a security transaction. While a confirmation of the trade is submitted to the customer showing the pertinent price, quantity, and commodity data, no monetary entry is made in the customer's ledger. The customer's account reflects only the margin deposit and the open contract in the commodity traded.

The commodity exchange usually establishes at the close of business each day a settlement price to which all contracts are to be adjusted, that is, marked-to-the-market. Each day, all open contracts are listed, together with the quantity, contract price, and settlement price. The net difference (gain or loss) is determined, after considering the nature of the individual variations, and is settled in cash with the clearing organization each day. The brokerage concern records the amount of the daily settlements in contract difference accounts from which gains and losses are transferred to the customers' accounts when round-turns have been completed.

Standing margins are established by the clearing organization and are used as collateral to guarantee a brokerage concern's commitments. The amount of margin is based upon the position in each commodity. The cash generally is deposited by the clearing organization in a bank account designated by the brokerage concern, and evidence of these deposits in the form of margin certificates is delivered by the bank to the member organization.

The foregoing procedures apply basically to all futures commodities trades, regulated as well as nonregulated. Futures contracts in regulated commodities, however, impose additional accounting requirements. All funds deposited by customers and all funds accruing to customers as a result of trades or contracts must be separately accounted for and deposited in separate bank accounts appropriately designated as customers' funds segregated under the Commodity Exchange Act or invested in qualified securities. Such investments are limited to obligations of the United States, general obligations of any State or of any political subdivision, or obligations fully guaranteed as to principal and interest by the United States, and the securities must be deposited in an escrow account with a bank. Income derived from these securities accrues to the brokerage concern. The amount of money and securities which must be deposited in segregated accounts in order to comply with the requirements of the Commodity Exchange Act must be computed as of the close of the market each business day.

In determining customers' funds to be segregated, a deficit in the account of one customer cannot be offset against another customers' equity. Separate accounts must be kept for customers trading in both regulated and nonregulated commodities as the

Commodity Exchange Act prohibits commingling of funds and transferring between customers' accounts except on specific written authorization of the customer. The Commodity Exchange Act does not regulate margin requirements on futures trades; these are regulated by the various exchanges. However, the Commodity Exchange Act specifies that customers' funds deposited in accounts designated as regulated commodity accounts may be used only to margin customers' regulated commodity positions.

Many brokerage concerns, particularly those located outside the exchange cities, do not deal directly with the commodity exchanges but place their commodity transactions through correspondent brokers. In such instances, the accounts of the brokerage concern may not contain a contract difference account since the offset to purchases and sales of futures commodity transactions will be in the account with the correspondent broker.

Examination of Commodity Department

In many respects, audit procedures applicable to commodity accounts do not differ materially from those relating to security accounts. The basic procedures of confirmation, balancing of positions, margining, inspection of documents, and account classification must be carried out. In addition, the independent public accountant should review the procedures for complying with the Commodity Exchange Act segregation requirements and, as of the audit date, check the calculation of such requirements and ascertain that sufficient funds are appropriately segregated.

Independent public accountants conducting examinations of financial statements of brokers and dealers doing business in commodities should obtain a copy of the Commodity Exchange Act and the regulations thereunder issued by the Secretary of Agriculture. (This material may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.)

It is important that the independent public accountant have a clear understanding of the following areas which are somewhat peculiar to the Commodity Department.

Clearing Organization for Settlement of Future Commodity Contracts. A brokerage concern ordinarily will be a member of

the clearing organization which is affiliated with any commodity exchange through which the concern, as a member, executes transactions. Daily settlement reports (recapitulation sheets) based upon receipts rendered by member brokerage concerns are prepared by the organization. The net amount payable or receivable is settled by a check or draft forwarded with the daily report. The daily settlement report also shows the amount of original margin deposits controlled by the clearing organization as protection against defaults on contracts.

The positions open with the clearing organizations, the amounts receivable or payable on settlements and the aggregate amounts of original margins should be confirmed by submitting to each clearing organization a copy of the clearing sheet as of the audit date together with a request for certification of the details shown therein. The independent public accountant should review subsequent clearing sheets for a selected number of days after the audit date for open trades, as of the audit date, which may have been cancelled thereafter.

Spot (Cash) Commodities in Physical Possession. Spot (cash) commodities ordinarily are represented by warehouse receipts or bills of lading, although some commodities such as gold, silver, or platinum may be in physical possession of the brokerage concern. The documentary evidences of ownership of such commodities may be in possession of the brokerage concern or they may have been deposited with a lender with whom such evidences of ownership are pledged as collateral.

The independent public accountant should inspect all warehouse receipts and bills of lading which are in the physical possession of the brokerage concern and should trace into the records any entries relating to such documents which may be in transit between offices of the brokerage concern at the audit date. Direct confirmation in writing should be obtained from the warehouses where the amounts involved are significant and from lenders as to any such documents that may have been pledged as collateral to loans.

The counting or weighing of commodities in physical possession should be observed by the independent public accountant, and he should take whatever steps are deemed necessary in the circumstances to satisfy himself concerning the types and grades of commodities.

Accounts Carried by Other Brokers and Dealers in Commodities. If a brokerage concern trades in commodities for which transactions are executed on a commodity exchange of which the concern is not a member, it probably maintains open accounts with other brokerage concerns who are members of that exchange. Such accounts are usually referred to as carrying brokers accounts and as of a given date, like other commodities accounts, show a debit or credit money balance and commodity positions either "long" or "short."

Brokerage concerns with which such accounts are maintained should be requested to forward directly to the independent public accountant a statement of the account as of the audit date, showing the cash balance and the commodity positions "long" or "short." These statements should be compared with the records of the brokerage concern under audit. The independent public accountant may, if he desires, mail a statement of the account to the carrying broker, requesting confirmation of the balance and position, to facilitate the reconcilement of the account.

Customers' Commodity Accounts. Customers' commodity accounts fall into two general classes: accounts with spot (cash) commodities positions and those with open futures contracts.

Written requests for confirmation of the balances and positions in these accounts as of the audit date should be mailed directly to customers in a manner similar to that followed for customers' securities accounts.

Accrued Commodity Commissions Receivable and Payable. These represent commissions due from customers or due other brokers on uncompleted "round-turns" (open "long" and "short" positions). These amounts should be tested by reference to the brokerage concern's commission schedule.

Commodity Suspense Accounts—Regulated and Non-Regulated. The balances herein represent checks payable to, or drafts receivable from, various clearing organizations on account of "variation margin" (last day point fluctuation—difference between prior day's settling price or contract prices during the day and last day settling price—on net "long" or "short" positions). This account should be analyzed, the net balance broadened to re-

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Commodity Exchange Fees. These represent fees due from the exchange members' customers on uncompleted round-turns (open "long" and "short" positions) and due to various clearing organizations upon execution of trades thereon. This account should be analyzed, the net balance broadened into fees receivable and payable, reconciled to copies of statements filed with clearing organizations, and subsequent payments traced to the cash journal.

Commodity Brokerage Payable. This represents brokerage due to member organizations of other exchanges with respect to trades executed by them on the floor of the exchange for the account of the brokerage concern under examination. This account should be examined by comparing the bills for the current month with payments subsequent thereto to determine adequacy of accrual.

Balancing Commodity Positions

Commodity positions are balanced in the same way as security positions, i.e., separately by customers, partners, trading accounts of the brokerage concern, and other brokers' positions "long" and "short" are posted from certified copies of clearing sheets, statements from correspondent brokers, etc. Frequently this is accomplished by preparation of a schedule in commodity sequence which includes each futures commodity contract by month of contract maturity together with extended contract values and market values and resultant gain or loss. This schedule is termed a point balance schedule. The gains and losses shown should be in agreement with the contract difference accounts.

Valuation of Commodity Contracts

Commodity contracts should be extended at both contract and market value (settling price at audit date as per certified copies of recapitulation sheets) and the resulting gains or losses computed. If the brokerage concern deals directly with the commodity exchange, the difference between the net clearing house

positions extended at contract and market should agree with the amount shown by the contract difference account and will balance the net gains or losses determined for offsetting contracts of customers, partners, etc. Also, since this operation automatically proves the balances in the contract difference accounts in the general ledger, it will eliminate the necessity for test-checking extensions of contract and market values.

Margining of Customers' Commodity Accounts

As with security accounts of customers, margining of customers' commodity accounts is not required for purposes of completing Form X-17A-5 of the Securities and Exchange Commission or Parts I and II of the financial questionnaires of the various regulatory bodies. However, for purposes of completing Part III of the financial questionnaire of the New York Stock Exchange (which part is also required with respect to other exchanges), margining of customers' commodity accounts is necessary.

Computing margins in customers' commodity accounts is performed in much the same way as computing margins in customers' security accounts, i.e., by testing the equity in the account with the margin required by the commodity exchanges for the various types of commodities carried in the account.

The independent public accountant, before undertaking the margining of commodity accounts, should obtain the following:

1. Latest bulletin on maintenance margin issued by the Securities Industry Association.
2. List of outstanding margin calls.
3. List of trade accounts, including accounts with credit lines granted.
4. List of proprietary accounts.

Customers' accounts with margin deficiencies should be reviewed for subsequent transactions to determine whether outstanding margin calls, if any, have been satisfied.

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Section 6

Option (Put and Call) Transactions

General

Options for the purchase or sale of securities, commonly referred to as "puts" and "calls," include variations thereof which are known as "straddles," "spreads," "strips" and "straps." In each case, the option constitutes a contract which confers upon the buyer the privilege of buying (i.e., "calling" for) or selling (i.e., "putting" to) a certain security. In each instance the privilege may or may not be exercised, at the option of the buyer. The various securities options may be distinguished as follows:

1. A "put" is an option to sell a certain number of shares of a specified security issue at a fixed price on or before a fixed date to the seller thereof.
2. A "call" is an option to buy a certain number of shares of a specified security issue at a fixed price on or before a fixed date from the seller thereof.
3. A "straddle" is a combination of one "put" and one "call," identical with respect to security issue, number of shares, exercise price and expiration date.

4. A "spread" is a combination of one "put" and one "call" covering the identical security issue, number of shares and expiration date. The exercise price for the "put" is customarily slightly below the current market price, while the exercise price for the "call" is customarily above the current market price at the time the option contract is created.
5. A "strip" consists of two "puts" and one "call" for the same security.
6. A "strap" consists of two "calls" and one "put" for the same security.

"Put" and "call" options are normally written on a standardized contract form adopted by members of the Put and Call Brokers and Dealers Association, Inc. In the normal course of events, an individual desiring to purchase an option will contact his broker or dealer and request a market quotation on the cost of such an option. The broker or dealer will ordinarily contact an active put and call broker or dealer, who will in turn contact an individual who has previously expressed an interest in selling options of the type required. Assuming that mutually satisfactory terms can be arranged, the option contract will be written, endorsed (guaranteed) and delivered to the purchaser. Most put and call brokers and dealers are thus typically engaged as middlemen or finders, without obligation to the option holder.

Options are customarily written only on the most active security issues listed on national securities exchanges. However, there is nothing to prevent two individuals from entering into an option contract covering less active securities, including over-the-counter securities. By the same token, option contracts may be written at any price and for any duration, but are most frequently written "at the market," i.e., at the current market price at the time of entering into the contract, for periods of 30 days, 60 days, 90 days or six months (actually six months and ten days, thereby permitting the option holder to sell the option and realize long-term capital gain). During the existence of the option, the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights and stock dividends or splits.

All forms of options may be referred to in the financial community as "papers."

Examination of Option Department

Option positions are usually carried in customer or proprietary accounts of the brokerage concern along with and in the same manner as securities; i.e., purchased options are carried as "long" and sold options are carried as "short." The description of the option, however, includes the quantity, the contract price and the date of expiration. Confirmation of option positions of customers is accomplished therefore simultaneously with confirmation of customers' accounts.

Purchased Options. Purchased options, which are carried as "long" in the accounts of the brokerage concern under examination, are evidenced by endorsed "papers" on hand in the "box" or are set forth in the account of the correspondent broker through which the brokerage concern placed its option order. Therefore, the "papers" are examined, confirmed and balanced in the same manner as securities.

Sold Options. Sold options are carried as "short" in the accounts of the brokerage concern under examination. If the brokerage concern placed its option order through a correspondent, it can be confirmed in the same manner as a security. If the brokerage concern under examination endorses its customers' options and delivers them to the purchasers, either directly or through put and call brokers, the "papers" are said to be "out on the street" and the identity of the purchaser is usually unknown. In such instances confirmation is not possible but since, of necessity, the endorsing organization must maintain a record of endorsed "papers" the sold options are verified by checking them to this record. The customer side of the endorsed option is confirmed in the same manner as a security and should be balanced against the record of endorsed "papers."

The confirmation of both purchased and sold options should include quantities, contract prices and dates of expiration.

Margining of Customers' Option Positions

The purchaser of a securities option must make full cash payment in an amount equal to the option cost (premium) in the time prescribed by Regulation T of the Board of Governors of

the Federal Reserve System. Purchased options (options which are "long") have no loan value and thus must be ignored when margining customers' accounts.

The seller of a securities option must deposit in his margin account an amount equal to the maintenance margin which would be required if the specific option were exercised. Thus, under New York Stock Exchange rules, a sale of a "put" would ordinarily result in a margin requirement of 25% of the contract price, assuming sale "at the market." Similarly, a sale of a call would ordinarily result in a margin requirement of 30% of the contract price, assuming sale "at the market." Following the date the option contract is written the margin requirement would be increased or decreased to reflect unrealized gain or loss. An exception to the above occurs whenever (a) the "short" call option is offset by adequately margined "long" stock or (b) the "short" put option is offset by adequately margined "short" stock, in which case no margin is required on the option contract. A further exception relates to the straddle; in this instance, margin is required on the "put" or the "call," whichever is greater, but not on both options.

In margining sold options each option is considered separately. Thus, in the case of a series of options for a particular customer, the excess of equity in one or more options cannot be used to reduce the deficit in other options.

The margin required on options should be entered on the customer's equity statement to determine any under-margined condition in the account as a whole. In cases where the sold options relate to existing positions in the customer's account, the market value of an existing "long" position cannot exceed the contract price of an applied call and an existing "short" position must be valued at the higher of the market value or the contract value of the applied put.

Accounting For Option Premiums

As a general rule, an option premium represents compensation to the seller for the risk he has assumed or, in a hedged situation, for the interest cost (actual or imputed) of carrying the related security position. In either event, it is appropriate to amortize the premium to income over the life of the option in order to achieve a proper matching of cost and revenue.

Conversion Accounts

The demand for call options by option buyers usually exceeds that for put options. Sellers of options, however, generally prefer to sell straddles. To cope with this imbalance of supply and demand, certain New York Stock Exchange member organizations operate option conversion accounts. Under this arrangement, the option dealer buys a straddle and sells the call portion. He then takes the remaining put and gives it, free of charge, to the member organization. In return, the member organization agrees to sell the option dealer another call, generally containing the same contract price as the put. The option dealer can then resell this call option to another buyer. The member organization simultaneously purchases the related security in the market to hedge the call. At this point, the member organization is "long" a put, "short" a call and "long" the related security. (It should be noted that the foregoing can operate in reverse if the demand for puts in a given security exceeds the demand for calls; however, this occurs less frequently.)

After the conversion, the member organization is in a fully hedged position; if the market value of the optioned stock increases, the purchaser of the option will call the stock. If the market value declines, the purchaser of the call option will not exercise his right and the member organization will exercise its put option.

The market value of the security positions in the conversion account must be shown separately in Question 10 of Part I of the Answers to Financial Questionnaire. Also, a separate schedule of such securities should be included in Part II. The Part II schedule must contain a separate column for the value of the securities *at the option price* (since this is a straddle, "put" and "call" prices are the same) and this value should also be parenthetically disclosed in Question 10 of Part I. These securities must be reflected in the statement of financial condition at the option price rather than at market value as this represents the realizable value of these securities to the brokerage concern. In addition, if such positions are material, separate disclosure must be made with appropriate description, i.e., "securities for which endorsed calls are outstanding and puts for like amounts are held."

It should be noted that similar situations can occur without a conversion arrangement, by market action. A brokerage concern

can buy a security, buy a put and sell a call in unrelated transactions. Such situations should be treated basically the same as conversion situations for purposes of the Answers to Financial Questionnaire. However, in these instances, the contract prices of the puts and calls could be different; if so, the value of the security to be parenthetically disclosed in the Answers to Financial Questionnaire would be the *lower* of the put price or the call price. It is important to note, however, that for purposes of the statement of financial condition, such value may be too conservative. A determination must be made as to the present realizable value of the security, considering the existing relationship among the put price, the call price and the current market price. (See illustrations of such determinations elsewhere in this guide.)

Preface to Exhibits

The regulatory agencies which require brokerage concerns to issue their statement of financial condition to customers do not require that they be in comparative form. However, if comparative statements are issued, the comparison should be to the last audited statement of financial condition distributed to customers.

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form X-17A-5

Information Required of Certain Members, Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NUMBER

FOR SEC USE

WORK LOCATION	DATE OF REPORT	DOCUMENT SEQ. NO.	

NAME OF REGISTRANT (If individual, state last, first, middle name) — I.R.S. Employer Identification or Social Security No.

STANDARD STOCKBROKERAGE CO., INC. — 00-0000000

NAME UNDER WHICH BUSINESS IS CONDUCTED (If different)

ADDRESS OF PRINCIPAL PLACE OF BUSINESS

Number and Street	City	State	ZIP Code
1 Main Street	New York	New York	10004

THE ATTACHED REPORT reflects the financial condition of the above registrant as of: (Date) December 31, 19X2

INDEPENDENT PUBLIC ACCOUNTANT whose Opinion is contained in this Report
Name (If individual, state last, first, middle name) — I.R.S. Employer Identification or Social Security No.

Accounting Firm — 99-9999999

Address

Number and Street	City	State	ZIP Code
2 Main Street	New York	New York	10004

Check one—

FOR SEC USE

- [X] Certified Public Accountant
- [ ] Public Accountant
- [ ] Accountant not resident in United States or any of its possessions

THIS REPORT CONSISTS OF (Check below)

- [X] Part I—Financial Information
- [X] Part II—Supporting Schedules — Filed under a separate confidential cover.
- [X] Accountant's Certificate

DO NOT WRITE BELOW THIS LINE . . . FOR SEC USE ONLY

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New York, Ne
February 15,

EXHIBIT A

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire

To the Board of Directors (1),
Standard Stockbrokerage Co., Inc.:

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2. Our examination was made in accordance with generally accepted auditing standards and with the audit requirements prescribed by (jurisdictional agency), and accordingly included a review of the accounting system, the internal accounting control and procedures for safeguarding securities and such tests thereof for the period since the prior examination date, December 31, 19X1, and of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the Answers to Financial Questionnaire, securities and investments not readily marketable amounting to $8,610,685 (21.7% of Stockholders' Equity) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the Answers to Financial Questionnaire of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the accompanying Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. at December 31, 19X2 present fairly the information required, in the form prescribed by the (jurisdictional agency (2)), in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The supplementary information included in Part II (2) has been subjected to the same auditing procedures and, in our opinion, includes all information required to be reported therein.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Board of Directors (1),
Standard Stockbrokerage Co., Inc.:

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2. Our examination was made in accordance with generally accepted auditing standards and with the audit requirements prescribed by (jurisdictional agency), and accordingly included a review of the accounting system, the internal accounting control and procedures for safeguarding securities and such tests thereof for the period since the prior examination date, December 31, 19X1, and of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. at December 31, 19X2, present fairly the information required in the form prescribed by the (jurisdictional agency (2)), in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The supplementary information included in Part II (2) has been subjected to the same auditing procedures and, in our opinion, includes all information required to be reported therein.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire, continued

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

For a partnership the report is addressed:

To the Partners,
Standard Stockbrokerage Co.:

(2) Brokers or dealers in securities are subject to the regulatory requirements of a number of organizations, depending on the extent of their business activities. It is essential that the accountant inquire as to what reports the broker must file with such organizations and become familiar with their specific reporting requirements, if any.

Certain stock exchanges require additional supplementary information to be submitted, including information which is not readily subject to examination in accordance with generally accepted auditing standards. Such information should be noted as "unaudited" and the opinion paragraph should be appropriately modified as follows:

> Our examination also included the supplementary information contained in the accompanying Parts II and III, except that the information required in Part II schedule .... relating to accounts in which voting stockholders have an interest, and schedule ...., relating to amounts authorized or proposed to be distributed or withdrawn within the next six months, and in Part III schedule .... relating to financial obligations of stockholders was furnished to us by the stockholders of Standard Stockbrokerage Co., Inc. We do not express an opinion on Part II schedules .... or on Part III schedule .... as our examination did not extend to the affairs of the individual stockholders. Otherwise, in our opinion, Parts II and III present fairly the information shown therein.

EXHIBIT B

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire
As of December 31, 19X2
PART I

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	1	**Bank Balances and Other Deposits:**						
A-1		Cash on hand	$ 10,000					
A-1		Cash in banks:						
		Subject to immediate withdrawal	2,413,709					
A-2		Segregated under the Commodity Exchange Act	5,000					
A-3		Contributions to security clearing organizations (cash and respondent's exempted securities)	740,000			$ 10,000		
A-3		Good faith deposit related to contractual commitment	5,000					
	2	**Money Borrowed, and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured by or Containing Customers' Collateral** (including $2,000,000 market value of securities owned by the respondent):						
L-1		A. Money borrowed:						
		1. From banks and trust companies		$20,000,000		30,000,000		
		B. Accounts carried by other banking or brokerage houses:						
		2. Commodities accounts:						
(b) A-4		a. Regulated commodities futures accounts:						
		ii. Accounts liquidating to a deficit	31,546					$3,855
(b) A-4		b. Nonregulated commodities futures accounts:						
		ii. Account liquidating to a deficit	6,992					4,049
	3	**Money Borrowed and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured Entirely by Collateral Owned by Respondent or its Officers and Directors, or by Securities Covered by "Satisfactory**						

		B. Accounts carried by other banking or brokerage houses:				
(b) A-4		2. Commodities accounts: a. Regulated commodities futures accounts:				
		ii. Accounts liquidating to a deficit	31,546			$3,855
		b. Nonregulated commodities futures accounts:				
(b) A-4		ii. Account liquidating to a deficit	6,992			4,049
	3	**Money Borrowed and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured Entirely by Collateral Owned by Respondent or its Officers and Directors, or by Securities Covered by "Satisfactory Subordination Agreements":**				
L-1		A. Money borrowed: 1. From banks and trust companies		9,000,000		15,000,000
	4	**Other Open Items With Brokers and Dealers:**				
A-4		A. Securities borrowed	1,420,500		$ 1,723,455	
		B. Securities failed to deliver:†				
A-4		1. Outstanding less than 30 days	21,315,716		21,285,731	
A-4		2. Outstanding 30 through 39 days	1,645,053		1,618,445	
A-4		3. Outstanding 40 through 49 days	226,547		224,500	
A-4		4. Outstanding 50 through 59 days	127,618		123,592	
A-4		5. Outstanding 60 days or longer	110,182		86,325	
		C. Securities loaned:				
L-2		1. Customers' securities		2,174,850		2,028,547
		D. Securities failed to receive:†				
		1. For customers:				
L-2		a. Outstanding less than 30 days		11,300,225		11,250,328
L-2		b. Outstanding 30 days or longer		3,185,423		3,027,433
		3. For accounts reportable under Question 10:				
L-2		a. Outstanding less than 30 days		7,820,425		7,784,638
		b. Outstanding 30 days or longer		1,548,320		1,470,528
A-4		E. Settlement balances with clearing organizations	600,000		1,000,000	425,000

The accompanying notes are an integral part of this financial statement.

†Information regarding age of fails may be presented in a footnote.

Continued

STANDARD STOCKBROKERAGE CO., INC.

Answers to Financial Questionnaire, continued

As of December 31, 19X2

PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	5	**Valuations of Securities and Spot (Cash) Commodities in Box, Transfer, Depositories and Transit:**						
		A. Negotiable securities in box, transfer, depositories and in transit between offices of respondent				$58,612,500		
		B. Spot (cash) commodities represented by warehouse receipts or bills of lading in box and in transit between offices of respondent				200,000		
	6	**Customers' Security Accounts:**						
		A. Bona fide cash accounts:						
A-5		1. Accounts with debit balances	$ 9,011,380		$ 8,960,875	117,309		
L-3		2. Accounts with credit balances		$2,088,967	20,567	2,065,842		
		B. Secured accounts:						
		1. Accounts with debit balances:						
(c) A-5, A-6		a. Joint account in which the respondent has a 50% interest†	58,808		60,510			
L-3		Deposit as margin on the above joint account		5,000				
A-5		b. Other	40,411,167		56,571,175	857,543		
L-3		2. Accounts with credit balances		6,254,915	45,435	4,345,187		
		C. Partly secured accounts:						
A-5		1. Accounts with debit balances	18,076		7,200	876		
L-3		2. Accounts with credit balances		1,538		1,784		
A-5		D. Unsecured accounts	18,731			1,527		
L-3		E. Accounts with credit balances having open contractual commitments		27,824	20,152			

		above joint account		5,000		
A-5		b. Other	40,411,167		56,571,175	857,543
L-3		2. Accounts with credit balances		6,254,915	45,435	4,345,187
		C. Partly secured accounts:				
A-5		1. Accounts with debit balances	18,076		7,200	876
L-3		2. Accounts with credit balances		1,538		1,784
A-5		D. Unsecured accounts	18,731			1,527
L-3		E. Accounts with credit balances having open contractual commitments		27,834	30,152	
L-3		F. Accounts with free credit balances		3,797,711		
		G. Fully paid securities not segregated (Note 2)			5,602,409	
	7	**Customers' Commodity Accounts:**				
		A. Accounts with open futures contracts liquidating to an equity:				
(b) L-3		1. Regulated commodities		24,408		$3,855
(b) L-3		2. Nonregulated commodities		4,900		2,849
		B. Accounts with open futures contracts liquidating to a deficit:				
(b) A-5		1. Regulated commodities		1,090		1,200
		C. Accounts with spot (cash) commodity positions:				
		2. Not hedged:				
		a. Secured			125,000	
(b) A-5		b. Partly secured	100,000		75,000	
	8	**Accounts of Officers and Directors:**				
		A. Officers				
A-5		1. Secured accounts with debit balances	51,206		74,008	
L-3		2. Accounts with free credit balances		90,060		
		3. Fully paid securities not segregated			123,040	

The accompanying notes are an integral part of this financial statement.

†Ledger balance has been adjusted to reflect respondent's interest at market valuation.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	10†	**Trading and Investment Accounts of Respondent (Note 1):**						
		A. Securities accounts:						
		1. Marketable securities at market quotations:						
A-6		a. Exempted securities	$ 1,008,060		$ 1,008,060			
A-6/L-4		b. Other securities	17,749,443		19,612,172	$1,862,729		
A-8		2. Not readily marketable—at estimated fair value (cost, $7,880,000)	8,110,685		8,110,685			
A-8		C. Other:						
		1. Investments in real estate, cattle, and oil and gas drilling funds not readily marketable, at estimated fair value (cost, $505,000)	500,000					
	11	**Capital Accounts:**						
		C. Corporation:						
		1. Capital stock:						
L-12		a. $5 cumulative preferred stock of $100 par value per share; redeemable at $105 per share plus accrued dividends. Authorized 100,000 shares; issued and outstanding 50,000 shares		$ 5,000,000				
L-13		b. Common stock without par value. Authorized 2,500,000 shares; issued 1,500,000 shares (Note 5)		6,289,000				
L-14		2. Additional paid-in capital		2,200,000				
L-15		3. Retained earnings		27,438,172				
L-16		4. Treasury stock:						
		a. Common stock—200,000 shares						

	accrued dividends. Authorized 100,000 shares; issued and outstanding 50,000 shares		$ 5,000,000	
L-13	b. Common stock without par value. Authorized 2,500,000 shares; issued 1,500,000 shares (Note 5)		6,289,000	
L-14	2. Additional paid-in capital		2,200,000	
L-15	3. Retained earnings		27,438,172	
	4. Treasury stock:			
L-16	a. Common stock—200,000 shares, at cost	1,200,000		
	12 Subordinated Accounts and Borrowings (Note 4):			
	B. Other subordinated borrowings:			
A-9/L-9	1. Securities borrowed under subordination agreements			6,281,725
L-9	2. Cash		400,000	
L-10	3. Pursuant to secured demand note collateral agreements		3,215,773	
A-13/L-11	4. Exchange memberships contributed for the use of the Company (market value $375,000)			

The accompanying notes are an integral part of this financial statement.

†Ledger balances may be combined with respect to all security accounts and also with respect to all spot (cash) commodity accounts.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	13†	**Other Accounts, etc.:**						
A-15		Accrued interest receivable on securities in trading and investment accounts	$ 20,000					
A-15		Accrued interest receivable on customers' secured accounts	67,809					
A-15		Deposit as margin on joint account with other broker (see Question 15)	15,000					
(d) A-6		Respondent's interest in unrealized appreciation in joint trading accounts carried by others	10,613					
A-15		Advances to employees	10,000					
A-15		Dividends receivable:						
		Outstanding under 30 days	65,350			$ 111,000		
		Outstanding 30 days or longer	3,300			1,875		
L-8		Dividends payable and unclaimed		$ 254,875	$ 15,750			
A-15		Securities shipped on open account	87,815					
A-15/L-8		Floor brokerage and similar commissions receivable and payable	52,187	545,125				
A-15		Miscellaneous accounts receivable	301,998					
—		Investments in subsidiaries, at cost plus equity in undistributed earnings (Note 1)	2,425,763					
A-10		Secured demand notes	3,215,773		6,387,235			
A-12		Exchange memberships at cost (market value $2,000,000)	2,100,000					
A-14/L-7		Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization of $1,225,249 and present value of future lease rental payments (Note 1)	2,881,709					

A-15	Miscellaneous accounts receivable	301,998					
—	Investments in subsidiaries, at cost plus equity in undistributed earnings (Note 1)	2,425,763					
A-10	Secured demand notes	3,215,773					
A-12	Exchange memberships at cost (market value $2,000,000)	2,100,000		6,387,235			
A-14/L-7	Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization of $1,225,249 and present value of future lease rental payments (Note 1)	2,881,769					
L-6	Accrued bank loan interest payable		2,000,000				
L-6	Accrued producers commissions payable		420,000				
L-8	Taxes withheld from employees		478,027				
L-6	Accounts payable and accrued expenses		36,272				
L-5	Federal and State income taxes:		262,913				
	Currently payable						
L-5	Deferred to future periods (Note 3)		1,076,473				
	Allowance for customers' accounts doubtful of collection		1,200,000				
A-5	Security difference account (Note 7)		10,500				
	Totals			14,100	12,500		
		$118,152,796	$118,152,796	$139,187,146	$139,187,146	$7,904	$7,904

The accompanying notes are an integral part of this financial statement.

†Immaterial balances in ledger accounts may be combined under appropriate captions, such as "Miscellaneous receivables" or "Miscellaneous payables."

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Question Number **14** — **Contractual Commitments That Are Not Recorded in a Ledger Account For Money:**

A. Respondent:

Security Description	Purchased Amount	Purchased Cost	Sold Amount	Sold Proceeds	Net Position Amount Long (Short)	Net Position Contract Value	Net Position Market Value	Unrealized Profit	Percentage Allowable in Lieu of 70% in Computation of Net Capital	Related Good Faith Deposit
1. "When issued" transactions:										
Delaware (State of) 5% various maturities	$375,000	$373,350	$375,000	$375,000				$1,650		
Portsmouth (City of), Virginia 6% various maturities	$300,000	306,000	$275,000	284,625	$25,000	$25,000	$25,875	4,500	100%	
2. Underwriting participations:										
XYZ Electronics Corporation common Class A Shs.	4,000	48,500	3,400	41,225	600	7,275	7,500	225		
Oakland (Port of), California: 5½% various maturities	$250,000	250,000	$250,000	252,500				2,500		$5,000
Respondent's interest in unsold bonds in										

Class A Shs.	4,000	48,500	3,400	41,225						
Oakland (Port of), California: 5½% various maturities	$250,000	250,000	$250,000	252,500				2,500		$5,000
Respondent's interest in unsold bonds in underwriting account					$50,000	50,000	50,500	500	100%	
3. "Delayed delivery" transactions: LSD Corp. 8⅞% due 9/30/X7			$ 10,000	10,000	($10,000)	(10,000)	(10,000)		100%	
Note: These bonds are "long" in trading and investment account reported in answer to Question 10; delivered January 15, 19X3										

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number	
(d)	15	**Participations of Respondent in Joint Trading and Investment Accounts Carried by Others That Are Not Recorded in a Ledger Account for Money:** A. The respondent has a 50% interest in a joint trading account carried by others. At December 31, 19X2 the account had a debit balance of $154,574 and was "long" securities having a market value of $175,800. The respondent has deposited $15,000 as margin on this joint account. This deposit is reported in the answer to Question 13.
	16	**Unrecorded Assets, Liabilities and Accountabilities:** A. Drafts with securities attached amounting to $1,000,000 have been deposited for collection for which immediate credit has been received. These drafts are collateralized by customers' securities.

Notes to Answers to Financial Questionnaire:

(1) Accounting policies followed by the respondent:
Securities transactions (and related commission revenue and expense) are recorded on a settlement data basis,* generally the fifth business day following the transaction date.
The respondent records as purchases lease transactions with a subsidiary. Accordingly, the property rights received and the obligation for future payments of rent have been recorded in the accounts at their respective present values based upon an assumed interest rate of 5%.

*An alternative method is discussed elsewhere in this guide.

Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the Board of Directors.

*An alternative method is discussed elsewhere in this guide.

Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the Board of Directors.

All subsidiaries are either wholly or majority owned. Investments in subsidiaries (not consolidated in these Answers) are carried at cost plus equity in undistributed earnings. Such companies are engaged primarily in leasing, investment advisory and venture capital endeavors.

Depreciation is provided on a straight-line basis using an estimate useful life of 10 years. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the life of the lease.

(2) The market value of fully paid securities not segregated for the account of customers is comprised of the long securities in accounts reported in answer to Question 6F, as well as the long securities in accounts with no debit money balance or short security positions and also includes securities for which instructions to segregate have been issued but which have not been accomplished.

(3) Deferred income taxes amounting to $1,200,000 are applicable to unrealized appreciation of securities owned by the respondent.

(4) Borrowings subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from 5% to 6% and expiring as follows:

Expiration Date	Borrowings Under Subordination Agreements			Liabilities Pursuant to Secured Demand Note Collateral Agreements	Total
	Cash	Securities	Exchange Memberships		
October 19X3		$4,000,000			$ 4,000,000
March 19X4		1,000,000			1,000,000
March 19X6		1,281,725			1,281,725
December 19X4	$400,000				400,000
August 19X8				$3,215,773	3,215,773
January 19X6			$375,000		375,000
	$400,000	$6,281,725	$375,000	$3,215,773	$10,272,498

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Notes to Answers to Financial Questionnaire, continued:

(5) During 19X2, the stockholders approved adoption of a qualified stock option plan covering 100,000 shares of common stock. Options may be granted during the period to June, 19X7, at 100% of the market value at the date of grant and are exercisable wihin five years from date of grant. No options have been granted under this plan.

(6) The respondent has several pension plans covering substantially all of its employees. Prior service cost of $3,000,000 is being amortized over periods ranging from 25 to 40 years. The respondent's policy is to fund pension cost accrued.

(7) The security difference account is made up of 2 long differences and 3 short differences disclosed by physical count on December 31, 19X2, at which time there were positions in approximately 7,500 securities. Short security differences amounting to $42,000 were liquidated between (date of last filing) and December 31, 19X2.

(8) The respondent leases its main office and 11 sales offices under noncancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

(9) Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000 respectively. The Company's net capital ratio was 1.79 to 1. The net capital rules may effectively restrict the payment of cash dividends.**

**Various regulatory agencies including stock exchanges may impose additional capital requirements.

Explanation of certain cross references to Statement of Financial Condition:

(a) A: Asset captions; L: Liability and Stockholders' Equity captions.

(b) The amounts of equities and deficits in commodity accounts should be shown in the statement of financial condition in lieu of the ledger balances.

(c) One-half of ledger balance and one-half of security valuation included in trading accounts for purposes of the statement of financial condition.

(d) One-half of debit balance and one-half of security valuation included in accounts payable and accrued expenses for purposes of the statement of financial condition.

(c) One-half of ledger balance and one-half of security valuation included in trading accounts for purposes of the statement of financial condition.

(d) One-half of debit balance and one-half of security valuation included in trading accounts and one-half of debit balance included in *accounts payable and accrued expenses for purposes of the statement of financial condition.*

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.

Supplementary Information Relating to Answers to Financial Questionnaire

Pursuant to (indicate jurisdictional agency and regulation)

As of December 31, 19X2

PART II

(Confidential)

STANDARD STOCKBROKERAGE CO., INC.

Supplementary Information Relating to
Answers to Financial Questionnaire
As of December 31, 19X2

PART II

Index of supporting schedules:

Question Number	Description	Page Number
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6C.	Customers' partly secured accounts	141
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7C.2.b.	Customers' partly secured account	142
	Trading and investment accounts:	
10A.1.a.	Exempted securities	143
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	Summary of security valuations by percentage charge	150
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12B.1.	Securities borrowed under subordination agreements	152
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STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to
Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules:
Question 6B.1.a.—Customers' secured accounts:
Joint account:

Security Description	Shares or Principal Amounts	Market Price	Security Valuation Long
ABC Corporation	500 shs	$18.00	$ 9,000
DEF Corporation	1,010 shs	$51.00	51,510
			$60,510
Respondent's participation, 50%			$30,255

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to
Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:
Question 6C.—Customers' partly secured accounts:

Security Description	Ledger Balance Dr. (Cr.)	Shares or Principal Amount	Market Price	Market Valuation Long	Market Valuation Short
Account #1:	$18,076				
EGM Co., Inc.		219 shs	$4.00		$ 876
BAB Corporation 6% 10/31/X6		$8,000	90.00	$7,200	
Account #2:	(1,538)				
IJK Corp.		446 shs	4.00		$1,784

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:
Question 7—Customers' commodity futures contracts:

	Open Contracts		Approximate Market Value
	Commodity	Quantity Long	Long
February	Silver	3	$25,000
April	Silver	6	50,000
June	Silver	5	42,000
August	Silver	1	8,000
November	Plywood	4	24,000
August	Broilers	1	7,000
November	Broilers	2	13,000
July	Eggs	1	6,000
April	Hogs	4	25,000
			$200,000

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:
Question 7C.2.b.—Customer's partly secured account:

Commodity Description	Ledger Balance Dr. (Cr.)	Quantity	Market Valuation Long
Account #1:	$100,000		
February Silver		3	$25,000
April Silver		6	50,000
			$75,000

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.A.1.a.—Trading and investment accounts of respondent, security accounts, exempted securities:

Security Description	Principal Amount	Market Price	Security Valuation Long	Percentage Charge	Accrued Interest Receivable
Obligations of the U.S. Government:					
U.S. Treasury Bonds 6% 11/30/X3	$ 90,000	$100.00	$ 90,000	0%	$ 500
U.S. Treasury Bonds 6½% 7/31/X4	400,000	100.00	400,000	0%	1,500
State and municipal obligations:					
New York State 5% 3/31/X3	20,000	90.30	18,060	0%	250
Illinois State 5½% 8/31/X6	220,000	90.91	200,000	0%	750
New York State 4% 9/30/X9	400,000	75.00	300,000	0%	1,000
			$1,008,060		$4,000

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:
Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities:

Security Description	Principal Amount	Market Price	Security Valuation Long	Percentage Charge	Accrued Interest Receivable
Corporate bonds:					
AAA Corporation 6% 4/30/X3	$ 500,000	$ 98.00	$ 490,000	5%	$ 975
AAB Corporation 5¾% 6/30/X3	400,000	96.00	384,000	5%	1,000
AAC Corporation 5% 1/31/X3	126,000	100.00	126,000	5%	25
BAA Corporation 6½% 5/31/X6	350,000	94.00	329,000	6%	800
BAB Corporation 6% 10/31/X6	70,000	90.00	63,000	10%	150
BAC Corporation 5% 2/28/X6	10,000	80.00	8,000	20%	50
LSD Corp. 8⅞% 9/30/X7	1,000,000	100.00	1,000,000*	5%	3,000
DAA Corporation 7% 3/31/X4	500,000	97.50	487,500	5%	825
DAB Co., Inc. 7½% 4/30/X8	300,000	92.75	278,250	7%	700

LSD Corp. 8⅞% 9/30/X7	1,000,000	100.00	1,000,000*	5%	3,000
DAA Corporation 7% 3/31/X4	500,000	97.50	487,500	5%	825
DAB Co., Inc. 7½% 4/30/X8	300,000	92.75	278,250	7%	700
DAC Incorporated 6% 6/30/X5	400,000	82.50	330,000	7%	1,200
DAD Company, Inc. 5% 11/30/X8	600,000	77.25	463,500	23%	300
DAE Corporation 7¼% 7/31/X3	650,000	105.75	687,375	5%	2,175
DAF Incorporated 6⅝% 10/31/X5	850,000	94.75	805,375	5%	1,500
DAG Incorporated 7% 8/31/X6	700,000	90.00	630,000	10%	1,700
DAH Corporation 8⅛% 7/31/X7	500,000	110.00	550,000	5%	850
DAI Co., Inc. Conv. 7% 3/31/X4	268,000	100.00	268,000	20%	750
			$6,900,000		$16,000

* Includes $10,000 market value of LSD Corp. 8⅞% due 19X7 for which no capital charge is taken and which is offset by delayed delivery transaction, delivered January 15, 19X3, reported in answer to Question 14.A.3.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities, continued:

Security Description	Shares Long (Short)	Market Price	Security Valuation Long	Aggregate Contract Price	Percentage Charge
Positions related to short calls:					
EAA Co., Inc.	3,000	$105.00	$315,000		
Call on EAA Co.,Inc. @ 100 Exp. 4/8/X3	(3,000)			$300,000	30%

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:

Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities, continued:

Security Description	Shares	Market Price	Security Valuation Long	Security Valuation Short
Corporate stocks and warrants:				
FAA Corporation	50,000	$15.750	$ 787,500	
FAB Co., Inc.	13,000	18.250	237,250	
FAC Incorporated	11,400	35.375		$ 403,275
FAD Company	12,450	57.000	709,650	
FAE Company	37,000	20.750	767,750	
FAF Corporation	15,000	44.000	660,000	
FAG Co., Inc.	25,000	31.250	781,250	
FAH Incorporated	10,000	60.500	605,000	
FAI Incorporated	30,019	30.000		900,570
FAJ Co., Inc.	10,400	48.000	499,200	
FAK Corporation	12,300	35.750	439,725	
FAL Corp.	11,400	28.625	326,325	
FAM Corp.	10,000	92.375	923,750	
FAN Corp.	12,500	43.250		540,625
FAO Co., Inc.	589	31.000		18,259
FAP Incorporated	30,000	22.000	660,000	
FAQ Corporation	22,800	35.375	806,550	
FAR Corporation	32,600	21.750	709,050	
FAS Inc.	92,300	9.000	830,700	
FAT Co., Inc.	45,600	13.500	615,600	
FAU Corporation	8,500	59.000	501,500	
FAV Inc.	15,750	50.000	787,500	
WTS. FAW Corp.	22,000	30.000	660,000	
WTS. FAY Co., Inc.	51,936	2.000	103,872	
			$12,412,172	$ 1,862,729

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:
Question 10A.2.—Trading and investment accounts of respondent, securities accounts, securities not readily marketable—at estimated fair value:

Security Description	Shares	Amount
XYZ Corporation	1,000	$ 550,000
WVU Corporation	2,000	700,000
TSR Corporation	1,500	610,550
QPO Co., Inc.	3,000	650,135
NML Company	7,500	400,000
KJI Inc.	4,000	675,000
HGF Co., Inc.	10,000	575,000
EDC Corp.	6,000	575,000
BAZ Corporation	1,350	475,000
YXW Corporation	8,000	350,000
VUT Co., Inc.	20,000	350,000
SRQ Inc.	17,000	475,000
PON Inc.	12,000	525,000
MLK Company	5,000	450,000
JIH Company	7,500	450,000
GFE Corp.	3,000	300,000
		$8,110,685

Note: If deemed appropriate the method of arriving at fair value may be disclosed.

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10C.—Trading and investment accounts of respondent, other:

Investments in real estate, cattle and oil and gas drilling funds, at estimated fair value:

Description	Amount
KAA Cattle	$100,000
KAB Real Estate	150,000
KAC Oil and Gas	250,000
	$500,000

Note: If deemed appropriate the method of arriving at fair value may be disclosed.

STANDARD STOCKBROKERAGE CO., INC.

Supplementary Information Relating to Answers to Financial Questionnaire, continued

As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.—Trading and investment accounts of respondent, summary of security valuations by percentage charge:

Percentage Charge		Long	Short	Capital Charge	Accrued Interest Receivable
0%	Exempted securities	$1,008,060			$ 4,000
5%	Corporate bonds	$4,530,250		$226,012*	$10,350
6%	Corporate bonds	329,000		19,740	800
7%	Corporate bonds	608,250		42,578	1,900
10%	Corporate bonds	693,000		69,300	1,850
20%	Corporate bonds	276,000		55,200	800
23%	Corporate bonds	463,500		106,605	300
		$6,900,000		$519,435	$16,000

*Excludes capital charge relating to $10,000 market value of LSD Corp. 8¾% due 19X7 offset by delayed delivery transaction, delivered January 15, 19X3, reported in answer to Question 14.A.3.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.—Trading and investment accounts of respondent, summary of security valuations by percentage charge:

Percentage Charge		Long	Short	Capital Charge	Accrued Interest Receivable
30%	Corporate security positions related to short calls	$ 300,000**		$ 90,000	
30%	Corporate stocks and warrants	$12,412,172	$1,862,729	$ 4,282,470	
100%	Securities not readily marketable	$ 8,110,685		$ 8,110,685	
100%	Other investments, at estimated fair value	$ 500,000		$ 500,000	
		$29,230,917	$1,862,729	$13,502,590	$20,000

** Value at the lower of market value or contract value of related option.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:

Question 12B.1.—Subordinated accounts and borrowings, securities borrowed under subordination agreements:

Name of Lender and Security Description	Shares or Principal Amount	Market Price	Security Valuation Long	Maturity Date of Agreement
Francis N. Stern*				October 19X3
GAA Corp. 8% 7/31/X9	$ 500,000	$110.000	$ 550,000	
GAB Corp. 6% 4/15/X8	$ 500,000	98.000	490,000	
			1,040,000	
Robert Wine*				October 19X3
GAC Corp.	22,000 shs	30.000	660,000	
GAD Corp., Inc.	10,000 shs	50.000	500,000	
			1,160,000	
Charles Trent**				October 19X3
GAE Corp. 6% 6/30/X9	$ 400,000	82.500	330,000	
GAF Corp. 7½% 5/31/X8	$ 400,000	105.000	420,000	
			750,000	
Frederick Sands**				October 19X3
GAG Incorporated	20,000 shs	25.000	500,000	
GAH Co., Inc.	5,500 shs	100.000	550,000	
			1,050,000	
Arthur Banker**				March 19X4
GAI Corp. 5¾% 6/30/X9	$1,000,000	100.000	1,000,000	
Alan Labor*				March 19X6
GAJ Co., Inc.	37,000 shs	20.750	767,750	
James Kent*				March 19X6
GAK Incorporated	20,559 shs	25.000	513,975	
			$6,281,725	

* Voting stockholder
** Non-voting stockholder

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 12B.2.—Subordinated accounts and borrowings, cash borrowings:

Name of Lender	Ledger Balance	Maturity Date of Agreement
A. Jones***	$400,000	December, 19X4

*** Officer of respondent.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:

Question 12B.3.—Subordinated accounts and borrowings pursuant to secured demand note collateral agreements:

Name of Lender and Security Description	Shares or Principal Amount	Market Price	Market Value	Ledger Balance	Maturity Date of Agreement
B. Doe*				$1,000,000	August 19X8
HAA Corp., 6%, 6/30/X8	$400,000	$110.00	$ 440,999		
HAB Corp., Inc.	22,000 shs	30.00	660,000		
HAC Corporation	20,000	10.00	200,000		
HAD Co., Inc.	32,600	21.75	709,050		
			2,009,050		
C. Jones**				1,000,000	August 19X8
HAE Corp.	37,000	20.75	767,750		
HAF Co., Inc.	10,000	60.50	605,000		
HAG Corp., 6¾%, 10/31/X5	$850,000	94.75	805,375		
			2,178,125		
D. Smith***				750,000	August 19X8
New York State, 4%, 8/31/X9	600,000	75.00	450,000		
HAH Corporation	10,400 shs	48.00	499,200		
HAI Co., Inc.	12,500	43.25	540,625		
			1,489,825		
E. Brown*				465,773	August 19X8
HAJ Company	142,047	5.00	710,235		
			$6,387,235	$3,215,773	

* Voting stockholder
** Non-voting stockholder
*** Officer of respondent

T B, cont'd
C.
d

orrowings
reements:

Maturity Date of Agreement

ugust 19X8

August 19X8

August 19X8

August 19X8

EXHIBIT C

Independent Public Accountant's Supplementary Report on Internal Accounting Control

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2, and have issued our report thereon dated February 15, 19X3. As part of our examination, we reviewed and tested the system of internal accounting control (including the accounting system, the procedures for safeguarding securities, and the practices and procedures employed quarterly in counting or accounting for securities and resolving securities differences) to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and by Rule 17a-5 under the Securities Exchange Act of 1934. Rule 17a-5 contemplates that the scope of the review and tests should be sufficient to provide reasonable assurance that any material weakness existing at the date of our examination would be disclosed. Under these standards and that Rule the purposes of such evaluation are to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to provide a basis for reporting material weaknesses in internal accounting control.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management. However, for the purposes of this report under Rule 17a-5, the cost-benefit relationship has been disregarded in determining weaknesses to be reported.*

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting

* This sentence makes it clear that the independent accountant is not permitted, in reporting on internal control under Rule 17a-5, to use the option indicated in paragraph 25 of SAP No. 49 which states in part: "In some cases the auditor may conclude that for certain weaknesses corrective action by management is not practicable in the circumstances and he may decide to exclude such weaknesses from his report."

Independent Public Accountant's Supplementary Report on Internal Accounting Control, continued

control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the system of internal accounting control for the (period) ended December 31, 19X2, which was made for the purposes set forth in the first paragraph above and would not necessarily disclose all weaknesses in the system which may have existed during the period under review, disclosed (certain) (no) weaknesses that we believe to be material. Such weaknesses, with an indication of (the) (any) corrective action taken or proposed, were as follows:

Accounting Firm

New York, New York
February 15, 19X3

(1) For a partnership the report is addressed:

To the Partners,
Standard Stockbrokerage Co.:

EXHIBIT D

Independent Public Accountant's Report On Examination of Corporate Financial Statements

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income and retained earnings, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (22% of Stockholders' Equity as of December 31, 19X2 and 26% as of December 31, 19X1) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the financial statements of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

Independent Public Accountant's Report On Examination of Corporate Financial Statements, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income and retained earnings, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

EXHIBIT E

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Financial Condition
December 31, 19X2 and 19X1

Cross Reference	Assets	19X2	19X1
A-1	Cash		

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Financial Condition
December 31, 19X2 and 19X1

EXHIBIT E

Cross Reference	Assets	19X2		19X1	
A-1	Cash		$ 2,657,472		$ 2,382,472
2	Cash segregated under Commodity Exchange Act		5,000		10,000
3	Deposits with clearing organizations and others		745,000		700,000
4	Receivable from brokers and dealers (Note 12)		25,476,250		24,476,250
5	Receivable from customers* (Note 13)		49,628,723		44,877,050
6 & 7	Securities owned† (Note 1):				
	At market value:				
	Obligations of the U. S. Government	$ 490,000		$ 624,763	
	State and municipal obligations	518,060		575,490	
	Corporate bonds	6,900,000		6,638,213	
	Stocks	11,930,327		10,091,806	
	Warrants	900,000		748,115	
		20,738,387		18,678,387	
8	Securities not readily marketable, at estimated fair value; (cost, $8,000,000)	8,230,685		8,230,685	
			28,969,072		26,909,072
8	Other investments not readily marketable, at estimated fair value; (cost, $525,000)		500,000		500,000
9	Securities borrowed under subordination agreements, at market value		6,281,725		5,181,725
10	Secured demand notes collateralized by marketable securities		3,215,773		3,215,773
12	Memberships in exchanges:				
	Owned by the Company, at cost (market value: 19X2, $2,000,000; 19X1, $2,200,000)		2,100,000		2,100,000
13	Contributed for the use of the Company, at market value		375,000		400,000
14	Furniture, equipment and leasehold improvements, at cost, net of accumulated depreciation and amortization: 19X2, $1,425,249; 19X1, $840,249 (Note 1)		4,881,769		4,353,769
15	Other assets		723,459		640,123
			$125,559,243		$115,746,234

Continued

EXHIBIT E, cont'd

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Financial Condition, continued
December 31, 19X2 and 19X1

Cross Reference	Liabilities and Stockholders' Equity		19X2			19X1	
L-1	Short-term bank loans (Note 2)			$ 29,000,000			$ 29,800,000
2	Payable to brokers and dealers (Note 12)			26,029,243			24,964,043
3	Payable to customers (including $3,887,771 (19X2) and $2,921,000 (19X1) of free credit balances)			12,288,629			10,486,956
4	Market value of securities sold, but not yet purchased			1,862,729			1,962,729
5	Accrued income taxes, including taxes deferred to future periods: 19X2, $1,200,000, 19X1, $775,000 (Note 3)			2,276,473			2,478,329
6	Accounts payable and accrued expenses†			1,238,227			534,650
7	Notes payable (Note 4)			2,000,000			2,250,000
8	Other liabilities			836,272			671,790
				75,531,573			73,148,497
	Liabilities subordinated to claims of general creditors (Note 5):						
9	Market value of securities and cash of $400,000		$ 6,681,725			$ 5,581,725	
10	Pursuant to secured demand note collateral agreements		3,215,773			3,215,773	
11	Market value of exchange memberships contributed for the use of the Company		375,000	10,272,498		400,000	9,197,498
	Minority interest in consolidated subsidiary			28,000			26,000
	Commitments and contingent liabilities (Note 9)						
	Stockholders' equity (Note 6 and 8):						
12	$5 cumulative preferred stock of $100 par value per share; redeemable at $105 per share plus accrued dividends						

11	use of the Company	375,000	10,272,105		
	Minority interest in consolidated subsidiary		28,000		26,000
	Commitments and contingent liabilities (Note 9)				
	Stockholders' equity (Note 6 and 8):				
12	$5 cumulative preferred stock of $100 par value per share; redeemable at $105 per share plus accrued dividends. Authorized 100,000 shares; issued and outstanding 50,000 shares	5,000,000		5,000,000	
13	Common stock without par value. Authorized 2,500,000 shares; issued 1,500,000 shares	6,289,000		6,289,000	
14	Additional paid-in capital	2,200,000		2,200,000	
15	Retained earnings (Note 10)	27,438,172		21,083,239	
		40,927,172		34,572,239	
16	Less, Common stock in treasury, 19X2, 199,100 shares; 19X1, 199,000 shares, at cost	1,200,000	39,727,172	1,198,000	33,374,239
			$125,559,243		$115,746,234

The accompanying notes are an integral part of this financial statement.

*Valuation reserves should be shown parenthetically, if material.
†Includes adjustment for joint trading accounts—see explanation of cross reference (c), in Exhibit B, Part I.
Cross references are to account balances as shown in Answers to Financial Questionnaire.

EXHIBIT F

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Income and Retained Earnings
For the years ended December 31, 19X2 and 19X1*

	19X2		19X1	
Revenues:				
Commissions**		$42,282,211		$41,235,718
Net dealer inventory and investment gains (losses)†		1,606,778		(326,004)
Investment banking		1,789,000		1,397,466
Interest and dividends		1,242,823		1,001,975
Rent		200,000		150,000
Other		200,000		188,882
		47,320,812		43,648,037
Expenses:				
Employee compensation and benefits (Note 7)	$10,289,128		$9,374,627	
Commissions and floor brokerage	9,128,491		8,767,241	
Communications	8,551,000		7,737,126	
Interest	896,482		823,910	
Taxes, other than income taxes	27,777		21,588	
Other operating expenses	3,421,001	32,313,879	3,723,868	30,448,360
Income before taxes on income and minority interest in net income of consolidated subsidiary		15,006,933		13,199,677
Taxes on income, including amounts deferred to future periods; 19X2, $425,000; 19X1, $100,000 (Note 3)		8,400,000		7,300,000
Income before minority interest in net income of consolidated subsidiary		6,606,933		5,899,677
Minority interest in net income of consolidated subsidiary		2,000		1,000
Net income		6,604,933		5,898,677
Retained earnings at beginning of year		21,083,239		15,434,562
		27,688,172		21,333,239
Less, Dividends on preferred stock		250,000		250,000
Retained earnings at end of year (Note 10)		$27,438,172		$21,083,239
Earnings per share of common stock (Note 11)				

Income before minority interest in net income of consolidated subsidiary	6,606,933	

Minority interest in net income of consolidated subsidiary	2,000	1,000
Net income	6,604,933	5,898,677
Retained earnings at beginning of year	21,083,239	15,434,562
	27,688,172	21,333,239
Less, Dividends on preferred stock	250,000	250,000
Retained earnings at end of year (Note 10)	$27,438,172	$21,083,239
Earnings per share of common stock (Note 11)	$4.89	$4.34

The accompanying notes are an integral part of this financial statement.

*Currently, examinations may be at dates other than year end, resulting in varying periods of income determination. In such circumstances, comparative statements may not be desirable.

**The composition of commission revenues (e.g., listed securities, over-the-counter securities, etc.) may be disclosed if deemed appropriate.

†The amount of the change in unrealized gains and losses attributable to marketable securities which have been valued at market quotations as well as securities and investments not readily marketable which have been valued at fair value by management should be disclosed, if material.

EXHIBIT G

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Subordinated Liabilities
For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Subordinated liabilities at beginning of year	$ 9,197,498	$8,937,498
Increase in market value of securities borrowed under subordination agreements	1,100,000	300,000
	10,297,498	9,237,498
Decrease in market value of exchange memberships contributed for the use of the Company	(25,000)	40,000
Subordinated liabilities at end of year	$10,272,498	$9,197,498

The accompanying notes are an integral part of this financial statement.

EXHIBIT H

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Financial Position
For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Funds provided by:		
Net income	$6,604,933	$5,898,677
Charges to net income not requiring funds:		
Depreciation and amortization	585,000	560,000
Deferred income taxes	425,000	100,000
Funds provided by operations	7,614,933	6,558,677
Increase (decrease) in net payable to brokers and dealers	65,200	(1,600,000)
	$7,680,133	$4,958,677
Funds applied to:		
Increase (decrease) in cash and deposits with clearing organizations and others	$ 315,000	$ (75,000)
Increase in net receivable from customers	2,950,000	2,480,000
Increase in net securities owned	2,160,000	550,000
Purchase of office equipment	1,113,000	700,000
Decrease in short-term bank loans (and repurchase agreements, if applicable)	800,000	1,000,000
Payment of dividends	250,000	250,000
Liquidation of securities differences	42,000	10,000
Acquisition of treasury stock	2,000	
Other changes, net	48,133	43,677
	$7,680,133	$4,958,677

The accompanying notes are an integral part of this financial statement.

EXHIBIT I

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Accounting policies followed by the companies:
   Securities transactions (and related commission revenue and expense) are recorded on a settlement date basis,* generally the fifth business day following the transaction date.
   The consolidated financial statements include the accounts of the Company, all wholly-owned subsidiaries and one subsidiary which is 80% owned. Such subsidiaries are engaged primarily in leasing, investment advisory and venture capital endeavors.
   Depreciation is provided on a straight-line basis using an estimated useful life of 10 to 15 years. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the life of the lease.
   Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the Board of Directors.

2. Short-term bank loans at December 31, 19X2 are fully collateralized by marketable securities valued at $29,000,000. Such collateral includes securities owned by the Company or borrowed under subordination agreements having a market value of $17,000,000.

3. Deferred income taxes amounting to $1,200,000 and $1,100,000 for 19X2 and 19X1, respectively, are applicable to unrealized appreciation of securities owned by the Company.

4. Notes payable bear interest of 5½% and are payable in semiannual installments of $250,000 through July 1, 19X6. Leased property with a net book value of $2,500,000 has been pledged to secure the notes.

5. Liabilities subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from 5% to 6% and expiring as follows:

Expiration Date	
October 19X3	
March 19X4	
March 19X6	
December 19X4	
August 19X8	
January 19X6	

* An alternative method is discussed elsewhere in this guide.

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, continued

Expiration Date	Borrowings Under Subordination Agreements: Cash	Securities	Exchange Memberships	Liabilities Pursuant to Secured Demand Note Collateral Agreements	Total
October 19X3		$4,000,000			$ 4,000,000
March 19X4		1,000,000			1,000,000
March 19X6		1,281,725			1,281,725
December 19X4	$400,000				400,000
August 19X8				$3,215,773	3,215,773
January 19X6			$375,000		375,000
	$400,000	$6,281,725	$375,000	$3,215,773	$10,272,498

6. During 19X2, stockholders approved adoption of a qualified stock option plan covering 100,000 shares of common stock. Options may be granted during the period to June, 19X7 at 100% of the market value at the date of grant and are exercisable within five years from date of grant. No options have been granted under this plan.

7. The Company and its subsidiaries have several pension plans covering substantially all of their employees. The total pension expense was $125,000 and $108,000 in 19X2 and 19X1, respectively. Prior service cost of $3,000,000 is being amortized over periods ranging from 25 to 40 years. The Company's policy is to fund pension cost accrued.

8. During the year the Company acquired 100 shares of capital stock for $2,000. There were no other changes in capital stock or additional paid-in capital during the year.

9. The Company leases its main office and 11 sales offices under non-cancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

10. Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, continued

related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000 respectively. The Company's net capital ratio was 1.79 to 1. The net capital rules may effectively restrict the payment of cash dividends.*

11. Earnings per share of common stock was calculated based on the average number of shares outstanding during the year.

12. The components of receivable from and payable to brokers and dealers are as follows:

	19X2	19X1
	(In thousands)	
Securities failed to deliver:		
Outstanding less than 30 days	$21,316	$21,000
Outstanding more than 30 days	2,109	2,256
	23,425	23,256
Deposits paid for securities borrowed	1,420	1,020
Other	631	200
Total receivable from brokers and dealers	$25,476	$24,476
Securities failed to receive:		
Outstanding less than 30 days	$19,120	$17,889
Outstanding more than 30 days	4,734	5,225
	23,854	23,114
Deposits received for securities loaned	2,175	1,850
Total payable to brokers and dealers	$26,029	$24,964

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

13. Accounts receivable from customers include amounts due on uncompleted transactions and margin balances. Securities owned by customers and held as collateral for these receivables are not reflected in the financial statements.

*Various regulatory agencies including stock exchanges may impose additional capital requirements.

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New York, New Yor
February 15, 19X3

EXHIBIT J

Independent Public Accountant's Report On Examination of Partnership Financial Statements

To the Partners,
Standard Stockbrokerage Co.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income, changes in partnership capital, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (19.3% of Partnership Capital as of December 31, 19X2 and 24.3% as of December 31, 19X1) have been valued at fair value as determined by the partners. We have reviewed the procedures applied by the partners in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involyes subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the financial statements of the valuation of securities and investments determined by the partners as described in the preceding paragraph, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report On Examination of Partnership Financial Statements, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Partners,
Standard Stockbrokerage Co.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income, changes in partnership capital, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

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EXHIBIT K

STANDARD STOCKBROKERAGE CO., AND SUBSIDIARIES
Consolidated Statement of Financial Condition

December 31, 19X2 and 19X1
(on following pages)

EXHIBIT K

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Financial Condition
December 31, 19X2 and 19X1

	19X2		19X1	
Assets				
Cash		$ 2,657,472		$ 2,382,472
Cash segregated under Commodity Exchange Act		5,000		10,000
Deposits with clearing organizations and others		745,000		700,000
Receivable from brokers and dealers (Note 8)		25,476,250		24,476,250
Receivable from customers* (Note 9)		49,628,723		44,877,050
Securities owned (Note 1):				
At market value:				
Obligations of the U.S. Government	$ 490,000		$ 624,763	
State and municipal obligations	518,060		575,490	
Corporate bonds	6,900,000		6,638,213	
Stocks	11,930,327		10,091,806	
Warrants	900,000		748,115	
	20,738,387		18,678,387	
	8,230,685		8,230,685	
Securities not readily marketable, at estimated fair value (cost, $8,000,000)		28,969,072		26,909,072
Other investments not readily marketable, at estimated fair value (cost, $525,000)		500,000		500,000
Securities owned by individual partners contributed to or considered as partnership capital, at market value		3,215,773		3,215,773
Securities borrowed under subordination agreements, at market value		6,281,725		5,181,725
Memberships in exchanges:				
Owned by the Company, at cost (market value: 19X2, $2,000,000; 19X1, $2,200,000)		2,100,000		2,100,000
Contributed for the use of the Company, at market value		375,000		400,000
Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization: 19X2, $1,425,249, 19X1, $840,249 (Note 1)		4,881,769		4,353,769
Other assets		723,459		640,123
		$125,559,243		$115,746,234

Liabilities and Partnership Capital				
Short-term borrowings				
Bank loans		$ 5,000,000		$ 4,000,000
Payable to brokers and dealers (Note 8)		1,000,000		1,000,000
Payable to customers* (Note 9)		45,000,000		40,000,000
Securities sold but not yet purchased, at market value		1,000,000		1,000,000
Accounts payable and accrued liabilities		2,000,000		2,000,000
Liabilities subordinated to claims of general creditors (Note 2)		10,000,000		10,000,000
Partnership capital		61,559,243		57,746,234
		$125,559,243		$115,746,234

Securities owned by [illegible] partnership capital, at market value		2,100,000
Securities borrowed under subordination agreements, at market value	2,100,000	400,000
Memberships in exchanges:		
Owned by the Company, at cost (market value: 19X2, $2,000,000; 19X1, $2,200,000)	375,000	
Contributed for the use of the Company, at market value		
Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization: 19X2, $1,425,249, 19X1, $840,249 (Note 1)	4,881,769	4,353,769
Other assets	723,459	640,123
	$125,559,243	$115,746,234

Liabilities and Partnership Capital	19X2		19X1	
Short-term bank loans (Note 2)		$29,000,000		$29,800,000
Payable to brokers and dealers (Note 8)		26,029,243		24,964,043
Payable to customers (including $3,887,771 (19X2) and $2,921,000 (19X1) of free credit balances)		12,288,629		10,486,956
Market value of securities sold but not yet purchased		1,862,729		1,962,729
Accounts payable and accrued expenses		1,238,227		2,826,508
Notes payable (Note 3)		2,000,000		2,250,000
Other liabilities		836,272		1,533,788
Minority interest in consolidated subsidiary		28,000		26,000
		73,283,100		73,850,024
Commitments and contingent liabilities (Note 6)				
Liabilities subordinated to claims of general creditors (Note 4):				
Market value of securities, and cash of $400,000	$ 6,681,725		$ 5,581,725	
Market value of exchange memberships contributed for the use of the Company	375,000	7,056,725	400,000	5,981,725
Partnership capital (Notes 1, 5 and 7)		45,219,418		35,914,485
		$125,559,243		$115,746,234

The accompanying notes are an integral part of this financial statement.

*Valuations reserves should be shown parenthetically, if material.

EXHIBIT L

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Income
For the years ended December 31, 19X2 and 19X1

	19X2		19X1	
Revenues:				
Commissions*		$42,282,211		$41,235,718
Net dealer inventory and investment gains (losses)**		1,606,778		(326,004)
Investment banking		1,789,000		1,397,466
Interest and dividends		1,242,823		1,001,975
Rent		200,000		150,000
Other		200,000		188,882
		47,320,812		43,648,037
Expenses:				
Partner and employee compensation	$10,289,128		$9,374,627	
Commissions and floor brokerage	9,128,491		8,767,241	
Communications	8,551,000		7,737,126	
Interest	896,482		823,910	
Miscellaneous taxes	27,777		21,588	
Other operating expenses	3,421,001	32,313,879	3,723,868	30,448,360
Income before minority interest in net income of consolidated subsidiary		15,006,933		13,199,677
Minority interest in net income of consolidated subsidiary		2,000		1,000
Net income		$15,004,933		$13,198,677

The accompanying notes are an integral part of this financial statement.

*The composition of commission revenues (e.g., listed securities, over-the-counter securities) may be disclosed if deemed appropriate.

**The amount of the change in unrealized gains and losses attributable to marketable securities as well as securities and investments not readily marketable valued at fair value by the partners should be disclosed, if material.

Statement of Changes in Partnership Capital
For the years ended December 31, 19X2 and 19X1

•The composition of commission revenues (e.g., ...
may be disclosed if deemed appropriate.

••The amount of the change in unrealized gains and losses attributable to marketable securities as well as securities and investments not readily marketable valued at fair value by the partners should be disclosed, if material.

Statement of Changes in Partnership Capital
For the years ended December 31, 19X2 and 19X1

	19X2		19X1
Partnership capital at beginning of year		$35,914,485	$30,515,808
Additions during the year:			
Additional capital contributions including $1,100,000 in market value of securities	$5,500,000		200,000
Increase in equities in partners' individual accounts	300,000	5,800,000	30,715,808
		41,714,485	
Withdrawals during the year		11,500,000	8,000,000
		30,214,485	22,715,808
Net income		15,004,933	13,198,677
Partnership capital at end of year (Notes 1, 5 and 7)		$45,219,418	$35,914,485

The accompanying notes are an integral part of this financial statement.

EXHIBIT M

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Changes In Subordinated Liabilities
For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Subordinated liabilities at beginning of year	$5,981,725	$5,721,725
Increase in market value of securities borrowed under subordination agreements	1,100,000	300,000
	7,081,725	6,021,725
Decrease in market value of exchange memberships contributed for the use of the Company	25,000	40,000
Subordinated liabilities at end of year	$7,056,725	$5,981,725

The accompanying notes are an integral part of this financial statement.

EXHIBIT N

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Changes In Financial Position
For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Funds provided by:		
Net income	$15,004,933	$13,198,677
Charges to net income not requiring funds:		
Depreciation and amortization	585,000	560,000
Funds provided by operations	15,589,933	13,758,677
Increase (decrease) in net payable to brokers and dealers	65,200	(1,600,000)
Additions to partnership capital	5,800,000	200,000
	$21,455,133	$12,358,677
Funds applied to:		
Increase (decrease) in cash and deposits with clearing organizations and others	$ 315,000	$ (75,000)
Increase in net receivable from customers	2,950,000	2,480,000
Increase in net securities owned	2,160,000	550,000
Purchase of office equipment	1,113,000	700,000
Decrease in short-term bank loans (and repurchase agreements, if applicable)	800,000	1,000,000
Liquidation of securities differences	42,000	10,000
Capital withdrawals	11,500,000	8,000,000
Other changes, net	2,575,133	(306,323)
	$21,455,133	$12,358,677

The accompanying notes are an integral part of this financial statement.

EXHIBIT O

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

1. Accounting policies followed by the companies:
   Securities transactions (and related commission revenue and expense if applicable) are recorded on a settlement date basis,* generally the fifth business day following the transaction date.
   The consolidated financial statements include the accounts of the Company, all wholly owned subsidiaries, and one subsidiary which is 80% owned. Such subsidiaries are engaged primarily in leasing, investment advisory and venture capital endeavors.
   Depreciation is provided on a straight-line basis, using an estimated useful life of 10 to 15 years. Leasehold improvements are amortized over the shorter of the economic useful life of the improvement or the life of the lease.
   Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the partners.
   Federal income taxes have not been provided as each partner is individually liable for his own tax payments; however, it is currently anticipated that $3,500,000 will be withdrawn by the partners in the coming year to meet their current federal income tax liabilities and for other purposes.**

2. Short-term bank loans at December 31, 19X2 are fully collateralized by marketable securities. Such collateral includes securities owned by the Company or borrowed under subordination agreements having a market value of $17,000,000.

3. Notes payable bear interest of 5½% and are payable in semiannual instalments of $250,000 through July 1, 19X6. Leased property with a net book value of $2,500,000 has been pledged to secure the notes.

4. Borrowings subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from 5% to 6% and expiring as follows:

Expiration Date	Cash	Securities	Exchange Memberships	Total
October 19X3		$4,000,000		$4,000,000
March 19X4		1,000,000		1,000,000
March 19X6		1,281,725		1,281,725
December 19X4	$400,000			400,000
January 19X6			$375,000	375,000
	$400,000	$6,281,725	$375,000	$7,056,725

5. Included in partnership capital at December 31, 19X2 are equities in partners' individual accounts aggregating $3,215,773 which are considered as capital in accordance with the partnership agreement. Subject to the approval of various regulatory agencies, these amounts may be withdrawn.

6. The Company leases its main office and 11 sales offices under noncancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

7. Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000, respectively. The Company's net capital ratio was 1.79 to 1.***

8. The components of receivable from and payable to brokers and dealers are as follows:

	19X2	19X1
	(In thousands)	
Securities failed to deliver:		
Outstanding less than 30 days	$21,316	$21,000
Outstanding more than 30 days	2,109	2,256
	23,425	23,256
Deposits paid for securities borrowed	1,420	1,020
Other	631	200
Total receivable from brokers and dealers	$25,476	$24,476
Securities failed to receive:		
Outstanding less than 30 days	$19,120	$17,889
Outstanding more than 30 days	4,734	5,225
	23,854	23,114
Deposits received for securities loaned	2,175	1,850
Total payable to brokers and dealers	$26,029	$24,964

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

9. Accounts receivable from customers include amounts due on uncompleted transactions and margin balances. Securities owned by customers and held as collateral for these receivables are not reflected in the financial statements.

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* An alternative method is discussed elsewhere in this guide.
** Under certain conditions, it may be appropriate to record anticipated withdrawals as a liability.
*** Various regulatory agencies including stock exchanges may impose additional capital requirements.

EXHIBIT P

Independent Public Accountant's Report On the Statement of Financial Condition Only

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (22% of Stockholders' Equity as of December 31, 19X2 and 26% as of December 31, 19X1) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the Directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the statement of financial condition of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the accompanying consolidated statement of financial condition presents fairly the financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.
For a partnership the report is addressed:
To the Partners,
Standard Stockbrokerage Co.:

Independent Public Accountant's Report On the Statement of Financial Condition Only, continued

Example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material and the independent public accountant is reporting only on the statement of financial condition:

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statement of financial condition presents fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.
For a partnership the report is addressed:
To the Partners,
Standard Stockbrokerage Co.:

EXHIBIT Q

Representation Letter

February 15, 19X3

Accounting Firm
Gentlemen:

We are writing at your request to confirm our understanding that the examination which you have made was directed to the expression of an opinion on the consolidated statement of financial condition (financial statements) of Standard Stockbrokerage Co. Inc. and Subsidiaries and the examination of Answers to Financial Questionnaire as of (for the period ended) December 31, 19X2, and that your auditing procedures, including your tests of our accounting records, were limited to those which you considered necessary in the circumstances on the basis of generally accepted auditing standards approved and adopted by the American Institute of Certified Public Accountants or required by the (applicable stock exchange, e.g., New York) and the Securities and Exchange Commission.

Also at your request, to supplement information obtained by you from the books and records of the Company and from other sources, we advise you that to the best of our knowledge and belief the Company and its subsidiaries at December 31, 19X2 had:

(1) Satisfactory title to all recorded assets.

(2) No assets pledged or assigned as security for liabilities, performance of contracts, etc., except as disclosed in the financial statements or notes thereto. (See Questions 2 and 3, Exhibit B)

(3) No material unrecorded assets or contingent assets (such as claims relating to buy-ins, unfulfilled contracts, etc., whose value depends on fulfillment of conditions regarded as uncertain).

(4) No securities or investments not readily marketable owned by the Company or borrowed under subordination agreements except as disclosed in the financial statements or notes thereto.

It is understood that the term "securities and investments not readily marketable" shall include, but not be limited to, (a) securities except "exempted securities," for which there is no market on a securities exchange or independent publicly quoted market, (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 (or the conditions of an exemption such as Regulation A, under Section 3(B) of such Act have been complied with, i.e., "restricted stock," and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company, i.e., "control stock."

(5) All exchange memberships recorded on the books.

(6) No participations in joint accounts carried by others except as reflected in the financial statements or notes thereto. (See Question 15, Exhibit B)

(7) No capital stock repurchase agreements and no capital stock reserved for options, warrants, conversions, or other requirements (cor-

poration only) except as disclosed in the financial statements or notes thereto. (See Note 5, Exhibit I)

(8) No material unrecorded liabilities or contingent liabilities (endorsements or guarantees, lawsuits, additional taxes for prior years, repurchase agreements, etc.), other than as disclosed in the financial statements.

(9) No open contractual commitments other than those appearing on the memo books and records (for when distributed and delayed delivery contracts, underwritings and when issued contracts, endorsements of puts and calls, and commitments in foreign currencies and spot (cash) commodity contracts).

(10) Charged off all property, furniture, fixtures, equipment, and leasehold improvements sold, destroyed, abandoned or considered to be obsolete or of no further use.

(11) No holder of voting stock having a proprietary interest in any account classified solely as that of a customer in Answers to Financial Questionnaire.

(12) No borrowings or claims which were unconditionally subordinated to all claims of general creditors pursuant to a written agreement except as disclosed in the financial statements or notes thereto. (See Question 12, Exhibit B)

(13) Established a reserve for security differences that is adequate to cover any anticipated losses in connection with the short securities that may have to be covered and/or claims arising from the liquidation of long securities.

Further, we advise you that, to the best of our knowledge and belief, all accounting and financial records and related data of the Company have been made available to you and as far as we know none of them were withheld from you; no shortages or other irregularities have been discovered that have not been disclosed to you; and no events have occurred nor have any matters been discovered since December 31, 19X2 which would require adjustments to or disclosure in the financial statements. We agree with the adjusting journal entries which are not recorded on the books but which are given effect to in the financial statements.

Very truly yours,

..... Company
..... Chief Executive Officer
.....Chief Accounting Officer

NOTE: Where separate representations are not provided by the Company, the independent public accountant should also obtain in this letter representations as to the accuracy of items not covered by his opinion, such as future capital withdrawals, financial obligations of partners, etc. In addition, appropriate representations should be obtained with respect to the minutes of the corporation or the partnership agreement of the partnership and the appropriateness of agreements providing for the inclusion of partners' individual accounts as partnership property in the financial statements and for the purpose of computing net capital.

EXHIBIT R

STANDARD STOCKBROKERAGE CO., INC.
Computation of Aggregate Indebtedness and Net Capital in Accordance with Rule 15c3-1 Under the Securities Exchange Act of 1934
As of December 31, 19X2

(Note: The computation under the various exchange rules differ from this example. Further, the SEC announced on December 5, 1972, in Securities Exchange Act Release No. 9891, a proposal to substantially revise Rule 15c3-1.)

Questionnaire Reference			
	Aggregate Indebtedness:		
2.A.1.	Money borrowed, secured by or containing customers' securities as collateral		$20,000,000
4.C.1.	Money payable against customers' securities in securities loaned accounts		2,174,850
4.D.1.a. & b.	Money payable against securities failed to receive on account of customers' transactions		14,485,648
	Credit Balances in Customers' Accounts:		
6.A.2.	Cash accounts	$ 2,088,967	
6.B.1.A.	Margin deposit on joint account	5,000	
6.B.2.	Secured accounts	6,254,915	
6.C.2.	Partly secured accounts	1,538	
6.E.	Accounts with credit balances having open contractual commitments	27,834	
6.F.	Accounts with free credit balances	3,797,711	
			12,175,965
7.A.2.	Equities in customers' nonregulated commodity accounts with open futures contracts		2,051
8.A.2.	Officers' accounts with free credit balances		90,060
13.	Dividends payable and unclaimed		254,875
13.	Floor brokerage and similar commissions payable		545,125
13.	Accrued bank loan interest payable		420,000
13.	Accrued producers' commissions payable		478,027
13.	Taxes withheld from employees		36,272
13.	Accounts payable and accrued expenses		262,913
	Federal income taxes currently payable		1,076,473
	Total aggregate indebtedness		$52,002,259
	Net Capital:		

7.A.2.	Equities in customers' nonregulated commodity accounts with open futures contracts		2,051
8.A.2.	Officers' accounts with free credit balances		90,060
13.	Dividends payable and unclaimed		254,875
13.	Floor brokerage and similar commissions payable		545,125
13.	Accrued bank loan interest payable		420,000
13.	Accrued producers' commissions payable		478,027
13.	Taxes withheld from employees		36,272
13.	Accounts payable and accrued expenses		262,913
13.	Federal income taxes currently payable		1,076,473
	Total aggregate indebtedness		$52,002,259
	Net Capital:		
	Credit Items:		
11.C.1.a.	Preferred stock	$ 5,000,000	
11.C.1.b.	Common stock	6,289,000	
11.C.2.	Additional paid-in capital	2,200,000	
11.C.3.	Retained earnings	27,438,172	
	Add—Deferred tax provision on unrealized appreciation of marketable securities	1,200,000	
		42,127,172	
	Less—Treasury stock	1,200,000	$40,927,172
12.B.1.	Market value of securities borrowed under subordination agreements		6,281,725
12.B.2.	Cash borrowings under subordination agreements		400,000
12.B.3.	Secured demand notes covered by subordination agreements		3,215,773
12.B.4.	Market value of exchange memberships contributed for the use by the Company under subordination agreements		375,000
13.	Allowance for customers' accounts doubtful of collection		10,500
	Total credit items		51,210,170

Continued

STANDARD STOCKBROKERAGE CO., INC.
Computation of Aggregate Indebtedness and Net Capital in Accordance with Rule 15c3-1 Under the Securities Exchange Act of 1934
As of December 31, 19X2
continued

Questionnaire Reference			
	Net Capital, Continued:		
	Debit Items:		
1.	Good faith deposit related to contractual commitment		$ 5,000
2.B.	Deficits in customers' commodities accounts carried by other brokers		30,634
4.B.	Contract value of securities failed to deliver:		
	Outstanding 40 through 49 days (10% of $226,547)	$ 22,655	
	Outstanding 50 through 59 days (20% of $127,618)	25,524	
	Outstanding 60 days or longer (30% of $110,182)	33,054	
			81,233
6.B.1a.	Percentage charge (30%) on respondent's interest in market value of securities long in joint accounts		9,077
6.C.	Deficits in customers' partly secured accounts		11,998
6.D.	Customers' unsecured accounts		20,258
7.B. & C.2.b.	Deficits in customers' commodity accounts		25,110
Part II. Q7	Percentage charge (1½%) on market value of long future contracts in each commodity carried for customers		3,000
Part II. Q10	Percentage charge on market value of securities in firm trading and investment accounts		13,502,590
12.B.1.	Percentage charge on securities borrowed under subordination agreements (30%)		1,884,517
12.B.4.	Market value of exchange memberships contributed for the use of the Company under subordination agreements		375,000

13.	Accrued interest receivable on securities in trading and investment accounts	
13.	Advances to employees	
13.	Dividends receivable	20,000*
13.	Securities shipped on open account	10,000
13.	Floor brokerage and similar commissions receivable	181,525
13.	Miscellaneous accounts receivable	87,815
13.	Investment in subsidiaries	

12.B.1.	Percentage charge on securities borrowed under subordination agreements (30%)		
12.B.4.	Market value of exchange memberships contributed for the use of the Company under *subordination agreements*		1,884,517
			375,000

13.	Accrued interest receivable on securities in trading and investment accounts		20,000*
13.	Advances to employees		10,000
13.	Dividends receivable		181,525
13.	Securities shipped on open account		87,815
13.	Floor brokerage and similar commissions receivable		52,187
13.	Miscellaneous accounts receivable		301,998
13.	Investment in subsidiaries		2,425,763
13.	Exchange memberships		2,100,000
13.	Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, less accumulated depreciation and amortization	2,881,769	
	Less—Capitalized lease obligation	2,000,000	
			881,769
13.	Unresolved short security differences		12,500
14.A.2.	Percentage charge on underwriting positions	2,250	
	Less—Unrealized profits thereon	225	2,025
15.A.	Percentage charge (30%) on respondent's interest in joint accounts carried by others		26,370
	Total debit items		22,050,369
	Net capital		$29,159,801

Capital Requirements:	
5% of aggregate indebtedness ($52,002,259)	$ 2,600,113
Net Capital in Excess of Requirements	26,559,688
Net capital as above	$29,159,801
Ratio of Aggregate Indebtedness to Net Capital	1.79 to 1

*This item will be subjected to the same haircut as the related securities rather than a 100% charge if details are furnished with the particular securities in Part II schedules supporting the answers to Question 10.

EXHIBIT S

Abbreviated Financial Statements of Subsidiaries
Statement of Financial Condition
December 31, 19X2

Cross Reference to Grouping in the Statement of Financial Condition		Leasing Subsidiary, Inc. (100% owned)	Investment Advisory Co., Inc. (100% owned)	Venture Capital Co., Inc. (80% owned)	Total
A-1	Cash	$ 200,000	$ 13,763	$ 20,000	$ 233,763
A-8	Restricted securities, at estimated fair value (cost, $120,000)			120,000	120,000
A-15	Accounts receivable		100,000		100,000
A-14	Leased property, at cost, less accumulated depreciation	4,000,000*			4,000,000
	Total assets	$4,200,000	$113,763	$140,000	$4,453,763
L-7	Notes payable	$2,000,000			$2,000,000
	Stockholders' equity	2,200,000	$113,763	$140,000**	2,453,763
		$4,200,000	$113,763	$140,000	$4,453,763

*Part of this property is leased to Standard Stockbrokerage Co., Inc.
**Includes minority interest of $28,000.

Statement of Income
For the year ended December 31, 19X2

Revenue	$ 200,000	$160,000	$ 40,000	$ 400,000
Expenses	99,000	105,000	20,000	224,000
Income before taxes on income	101,000	55,000	20,000	176,000
Taxes on income	50,000	25,000	10,000	85,000
Net income	$ 51,000	$ 30,000	$ 10,000	$ 91,000

These statements are included for reference purposes only, and are not to be included as part of financial statements.

EXHIBIT T

Audit Requirements Prescribed on Form X-17A-5

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. It shall include all procedures necessary under the circumstances to substantiate the assets and liabilities and securities and commodities positions as of the date of the responses to the financial questionnaire and to permit the expression of an opinion by the independent public accountant as to the financial condition of the respondent at that date. Based upon such audit, the accountant shall comment upon any material inadequacies found to exist in: (*a*) the accounting system; (*b*) the internal accounting control; (*c*) procedures for safeguarding securities; (*d*) the practices and procedures employed in complying with Rule 17a-13 and in the resolution of securities differences; and shall indicate any corrective action taken or proposed.

The scope of the audit shall include the following procedures, but nothing herein shall be construed as limiting the audit or permitting the omission of any additional audit procedure which an independent public accountant would deem necessary under the circumstances. As of the audit date the independent public accountant shall:

(1) Compare ledger accounts with the trial balances obtained from the general and private ledgers and prove the aggregates of subsidiary ledgers with their respective controlling accounts.

(2) Account for by physical examination and comparison with the books and records: all securities, including those held in segregation and safekeeping; material amounts of currency and tax stamps; warehouse receipts; and other assets on hand, in vault, in box or otherwise in physical possession. Control shall be maintained over such assets during the course of the physical examination and comparison.

(3) Verify securities in transfer and in transit between offices of respondent.

(4) Balance positions in all securities and spot and future commodities as shown by the books and records at the audit date.

Audit Requirements Prescribed on Form X-17A-5, continued

(5) Reconcile balances shown by bank statements with cash accounts. After giving ample time for clearance of outstanding checks and transfers of funds, the independent public accountant shall obtain from depositaries bank statements and canceled checks of the accounts and by appropriate audit procedures substantiate the reconciliation as of the audit date.

(6) Obtain written confirmation with respect to the following (see note):

(a) Bank balances and other deposits.

(b) Open contractual positions and deposits of funds with clearing corporations and associations.

(c) Money borrowed and detail of collateral.

(d) Accounts, securities, commodities, and commitments carried for the respondent by others.

(e) Details of:

(i) Securities borrowed

(ii) Securities loaned

(iii) Securities failed to deliver

(iv) Securities failed to receive

(v) Contractual commitments (see General Instruction B.11).

(f) Customers', partners', officers', directors', and respondent's accounts. Confirmation of these accounts may be in the form of a written acknowledgment of the accuracy of the statement of money balances, securities and/or commodities positions, and open contractual commitments (other than uncleared "regular way" purchases and sales of securities) accompanying the first request for confirmation mailed by the independent public accountant. Customers' accounts without balances, positions or commitments, and accounts closed since the last prior audit shall be confirmed on a test basis.

(g) Borrowings and accounts covered by "satisfactory subordination agreements."

(h) Guarantees in cases where required to protect accounts guaranteed as of audit date.

(i) All other accounts which in the opinion of the independent public accountant should be confirmed.

Audit Requirements Prescribed on Form X-17A-5, continued

NOTE: Compliance with requirements for obtaining written confirmation with respect to the above accounts shall be deemed to have been made if requests for confirmation have been mailed by the independent public accountant in an envelope bearing his own return address and second requests are similarly mailed to those not replying to the first requests, together with such auditing procedures as may be necessary; provided, however, that with respect to customers' accounts closed since the last prior audit the accountant may use either positive or negative confirmation requests; and it is further provided that with respect to periodic investment plans sponsored by member firms of a national securities exchange, whose members are exempted from Rule 15c3-1 by paragraph (*b*)(2) thereof, the independent public accountant examining the financial statements of the originating member firm may omit direct written confirmation of such plan accounts with customers when, in his judgment, such procedures are not necessary, if (1) the originating member firm does not receive or hold securities belonging to such plan accounts and does not receive or hold funds for such accounts, except the initial payment which is promptly transmitted to the custodian; (2) the custodian is a member firm of such national securities exchange and files certified reports complying with Rule 17a-5 in connection with which the customers' accounts are confirmed by an independent public accountant; and (3) funds and securities held by the custodian for each such customer's account are reconciled with the records of the originating member firm as of the date of the most recent audit of the custodian.

(7) Obtain a written statement from the proprietor, partner (if a partnership) or officer (if a corporation) as to the assets, liabilities, and accountabilities, contingent or otherwise, not recorded on the books of the respondent.

(8) Verify the computation of the ratio of aggregate indebtedness to net capital at the audit date and review the procedures followed in making the periodic computations required under the provisions of Rule 17a-3(*a*)(11).

(9) Review the practices and procedures employed for the making of the securities examinations, counts, verifications, comparisons, and the recordation of differences required by Rule 17a-13, and the methods employed in the resolution of the differences uncovered.

NOTE: Provisions of Rule 17a-5 require that the reports of certain brokers and dealers be audited by a certified public accountant or public accountant who shall be in fact independent. With respect to qualifications of accountants, accountant's certificate, opinions to be expressed, and exceptions, please refer to Rule 17a-5.

NOTE: Important additional audit and reporting requirements are imposed by Release Nos. 9658 and 9766 under the Securities Exchange Act of 1934. Reference should be made to such releases for specific requirements.

Glossary

A.D.R. Abbreviation for American Depository Receipt.

Account executive. *See* Registered representative.

Active box. A position on the Stock Record (Street Side) indicating securities located in the Cashier's Department which are normally available to the brokerage concern for its general use.

Adequately collateralized. Indebtedness shall be deemed to be "adequately collateralized" when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community.

Aggregate indebtedness. The total of certain liabilities of a broker-dealer which are set forth in Rule 15c3-1 of the Securities and Exchange Commission. A broker-dealer shall not permit his aggregate indebtedness to exceed a specified percentage of this net worth as defined in this same rule.

Allied member. Any general partner or qualified voting stockholder of a member organization who is not himself a member of a stock exchange.

American depository receipt (A.D.R.). A certificate issued by an American bank that serves as evidence of ownership of original foreign shares. These certificates are transferable and can be traded. The original foreign stock certificates are deposited with a foreign branch or correspondent bank of the issuing American bank.

AMEX. The popular name for the American Stock Exchange.

Arbitrage. The act of buying a security in one market and selling it in another. Also buying a security subject to exchange, conversion or reorganization and selling the security or securities to be received upon completion of the exchange, conversion, or reorganization.

Asked. A potential seller's lowest acceptable price for a security.

Back office. The administrative area of a brokerage office which contains the bookkeeping, margin, P&S, cashiers', and dividend departments.

Bad delivery. A delivery of securities that does not fulfill the requirements for delivery.

Balance order. The net balance instructions, issued by a clearing corporation, to receive or deliver securities. The instructions set forth all the information needed by the member firm to clear its transactions on a given settlement date.

Best efforts. Refers to an agreement by an underwriter to buy from the issuing corporation only those securities which it is able to sell to the public.

Bid. The highest declared price a buyer is willing to pay for a security at a particular time.

Big Board. The popular name for the New York Stock Exchange.

Blotter. A record of original entry. A book or individual units used as a record of original entry to record transactions as they occur. Covers purchases, sales, cash receipts and disbursements, and securities received and delivered.

Board room. Popular name for the area in a brokerage concern's office where customers can watch security prices and activity and enter orders for the purchase and sale of securities.

Books closed. The cutoff time that determines stockholders of record for a prescribed period. Any entries affecting the registration or ownership of securities for dividend disbursements or proxy purposes must be made before this time.

Borrowed. The act of borrowing a security for delivery. The equivalent value in money is usually deposited with the lender.

Box. A "short" position in the Stock Record representing securities on hand in the possession of the brokerage concern. A place where securities are kept such as a vault, file cabinet, or other place so used. Boxes are also identified as Safekeeping Box, Segregation Box, Name of Box, Active Box, etc.

Box count. An actual count of the securities in the box either in connection with an audit or with periodic checking.

Broker loans. Money borrowed by brokers from banks.

Brokers transfer account. An account kept by the transfer clerk of a brokerage concern giving details of securities transferred for the account of other brokers. The occasion for this arises when delivery is made by transfer (TAD—transfer as directed) instead of by delivery of the actual certificates.

Bulk segregation. Securities (usually constituting excess collateral in margin accounts) which are filed in alphabetical order in special boxes in the vault but which are not specifically identified with the owners. Collateral records are maintained by the brokerage concern to indicate the owners and the securities are usually in the name of the brokerage concern.

Buy-in. The procedure followed by a broker desiring to settle a buy contract which is past due. He may file with a stock exchange or the National Association of Security Dealers, Inc., as appropriate, a notice termed a "Buy-in," a copy of which is also served on the broker from whom the securities were to be received. If the securities are not delivered, the stock or bond may be bought in for cash for the account of the broker who is to receive the securities. The difference in price between the "Buy-in" and the contract price is adjusted by check from one broker to another.

Buying power. The equity remaining in a margin account after providing for the margining of existing securities in the account in accordance with federal and "House" margin requirements.

Cage. The term given to the area of the brokerage concern's office in which is located the cashier, stock clerk, loan clerk, transfer clerk, blotter clerk, and others having as a part of their duties the receiving and delivering of securities.

Call (margin). A request for a margin customer to put up additional collateral (cash or securities). Usually a written request.

Call loan. A loan which has no definite maturity or rate of interest. The loan may be "called" by the lender or paid off by the borrower at any time.

Call option. A contract which entitles the holder to buy (call) entirely at his option, a specified number of shares of a particular stock at a specified price at any time until the stated expiration date of the contract. Such an option (which is always for a round lot amount and which is transferable) is bought in the expectation of a price rise above the contract price. If the price rise occurs, the purchaser will exercise the option. If the rise does not occur, he will let the option expire and will lose only the cost of the option. During the existence of the option, the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights, and stock dividends or splits.

Cash account. A customer account with a brokerage concern in which purchases and sales of securities are handled on a strictly cash basis. No credit or margin is allowed.

Cash sale. A sale on which the trade and settlement dates are the same. The selling broker must be able to make delivery of the security sold on the trade date. The customer who is selling usually receives a discounted price on the sale for this special service.

Cash transaction. A transaction which is expected to clear within the time prescribed by Regulation T of the Board of Governors of the Federal Reserve System.

Cashier's department. A division of the Operations Department of a brokerage concern that handles securities and money that are received or delivered by the brokerage concern. (*See* Cage.)

Central Certificate Service (C.C.S.). A subsidiary of the Stock Clearing Corporation of the New York Stock Exchange and a depositary for eligible securities to facilitate clearances between member organizations without the necessity of receiving or delivering actual certificates.

Churning. The process of unnecessary purchases and sales in customers' accounts for the purpose of generating commissions.

Clearance. The act of clearing securities between buyers and sellers. Receipt or delivery of securities against payment.

Clearing house. Term given to the central location for matching security transactions of members to enable the determination of minimum quantities to be received or delivered.

Clearing member. A brokerage concern entitled to use the services of the clearing corporation.

Clearing organization. Usually a brokerage concern which clears the transaction of another brokerage concern. (*See* Correspondent.)

Commodity hold out. Commodity transactions on the brokerage concern's records but not reported on the clearing house sheets.

Commodity spreading. Implies open purchase ("long") and sale ("short") contracts in the same commodity or in different commodities.

Comparison. A formal notice that details the terms of the contract between brokerage concerns who are parties to non-exchange trades. If the details of the trade are correct, the comparison is stamped (acknowledged) and returned; if they are incorrect, the broker indicates the difference(s) and returns the comparison. (*See* D.K.)

Compliance department. The department in a brokerage concern that enforces adherence to policies established by the brokerage

concern, plus all rules and regulations fixed by the various regulatory agencies.

Confirmation. A confirmation sets forth the terms of a contract between a brokerage concern and its customer for the purchase or sale of securities. Details shown on a confirmation are: trade date, settlement date, number of shares or par value of bonds, security description, contract price, commission, account number and type of account, customer's name and address, and any other information required.

Contract difference. The difference between the contract and the market values of commodities.

Contract sheet. A listing of compared and uncompared transactions sent to each member firm by a stock clearing corporation.

Conversion account. An account carried by a New York Stock Exchange member who endorses put and call options for a put and call dealer under a completely hedged condition.

Correspondent. One of the parties to an agreement between two brokerage concerns that performs services for the other, such as the execution and the clearance of trades. A New York City brokerage concern (a clearing member) is usually the correspondent for an out-of-town brokerage concern (often a non-member).

Cover value. The amount necessary to buy-in a "short" security position at the current market value.

Credit department. Another name for Margin Department.

Current market value. Generally, as used in connection with margin trading, means the closing price of a security as of the preceding business day.

CUSIP (number). A means of uniformly describing and identifying specific security issues. Developed by the Committee on Uniform Security Identification Procedure.

Customers' man. A salesman or registered representative.

D.A.P. Abbreviation for delivery against payment. Also referred to as C.O.D. (cash on delivery), P.O.D. (payment on delivery), and D.V.P. (delivery versus payment).

D.K. Abbreviation for Don't Know. An expression used by a brokerage concern to indicate that a certain transaction which another brokerage concern is attempting to confirm or compare is unknown to them. When mutual understanding is reached the transaction is properly compared or cancelled.

Day loan. A loan made for one day only for the convenience of the brokerage concern. Generally on an unsecured basis.

Dealer. A person or firm acting as a principal rather than as an agent in the purchase and sale of securities.

Definitive certificates. Actual and permanent certificates of bonds or stock given in exchange for temporary receipts. These temporary receipts are usually issued at the time of a new offering before the engraved certificates are available.

Delayed delivery. A transaction the delivery of which is longer than the usual regular way transaction. (*See* Sellers' option.)

Directed sale. Sale by the manager of a syndicate to a customer (usually an institution) of a syndicate member.

Discretionary account. An account over which a broker or some other person has been given discretion by the customer as to purchases and sales of securities, including the kind of securities, the time when and the prices to be paid or received. The discretion may be complete or limited.

Distribution. The sale of a large block of securities to the investing public.

Divided liability. Liability in a syndicate or underwriting which is fixed or definite in amount. (*See* Undivided liability.)

Dividend department. A division of the Operations Department that is charged with the collection of dividends and the crediting of these dividends to the accounts of customers.

Due bill. A document passed between brokerage concerns stating that dividends, rights to subscribe, stock dividends, etc., are the property of the holder of the due bill.

Equity. The net worth in a margin account, computed by subtracting the total of the "short" security values and the debit balance from the total of the "long" security values and the credit balance. If the result is a net credit the account is said to liquidate to an equity.

Equity securities. Term applied to common stocks or to debentures or preferred stock which are convertible into common stocks.

Equity statement (runs). Statements showing details of an account together with security valuations.

Ex-clearing house. Transactions which are not settled through the clearing house.

Ex-dividend. A synonym for "without dividend." The buyer of a stock selling ex-dividend does not receive the recently declared dividend. Open buy and sell stop orders, and sell stop limit orders in a stock on the ex-dividend date are ordinarily reduced by the

value of the particular dividend. In the case of open stop limit orders to sell, both the stop price and the limit price are reduced. Every dividend is payable on a fixed date to all shareholders recorded on the books of the disbursing company as of a previous date of record. For example, a dividend may be declared as payable to holders of record on the books of the disbursing company on a given Friday. Since five business days are allowed for delivery of the security "regular way" in transactions on the Stock Exchange, the exchange would declare the stock "ex-dividend" as of the opening of the market on the preceding Monday. This means that anyone buying the stock on and after Monday would not be entitled to the dividend.

Ex-rights. Same as for ex-dividend. The buyer of stock selling ex-rights is not entitled to the rights distribution.

Ex-warrants. On occasion stock or bonds have warrants attached entitling the holder to subscribe to additional shares within specified periods of time and at specified prices. When these warrants are detached the security is traded "ex-warrants."

Exchange tickets. The tickets (usually data processing cards) in a clearing corporation format, prepared by a brokerage concern for each transaction made on an exchange. These tickets list all pertinent details of the trade and are sent with a daily summary listing to the clearing corporation for comparison and confirmation.

Execution report. A confirmation notice of the completion of a trade that is sent from the floor of an exchange (for listed securities) or trading desk (for over-the-counter securities) back to the point of origin of the order.

Exempt securities. Securities exempted from registration under the Securities Exchange Act of 1934, otherwise than by action of the Securities and Exchange Commission.

Extension. Permission to extend credit beyond the time prescribed by Regulation T of the Board of Governors of the Federal Reserve System.

Fails. Uncompleted security transactions between two brokerage concerns. (*See* Fail to deliver *and* Fail to receive.)

Fail to deliver. Securities which the selling brokerage concern has not delivered to the purchasing brokerage concern at the settlement or clearance date.

Fail to receive. Securities which the purchasing brokerage concern has not yet received from the selling brokerage concern at the settlement or clearance date.

Firm account. An account consisting of securities in which the brokerage concern has taken a position for investment purposes, is

making a market (principal wholesaler) or has an interest with another party (joint account).

Firm commitment. Refers to the agreement of an underwriter to buy the entire issue of a security from the issuing corporation at a specified price.

Firm price. The price at which a security can be bought or sold in the over-the-counter market for such period of time as the seller may specify.

Flat. A method of trading in certain kinds of bonds. Usually used in trading income bonds which do not pay interest unless it has been earned and declared payable, or bonds on which the issuing corporation has defaulted in the payment of interest. When bonds are traded "flat" the seller is not entitled to receive in addition to the price of the bond the interest that has accumulated since the date of the last interest payment. The seller of a bond that is traded "flat" must deliver the bond with all unpaid coupons attached or a due bill authorizing the buyer to collect any payments of interest that may be made by the issuing corporation in the future.

Flat statement. A statement with no money or security balance.

Floor. The popular name for the area where securities are bought or sold on an exchange.

Floor broker. Member of exchange who executes transactions on the exchange for the account of his own organization or for the account of other member organizations.

Floor brokerage. The commission charged by one broker to another broker for executions of transactions on exchanges.

Floor clerk. An employee of a brokerage concern who maintains liaison between the order room and the floor broker.

Floor report. A report of an executed trade given to the floor clerk by the floor broker which contains the number of shares, the price, and the other broker on the trade.

Free securities. Securities which are fully paid for.

Free shipment. Shipments of securities usually to out-of-town brokerage concerns without draft attached in order to avoid payment of collection charges.

Fully paid accounts. Customer accounts in which the contract price to purchase securities has been paid. These securities should be "locked-up" in the segregation or safekeeping box.

Futures contract. Contracts for purchase or sale of commodities at some time in the future.

G.T.C. Abbreviation for "Good 'Til Cancelled." Also called an "open order." When this term appears on an order to buy or sell a security it means that the order is to remain in effect until it is either executed or cancelled.

Give-up. Type of order which is given by a customer to a member firm on whose books the customer does not have an account.

Good delivery. Certain basic qualifications must be met before a security sold may be delivered. The security must be in proper form to comply with the contract of sale and to transfer title by delivery to the purchaser.

Good faith deposit. Deposit to guarantee performance. Usually with respect to new issues of securities.

Group account. A syndicate or joint account.

Haircut. Deductions from "net worth" of certain specified percentages of the market value of securities and future commodity contracts "long" and "short" in the capital and proprietary accounts of a broker or dealer, and in the accounts of partners. These deductions are solely for the purpose of computing "net capital" and are not entered on the books.

Holder of record. The party listed as the registered owner on the transfer records of a corporation.

Holders' file. A subsidiary file (punched cards, discs or tapes) in account sequence showing securities owned or carried in such accounts.

House account. An account used by a brokerage concern to maintain a trading and/or investment position in a security for itself or its officers or partners. Also a name given to a customer's account to which no registered representative has been assigned.

House rules. Rules promulgated by the brokerage concern. Usually refers to the maintenance margin required by the brokerage concern which is over and above requirements of governing bodies.

Hypothecation agreement. An agreement signed by a customer that permits his broker to use securities in the customer's margin account as collateral for loans made to the broker.

In-box sheet. Sheet on which is listed items going into the box.

In-house. Within the brokerage concern itself.

Initial margin. The amount of money or its equivalent specified by the Board of Governors of the Federal Reserve System that a customer must deposit with his broker when the customer buys a security on margin.

International arbitrage. Same as arbitrage except markets are in different countries.

Investment banker. One who underwrites securities on an initial or secondary basis. This often involves private placements where the investment banker may act as both a broker and/or dealer.

Joint account. An account in which two or more persons have an interest.

Legal list. A list of securities in which insurance companies, banks, and fiduciaries are permitted by law to invest.

Legal transfer. A stock certificate having an assignment executed by an executor, administrator, trustee, guardian, etc., and requiring certain legal documents indicating the authority of the party assigning the securities.

Limit order. Also called a "limited order" or "limited price order." An order to buy or sell a security at a price specified by the customer or at a better price if such price can be obtained.

Listed security. A security which is traded on an exchange.

Loan consent. An agreement signed by a customer that permits the brokerage concern to lend securities in a margin account to other brokers.

Loan value. The value at which a security is accepted for margin. This value is usually less than or at a discount from current market value.

Loaned. Opposite of borrowed. The act of lending a security usually for delivery against a "short" sale. The equivalent value in money is usually deposited by the borrower.

Lock-up. The act of placing securities in safekeeping or segregation.

Long. Denotes ownership of securities. Due to.

Long and short record. *See* Stock record.

Maintenance margin. The amount of equity required to be maintained in a margin account in accordance with exchange regulations or house rules.

Margin. The equity in an account. The requirements as to the amount of margin vary between initial margin and maintenance margin and also according to the type of collateral used in computing the equity.

Margin call. A request for additional margin.

Margin department. A division of the "Operating Department." Its function is to keep an up-to-date record of each customer's pur-

chases and sales of securities and to watch carefully margin transactions in a customer's margin account.

Margin transaction. A transaction on which the brokerage concern advances credit to the customer for a portion of the purchase price.

Mark-to-the-market. A procedure whereby a brokerage concern has the right to demand that the price of a past due or open contract be adjusted to current market values by the advancement of additional funds.

Mark-up. Refers to the difference between what a dealer has paid for a security and the price at which he offers the security to another person.

Market maker. A broker-dealer concern that stands ready to buy or sell a particular security in the over-the-counter market at prices which the concern has quoted.

Market price. Usually means the last reported price at which a security has been sold.

Master file. A file which contains the official account numbers and descriptions of securities or customers' names and addresses.

Maximum loan value. Refers to the percentage of the purchase price of a security which the broker may lend to a customer who is buying a security on margin.

Member corporation. A brokerage concern that is organized as a corporation and that has at least one director-holder of voting stock who is a member of an organized stock exchange.

Member firm. A brokerage concern that is organized as a partnership and that has at least one general partner who is a member of an organized stock exchange.

Mixed account. An account which contains both "long" and "short" securities.

NASDAQ. An electronic quotation system for over-the-counter market sponsored by the National Association of Securities Dealers, Inc.

Name-of securities. Securities registered in the name of customers of the brokerage concern.

National Association of Securities Dealers, Inc. (N.A.S.D.). Also referred to as N.A.S.D. An association of broker-dealers who do business in the over-the-counter market. The Association supervises and regulates the trading conduct of its members.

Net capital. Net worth of a brokerage concern less certain items such as exchange memberships, carrying value of securities which are not readily marketable, "haircuts" on marketable securities in

proprietary accounts, furniture and equipment, etc., as defined in the net capital rules.

New issue. A security that is sold by an issuing corporation for the first time.

Non-regulated commodity. A commodity not regulated by the Commodity Exchange Act.

Odd lot. A quantity of securities which is less than the trading unit. Usually a quantity less than an even one hundred shares.

Odd-lot broker. A broker who executes odd lot transactions for other brokers. Such brokers buy or sell round lots on the exchange to cover the odd lot transactions.

Odd-lot differential. The fraction which is added to or deducted from the round lot price by the odd-lot broker.

Off-board. Means trading in unlisted securities in the over-the-counter market. Also used to describe transactions in listed securities not executed on a stock exchange.

Offer. The lowest price at which a seller is willing to sell a security.

Omnibus account. An open account carried by another brokerage concern (a margin account) as distinguished from a similar account where transactions are cleared on an individual basis (a cash account).

Operations department. The name associated with the overall clerical functions of a brokerage concern. Sometimes referred to as the "back office."

Optional dividend. A dividend that is payable in either stock or cash at the option of the holder of record.

Order department. A division of the Operations Department that receives customers' orders and transmits them either to the floor of a stock exchange or the trading department for execution. The Order Department also receives notices of executed trades and transmits such notices to the purchase and sales department and to the registered representatives.

Order room. Another name for the Order Department.

Out-of-box sheet. A sheet on which is listed securities removed from the box.

Over delivery. Delivering a greater amount of securities than called for; the surplus amount being returned by transferring it to the name of the delivering brokerage concern.

Over-the-counter (O.T.C.). A market for securities made up of

brokerage concerns who may or may not be members of a securities exchange. Over-the-counter is mainly a market made over the telephone. Thousands of companies have insufficient shares outstanding, stockholders, or earnings to warrant application for listing on a stock exchange. Securities of these and other companies are traded in the over-the-counter market between brokerage concerns who act either as principals or as brokers for customers. The over-the-counter market is the principal market for United States Government bonds and municipal securities.

Over-the-window. The direct delivery of securities between two brokerage concerns, excluding the clearing-house facilities. Delivery is made by hand to the receive window of the broker and is said to be "over-the-window."

P. & S. department. Abbreviation for Purchase and Sales Department.

Pair off. Sometimes it occurs that two brokerage concerns each owe one another the same number of shares of the same security. Instead of actually receiving the security and delivering it back again they will "pair off" the transaction by giving or receiving a check for the difference in price, or by exchanging checks for the full amount of each side of the transaction.

Papers. A term sometimes given to put and call options.

Payable date. The date on which a dividend is payable to holders of record as of some previous date.

Pink sheets. A listing of over-the-counter securities published on pink paper by the National Quotation Bureau. It shows the most recent bid and asked prices for the securities listed, as well as the broker-dealers making a market in those securities. While pink paper is used for stock quotations the definition also applies to listings of bond quotations, etc., which are printed on papers of different color.

Point. When used in connection with the purchase or sale of stocks, means a rise or decline of $1.00 per share. When used in connection with the purchase or sale of bonds means a rise or decline of $10.00 per $1,000 principal amount.

Point balance run. A listing of each future commodities contract by month of contract on which the extended contract value and market value are indicated, together with the resulting gain or loss.

Position. This term is used in referring to the securities "long" or "short" in an account or in the stock record.

Position record. *See* Stock record.

Post. A booth or trading location on the floor of a stock exchange at which securities assigned to that location are traded.

Price-earnings ratio (P.E.). The market value of a stock divided by its earnings per share.

Primary distribution. The original offering to investors of securities that have never before been issued.

Principal. A dealer who buys or sells securities for his own account acts as a "principal." Also, a customer is the "principal" of the broker who executes his order.

Private placement. The direct sale of a block of securities, either a new issue or a secondary issue, to a single investor or group of investors. This is usually accomplished through an investment banker.

Proprietary accounts. This term includes capital accounts of partners or sole proprietor, investment and trading accounts, participation in joint accounts, accounts of partners which are covered by approved agreements providing for the inclusion of equities therein as partnership property, and borrowings covered by subordination agreements approved by regulatory bodies.

Proxy department. A division of the Operations Department that helps corporations communicate with their stockholders in cases where stock certificates are in street name.

Proxy statement. A document containing specified information that must be sent to stockholders at the time they are asked to sign proxies for a meeting of stockholders.

Purchase and Sales department. A division of the Operations Department that is concerned with the preparation of customers' confirmations of security transactions and the comparison of such transactions with other brokerage concerns.

Put option. A contract which entitles the holder to sell (put), entirely at his option, a specified number of shares of a particular security at a specified price anytime until the stated expiration date of the contract. Such an option (which is always for a round lot amount and which is transferable), is bought with the expectation of a price decline below the contract price. If the price decline occurs, the purchaser will exercise the option. If the decline does not occur, he will let the option expire and will lose only the cost of the option. During the existence of the option the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights, and stock dividends or splits.

Puts and calls. Options to sell (put) or buy (call) securities within a specified period of time at specified prices. *See* Put option and Call option, Straddle, Strip, and Strap.

Quote. The price of a security. It may be the price of the last sale made on an exchange or the current bid and asked price.

Receive and deliver department. A division of the Operations Department responsible for the physical receipt and/or delivery of incoming and outgoing securities. Often it is also responsible for the daily balancing of cash entries made by the various operations departments.

Record date. The date on which the stockholder's name must be registered on the books of a company in order to receive a declared dividend or, among other things, to vote on company affairs.

Registered owner. The owner of a security whose name is recorded on the face of the certificate and on the books of the issuing corporation or its agent.

Registered representative. Name given to a salesman in a brokerage concern. Salesmen are registered with the exchange of which the brokerage concern is a member.

Registrar. Usually a trust company or bank charged with the responsibility of preventing the issuance of more stock than that authorized by the issuing company.

Regular-way delivery. Unless otherwise specified, securities (other than government's) are to be delivered to the buying brokerage concern by the selling brokerage concern and payment made on the fifth business day after the transaction. Regular-way delivery for government bonds is the business day following the transaction.

Regulated commodity. Commodity which is regulated by the Commodity Exchange Act.

Regulation T. The name for Federal Reserve Board's regulation governing the amount of credit that brokers and dealers may extend to customers who buy securities.

Regulation U. The name for Federal Reserve Board's regulation governing the amount of credit that banks may extend to customers who borrow money to buy securities on margin.

Reorganization department. A division of the Operations Department that processes securities involving corporate reorganizations, mergers, consolidations, subscriptions and the exchange of convertible securities into common stocks.

Repurchase agreement. An agreement whereby the seller of securities agrees to repurchase the securities within a specified time at a specified price.

Restricted account. Means that a broker may not buy securities for a particular customer for a specified period of time unless the customer has on deposit enough money in his account to pay for the securities before his orders are executed.

Reverse split. Opposite of stock split.

Rights. The privilege offered by a corporation to its stockholders to subscribe to certain securities at an advantageous price.

Round lot. A unit of trading or a multiple thereof. On the New York Stock Exchange the unit of trading is generally 100 shares in stocks and $1,000 par value in bonds.

Round turn. A purchase and a subsequent sale or a sale and subsequent purchase of a future commodity contract.

S.C.A. Abbreviation for subsequent coupons attached.

Safekeeping. A position on the Stock Record (Street Side) indicating securities that have been fully paid for by customers and are being held by the brokerage concern under custody arrangements. These securities are generally in the name of the customer.

Safekeeping box. Box in which fully paid for securities of customers are kept.

Scrip. A certificate issued to stockholders of a corporation which may be exchanged for fractional shares of stock or the equivalent in cash by a fixed date. Scrip is usually issued in connection with a stock dividend or a stock split.

Seat. The popular name for a membership on a stock exchange.

Secondary distribution. The sale of a large block of securities (other than an initial issue of a corporation). It is usually the holdings of a large individual stockholder or an estate that are being liquidated.

Secondary offering. An offering of large blocks of listed securities outside of the exchange on which they are listed.

Securities and Exchange Commission (S.E.C.). An agency established by Congress to administer Federal securities laws.

Securities borrowed. *See* Borrowed.

Securities bought but not received. A liability account used by brokerage concerns which act principally as underwriters or dealers to record purchases as of the trade date rather than the settlement date.

Securities Investor Protection Corporation (S.I.P.C.). A corporation established for the purpose of protecting customers of broker-dealers in financial difficulty.

Securities loaned. *See* Loaned.

Securities not readily marketable. This term refers to (a) securities, except exempted securities, for which there is no market on a securities exchange or no independent publicly quoted market, (b) securities which cannot be publicly offered or sold unless registra-

tion has been effected under the Securities Act of 1933 (or the conditions of an exemption such as Regulation A under Section 3(b) of such Act have been complied with, and (c) securities which cannot be offered or sold because of other arrangements, restrictions or conditions applicable to the securities or the brokerage concern.

Securities sold but not delivered. An asset account used by brokerage concerns which act principally as underwriters or dealers to record sales of securities as of the trade date rather than the settlement date.

Segregation. A position on the Stock Record (Street Side) indicating customers' fully paid for or excess margin securities which are subject to the customers' instructions and which have been set aside. These securities are generally in the name of the brokerage concern. (*See* Bulk segregation.)

Segregation box. Box in which are kept segregated securities.

Sell out. Action taken by a broker to liquidate an account or transaction for failure to maintain proper margin or make timely payment.

Sellers' option. Transaction which by agreement is to be settled at a date later than the usual regular way transaction.

Selling against the box. This is similar to a "short sale" except that the seller already owns the stock being sold but keeps possession of it and so has to borrow the equivalent stock with which to make delivery to the purchaser.

Selling group. A group of brokerage concerns which have formed a joint account for the sale of securities. Usually in connection with an underwriting.

Service bureau. A data processing center which processes transactions of brokerage concerns. These centers are located away from the brokerage concern's office.

Settlement date. The date on which security transactions are to be settled by the delivery or receipt of securities and the receipt or payment of cash.

Settlement price. The price at which a security or commodity is to be settled. Used primarily in connection with clearing house operations.

Short. A Stock Record position (Street Side) which represents location (such as box, transfer, etc.) or due from (such as failed to receive, owed to the brokerage concern by a customer on account of a short sale, etc.).

Short against box. *See* Selling against the box.

Short covering. Refers to the purchase of securities so that stock

previously borrowed to make delivery on a "short" sale may be returned.

Short sale. A sale of securities by a customer which requires the borrowing of equivalent securities to make delivery to the purchaser.

Signature guaranteed. In order that a registered security may be a good delivery on the exchange or a good transfer the signature of the registered owner must be properly guaranteed. The guarantee of a stock exchange firm or a bank is usually considered sufficient guarantee.

Special offering. The sale of a large block of securities on the floor of the stock exchange. The sale is made in accordance with special procedures worked out by officials of the exchange.

Specialist. A broker who is a member of an exchange and who operates on the floor of the exchange to execute transactions and to maintain an orderly market in certain specified securities.

Split. The action of increasing the number of outstanding shares of stock of a company so as to decrease the market price and afford a greater distribution of the shares, i.e., two shares for each share held will have the effect of reducing the price of the shares by one half.

Spot commodity. A contract for the future delivery of a commodity. In these cases the commodity is evidenced by a warehouse receipt.

Spread. A combination of a "put" and "call" option at different prices; one below and the other above the current market price. Also refers to the difference between the bid and ask prices of a security.

Stock Clearing Corporation (S.C.C.). A subsidiary of the New York Stock Exchange which acts as a central agency for security deliveries and money payments between member firms of the exchange.

Stock dividend. A dividend payable in stock of the issuing corporation.

Stock power. A legal document used in lieu of the assignment section of a stock certificate. It cannot be used on a bond certificate.

Stock record. The record of individual securities on which both the "long" and "short" positions are shown; the total of the "long" positions and the total of the "short" positions being in balance.

Stock record department. A division of the Operations Department that keeps up-to-date records of all securities positions.

Stock split. A method used by corporations to increase the number of shares of its stock outstanding but without changing each stockholder's interest in the corporation. Usually accomplished by reducing the par value, or stated value, of the stock.

Stockholder of record. A stockholder whose name is registered on the books of the issuing corporation.

Stop order. Also called a stop loss order. An order used by a customer to protect a paper profit in a security or to keep down a possible loss in a security. The stop order becomes a market order when the price of the security reaches, or sells through, the price specified by the customer.

Straddle. A combination of one put and one call, identical with respect to the security issue, number of shares, exercise price and expiration date.

Strap. A combination of two calls and one put for the same security issue.

Street. A term of reference for brokerage and other financial business concerns.

Street item. A transaction or account between brokers (e.g., "failed to receive," "failed to deliver," "stock loaned," and "stock borrowed").

Street name. Securities held in the name of a brokerage concern instead of in customers' names are said to be carried in "street name."

Strip. A combination of two puts and one call for the same security issue.

Subscription. The offer to purchase a certain offering, as a certain number of shares of the stipulated stock or principal amount of bonds for a stipulated amount of money. Such offer is not binding unless accepted by the proper authorized representatives of the issuing corporation.

Subordinated account. An account which is subordinated to the claims of general creditors of the brokerage concern.

Substitution. The act of withdrawing securities from a bank loan and substituting other securities of approximate equal value.

Suspense account. An account used to record securities and/or monies that cannot be immediately identified and cleared; reclamations, D.K. items, bad deliveries, etc.

Syndicate. A group of brokerage concerns who together underwrite and distribute new issues of securities or large blocks of an outstanding issue.

T.A.D. An abbreviation of transfer as directed.

Take-off. Sometimes referred to as a "Daily Activity List." A daily record showing the net changes in each security. A separate record is prepared for each security and the information is used to post (update) the Stock Record. Also a record of the "long" and "short"

positions in a security on the record date which is used by the dividend department to make the appropriate dividend entries.

Tax stamp. A rubber stamp facsimile (in some instances a documentary stamp) affixed to a certificate to indicate that all applicable transfer taxes for the item have been paid.

Ticker. An instrument that prints the price at which a security has been traded on an exchange within minutes after the trade is executed.

Time loan. A loan having a definite date of maturity and a specified rate of interest for the entire period.

Trade. A term that indicates the consummation of a security transaction, either a purchase or a sale.

Trade date. The date a security transaction is actually executed.

Trader. An employee of a brokerage concern who executes orders in the over-the-counter market for customers. Also means a person who buys or sells securities for his own account for short-term profit.

Trading post. Another name for Post.

Trading unit. The unit by which the security is traded on the exchange. Usually 100 shares of stock or $1,000 principal amount of bonds (round lot).

Transfer. Usually refers to the act of changing the ownership of registered securities on the books of the issuing corporation.

Transfer agent. A transfer agent keeps a record of the name of each registered shareholder, his or her address, the number of shares owned and sees that certificates presented to his office for transfer are properly cancelled and new certificates issued in the name of the transferee.

Transfer department. A division of the Operations Department that matches, processes and controls securities being transferred.

Two-dollar broker. A name given to a member of an exchange who executes orders for other brokers on that exchange.

Underwriting. The act of distributing a new issue of securities or a large block of issued securities, i.e., a secondary offering.

Undivided liability. An arrangement whereby each member of an underwriting syndicate is liable for his proportionate share of unsold securities in the underwriting account regardless of the number of securities which he has previously sold.

Unit record. A term applied to a data processing system which utilizes only punch cards.

Unlisted security. A security which is not listed on an exchange.

Value date. Same as settlement date.

Valued stock record. The stock record at examination date with each security position other than those in segregation and safekeeping are assigned a price. Active quantities within the position are valued at the assigned price.

Variation margin. A term used in commodity operations. Refers to last day point fluctuation—difference between prior days settling price and last day settling price—on net positions "long" and "short."

Warrants. Rights to purchase additional securities. Usually affixed to the certificate at the time securities are originally issued. Also refer to document evidencing rights, i.e., a warrant for 125 rights.

When distributed. Refers to the distribution of new securities. Transactions are sometimes entered into on a "when distributed" basis before the distribution takes place.

When issued. A short form of "when, as and if issued." The term indicates a conditional transaction in a security authorized for issuance but not yet actually issued. All "when issued" transactions are on an "if" basis to be settled if and when the actual security is issued and the exchange or National Association of Security Dealers rules that the transactions are to be settled.

Window. A term applied to a place in the office of a brokerage concern where securities are actually received or delivered.

Window ticket. A term applied to a document given to the brokerage house by a transfer agent as a receipt. Also applies to a transfer document originating with the brokerage concern (broker originated window ticket).

Wire house. A brokerage concern that has a network of communications (telephone or teletype) that link the main office to branch offices and offices of correspondent brokerage concerns.

Wire room. Another name for the order room.

Yield. The return on investment that an investor will receive from dividends or interest. This is expressed as a percentage of the current market price of the security, or, if the investor already owns the security, of the price he paid. The return on stocks is figured by dividing the total dividends paid in the past calendar year by the price of the stock. The return on bonds is figured by dividing the interest by the price of the bond.

INTRODUCTION TO

Brokerage Operations Department Procedures

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INTRODUCTION TO

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Preface

Our purpose in writing this book is to explain, in simple form, that most complicated area known as the brokerage industry's operations function.

A firm base is first established. Early chapters are devoted to an explanation of corporate structure, an overview of the securities industry, the difference between listed and unlisted trading—and the basic types of equity and debt securities. Only then does the author begin to paint in the picture of the many departments involved when a customer's order is entered and executed.

The sequence is logical and, as closely as is practicable, "follows" an order for securities from its inception through to its final payment and delivery. While this work has been designed as a primer for the newer brokerage firm employee, we are confident that it will also be valuable to *anyone* who wishes to learn about this fascinating aspect of the brokerage business.

Readers should find the glossary at the end of this book to be especially helpful.

BENJAMIN F. RUSSELL
President
New York Institute of Finance

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INTRODUCTION TO

brokerage operations department procedures

Introduction

This book is directed to you, an employee of a securities house. Its purpose is to help you understand and learn the work that is performed in the several divisions of the Operations Department of a securities house. The term "securities house," as used throughout this book, means any individual or organization that holds itself out as ready to buy and sell securities for members of the general public.

The Operations Department plays a very important role in the securities industry. The failure of this Department to perform its functions properly can cause a breakdown in the services that a securities house renders to its customers. It can also mean a loss of many thousands of dollars to the securities house.

The several divisions that make up the Operations Department are interrelated. A breakdown in the work of any division means a breakdown all along the line. Thus, to better perform your job, you must know how it fits in with the work of the other divisions.

However, before you attempt to learn the work of the Operations Department, you should know something about securities and the securities industry itself. For that reason, we have devoted one part of this book to a basic examination of the kinds of business organizations, particularly the organizations that issue

securities to the public. Also, it explains different kinds of securities and the securities industry. This is then followed by a detailed explanation of the several divisions of the Operations Department, the functions of each division and how they are performed.

YOU AND YOUR JOB

Study carefully the Work Flow Chart on page 3. Look at the number of steps involved in handling just one customer's order. Now multiply that by several hundred orders or, perhaps, a few thousand. You do not have to be an expert in the work of the Operations Department to understand the importance of each step and of each job.

Bear in mind that the securities business is a *service* business. The success of any securities house depends on the speed and accuracy with which it services its customers. Many factors influence the customer in selecting the securities house with which he places his orders. Among these are: How quickly his order is executed. How quickly he receives his securities, if he is purchasing. How quickly he receives his money, if he is selling. And, of course, a big factor is the accuracy with which the transaction is handled.

THE IMPORTANCE OF ACCURACY

Take another hard look at the Work Flow Chart. See how the steps keep pyramiding. An error anywhere along the way means the error will be carried through the steps that follow. And a customer may take his business elsewhere because of an error. Even if he does not, an error can still be costly.

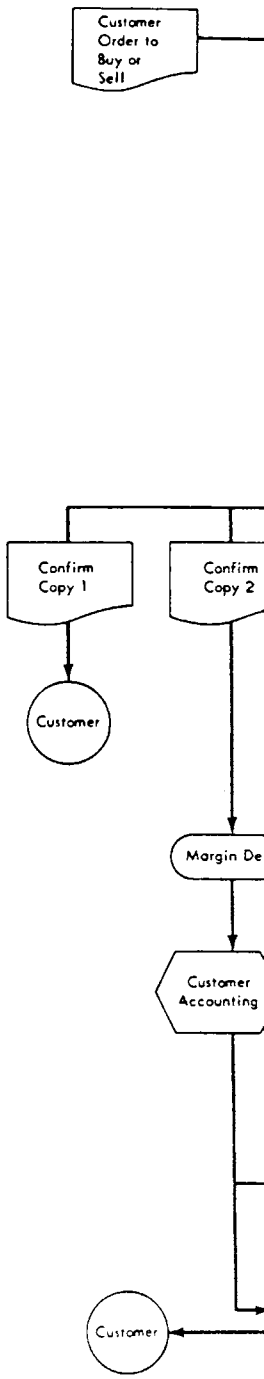


Figure 1 *Reprinted by*

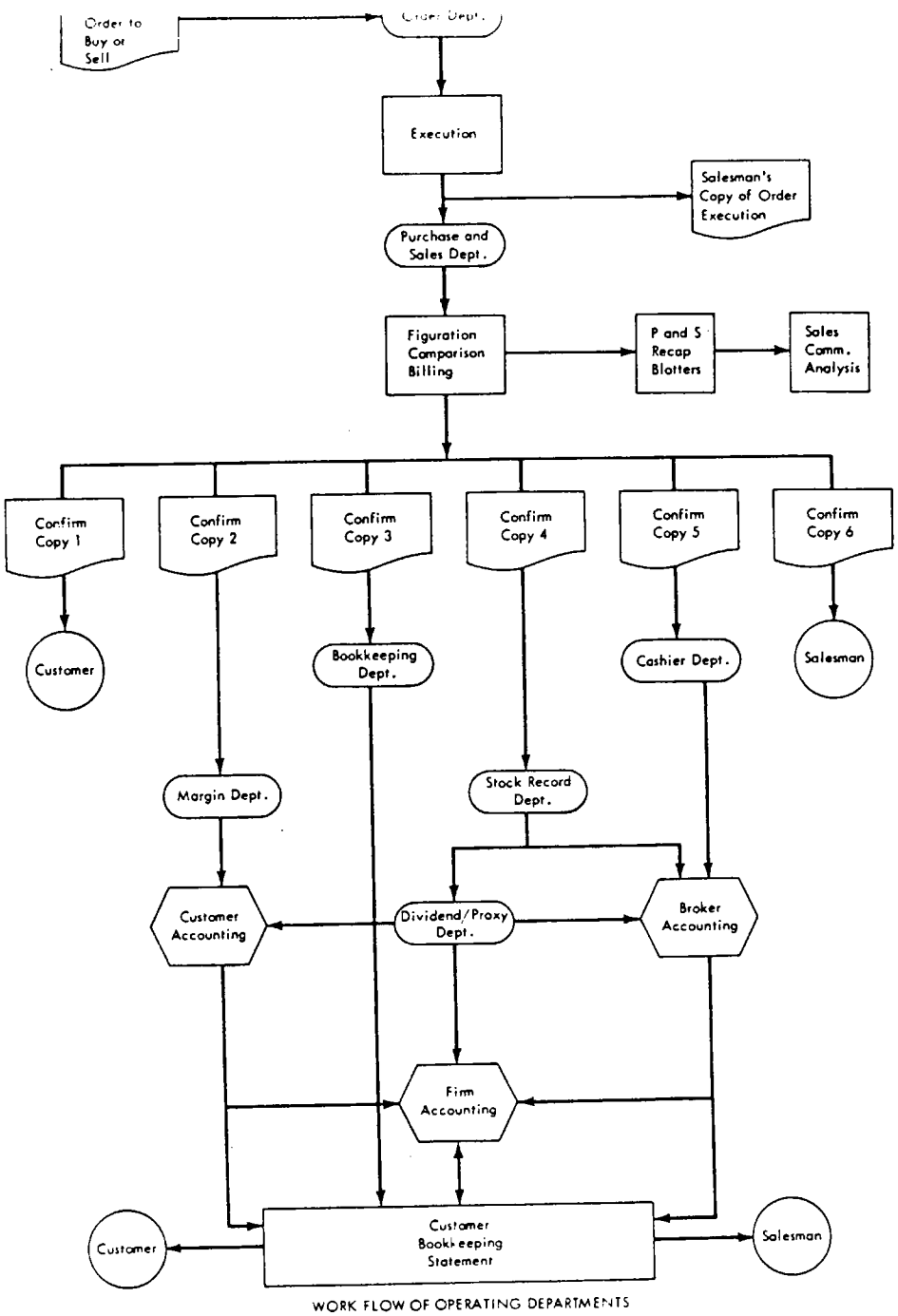


Figure 1 *Reprinted by permission of M. G. Mastrangelo.*

To illustrate:

A customer places an order with your firm to buy "100" shares of stock. An error is made in one of the departments handling the transaction. Let us take a look at just one of the many possible consequences of that error.

Instead of executing the order to buy "100" shares, the order goes through to buy "10" shares. Result: A new order to buy "100" shares must be entered and executed. Meanwhile, your firm owns "10" shares of stock that it doesn't want and that it now has to sell. If the price of the stock has gone up, then the customer may demand the difference between the price at which the "100" shares should have been bought and the price at which it was bought. Your firm will most likely credit the customer's account for this difference. But, though your firm may make a small profit on the sale of the "10" shares, this will not be enough to make up for the credit to the customer's account. In addition, there is the dollars–and–cents cost involved in making the necessary corrections. This can wipe out the commission on the trade.

Business

There are three basic forms of busi
proprietorship, the partnership, and the
important for our purposes is the c
corporation issues securities that are tra
publicly. Before discussing the corporati
other two forms of business organization.

The proprietorship is the earlies
business organization; it is also the s

A *proprietorship* is a business owne
who is called the *proprietor* or
businesses—like a shoe repair shop
dry cleaner—have only one owner.
usually operated as proprietorships.

A person who wants to do business
does not have to have legal papers
he usually have to pay any organiza
he may have to pay a license tax to b

As a proprietor, the owner has sc
operation and management of the b
business is successful, all of the prof

On the other hand, if the business l
into debt, the owner is responsible

Forms of Business Organization

ere are three basic forms of business organization—the prietorship, the partnership, and the corporation. The most portant for our purposes is the corporation. Only the poration issues securities that are traded (bought and sold) olicly. Before discussing the corporation, let us examine the er two forms of business organization.

THE PROPRIETORSHIP

e proprietorship is the earliest known form of siness organization; it is also the simplest.

proprietorship is a business owned by only one man, o is called the *proprietor* or owner. Many small sinesses—like a shoe repair shop and a neighborhood y cleaner—have only one owner. These businesses are ually operated as proprietorships.

person who wants to do business as a proprietorship es not have to have legal papers drawn up. Nor does usually have to pay any organization fees. However, may have to pay a license tax to begin business.

a proprietor, the owner has sole control over the eration and management of the business. And, if the siness is successful, all of the profits belong to him.

the other hand, if the business loses money and goes o debt, the owner is responsible for the payment of

these debts. This responsibility is called the *owner's liability.* And in a proprietorship, the owner's liability is unlimited.

To illustrate:

John Jones gets together $5,000 and opens a small retail store. However, the business loses money and is finally $9,000 in debt. Because the business is a proprietorship, John Jones has unlimited liability for the debts of the business. In other words, he has to pay the entire $9,000 debt. Jones must pay, even if it means selling his home, his car and other property. What is more, he has to pay the whole debt, even though he invested only $5,000 in the business to begin with.

A proprietorship is so much a one—man business that the proprietor himself is the business. If he dies or leaves the business, the business will end. And, though a new proprietor may take over after the former owner dies or leaves the business, legally, the business does not continue. A new owner creates a new proprietorship.

Lastly, there's the question of raising *capital*—that is, money used to start the business and to keep it going. Businesses use capital for such things as to pay rent on space in which to operate, to hire workers and pay their salaries, and to buy supplies. Some types of business organizations find it easier to raise capital than others. As business organizations go, the proprietorship probably is least able to raise capital. Usually, in a proprietorship the capital is limited to that which the owner himself can provide, plus what he can borrow on his personal credit.

THE PARTNERSHIP

Two or more persons who carry on a business as co—owners are called *partners.* The business they own is

called a *partnership.* There are several kinds of partnerships. However, here we shall only talk about the general partnership—the most common form of partnership.

Like the proprietorship, the partnership form of business organization has certain disadvantages. For example, each partner is jointly and severally responsible along with the other partners for the debts of the partnership.

To illustrate:

> Mr. A and Mr. B form a partnership. The partnership incurs debts of $10,000. Mr. A and Mr. B are each individually responsible for payment of these debts. If the business does not have the $10,000, Mr. A and Mr. B themselves must pay the debts. They may be forced to sell their homes, automobiles and other property to raise money to do so.

A partnership also has a limited life. Thus, a partnership will usually end on the death or withdrawal of one of the partners. It will also end, if the agreement between the partners ends and is not renewed.

Because of its limited life, it is difficult for a partnership to raise capital. Normally, the capital of a partnership is limited to the amount that the partners can contribute or that they can borrow.

THE CORPORATION

As we have seen, the proprietorship and its owner are one and the same. The general partnership and its partners are also one and the same. Thus, if you want to sue a proprietorship, you sue the owner. And, if you want to sue a general partnership, you bring your action against the partners. But, if you want to sue a

corporation, you bring your action against the corporation.

A *corporation* is separate and distinct from its owners, who are called *stockholders* or *shareholders.* In other words, a corporation is an artificial being created under the laws of a state.

The legal entity (being) concept gives the corporation many advantages not enjoyed by the proprietorship or the partnership. One advantage is that a corporation may enjoy a continuous existence: If one or even all of the owners sell their shares, it will not end the corporation's life; the corporation will still continue.

Another advantage is that the stockholders in a corporation have a limited liability. Usually, this liability is limited to the amount of the stockholder's investment in the corporation.

To illustrate:

> You invest $5,000 in the common stock of a corporation. Later, the corporation goes bankrupt. You may lose your $5,000; but usually that is all you will lose. The corporation may have debts of thousands, even millions of dollars. However, as a stockholder, you will not be responsible for paying these debts.

A major advantage in doing business as a corporation is the ability to raise large amounts of capital. This the corporation can do either through the sale of stock (ownership interests) or of bonds (debt securities), or both. The people who buy these stocks and bonds can then sell them either on a stock exchange or in the over–the–counter market. (We discuss this in more detail in later chapters.)

The stockholders of a corporation do not themselves manage the business of the corporation. Instead, these

shareholders elect directors who set policy. The directors, in turn, appoint officers (a president, treasurer, secretary) who run the business in line with the policies set by the directors.

QUICK REVIEW

A business owned by only one man is called a *proprietorship.* A business organized for profit by two or more persons is called a *partnership.* A business that is created under the laws of the state and that issues shares of ownership (shares of stock) is called a *corporation.*

The proprietorship and the partnership each have a *limited* life. But the owners—the proprietor or the partner—each have *unlimited* liability or responsibility for the debts of the business. A corporation, on the other hand, may have continuous existence, or life. This is because it is a legal entity (being), separate and distinct from its shareholders. Also, the shareholders of a corporation have a *limited* liability. Their liability is usually the amount they have invested.

Lastly, the capital of a proprietorship, as well as that of a partnership, generally consists of money contributed by the owner or partners, *plus* any other funds they may be able to borrow. The corporation, however, is better able to raise capital. One way it does this is to sell shares of stock; another way is to sell its bonds.

The Securities Industry

The securities industry consists of the stock exchanges, the over–the–counter market, and the brokers and dealers who trade on these markets. It has played a very important role in the growth of American business. By providing a market for the purchase and sale of stocks and bonds, the industry has made investment in these securities more attractive to the public. This, in turn, has made it possible for corporations to sell their stocks and bonds to the public and so raise capital for new plants and equipment and for other purposes.

Let us take a look at the securities houses (broker and dealer firms) and their functions. Most securities houses are organized as partnerships or corporations. Some do business as proprietorships.

KINDS OF SECURITIES HOUSES

Securities houses are generally classified according to the kind of business they do.

The Member Firm

The member firm, also called a brokerage firm, gets its name from the fact that it is a member of an organized stock exchange, for example, the New York Stock Exchange, or the American Stock Exchange. The business of a member firm is to buy and sell securities for its customers on the stock exchange of which it is a member.

The Investment Banking Firm

The business of this firm is to distribute securities to the public. It does this by buying newly issued securities from the corporation. Then it sells these securities to the public at a price that includes the firm's profit. Another name for the investment banking firm is *underwriter.*

The Over–the–Counter Firm

This firm does *not* buy and sell securities on a stock exchange. Instead, it buys and sells securities *over–the–counter.* The purchase and sale of securities in a place other than on a stock exchange is known as *over–the–counter trading.* And firms that do this kind of trading are known as *over–the–counter firms.*

Many securities houses do business in all three areas. Thus, the same firm may execute orders for customers on a stock exchange or in the over–the–counter market. It may also act as an underwriter for newly issued securities.

THE DIFFERENCE BETWEEN A BROKER AND A DEALER

A *broker* is an agent; he buys and sells for the account of his customers. The broker's compensation is the commission that is paid to him by the customer for his (the broker's) services. For example, let us assume that you want to sell your home. You can go to a real estate broker and ask him to find a buyer. If he is successful, you pay him a commission for his services.

The same is true when you place an order with a broker to buy or sell a security. You are hiring the broker to act as your *agent.* When the trade is executed, he will charge you a commission for his services.

A member firm usually acts as a broker. The commission a member firm charges for executing an order is based on the quantity of shares or dollar amount of the transaction. The customer pays a commission when he buys a security and again when he sells it.

A *dealer,* on the other hand, buys and sells securities for his own account. He then tries to sell the securities to others at a higher price than he paid when he bought them. Because of this, we say that a dealer acts as a *principal.*

The dealer does not charge his customers a commission. Instead, he takes a *markup.* This markup is the difference between the price the dealer has paid for the security and the price he sells it for. Generally, the markup will not be more than 5% of the price the dealer paid for the security—often, it will be less.

To illustrate:

You want to buy 100 shares of XYZ common stock. The stock is traded in the over-the-counter market. You could go to an over-the-counter firm and give the firm your order. The firm is able to buy the stock at $41 a share, or a total of $4,100 for the 100 shares. The firm might then sell the stock to you for $42 a share, or a total of $4,200. The difference between the price the firm paid for the stock ($4,100) and the price it sold the stock to you for ($4,200) is the markup. In this example, the markup would be $100—($4,200—$4,100).

Many member firms also trade in the over-the-counter market. Some of these firms may execute orders in the over-the-counter market as a broker. When they do, they will *not* take a markup; instead they will charge their customers a commission for their services. This commission is often the same as that which the member firm would charge for executing the order on a stock exchange.

THE UNDERWRITER

You have already learned that the function of an investment banking firm—underwriter—is to sell newly issued securities to the public. In other words, the investment banking firm helps corporations raise capital needed for the expansion of their plants and for other purposes.

In performing this function, the underwriter may act either on a *firm commitment* basis or on a *best efforts* basis. When acting on a firm commitment basis, the underwriter is acting as a dealer. That is, the underwriter has agreed to buy the entire issue from the corporation, at a specified price, in the hope that it can sell the securities to the public at a higher price, or markup.

When the underwriter agrees to sell the securities on a *best efforts* basis, it is also acting as a dealer. Here, however, the underwriter is not committed to buy the entire issue from the corporation. Instead, it has merely agreed to use its best efforts to sell the securities. In other words, the underwriter has to buy from the corporation only those securities it is able to sell.

MULTISERVICE FIRMS

Some firms are not restricted to a particular facet of the industry. These firms are known as multiservice organizations. They may offer their customers brokerage facilities for listed trading, principal positioning for OTC customer trades and syndicate participation. The firm's expertise and product mix will determine which service or services they will offer to their customer base.

REGULATION OF THE SECURITIES INDUSTRY

Both the federal government and the states regulate the activities of the securities industry.

Federal Laws

These laws regulate the sale of securities and the conduct of business in the securities market. The federal

laws are administered by the Securities and Exchange Commission (SEC) and the Federal Reserve Board (FRB). FRB regulates margin lending; its rules fix the maximum amount of credit a securities house may give to its customers for the purchase of securities.

SEC regulates all other activities. For example:

1. Before a corporation can first offer its securities for sale to the public—either directly or through an underwriter—the corporation must give the SEC much detailed information.

2. A stock exchange cannot do business unless it is registered with the SEC. Registration means supplying the SEC with detailed information about the exchange's rules and procedures and about its ability to supervise the activities of its members.

3. Before it can do business in the over—the—counter market, a securities house must register with the SEC as a broker—dealer. Here, registration means filing detailed information with the SEC, including the background of the firm's partners or stockholders, their education and experience, and financial information. The registration must be approved by the SEC. Thereafter, if the firm commits any infraction of the rules, SEC may suspend or revoke its registration.

State Laws

State securities laws—more commonly known as *blue sky laws* also regulate the sale of securities and the ways in which the securities houses conduct their business in the state. Most blue sky laws are similar to the federal laws. However, blue sky laws are generally stricter.

The federal laws provide for disclosure of relevant information. State blue sky laws, on the other hand, are *permit,* or *licensing,* laws. The state administrators have

broad authority to deny registration for a wide variety of reasons.

QUICK REVIEW

Securities houses may be organized either as partnerships or corporations. These firms may be classified as (a) member firms, (b) over–the–counter firms, (c) investment banking firms, or (d) a combination of these functions.

A securities house that buys and sells for its customers securities traded on a stock exchange is called a *member firm,* or brokerage firm. It is a member firm because a partner (or stockholder) is a member of the particular stock exchange. A member firm acts as the broker, or agent, of the customer; it charges the customer a commission for its services.

An *over–the–counter firm* is a securities house that buys and sells securities for customers on the over–the–counter market. The over–the–counter firm does business as a *dealer*–that is, the firm buys and sells for its own account. Instead of charging a commission, the firm takes a *markup*–this is the difference between the price the firm pays for the security and the price at which it can sell the security to the customer. Many member firms also execute orders in the over–the–counter market. Some of these firms, however, may act as a broker and charge a commission for their services.

An *investment banking firm,* or underwriter, helps corporations raise capital through the sale of their securities to the public. When the underwriter agrees to buy the entire issue from the corporation, we say this underwriter has entered into a *firm commitment.* However, when the underwriter has not agreed to purchase the entire issue, but only to try to sell the securities for the corporation, we say the underwriter has entered into a *best efforts* arrangement.

The securities industry is regulated by both the federal government and the states. The federal rules are administered by the Federal Reserve Board and by the Securities and Exchange Commission (SEC). Among other things, federal regulation requires the filing of detailed information with the SEC.

The state blue sky laws also require the filing of detailed information; but, unlike the federal laws, the state blue sky laws give the administrators broad power to grant or deny a license to sell securities.

The Stock Exchanges

The chief markets for trading in securities in this country are the organized stock exchanges and the over–the–counter market. We call the exchanges *stock exchanges,* even though both stocks and bonds are traded there. The two major stock exchanges are the New York Stock Exchange and the American Stock Exchange. In this lesson we will study these two exchanges, their organization and how they operate.

In the last chapter, you read that a stock exchange must register with the Securities and Exchange Commission (SEC). This is a federal agency that supervises trading and other activities in the securities markets. Thirteen stock exchanges are registered with the SEC. There are several smaller exchanges in the United States, but these do not have to register with the SEC.

WHAT IS A STOCK EXCHANGE

A *stock exchange* is a private association of brokers. The main purpose of an exchange is to provide a central meeting place for its member–brokers. This central meeting place is often called the *floor.* Here, the brokers, called *members,* can trade in securities.

Usually, the brokers trade in securities for the accounts of their customers. However, as we shall see, some members also trade for their own account.

It is important to remember that a stock exchange itself does not own any of the securities that are traded on its floor. Nor does the stock exchange itself buy or sell any of the securities traded on the exchange. Instead, the securities are owned either by the exchange's members or by their customers.

It is also important to remember that a stock exchange does not establish (fix) the price at which any security is traded on the exchange. The price is determined in a free and open auction type of trading. It depends on the demand for a security and the supply of that security at a particular time. In other words, if sellers of a stock are offering to sell more shares of that stock than buyers want to buy, the price of that stock will tend to go lower. On the other hand, if buyers want to buy more shares of a stock than sellers are offering to sell, the price of that stock will tend to go higher.

THE NEW YORK STOCK EXCHANGE

The New York Stock Exchange is the largest of the organized stock exchanges. It is popularly called the Exchange or the Big Board. The Exchange is located in downtown New York City. It is in the financial district, at Broad and Wall Streets.

The Exchange was started in 1792. It was organized by a group of 24 stock brokers who signed the Buttonwood Tree Agreement. These brokers met daily under a buttonwood tree on Wall Street at regular hours. They came to buy and sell securities.

In the early days, these brokers traded in public issues, like United States Government bonds and New York State bonds. Later, as private businesses were organized and issued securities, the brokers traded in these securities. Today, the securities of over 1,400 companies are traded on the New York Stock Exchange.

The Administration of the New York Stock Exchange

In its early days, the Exchange was small and easy to run. But as time went on, the amount of securities traded on the Exchange kept increasing. The administration or management of the Exchange has now become a complex operation.

Before 1938, the administration of the Exchange was in the hands of a governing committee. Those who served on this governing committee had to be members of the Exchange. They were elected to the committee by their fellow Exchange members.

Besides the governing committee, there were several permanent committees. These committees helped the governing committee run the Exchange. The Exchange also had a president. He, too, was a member of the Exchange. He was elected to his office by the other members. The Exchange's president was not paid for carrying out his duties.

Beginning in 1938, the Stock Exchange made major changes in its management. All important decisions are now made by a Board of Directors. This Board is made up of Exchange members, allied members, and even some nonmembers. Also, the Exchange decided to hire a president to carry out the decisions of the Board of Directors. The president is paid a salary for heading the Exchange. The man chosen president cannot be a member of the Exchange.

Among its powers, the Board of Directors decides which securities may be traded on the Exchange. Securities approved by the Board are said to be *listed* for trading on the Exchange. Once they are listed, the securities may be traded (bought and sold) on the floor of the Exchange by the members.

The Board of Directors may, however, delist a security. To *delist* a security means that the security can no longer be bought and sold on the floor of the Exchange by the members. Or the Board may *suspend* trading in a security. This means the members, can *not* trade in the security on the floor for a period of time.

The Board has the right to examine the way in which Exchange members and member firms conduct their business. It may also look into their financial condition. Most importantly, the Board has the right to punish members for violations of the Exchange's rules. It may make the member pay a fine. Or it may not allow him to trade on the Exchange for a certain period of time. And, if the violation is a very bad one, the Board may expel the member, that is, take away his membership.

Membership in the Stock Exchange

Only individuals can become members of the Exchange. And only members can buy and sell securities on the floor. A member of the Exchange is known as a *broker.* He is sometimes called a *floor broker.*

A member of the Exchange can get together with other persons and organize a *brokerage firm,* or *member firm.* To do this, he must get the approval of the Exchange.

And the Exchange will not give its approval unless all persons meet its standards, or requirements.

The member firm can be a partnership, in which case the Exchange member must be a partner. The member firm also can be a corporation. If it is a corporation, the broker must be a voting stockholder and director of the corporation. The other persons who join with the Exchange member to organize the member firm become *allied members* of the Exchange.

The member firm can accept orders to buy and sell for its customers securities listed for trading on the Exchange. Usually, these orders will be executed by the firm's own broker. If he is too busy or is not available, however, the order can be executed by another broker.

Requirements for Membership

The New York Stock Exchange has very high standards, or requirements, for membership. *The reasons:* (1) All trading on the floor is oral, by word of mouth. Brokers do not make any written agreements. (2) The member firms handle tremendous amounts of money and securities that belong to their customers. Thus, it is important that Exchange members and the persons who work for member firms are honest and reliable.

A person who wants to become a *member* (broker) of the New York Stock Exchange must:

1. Buy a membership—more popularly called a *seat;* and
2. Be approved by the Board of Directors.

Before the Board approves an individual for membership, it carefully investigates his background and character. Also, the Board requires that the individual have a number of years of experience in the securities business. And it makes him demonstrate his knowledge of the business by passing a written examination.

The *allied members*—that is, the partners or voting stockholders of a member firm—must also be approved by the Board of Directors. Here, too, before the Board approves an allied member, it investigates his background, character and experience in the securities business. It also requires him to pass a written examination on the securities business.

In addition, the Board requires that the member firm being started have a specified minimum amount of capital. And the member firm must meet this minimum requirement at all times.

TYPES OF BROKERS

Earlier, you learned the difference between a *broker* and a *dealer.* You will recall that a *broker* is a person who acts as an agent for his customers, and that he receives a commission for his services. Usually, members of the Exchange act as brokers and charge their customers a commission. The minimum amount of this commission is set by the firm.

To illustrate

> You want to buy 100 shares of XYZ common stock, which is traded on the Big Board. You go to a member firm and give them the order. (You can recognize a member firm from the words, "Member of the New York Stock Exchange," which appear under the firm's name.) The firm transmits your order to its broker on the floor. He, in turn, tries to execute the order (buy the shares) for you. If he is successful, you pay the brokerage firm the cost of the shares, *plus* its commission.
>
> You might also have the firm sell some share of stock for you. Then the firm would deduct its commission, the stamp taxes and other fees from the sale proceeds. You would receive a check for the difference.

There are several kinds of brokers on the Exchange, depending on their activities, as we explain below.

Commission House Broker

Most members of the Exchange are partners (or voting stockholders and directors) in a member firm. The

member firm is also known as a *commission house.* This is because it charges its customers a commission for its services. The broker—partner, who executes the orders of the firm's customers on the floor of the Exchange, is called a *commission house broker* or *floor broker.*

$2 Broker

This Exchange member is an independent broker. He does not belong to a member firm. He executes orders for any member firm that hires him. If a member firm's floor broker has more orders than he can handle, or if he is absent from the floor, then the firm will give some orders to the independent broker. The member firm pays the independent broker a fee for his services. At one time, the independent broker's fee was $2 for each 100 shares he bought or sold for a member firm. That's how he got the name *$2 broker.* Today, however, the independent broker's fee is usually more than $2.

Registered Floor Trader

Some persons buy a seat on the Exchange just to buy and sell securities for their own personal account. Such a person is called a *registered floor trader.* Generally, he does not belong to any member firm; nor does he execute orders as a $2 broker for member firms. Since he buys securities for his own account and tries to resell them at a profit, the registered floor trader really acts as a dealer rather than as a broker.

Specialist

Each security listed on the Exchange is traded only at a particular location on the floor. This location is called a *post.* At each *post,* there are several brokers known as

specialists. Each of these *specialists* is assigned to a particular post by the Board of Directors. He buys and sells securities that have been assigned to him by the Board of Directors.

The specialist performs two main functions: One is to execute orders given to him by other brokers. Usually, these are limited price orders (discussed in the example below). Here, the specialist acts as a broker, and receives the usual floor brokerage fee, or commission, for his services.

To illustrate:

> You go to a brokerage firm and give it an order to sell 100 shares of XYZ stock. However, you will only sell your stock at $100 or more a share. You will not accept a lower price. An order such as yours is called a *limited price order,* or *limit order.*
>
> When the firm's broker goes to the post at which XYZ stock is traded, he finds that the market price is now $95 a share. Since the broker also has orders to execute for his firm's other customers, he cannot stay at the post to watch the price of XYZ stock. So he gives your order to the specialist in XYZ stock. The specialist will see that your stock is sold when the market reaches the price you are asking.

Another function performed by the specialist is to help *maintain an orderly market* in his stocks. Perhaps a stock in which he is the specialist has a great difference, or spread, between its bid and offer prices. This means buyers of the stock want to pay a much lower price for the stock than the sellers will accept. The specialist will then bid or offer shares of this stock for his own account at prices in between the spread. In this way, he lessens the spread between the bid and the offer prices. Here, since he is buying and selling for his own account, the specialist is acting as a dealer.

ODD LOT TRANSACTIONS

Securities are traded in units called lots. Most of the stock or equity securities trade in lots of 100 shares. These are called round lots. A few securities trade in smaller lots. These securities are traded in ten share lots. Most securities on the exchange therefore are 100 round lot trades and few are 10 share trades.

The public may purchase or sell shares of stock that are less than a round lot. In the case of 100 share round lot, a customer of a firm may trade 1-99 shares and in the case of a 10 share round lot, a customer may trade 1-9 shares. When the customer trades in quantities less than a round lot, the transaction is known as an odd lot.

Odd lots are traded on the NYSE and Amex with the assistance of the specialists. The specialists execute customer odd lot orders against their own inventory positions. Odd lot orders are executed by the specialists based on Round Lot execution prices.

For example, a customer of a firm enters an order to purchase 25 shares of XYZ at the market. The order is sent to the Specialist making a market in XYZ. The specialist holds the order until a round lot trade takes place. The odd lot will be executed against the specialist position. The transaction may or may not include an odd lot differential.

The odd lot differential is a fee that some specialists charge for executing odd lot orders. It is usually 1/8 of a point for odd lot transactions. The differential is added to the purchase price and subtracted from sell prices. An odd lot buy order being executed on a round lot transaction @ 30 would cost 30 1/8 per share to the odd lot customer.

Odd lot transactions are executed on the NYSE and the AMEX in similar fashions. Specialists on both exchanges execute the odd lot orders entered by the customer of the respective exchanges member firms.

Bond Broker

This broker is a member of the Exchange who specializes in buying and selling bonds for member firms. The volume of trading in stock on the Exchange is several times greater than in bonds. Generally, a firm's floor broker is kept busy executing orders in stocks. Thus, most firms send their customers' bond orders to a *bond broker*, who charges a fee for his services in the same fashion as a $2 broker.

LISTING SECURITIES FOR TRADING ON THE EXCHANGE

The New York Stock Exchange trades only in *listed securities.* These are securities that have met the listing standards of the Exchange and so have been approved for trading by the Board of Directors.

To have its securities listed on the Exchange, a corporation files an application giving information about itself, along with a detailed description of the securities to be listed. The corporation also pays the Exchange a listing fee. In addition, the corporation must register the securities with the Securities and Exchange Commission.

TRADING ON THE EXCHANGE

Securities are traded on the New York Stock Exchange in a huge room known as the *floor.* As you have already learned, each security is assigned to a particular *post* on the floor. The security can be traded at that post only. (Actually, a *post* is a horseshoe–shaped booth. On the outside of the post, or booth, is a price indicator that shows the last sale price for each stock traded there.)

When a broker wants to execute an order in a stock, he will go to the post where the stock is traded. There he

will try to make a trade at the best possible price for his firm's customer.

Stocks are bought and sold on the Exchange in units of 100 shares, called a *round lot*. The price of the stock is quoted at a dollar amount per share. For example, a price of "74 1/2" means "$74.50 a share." The cost of 100 shares at this price would be $7,450 ($74.50 x 100).

Under the rules of the Exchange, trading is done by bids and offers. These must be called out so that all brokers who want to trade can hear them. The highest bid and lowest offer are known as the quote.

A *bid* is the highest price a buyer is willing to pay for a stock. An *offer* is the lowest price at which a seller is willing to sell. Bids and offers are made in multiples of 1/8 of a point; that is, 1/8, 1/4, 3/8, 1/2, and so on. Each 1/8 represents 1/8 of a dollar a share, or 12 1/2 cents.

Here is a simplified example that shows how a trade takes place on the floor of the Exchange:

> A broker has an order to buy 100 shares of XYZ stock at the market. (*At the market* means he has been told to buy the stock at the best possible price.) The broker goes to the post at which XYZ stock is traded. There he learns that the latest quote for XYZ stock is "34 1/2–3/4." This means that $34.50 a share is the highest price that a buyer is willing to pay, and that $34.75 a share is the lowest price at which a seller is willing to sell.
>
> The broker could immediately accept the offer of 34 3/4 and so execute the order. However, he wants to buy the stock at the lowest possible price, so he calls out "34 5/8 for 100." This is the shorthand way of saying the broker will buy 100 shares at a price of $34.625 a share. But he finds no one willing to sell at that price. The broker then decides to accept the offer to sell at 34 3/4. He shows his

acceptance by calling out "take 100." This means that he will buy the 100 shares at $34.75 a share. With this, the trade ends.

It is interesting to note that the brokers do not exchange written contracts. Instead, each broker makes out his own memorandum, or note, of the trade. This shows the number of shares, the ticker symbol of the stock, and the price of the stock. It also includes the other member's badge number and the name of that member's brokerage firm. Each broker sends his memorandum to his own telephone clerk. The clerk then transmits the information to the brokerage firm.

THE AMERICAN STOCK EXCHANGE

The American Stock Exchange is the second largest organized stock exchange in the country. It is well over 100 years old.

The American Stock Exchange began as an open air market on the sidewalks of New York City's financial district. In 1921, the *New York Curb Market,* as this exchange was then known, moved indoors to its present building.

In 1929, it changed its name from *New York Curb Market* to *New York Curb Exchange.* And in 1953, its name was again changed, this time to *American Stock Exchange* (AMEX).

Administration of AMEX

The organization and operation of the American Stock Exchange are like those of the Big Board. The policy making functions are in the hands of a Board of

Governors. This Board is elected by the AMEX members. It is made up of floor members, allied members and some representatives of the public.

The American Stock Exchange also has a paid president. He serves as the chief executive of AMEX and is responsible for carrying out the policies of the Board. The president is not a member of AMEX.

Requirements for Membership

As on the Big Board, membership in the American Stock Exchange is restricted to individuals. Together with nonmembers, they may organize a member firm. Those who apply for membership in AMEX and their associates must be approved by the Board of Governors. They must meet tests as to their character and their experience. Also, they must pass written examinations.

Trading on the American Stock Exchange

Trading procedures on the American Stock Exchange are generally similar to those on the New York Stock Exchange. Standards for listing securities for trading on the American Stock Exchange represent a basic difference between AMEX and the Big Board. Generally, the listing standards of the American Stock Exchange are not as rigid as those of the New York Stock Exchange. Another difference is that the American Stock Exchange permits trading in a few stocks known as "securities admitted to unlisted trading."

Like the New York Stock Exchange, the American Stock Exchange has several kinds of brokers. These brokers are classified by their activities on the

Exchange. However, the American Stock Exchange does not have special firms that act as odd lot dealers. Instead, the specialists in a particular stock act as the odd–lot dealer for that stock.

QUICK REVIEW

An organized stock exchange is an association of securities brokers. The exchange provides a central meeting place where these brokers can trade in securities.

Only members of an exchange can trade in securities on that exchange; and only individuals can become exchange members. To become a member, a person has to buy a *seat.* He must also get the approval of the Board of Directors. A member may join with nonmembers to organize a member firm. Such firms may be either partnerships or corporations. The nonmembers must also be approved by the Board of Directors. All members and allied members have to pass a written examination.

Brokers may be classified as: (1) *Commission house* brokers. These brokers belong to a member firm and execute orders for the firm's customers on the floor of the exchange. (2) *Independent or $2 brokers.* These brokers usually do not belong to any member firm. Such brokers execute orders for member firms when the latter's regular broker is too busy or is absent from the floor. (3) *Specialist.* A specialist deals only in stocks assigned to him by the Board of Directors. He executes limited price orders for commission house brokers. He also buys and sells for his own account in order to "maintain an orderly market." (4) *Registered floor trader.* This broker has bought a seat in order to trade for his own personal account. Rarely, does such broker execute orders for the account of others.

Each security traded on an exchange is assigned a particular location on the floor of the exchange. This location is called a *post.* Trading is done by bids and offers which must be called aloud by the broker. A *bid* is the highest price that a person is willing to pay for a security. An *offer* is the lowest price at which a person will sell a security. When the highest bid meets the lowest offer, a trade is completed.

The Over-the-Counter Market

Unlike the stock exchanges, the over–the–counter market has no central meeting place. Instead, the securities houses that trade in securities in this market do business with each other over a large network of telephones and teletype instruments. Let us take a look at the firms that do business in this market and how they operate.

All securities transactions except those that take place on an organized stock exchange are handled in the over–the–counter market. The over–the–counter market is not located in any central place. Instead, it consists of thousands of securities houses throughout the country. These securities houses, called broker–dealers, buy and sell securities usually for their *own account*. When they trade this way they are doing business as a *dealer*.

However, a broker–dealer may also trade in the over–the–counter market as an *agent* of the customer. Then he charges a commission for his services. When a broker–dealer acts as an agent, he is doing business as a *broker*.

Trading in securities in the over–the–counter market takes place in many different places. Because of this, the exact size of this market is not known. However, the dollar value of securities traded in the over–the–counter market is estimated to be many

times greater than that on all the organized stock exchanges. Also the securities of more companies are traded in the over–the–counter market than are *listed* on the organized stock exchanges. And, even securities listed on a stock exchange can be traded in the over–the–counter market. This is the so–called *third market.*

KINDS OF SECURITIES TRADED IN THE OVER–THE–COUNTER MARKET

You have learned that trading in securities on a stock exchange is limited to *listed* securities. Generally, these are securities of national companies. A national company is a company whose securities are owned by many investors throughout the country.

In the over–the–counter market, however, the trading ranges from securities of large national companies to those of purely local companies. The securities of a local company are often owned by the residents of a particular town or city.

It is not unusual for a local business or industry to raise capital through the sale of its securities to residents of the community. Also, in order to attract business or industry to its community, the residents will buy a company's securities and so help it raise capital. A local broker–dealer will then buy and sell the securities.

Many different kinds of securities are traded in the over–the–counter market. These include bank stocks, insurance company stocks, U.S. government and municipal securities, mutual fund shares, railroad equipment trust certificates, most corporation bonds, securities of many industrial and utility corporations, and the securities of foreign corporations.

Keep in mind that almost all new issues of securities are first traded in the over–the–counter market. Later some of these securities may be *listed for trading* on a stock exchange. Many, however, will not be listed. These will continue to be traded in the over–the–counter market.

THE BROKER–DEALER

There is no such thing as a *seat* on the over–the–counter market. Any securities house–proprietorship, partnership or corporation–may do business in the over–the–counter market.

However, there are these conditions: Before a securities house can do business as a broker–dealer, it must register with the Securities and Exchange Commission. In addition, the broker–dealer and all persons connected with the broker–dealer (except clerical employees) must meet certain standards of training and experience. They must also pass a written examination.

TYPES OF OVER–THE–COUNTER FIRMS

An over–the–counter securities firm may do business in one particular part of the over–the–counter market, or it may do business in all. An over–the–counter firm may be classified as:

Investment Banking House

This is a firm that specializes in distributing new issues of securities. As you have learned, this type of firm is also called an underwriter.

When an investment banking firm distributes securities, it acts as a *dealer*. That is, the firm buys securities from

the issuing corporation for its own account. It then tries to resell these securities at a higher price. The difference between the price at which it buys the securities and the price it sells them for is its profit.

Bond House

This is a firm that specializes in trading in U.S. government bonds, as well as state and municipal bonds. It is called a *bond house.* Some firms will trade either in government bonds or in municipal bonds. Other firms, however, may trade in both.

Over–the–Counter Securities House

This kind of firm may be likened to the member firm that does business on an organized stock exchange. Another name for the over–the–counter securities house is *broker–dealer* firm.

The broker–dealer firm trades in over–the–counter securities for its customers. Generally, the broker–dealer firm will not trade in government and municipal bonds. It leaves that to the bond houses that specialize in these securities.

The larger broker–dealer firms may also act as underwriters for new issues of securities. But most often they will act as dealers in the distribution of those securities, and later they will trade in them.

REGULATION OF THE OVER–THE–COUNTER MARKET

You will recall that an organized stock exchange must register with the Securities and Exchange Commission. And the stock exchange must satisfy the Securities and Exchange Commission that it can properly police its members.

Regulation of the over–the–counter market works a little differently. Each broker–dealer firm must register with the Securities and Exchange Commission before it can do business in the over–the–counter market.

In addition, there is an association of broker–dealer firms that is also registered with the Securities and Exchange Commission. This association is called the National Association of Securities Dealers, Inc. (NASD). It was created under a federal securities law. The purpose of NASD is to adopt, administer and enforce rules of fair practice in connection with transactions in the over–the–counter market.

MEMBERSHIP IN NASD

Any broker–dealer firm registered with the SEC may become a member of NASD. But membership in NASD is not mandatory. This means that a broker–dealer firm may do business in the over–the–counter market without being a member of NASD. However, a broker–dealer who is not a member of NASD comes directly under the supervision of the Securities and Exchange Commission.

Unless a securities house is a member of NASD, it cannot get certain dealer discounts, especially those involving new issues of securities. To become a member of NASD, a broker–dealer firm has to fill out and file certain application forms. It must send them to NASD, together with a registration fee.

Like the organized stock exchanges, NASD supervises the way in which its members do business. NASD may censure, fine or suspend a member, if he breaks the rules. To suspend a member means that he cannot do business as a broker–dealer on the over–the–counter market for a period of time.

Another way NASD can discipline a broker-dealer who has violated the rules is to revoke his membership. This, in effect, puts the broker-dealer out of business.

A member who is suspended or whose registration is revoked may ask the Securities and Exchange Commission to review the NASD's decision

TRADING IN THE OVER–THE–COUNTER MARKET

You have learned that a stock exchange is an auction–type market. That is, at the time that the highest bid and the lowest offer meet, a trade is made or executed.

Trading in securities in the over–the–counter market works differently: Here the purchase and sale of securities is carried on by negotiation, or bargaining, between the parties. (Later in this chapter, we will show you how negotiation works.)

The over–the–counter market has no central meeting place. So there is no floor and no post to which a broker–dealer can go to trade in over–the–counter securities.

The Market Maker

However, the over–the–counter market does have its *specialists* in securities. These are broker–dealer firms

that *maintain a market* in a security. This means that the firm stands ready at all times to buy or sell a particular security, at prices the firm quotes. In these transactions, the firm usually acts as a *dealer.* A broker–dealer firm that maintains a market, or makes a market, in a security is known as a *market maker.*

The Bid and Asked

The market maker's quotation for a stock will consist of a bid price and an asked, or offer, price. The *bid* price is the highest price the market maker is willing to pay for a particular security. The *asked* price is the lowest price at which the market maker will sell a particular security. The difference between the bid and asked prices is called the *spread.*

Another thing to remember about quotations in the over–the–counter market is that they may be either *firm* or *subject.* A *firm* price is the price at which a security can be bought or sold for such period of time as the seller may name. On the other hand, a *subject* price means that the price is subject to confirmation with the opposing side of the proposed transaction.

HOW A TRADE IS MADE IN THE OVER–THE–COUNTER MARKET

So that you will better understand how a trade is made, or executed, in the over–the–counter market, we have made up the following example:

Suppose you want to buy 100 shares of Golden Gondola common stock. This stock is traded on the over–the–counter market. You call Johns & Co., a broker–dealer firm, and speak to the registered representative there who handles your account.

However, this firm does not *make a market* in Golden Gondola common stock. Because of this, the registered representative cannot give you an immediate quotation on the stock. So he tells you that he will check the market and call you back. To *check the market* means that Johns & Co. will call several dealers who *make a market* in the stock. In this way it can get quotations for you.

The first dealer, let's call him Dealer A, quotes the stock at "35–35 3/8." In other words, Dealer A will buy Golden Gondola common at $35 a share and will sell it at $35.375 a share.

Another dealer, Dealer B, quotes the stock at "34 7/8–35 1/2." This means that Dealer B will buy Golden Gondola common at $34.875 a share. He will sell it at $35.50 a share.

Still another dealer, Dealer C, quotes the stock at "35–35 1/2." In other words, this dealer will buy Golden Gondola common at $35 a share; he will sell it at $35.50 a share.

From these quotations, Johns & Co. knows that it can most likely buy Golden Gondola at the low price of $35.375 a share–the price quoted by Dealer A. Based on this, the registered representative calls you back and tells you that he can sell you 100 shares of Golden Gondola common at, say, $36 a share. Johns & Co. added a *markup* of $.625 a share to the price. This is the difference between what it will pay for the stock and what it will sell the stock to you.

You are willing to pay $36 a share, and you tell the registered representative that you are. He will then have the firm call Dealer A again, and check the quotation with Dealer A. If it is still the same, the firm confirms its purchase of 100 shares at 35 3/8.

From the above description of this transaction, you

recognize that Johns & Co. is acting as a *dealer.* However, there is nothing to stop Johns & Co. from acting as a *broker.* It would then charge you a commission for its services. In fact, if Johns & Co. is a member firm, it might handle the transaction that way.

PUBLICIZING OVER–THE–COUNTER QUOTATIONS

Due to the fact the trades occurring on the exchanges are executed in a specific location, recording of transactions for public display is relatively easy. Almost every branch of every brokerage firm has various types of video displays that reflect the executions taking place on the various exchanges. Other types of units will display the last sale price, opening price, etc., etc. This feature of listed trading market does not exist in the Over-the-Counter market as trades are executed between firms through a telephone network.

The current market price of the more popular OTC issues are found on various NASDAQ display equipment. The National Association of Security Dealers's Automated Quotation system displays the current bid and offer on these securities. There are three levels of NASDAQ service. Level one is a representative quote comprised of the highest bid and lowest offer existing at that particular moment. It takes into account all of the quotes existing with the marketmakers and displays a single quote for use by the public. Level two is used by the traders on the various firms OTC's trading desks. It displays all of the marketmakers and their respective quotes. This data informs the traders who the marketmakers are and what their current quotes are. Level three is used by the marketmakers only. This level permits the marketmakers to adjust the quotes.

Through NASDAQ, the public is informed of the cur-

rent market prices of Over-the-Counter securities. While NASDAQ cannot give last sales or opening high and last, etc., it will provide the current nominal quote.

Selected Quotations

NASD, through its quotations committees, gathers each business day the bid and asked prices on a selected list of over–the–counter securities. These quotations are released to about 300 newspapers throughout the country. These newspapers print these bid and asked prices daily.

A broker–dealer firm that belongs to NASD may request his local quotations committee to include a particular security in the list of bid and asked prices. Whether the quotations committee will honor the request depends to a great extent on how well the particular security meets the standards set by the committee.

The Pink Sheets

In addition, a private organization–the National Quotation Bureau–publishes what are known as the *pink sheets.* These sheets are published daily. They give the so–called *wholesale* quotations for over–the–counter securities.

These wholesale quotations are the prices at which dealers will buy and sell securities. Actually, they represent quotations of the dealers making a market in a security. Alongside each quotation, the pink sheet will give the name of the dealer or dealers involved. The pink sheets are not distributed to the public. They are distributed only to securities houses that subscribe for them.

QUICK REVIEW

The over–the–counter market has no trading floor. Nor does it have any *post* at which securities can be bought and sold. Instead the securities houses, called *broker–dealer* firms, do business with each other by means of the telephone and teletype.

Securities houses that do business in the over–the–counter market generally act as *dealers.* Some, however, may act as *brokers* in over–the–counter transactions.

New issues of securities are first sold in the over–the–counter market. Some of these may later be *listed* for trading on an organized stock exchange. However, many will continue to be traded in the over–the–counter market.

The over–the–counter market also trades in bank stocks, insurance company securities, government and municipal bonds, mutual fund shares, corporate bonds, industrial and utility securities, and securities of foreign corporations.

Some securities houses do business in one particular part of the over–the–counter market. For example, the *investment banking house* specializes in distributing new issues of securities. The *bond house,* on the other hand, specializes in trading in U. S. government bonds or only in state and local bonds. Generally, securities houses will trade in all over–the–counter securities.

Before a securities house can do business in the over–the–counter market, it must register with the Securities and Exchange Commission. In addition, the firm may become a member of the National Association of Securities Dealers. This association helps to police securities houses that do business in the

over—the—counter market. It adopts, administers and enforces rules of fair practice in transactions in the over—the—counter market.

Some broker—dealer firms act as *market makers* in one or more over—the—counter securities. These firms stand ready to buy a security at a fixed price from all sellers. They will also sell a security at a fixed price to all buyers. Such dealers are said to be *maintaining a market* in the security.

Types of Securities: Stock

Stocks and bonds are the most common types of securities that a corporation can issue. A corporation can issue two kinds of stock—common and preferred—and several kinds of bonds. In this lesson you will learn about those securities known as *stock.*

COMMON STOCK

At the time the corporation is organized, it issues shares of common stock. Figure 2, on page 47, is a specimen certificate of common stock.

Each share of common stock represents an ownership interest of the shareholder in the corporation. The greater the number of shares a shareholder owns, the greater is his ownership interest in the corporation.

To illustrate:

> A corporation has 1,000 shares of common stock outstanding and one person owns 100 shares of this stock. This person then has a 10% ownership interest in the corporation. (100 shares divided by 1000 shares).

Sometimes a corporation will issue different kinds of common stock—Class A common stock and Class B common stock. These two classes of stock may differ in several ways: One class of stock may have the right to

vote for the election of directors, while the other class may be denied that right. Or, where the company pays a dividend (distributes its earnings) to its stockholders, one class of stock may receive a larger share of the dividend than the other class of stock. Also, if the company is liquidated (goes out of business), one class of stock may receive a greater share of the assets than the other class of stock.

RIGHTS OF COMMON STOCKHOLDERS

Ownership of *common stock* normally carries with it certain rights or privileges. Among these are:

1. The right to vote for the election of the board of directors. The directors are responsible for managing the corporation.

2. The right to receive dividends when they are declared by the directors. Dividends are a distribution to stockholders of the corporation's earnings. The common stockholders are not entitled to dividends unless declared by the directors.

3. The right to transfer ownership of the shares. This right may be exercised by selling the shares, or by making a gift of the shares, or by bequeathing them to someone in a will.

4. The right to vote on questions affecting the corporation as a whole. For example, the shareholders would vote on whether the corporation should sell its assets. Assets means everything the corporation owns—land, buildings, machinery, etc.

5. The right to inspect the corporate books. For example, a shareholder can examine the stock register, or list of stockholders.

6. The right to share in money obtained by the dissolution of the corporation. However, first the corporation's creditors and other persons having a preference must be paid. Dissolution means the termination of the corporation's existence.

PAR VALUE OF COMMON STOCK

Most corporations assign a *par value* to each share of stock. This is printed on the stock certificate as shown in Figure 2.

The par value has no relation to the *market price,* or *market value,* of the stock. Its only importance is at the time the stock is first issued. Then the par value represents the minimum, or lowest, price the company must receive for each share of stock that it sells.

To illustrate:

> A company assigns a *par value* of, say, $10 to each share of common stock. This means the company must receive at least $10 in cash or property for each share that it sells. But it may get more. If the company has issued 1,000 shares of common stock, it should receive at least $10,000. This money becomes the original capital of the corporation.

If a company wishes, it may issue *no par value* stock. The advantage of this kind of stock is that the company can sell the shares for whatever it believes these shares will bring in the market.

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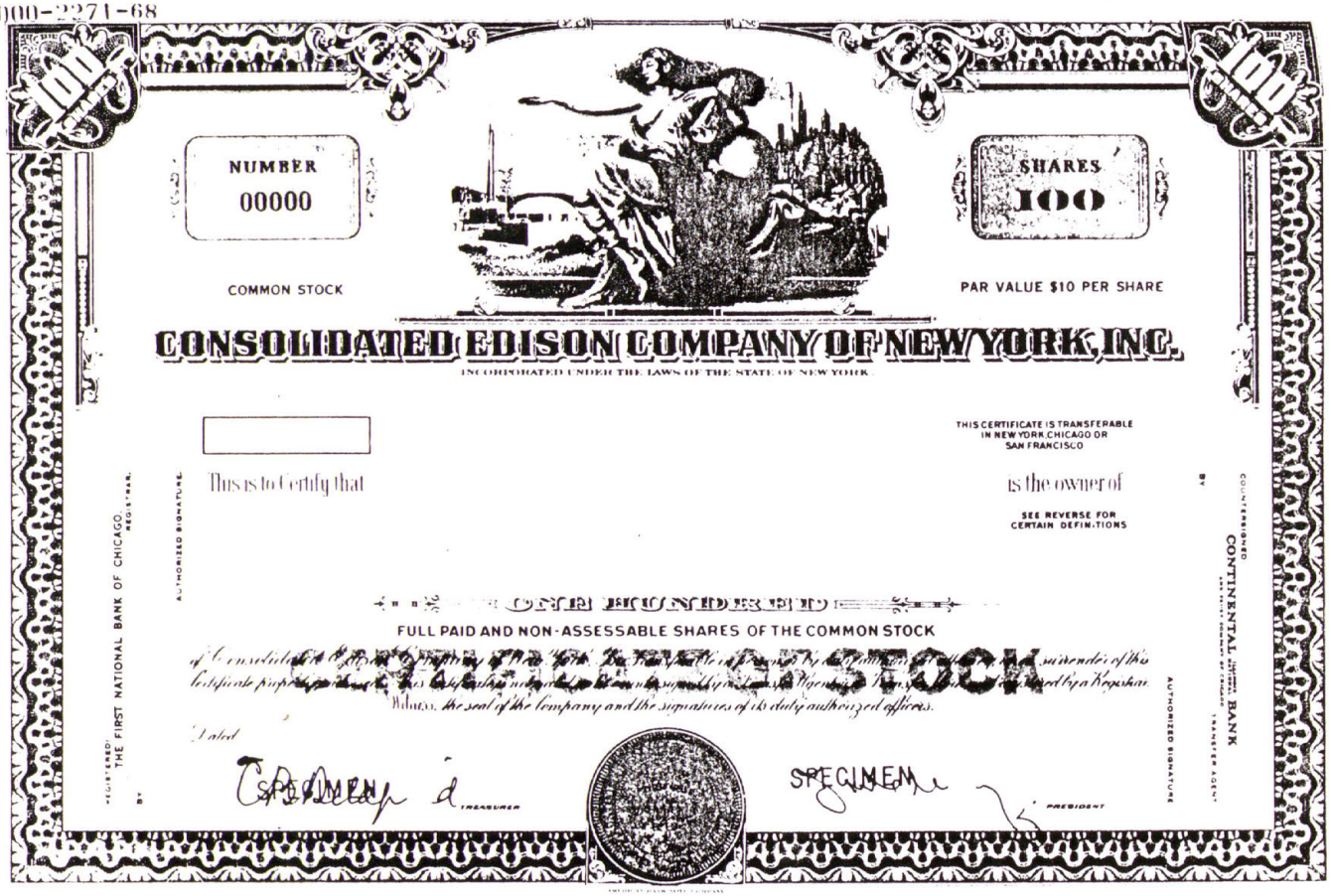


Figure 2

MARKET VALUE OF STOCK

Once stock has been sold to the public, its price is determined by the value investors place on it. This value is called the *market price,* or *market value.* It will usually depend on what investors believe this value should be. In arriving at their decision, the investors will consider such factors as the earnings for each share of stock, the company's dividend policy, and the company's future prospects (how well the company is expected to do).

The par value of a stock has no effect on its market price. In fact, the market price of a stock is not fixed by the corporation. Nor is it fixed by anyone else. Instead, the market price of a stock is determined by the lowest price a seller is willing to sell it for, and the highest price a buyer is willing to pay for it.

PREFERRED STOCK

Preferred stock also represents an ownership interest in a corporation. It is called *preferred* stock because of preferences given to the holders of this stock over the holders of common stock.

Generally, the preferred stockholder has the right to receive dividends before any dividend is declared, or paid, on the common stock. The dividend is printed on the stock certificate. It will be shown as a definite dollar amount for each share or as a fixed percentage of the par value of the stock.

Also, the preferred stockholder usually has a prior claim against the assets of the company, in the event of its dissolution. For example, if the company has to liquidate its assets, the preferred stockholder usually will be paid the value of his shares before any payment is made to the common stockholders.

However, unlike the common stockholder, the holder of preferred stock usually may not be entitled to vote for the election of the board of directors. Thus, because the preferred stockholder may have no voting rights and because his right to dividends may be limited to a fixed amount, we say that the preferred stockholder has limited ownership rights in the corporation.

PAR VALUE OF PREFERRED STOCK

Like common stock, the preferred stock may be either *par value* or *no par value* stock. Here, again, this will have no relation to its *market value.* However, if the preferred stock has a par value, then the dividend—which may be expressed as a fixed percentage or definite dollar amount— will be based on that par value.

To illustrate:

> A '$100 par value, 4 1/2% preferred" would pay a fixed amount of $4.50 per share ($100 x 4 1/2%). But a "$50 par value, 5% preferred" would pay $2.50 per share ($50x5%).

But, if the preferred stock has *no par value,* the dividend will simply be stated as "$5 per share" or "$2.50 per share" or such other dollar amount per share as the issuing corporation may have assigned.

KINDS OF PREFERRED STOCK

Normally, a corporation will issue only one class of common stock. But a corporation may issue more than one class or kind of preferred stock. This, too, wil' be shown on the stock certificate.

If a corporation issues more than one series of preferred stock, it may designate one as *first preferred* and the

other as *second preferred.* Or it may call one *prior preferred* and the other simply *preferred.*

This establishes the priority of one class over the other as to dividends or distribution of assets, or both. For example, the holder of *first preferred* stock will be entitled to receive his dividend before any dividend is paid to the holder of *second preferred* stock.

Again, a company may classify preferred stock by its dividend preferences. For example, *participating* or *non–participating; cumulative* or *non–cumulative.* These terms are explained below.

Non–Participating Preferred

Ordinarily, a preferred stockholder is not entitled to receive any dividends beyond the fixed or stipulated rates. Thus, an investor who owns "$100 par value, 5% preferred" is entitled to receive dividends of $5 a share before any dividends are distributed to the common stockholders. But he is not entitled to receive more than the $5 a share. Such preferred stock is called *non–participating* preferred.

Participating Preferred

Sometimes, in order to attract investors a corporation may issue *participating* preferred. This means that the preferred stockholder, in addition to receiving his stipulated dividend, is given the right to participate with the common stockholder in any distributions of earnings. Participation may be made in any number of different ways.

To illustrate:

One company has this arrangement: Preferred, $5 per share; then common stock, $5 per share; then preferred and

common to share equally up to $1 per share in any one year.

Another company uses this arrangement: Preferred, $1.50 a share; then common, $1.50 a share; then preferred and common to share equally in the remainder.

Cumulative and Non–Cumulative Preferred

Dividends on preferred stock may also be *cumulative* or *non–cumulative.* A *cumulative* dividend means that if the dividend on the preferred stock is not declared in a particular year, the dividend will accumulate or add up. This accumulation must be paid before any dividends can be declared on the common stock.

To illustrate:

A corporation has outstanding "$4 cumulative preferred" stock. The earnings in a particular year are low. Because of this, the directors of the corporation decide to *pass,* or omit, payment of the dividend. This dividend of $4 a share will accumulate. The next year it must be paid, together with that year's dividend of $4 a share, before any dividends can be paid on the common stock.

On the other hand, if the dividend is *non–cumulative,* and the corporation has omitted the dividend in a particular year, the dividend need not be made up before a dividend may be paid on the common stock.

Convertible Preferred

Still another type of preferred stock is the *convertible* preferred. Here, the holder receives the right to exchange his preferred stock for a share or shares of common stock of the same company. The formula for making the exchange of convertible preferred stock for

fixed by the company
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Dividends are stated c
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These are expressed at
e, 50 cents a share or $1

der to conserve its cash,
ck dividend. This means t
ny's own stock.

ay be in the process o
poration is terminating
ens, the corporation m
in corporate property.
a *property* or *liquidating*

security issued by corp
commonly called a *right*

ion stock is fixed by the company at the time the
rtible preferred is issued.

ghout the discussion of common and preferred
we have spoken about the corporation distributing
nds to the holders of its stocks. Now, let's see in
forms dividends may be distributed.

ends are a distribution of the corporation's
gs to the stockholders in proportion to their
holdings. Dividends are stated on an annual
y) basis, though payment is usually made quarterly
three months). Thus, when we say a company
dividend of 20 cents a share we mean the dividend
ents a share each year. Generally, stockholders are
ntitled to dividends unless declared by the corpora-

poration may declare that a dividend shall be paid
h, in stock, or in property. Most companies pay
dividends. These are expressed at so much per
-for instance, 50 cents a share or $1 a share.

imes, in order to conserve its cash, a corporation
eclare a *stock* dividend. This means the dividend is
the company's own stock.

poration may be in the process of dissolution.
is, the corporation is terminating its existence.
that happens, the corporation may declare a
nd payable in corporate property. This kind of
nd is called a *property* or *liquidating* dividend.

er type of security issued by corporations is the
right more commonly called a *right* or *rights*.

Generally, when a corporation decides to sell additional shares in an issue of securities, it will give those persons who already own stock in the company the right or opportunity to purchase additional shares of stock in proportion to their present holdings. For example, the corporation may give its stockholders the privilege of buying *one* new share of stock for each *ten* shares they now own.

Each stockholder entitled to this privilege receives a certificate showing the exact number of rights to which he is entitled. The rights must be exercised (exchanged for the stock) within a fixed period of time and at a stipulated price.

Usually the rights will give the stockholder the privilege of purchasing the stock at a price that is lower than the current market price. For example, if the market price of the stock is $54, the company might give its stockholders the privilege of buying the new stock at $45 a share. Because of this, *rights have a market value of their own.*

If a stockholder wants to exercise his rights, he fills in the certificate and sends it to the corporation. He also sends a check or money order for the price of the additional shares he wants to buy. Or, if he wishes, a stockholder may sell his rights in the market, at their prevailing market price. Whichever a stockholder decides to do must be done by the date stated in the rights certificate. After that date the rights become worthless; that is, they can neither be exercised nor sold.

QUICK REVIEW

A corporation may issue either *common* stock or *preferred* stock, or both. *Common* stock is the basic ownership stock. It is issued by all corporations at the time they are organized. The holder of common stock has certain rights and privileges. The major ones are the

right to vote for the board of directors; the right to receive dividends when declared by the directors.

Common stock may be either *par value* stock or *no par value* stock. The purpose of *par value* is to fix the minimum amount the company must receive when the stock is first offered for sale. If stock has *no par value,* the company may sell it for what it believes is the best price. After stock has been sold to the public, its price will depend on what investors are willing to pay for it. This price is called the *market price* or *market value* of the stock.

Preferred stockholders have the right to receive a fixed dividend before any dividend is declared on the common stock. They also have a first claim against the company's assets in the event of its dissolution. However, such stockholders may not have the right to vote for the board of directors. The *par value* assigned to preferred stock is used to figure the amount of the dividend. For example, the holder of "$100 par value, 5% preferred" stock would receive a dividend of $5 a share.

Normally, a corporation will issue only one class of common stock. It may, however, issue several classes of preferred stock. For example, it may issue *participating* preferred stock. This stock entitles the holder in addition to receiving his fixed dividend, to share with the common stockholder in distributions of earnings. Or a company may issue *cumulative* preferred stock. This means that if a dividend is not declared in a particular year, it will accumulate; and the dividends must be paid before any dividends can be declared on the common stock.

Dividends are a distribution of earnings to the stockholders. A corporation may pay dividends either in cash, in stock or in property. Most dividends are paid in *cash* at a specified amount per share.

When a corporation decides to sell a new issue of securities, it may give existing stockholders the opportunity to purchase the additional shares. It does this by sending such stockholders certificates called *rights.* The rights must be exercised within a fixed period of time and at a stipulated price. Because these rights permit the holder to buy the new securities at less than their market price, the rights may have a value of their own. The holder of the rights may either exercise them, or he may sell them in the open market. If he does neither by the date fixed by the company, the rights become worthless.

Types of Securities: Bonds

In the previous chapter, you learned about the kinds of stock a corporation can sell to raise capital. Now, let us take a look at another kind of security a corporation can sell. This security is known as a *bond* or *debt* security.

We speak of a corporation issuing or selling bonds. Actually, what the corporation is doing is borrowing money from the purchasers of these bonds.

A corporation does not usually sell bonds when it wants to obtain only small amounts of working capital. Neither does the corporation sell its bonds to raise money that will be needed for a short period of time. A corporation can raise such funds less expensively by borrowing from a bank or by obtaining trade credit from its suppliers.

However, corporations will sell bonds when they want to borrow large amounts of money to finance their long–range needs. For example, a corporation may sell bonds when it wants to build a new plant or to buy new equipment and machinery.

Corporations can issue many kinds of bonds and for many purposes. Before we discuss these bonds, however, let us take a look at what a bond is and how it differs from stock.

WHAT IS A BOND?

Briefly, a *bond* is a promise in writing (1) to pay a specific sum of money, (2) at a definite date in the future, and (3) with interest at a fixed rate and on specified dates. Figure 3, on page 58, is a specimen bond.

Though a corporation may issue different kinds of bonds, all bonds have the following things in common.

Face Value

On the front of the bond, there is usually a statement of the amount the corporation has promised to pay the holder of the bond. This amount is called the *face value* or *face amount* of the bond. Bonds may be issued in face amounts ranging from $50 to $10,000. The most common face amount is $1,000.

Maturity Date

Also on the front of the bond is the *maturity date.* This is the date on which the corporation will pay the face amount to the bondholder. This date is also called the *due date* of the bond. Maturity dates of corporate bonds vary, ranging up to 30 years or more.

Interest Rate

Each bond also contains a promise by the corporation to pay the bondholder a fixed rate of interest at specified interest dates. The rate of interest is usually stated as a percentage of the face amount of the bond. Though the interest rate is stated as a yearly rate, it is normally payable semi–annually (twice a year). For example, the interest may be paid July 1 and January 1, or May 1 and October 1.

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Figure 3

Purchase Price

At this point, we should note that the purchase price of a bond is stated as a percentage of the face amount. If the purchaser pays the face amount, we say he has paid 100%, or *par* for the bond. However, if he has paid more than the face amount—for example, 102%—then we say he has paid a *premium* for the bond. On the other hand, if he has paid less than the face amount—for example, 98%—then we say he has bought the bond at a *discount.* But whether the purchaser has paid par, or a premium or a discount for the bond, the interest will always be figured on the face amount of the bond. Also, at maturity, the bondholder will be paid the face amount of the bond.

To illustrate:

> You buy a $1,000 bond, with a 5% interest rate, at 98%. This means you will have paid $980 for the bond. But, you will receive interest figured at 5% of $1,000, or $50 each year. Also, if you hold the bond to maturity, you will receive the face amount, or $1,000, not the $980 that you paid for the bond.

HOW BONDS DIFFER FROM STOCK

Bonds differ from stock in several ways:

1. A stockholder is a *part owner* in the corporation. The certificate of stock is evidence of his ownership. The bondholder, however, is a *creditor* of the corporation that has issued the bond. The bond itself is evidence of the debt owed him by the corporation.

2. The bondholder receives *interest* on the bond. This interest is fixed and definite. It must be paid before the corporation can declare or pay a dividend on its outstanding stock.

Figure 3

If the corporation fails to pay the interest when it is due, this may *accelerate the maturity date* of the bond. To accelerate the maturity date means the bondholders may demand the corporation pay them the face amount of their bonds at once.

Also, failure to pay the interest may result in the corporation's being placed in receivership or being reorganized.

On the other hand, a stockholder normally receives *dividends.* This dividend is not fixed and need not be paid on specified dates. If the corporation decides not to declare or pay a dividend the stockholders can't do anything about it; they are bound by the corporation's decision.

3. Like any other creditor, the bondholder normally has no voting rights and so no voice in the management of the corporation. The stockholder, on the other hand, votes for the board of directors and so has a voice in the management of the corporation.

TYPES OF CORPORATE BONDS

Corporate bonds may take many different forms:

Bearer Bond

The name of owner of this bond is not registered with the issuing corporation. Because of this we say the bond is payable to the *bearer*—that is, to the person who has possession of the bond.

Bearer bonds have coupons attached. The bondholder clips a coupon on the interest date and sends it to the corporation's agent for payment. Bearer bonds are also known as *coupon* bonds.

Registered Bond

Here the name of the owner is registered (listed) with the issuing corporation. The holder of a registered bond does not have to send in coupons to the paying agent to receive his interest. Instead, the agent on the due date will automatically mail him a check for the interest.

Serial Bond

Rather than have the total amount of a bond issue become due on a specified date, some corporations like to arrange for portions of the bond issue to become due and payable in different years. For example, the corporation may arrange that bonds numbered from 1 to 100 will become payable in the fifth year after they are issued. Bonds numbered from 201 to 300 will mature in the sixth year, and so on.

Callable Bond

Some corporations include in their bonds a clause giving the corporation a right to call in (redeem) the bonds before the maturity date. Usually, the corporation agrees to pay the bondholder a *premium* (that is, more than the face amount of the bond) when it calls in the bond.

Convertible Bond

This bond is similar to convertible preferred stock (discussed on page 51). The convertible bond gives the owner the right to exchange his bond for some other kind of security. This may be either the preferred stock or common stock of the issuing corporation. Many companies issue bonds that are convertible into stock

because it makes the bond more attractive and so more readily saleable.

Sinking Fund

This kind of bond obligates the issuing corporation to set aside each year from its earnings a certain sum of money to be used to retire (pay off) the bond issue. Under this *sinking fund* provision, the corporation turns over the funds to the trustee for the bond issue. The trustee, in turn, uses it to retire a portion of the bond issue. In this way, the issuing corporation is able to pay off its debt a little at a time.

SECURED BONDS

Like any other borrower, a corporation often puts up something of value as a pledge for its borrowings. When the corporation does this, we say it has issued a *secured* bond.

For example, a corporation may pledge a building or land that it owns. If later the corporation should default (fail to pay) the bonds, then the bondholders can take over and sell the building or the land. Also, if the corporation does not pay the interest on the bonds, then the bondholders may have the right to take over the building or land and sell it.

The major kinds of *secured* bonds are:

Mortgage Bond

This is similar to the ordinary real estate mortgage that a person gives to a bank to secure the payment of a loan on his home.

The corporation's mortgage may cover specific property (for example, a new plant). Or it may be a general mortgage on all the property owned by the corporation, including property that it will later acquire. Most corporate mortgage bond issues are of the general variety.

Collateral Trust Bond

Here, the issuing corporation puts up negotiable securities (stock and bonds) that it owns of other corporations. These securities are called the *collateral.*

The corporation deposits this collateral with a third party, usually a trust company. Of course, the value of the collateral is greater than the face amount of the bonds that the corporation issues.

Equipment Trust Certificate

This type of bond is used mainly by railroads. It is secured by the railroad's rolling stock (passenger cars, freight cars and engines) and other standard equipment of the railroad. A certain portion of the bond issue is paid off each year. This results in increasing the security available for the remaining bondholders.

UNSECURED BONDS

In much the same way that a person with a good credit rating can borrow without pledging any property, so too can a corporation.

If a corporation has a good credit rating, it can issue bonds on just its name. These bonds are called *debentures,* and the corporation pledges no specific property as security for them.

Often, to make the debentures more attractive, the corporation may add a conversion feature (discussed above). These debentures are then known as *convertible debentures.*

GOVERNMENT AND MUNICIPAL BONDS

In order to raise money the United States government sells its bonds to the public. These bonds are popularly known as *government bonds.* The states, cities, towns, and state agencies and authorities also issue bonds. These bonds are more commonly known as *municipal bonds.*

Government Bonds

These bonds are considered the highest–grade securities. They are generally backed by the full faith and credit of the Federal government.

Municipal Bonds

The bonds issued by the state and local governments and their agencies are usually exempt from income taxes. That is, the owners of these bonds do not have to pay income taxes on them. We say these bonds are *tax exempt.*

QUICK REVIEW

Bonds are one of the two types of securities a corporation can sell in order to raise capital.

When a corporation sells bonds, it is actually borrowing money from the purchasers of the bonds. The bond certificate is evidence of the debt the issuing corporation owes to the bondholder.

Bonds are issued in various denominations, ranging from $50 to $10,000. The most common denomination is $1,000.

A bondholder is entitled to receive interest at specified intervals, usually twice a year. The interest is generally a percentage of the face amount of the bond. In addition, the bondholder is entitled to be paid the face value of the bond on its maturity date.

Bonds are issued either in *registered* form or *bearer* form. When the bond owner's name is listed with the corporation, the bond is called a *registered* bond. When the bond owner's name is not listed with the corporation, the bond is called a *bearer* bond.

A corporation may issue either *secured* or *unsecured* bonds. Major kinds of secured bonds are: the *mortgage* bond, which is secured by real estate owned by the issuing corporation; the *collateral* trust bond, which is secured by securities of other companies. the *equipment* trust certificate, which is secured by the rolling stock and other standard equipment of a railroad company.

An *unsecured* bond is one based on the general credit of the issuing corporation. This kind of bond is called a *debenture.*

To make its bonds more attractive to purchasers, the issuing corporation may add various features. For example, it may give the bondholder the right to exchange the bond for other securities of the corporation, such as common stock or preferred stock. Such bonds are known as *convertible* bonds. Also, the issuing corporation may state that it may redeem the bond before its maturity, usually for more than the face amount of the bond. This kind of bond is known as a *callable* bond.

The Operations Department

Earlier, you learned about stocks and bonds and the organizations that issue (sell) these securities. You also learned about the organized stock exchanges, the over–the–counter market, and the securities houses that do business on either or both of these markets. We will now go behind the scenes of a securities house. We will examine the operations of the various departments in what is popularly known as the *back office.* Our purpose here is to find out who does what—and why, and how the jobs of the people around you fit in with your job.

The work of the Operations Department begins when a customer enters an order for the purchase or sale of securities. Figure 1 on page 3 is a Work Flow Chart. It shows you what takes place after an order is entered.

CUSTOMERS AND CUSTOMERS' ACCOUNTS

Who are the customers of a securities house? They are individuals, partnerships, corporations and others, who purchase or sell securities either for investment or for speculation.

Many securities houses have a main office in one city and a branch or branch offices in other cities. The customers may enter orders to buy or sell securities either through a branch office or the main office. However, before a customer can enter an order (do any trading), he must open an account with the securities house.

OPENING AN ACCOUNT

It is not difficult for a financially responsible person to open an account with a securities house. The procedure is basically similar to opening a customer charge account.

A person who wants to open an account must satisfy the firm that he is financially responsible. Also, he must supply personal information such as, his name and address, his age, and his investment objectives.

An account is usually opened through the firm's registered representative. A *registered representative* is an employee of a securities house. He accepts orders for the purchase and sale of securities from the firm's customers and also deals with them on other matters. Such a person must have a good knowledge of the securities business. He has to pass a written examination. The registered representative may also be called an *account executive* or a *customer's broker.*

After an account has been opened, it will usually be assigned a code number. In addition, the customer's credit references will be checked. Also, a partner or officer of the firm will have to approve the account.

KINDS OF ACCOUNTS

When opening the account, the customer will indicate how he wants to do business, whether on a cash basis or a margin basis. Depending on his wishes and the firm's approval, he may either have a *cash* account or a *margin* account or both.

A *cash* account is, as its name implies, an account in which the customer will pay in cash or by check for the securities he purchases. Such payment must be made on

the *settlement* date, which is usually five full business days after the *trade* date.

The *trade* date is the date on which the purchase or sale is executed. The *settlement* date is the date on which the customer has agreed to settle the contract made for him by his broker.

A *margin* account is, in effect, like a credit account. Here, the customer will put up part of the cash for his purchases; the broker will then lend him the rest of the money. A margin account customer will sign a customer's agreement. In it, among other things, he authorizes the broker to liquidate (sell) sufficient securities in order to keep the account within the margin requirements.

KINDS OF ORDERS

If he can meet all the requirements, the customer is now ready to buy and sell securities in his account.

The customer places his order with his registered representative. He may do this by telephone, personal visit or by letter. Most customers enter orders by telephone.

The Market Order

The customer may attach conditions to his order. For example, he may instruct the registered representative to have his order executed *at the market.* This means the order—called a *market* order—is to be executed immediately at the best possible price at which the stock is selling at the time. Unless the customer gives instructions to the contrary, his order will be entered as a *market* order.

The Limit Order

On the other hand, the customer may enter a *limited price* or *limit* order. Here, the customer is specifying the price at which he will buy or sell the security. The security cannot be bought for more, nor sold for less than the *limit* price. Normally, a limit order will not be executed immediately. Thus, the customer may specify that the limit order shall be "good for the day" or "good till cancelled."

The Stop Order

Another kind of order that can be entered is a stop or stop loss order. This is a protection order used to limit loss exposure. It is a memorandum order as it remains dormant until its price is reached or passed at which time it becomes a market order and is executed. Stop orders are entered in the "in the money side" of the market and would normally be executed if the "stop instructions" weren't there. For example, Customer A purchases 100 XYZ at 50 for $5,000. If XYZ falls in value, Customer A loses $100 for every point. The most Customer A wants to risk on this transaction is $500. Customer A would instruct his Registered Representative to enter an order to Sell 100 XYZ @ 45 Stop. As long as the security did not trade down to 45, A's order would not be executed. Once it did trade at 45 or below, the order would become a market order and the security would be sold.

BACK OFFICE OPERATIONS

The basic concepts in the "back office" operations are the same in most securities houses, though often each securities house will vary as to some details of these

operations. For example, on each trade executed for his account, the customer must receive a confirmation. In some firms the confirmation may be prepared on a typewriter. In other firms it may be prepared on a billing machine. And in still other firms it may be prepared by a computer. But the confirmation does get to the customer, and the information in that confirmation will be identical regardless of how it was prepared.

QUICK REVIEW

Your work begins when the customer enters a buy or sell order.

Before he can enter an order, the customer must open an account. Most any financially responsible person can open an account with a securities house.

A customer's account may be either a *cash* account or a *margin* account. In a *cash* account, the customer will pay for his securities purchases in cash by the settlement date. In a *margin* account, the customer puts up part of the cash for his purchases; the broker lends him the balance.

A customer may enter a *market* order or a *limit* order or a *stop* order. A market order means the broker will buy or sell the stock at the best possible price at the time he receives the order. A limit order restricts the purchase or sale to the price specified by the customer. A *stop* order fixes an approximate price on the purchase or sale of a security; it becomes a *market* order when the stop price is reached.

Work of the Order Department

Trading in securities begins when a customer places an order with a securities house. As you have learned, securities are traded (bought and sold) in two different kinds of securities markets. One of these markets is the organized stock exchange where only *listed* securities are traded. The other market is the over–the–counter market where all *unlisted* securities are traded. However, *listed* securities may also be bought and sold in the over–the–counter market. In this chapter, we shall study the basic procedures involved in processing customers' orders for the purchase and sale of securities.

HOW CUSTOMERS' ORDERS ARE HANDLED

The registered representatives of a securities house act as liason between the customers and the firm. When a customer wants to buy or sell a security, he must contact the registered representative who is handling his account and give that person his order.

At one time, the registered representative would send all customers' orders for the purchase or sale of securities to the Order Department (also known as the order room, or wire room). There an order clerk would decide on which securities market (organized stock exchange or over–the–counter market) the security was traded. He would then send the order to the appropriate market place to be executed.

Today, however, many securities houses have direct wires from their main offices and branch offices to the

floor of the exchange. So, in these firms, orders for the purchase or sale of listed securities are no longer sent to the Order Department. Instead these orders are transmitted directly to the floor of the exchange.

However, all customers' orders for the purchase or sale of *unlisted* securities are still sent to the Order Department. That's because *unlisted* securities are traded in the over–the–counter market only. You will recall the over–the–counter market has no central market place, or floor. Instead, all trading in the over–the–counter market is conducted by telephone or teletype between the dealers who do business in this market.

Whether an order goes first to the Order Department or is sent directly to the floor of an exchange, the procedures for handling *all* customers' orders are practically the same: Someone must write out an order form. The order must then be transmitted to the proper securities market to be executed. And if executed, a report of the execution must be made.

THE ORDER FORM

The customer's instructions to buy or sell a security must be written out on an order form. This is usually done by the registered representative. But it may be done by a clerk. Figures 4 and 5 are specimen order forms.

CONTENTS OF THE ORDER FORM

Each order form must contain the following information:

1. Whether it is a *buy* or *sell* order. Generally, the words "buy" or "sell" are not written out; instead the letters

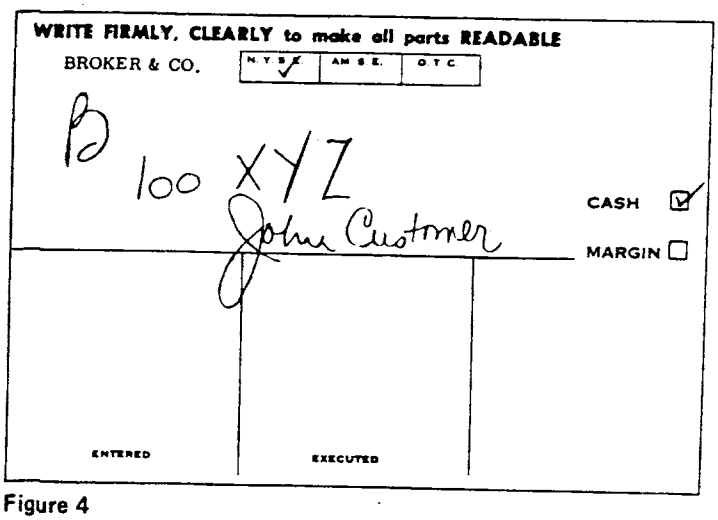


Figure 4

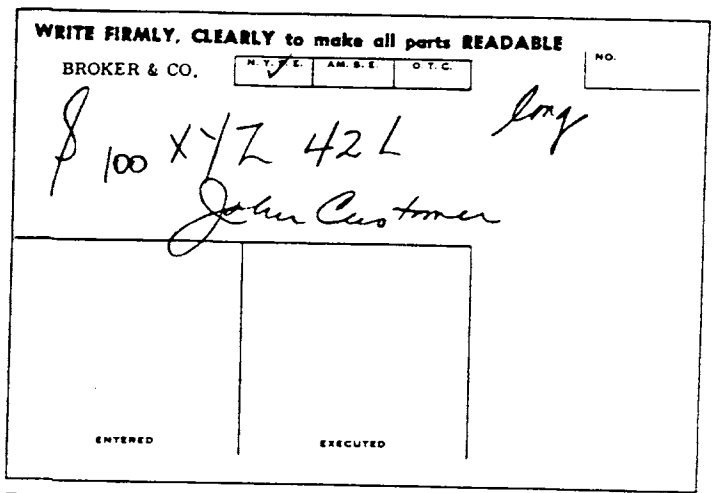


Figure 5

"B" or "S" are used. Some securities houses use order forms on which the words "buy" or "sell" are already printed. On these order forms, the word "buy" is printed in black, and the word "sell" is printed in red.

2. If the order is a *sell* order, whether the sale is *long* or *short*. A *long* sale means the customer owns the security being sold. A *short* sale, on the other hand, means the customer is selling a security he does not own, but has borrowed. In a short sale, the customer believes the price of the security will drop. If it does, he then buys in the security at the lower price, and returns the borrowed stock. His profit is the difference between the sales price and the purchase price. If he has to buy in the security at a higher price, he, of course, has a loss.

3. The *number of shares* which is indicated by numerals; for example, "100," "200," etc. If the order is for a combination of a round lot and an odd lot, say, 250 shares, it is written as two separate orders. The "200" shares on one order form, the "50" shares on another order form. The word "shares" is not written.

4. The *name of the security*. This may be written out, or abbreviated, or shown by its ticker symbol. Securities listed for trading on a stock exchange are assigned ticker symbols. Securities traded only in the over–the–counter market do not have any ticker symbols. The names of these securities should be written out, or abbreviated in such form as to be readily understood.

It is not necessary to indicate that the security involved is *common stock*. However, if a company has, say, Class A and Class B common stock, you must indicate this on the order form. Also, preferred stock must be indicated. If a company has outstanding more than one kind of preferred stock–for example, 4% preferred and 5% preferred–the order form must show which preferred is intended.

If the order is to buy or to sell bonds, the order form should specify the interest rate and maturity date of the bond.

5. Whether the order is a *market* order or a *limit* order or a *stop* order. These terms are explained on pages 68-69.

6. The customer's name or code number, and the date the order is entered.

PROCESSING THE ORDER

After the order has been written out, the next step is to determine whether the security involved is a *listed* security or an *unlisted* security.

Thousands of securities are traded on the stock exchanges and in the over-the-counter market. It is not possible to know in which market each security is traded. However, every firm has available various charts and books containing that information.

If the order is for a security listed on an exchange, say, the New York Stock Exchange, it is transmitted to the firm's telephone clerk on the floor of that exchange. He is told whether it is a *buy* or *sell* order, the number of shares, the name of the stock and whether it is a *market* or a *limit* or a *stop* order. If it is a *limit* or a *stock* order, then he must also be given the limit or stop price. The telephone clerk gives this information to the firm's floor broker, who then tries to execute the order.

If the order is for an over-the-counter security, it is sent to the Trading Department. Here, the *trader* will get in touch with the broker-dealers who are making a market in that security. The trader will execute the order with the broker-dealer who offers the best price.

At this point, it should be mentioned that each order is time-stamped when it is received, and when it is transmitted to the telephone clerk on the floor of the exchange or to the trader in the Trading Department.

The order is also time–stamped when the telephone clerk or the trader calls back and reports the execution of the order. Time–stamping the order is very important. It may be needed to settle a dispute as to the price at which the order was executed.

HOW ORDERS ARE EXECUTED

Earlier, you learned how an order is executed on the floor of an exchange, and also how an order is executed on the over–the–counter market. So that you may refresh your memory, here's a description of what takes place:

Executing an Order on an Exchange

Let's assume an order to buy 100 shares of ABC common, at the market, has been transmitted to your firm's telephone clerk on the floor of the Exchange. The telephone clerk puts the information on an order slip and sends it out to your firm's floor broker.

When the floor broker receives the slip, he goes to the post at which ABC common is traded. There he gets the latest quote for this stock. Let's assume it's "35 1/4 to 35 3/4."

Your firm's floor broker then calls out his bid "35 1/2 for 100." This means he is ready to buy 100 shares of ABC common at $35.50 a share.

A floor broker for another firm has an order to sell 100 shares of ABC common, also at the market. He hears the bid and decides to sell at that price. This floor broker then calls out "sold." This means that he is willing to sell 100 shares of ABC common to your floor broker at $35.50 a share.

Your firm's broker now writes the price of "35 1/2" and the other broker's number on his order slip. He sends the order slip back to your firm's telephone clerk.

You will recall that an order form has been written up; but it has no price on it. When the telephone clerk receives the order slip, he reports the execution of the order and gives the price at which it was executed. This price is entered on the order form and a circle is put around it. The reason for circling the price is to show that it is an executed order. Figure 6, below, is a specimen form of an executed order.

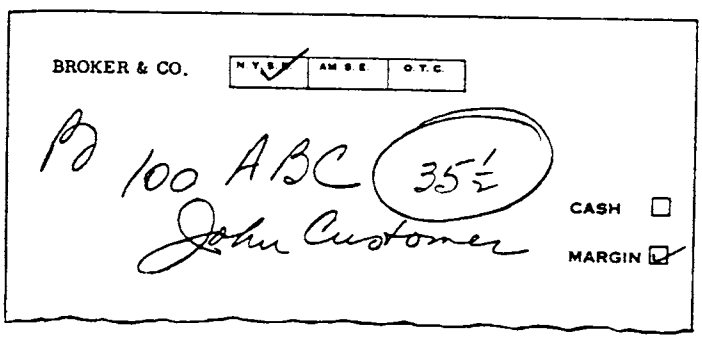


Figure 6

Executing an Order on the Over–the–Counter Market

Now let's assume that XYZ common is traded in the over–the–counter market. When the registered representative receives the order he will send it to the Order Department. There a clerk will send the order to the firm's Trading Department.

In the Trading Department, the order will be given to a *trader.* The trader will contact several broker–dealers who make a market in XYZ common stock. Usually, a trader will call three broker–dealers. He will ask each of

these broker–dealers for a quotation. The trader will complete the trade with the broker–dealer who gives him the lowest offer.

The trader now enters the price on the order form, together with the broker–dealers name, and sends it to the Order Department. The Order Department reports the execution to the registered representative who took the order. Figure 7 is a specimen of an executed order.

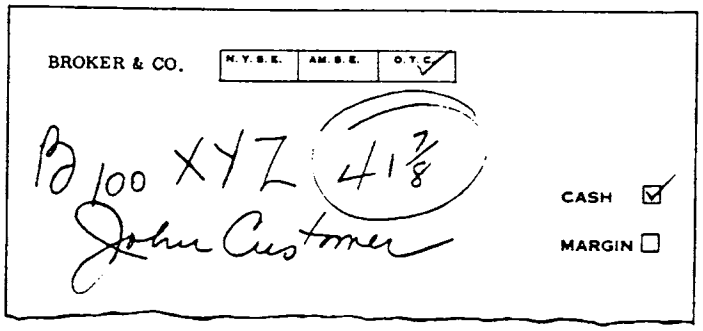


Figure 7

QUICK REVIEW

The customers of a security house give their instructions to buy or sell securities to their registered representatives. The instructions are written out on an order form. This shows whether the order is to buy or to sell a security, the number of shares, the name of the security, the kind of order (*market* or *limit* or *stop*), and the customer's name or code number.

If the order is for a *listed* security, it is transmitted to the telephone clerk on the floor of the exchange where the security is traded. The telephone clerk sends the order to the firm's broker to be executed. When the order is executed, the execution is reported back to the Order Department.

If the security involved is an *unlisted* security, it is sent to the firm's trading department where a *trader* will try to execute the order. If the trader is successful, he will notify the Order Department.

Notice that an order has been executed is sent to the registered representative who will notify the customer.

At various stages of the processing of an order, the order is time–stamped. Thus, when the instructions are received they are time–stamped; when the order is transmitted to the telephone clerk on the floor of the exchange or to the Trading Department, it is time–stamped. When the execution is reported back to the order clerk, it is again time–stamped. Usually, from the time that an order is first entered until its execution, only several minutes will elapse.

Work of the Purchase and Sales Department

The execution of an order marks the start of a long line of jobs that have to be performed in the Operations Department of a securities house. Among them are preparing the customer's confirmation and comparing the trade with the other securities house involved. These jobs are done in the Purchase and Sales (P & S) Department. Let us see how these jobs are performed.

Many securities houses now use computers to do much of the work in the Purchase and Sales Department. In other securities houses, clerks perform all functions by hand. Whether the job is done by a computer or by a clerk, the procedures are almost the same. If done by a computer, it is programmed to perform the work which would otherwise be done manually. So, for learning purposes, we shall assume that all functions are performed by hand.

PREPARING THE CUSTOMER'S CONFIRMATION

When the registered representative learns that the customer's order has been executed he notifies the customer. At this point, all the customer is told is that he has bought or sold a specific number of shares of a security at a particular price. He is not given any details about the commission, taxes, or other fees. The customer learns these details from the customer's confirmation that is mailed to him by the securities house.

The customer's confirmation is prepared either in the P&S Department by a clerk or if the firm has automation, through programs being processed by the computer. The computation of the monies involved, commission, and the like is either performed beforehand by manual or automated processes. See Figures 8 and 9 on page 82 for an example of a hand-figured trade.

The Amount

This is the price per share multiplied by the number of shares. It shows the cost of the security to the *buying* broker. Stated another way, it is the amount of money the *selling* broker will receive when he delivers the security.

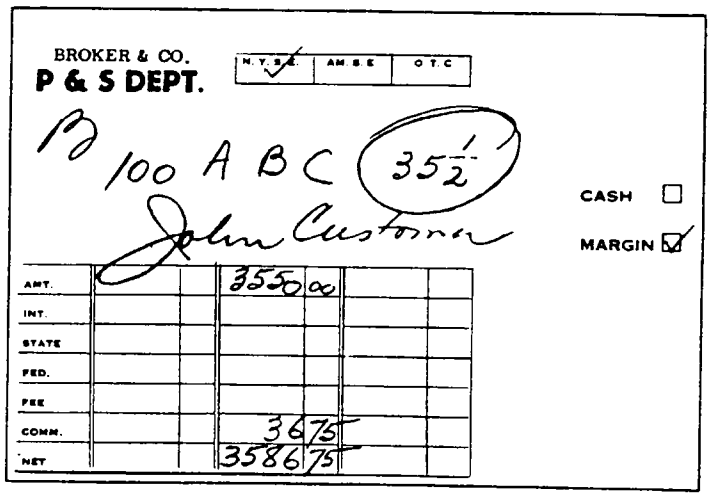
The Commission

This is the broker's charge for his services. The commission varies with the dollar amount involved. It is based on the minimum rate schedules adopted by the firm.

The Total or Net Amount

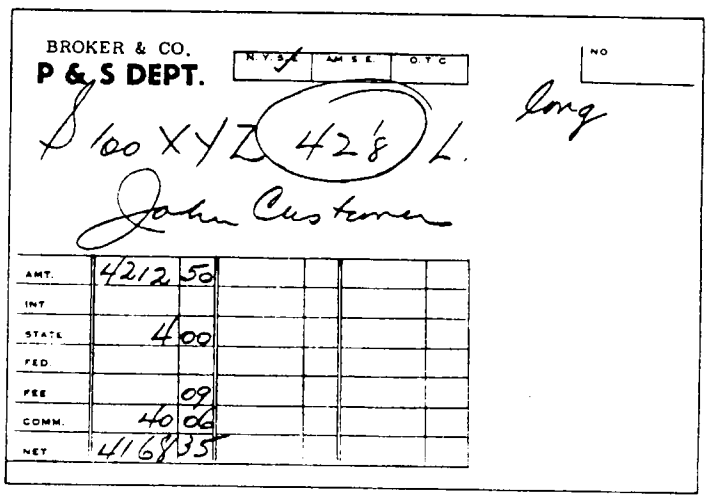
On a *buy* order it is the *amount* plus the *commission*. This total or net amount is the *cost* of the security to the customer.

On a *sell* order, the total or net amount is the amount less the sum of the commission, transfer taxes, and a registration fee. At present, on sell orders executed in New York, the customer pays a stock transfer tax. The net amount remaining after the commission, taxes, and fees have been deducted is the *net proceeds* to the customer.


BROKER & CO.
P & S DEPT.
N.Y.S.E. ✓ | AM.S.E. | O.T.C.
B 100 A B C (35½)
John Customer
CASH ☐
MARGIN ☑

AMT.				3550	00						
INT.											
STATE											
FED.											
FEE											
COMM.							36	75			
NET				3586	75						

Figure 8


BROKER & CO.
P & S DEPT.
N.Y.S.E. ✓ | AM.S.E. | O.T.C.
NO
S 100 X Y Z (42⅛) L.
long
John Customer

AMT.			4212	50							
INT.											
STATE				4	00						
FED.											
FEE					09						
COMM.				40	06						
NET			4168	35							

Figure 9

SEC Fee

On all sell orders executed on an organized stock exchange the customer also pays a SEC registration fee. This registration fee is imposed by federal law. It is figured at the rate of 1 cent for each $300 of value, or fraction thereof.

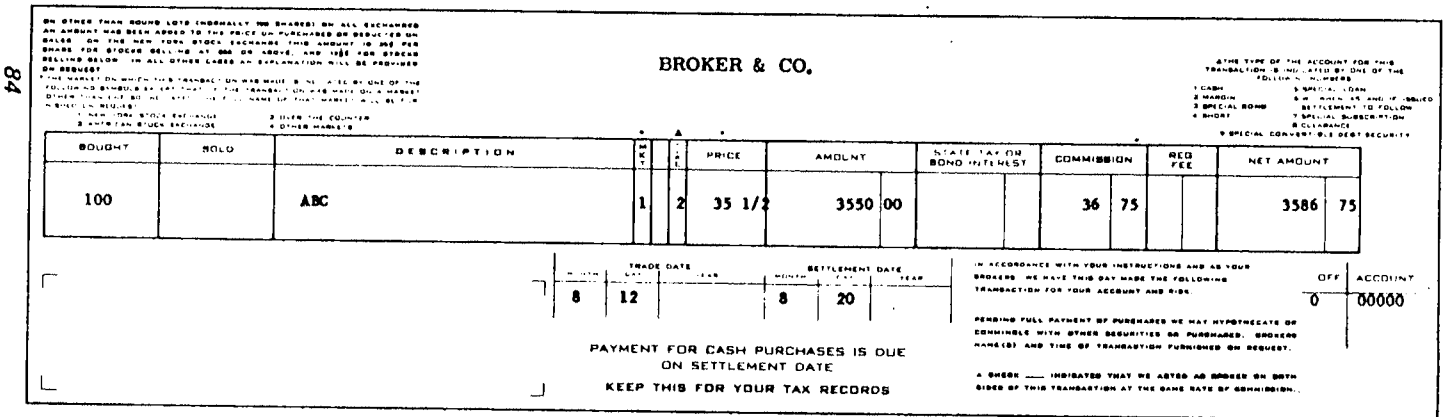
The customer's confirmation is a multipart form: The original is mailed to the customer; other copies go to the Margin Department, the Bookkeeping Department, and the Stock Record Department. Figure 10, on page 84, is a specimen *buy* confirmation; Figure 11, on page 84, is a specimen *sell* confirmation.

At the same time that the customer's confirmation is prepared, it is usual to prepare a so–called *blotter* or list giving the details of each buy and sell trade for the day. See Figures 12 and 13 on pages 85 and 86. Copies of the blotters are sent to the Cashier's Department for its use.

Also, the Purchase and Sales Department prepares *exchange* (comparison) tickets. These are used to confirm transactions with the other brokers. How this is done is discussed below.

HOW EXECUTED TRADES ARE COMPARED

The reconciliation of the customer transactions to the brokerage firms that were traded with is the most important function performed by the P&S Department. For every customer side transaction, there must be an opposing broker transaction.



BROKER & CO.

BOUGHT	SOLD	DESCRIPTION	MKT	CAT	PRICE	AMOUNT	STATE TAX ON BOND INTEREST	COMMISSION	REG FEE	NET AMOUNT
100		ABC	1	2	35 1/2	3550 00		36 75		3586 75

TRADE DATE: 8 12 — SETTLEMENT DATE: 8 20

PAYMENT FOR CASH PURCHASES IS DUE ON SETTLEMENT DATE

KEEP THIS FOR YOUR TAX RECORDS

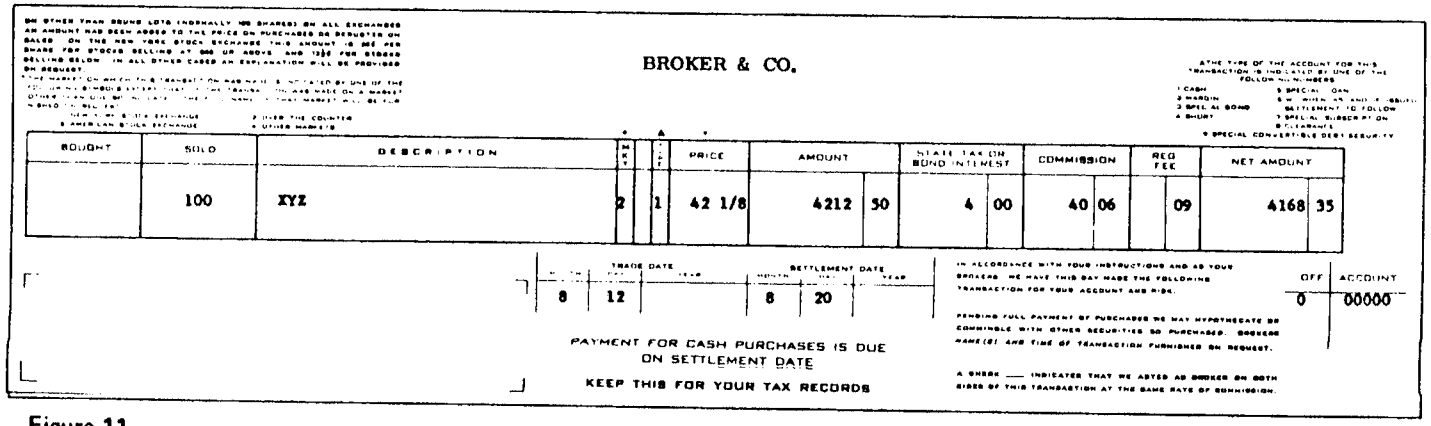
IN ACCORDANCE WITH YOUR INSTRUCTIONS AND AS YOUR BROKERS WE HAVE THIS DAY MADE THE FOLLOWING TRANSACTION FOR YOUR ACCOUNT AND RISK

OFF 0 — ACCOUNT 00000

PENDING FULL PAYMENT OF PURCHASES WE MAY HYPOTHECATE OR COMMINGLE WITH OTHER SECURITIES SO PURCHASED. BROKERS NAME(S) AND TIME OF TRANSACTION FURNISHED ON REQUEST.

A CHECK ___ INDICATES THAT WE ACTED AS BROKER ON BOTH SIDES OF THIS TRANSACTION AT THE SAME RATE OF COMMISSION.

Figure 10



BROKER & CO.

BOUGHT	SOLD	DESCRIPTION	MKT	CAT	PRICE	AMOUNT	STATE TAX ON BOND INTEREST	COMMISSION	REG FEE	NET AMOUNT
	100	XYZ	2	1	42 1/8	4212 50	4 00	40 06	09	4168 35

TRADE DATE: 8 12 — SETTLEMENT DATE: 8 20

PAYMENT FOR CASH PURCHASES IS DUE ON SETTLEMENT DATE

KEEP THIS FOR YOUR TAX RECORDS

IN ACCORDANCE WITH YOUR INSTRUCTIONS AND AS YOUR BROKERS WE HAVE THIS DAY MADE THE FOLLOWING TRANSACTION FOR YOUR ACCOUNT AND RISK

OFF 0 — ACCOUNT 00000

PENDING FULL PAYMENT OF PURCHASES WE MAY HYPOTHECATE OR COMMINGLE WITH OTHER SECURITIES SO PURCHASED. BROKERS NAME(S) AND TIME OF TRANSACTION FURNISHED ON REQUEST.

A CHECK ___ INDICATES THAT WE ACTED AS BROKER ON BOTH SIDES OF THIS TRANSACTION AT THE SAME RATE OF COMMISSION.

Figure 11

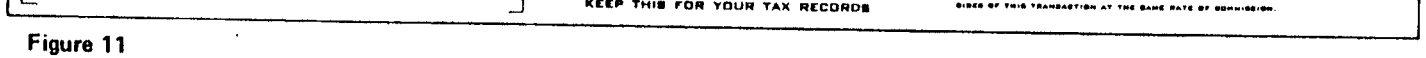

KEEP THIS FOR YOUR TAX RECORDS

Figure 11

P and S BLOTTER

BUY

TRADE DATE _____

SETTLEMENT DATE _____

From Whom Bought	Shares	Description	Price	Principal	Interest	Comm.	State Tax	S.E.C. Fee		Net Amount	Client
	100	American Tel. and Tel. T	51	5100-		44.10				5144.10	
	500	Brunswick Corp. BC	11 1/8	5562.50		90.65				5653.15	
	100	Capital Cities Broadcasting CCB	39	3900-		38.50				3938.50	
	1000	Hilton Hotels HLT	55 7/8	55875-		445.90				56320.90	
	300	Monsanto Co. MTC	42	12600-		120-				12720-	
	200	U.S. Steel X	40 3/4	8150-		78.76				8228.76	
TOTALS	2200			91187.50		817.91				92005.41	

Figure 12

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P and S BLOTTER

SOLD

TRADE DATE _____

SETTLEMENT DATE _____

To Whom Sold	Shares	Description		Price	Principal	Interest	Comm.	State Tax	S.E.C. Fee		Net Amount	Client
	500	Bethlehem Steel	BS	31 7/8	15937.50		174.70	25-	.54		15737.26	
	100	Brunswick Corp.	BC	11	1100.-		18.-	3.75	.04		1078.21	
	200	Hilton Hotels	HLT	56	11200.-		89.20	10.-	.38		11100.42	
	1000	Litton Industries	LIT	105 1/2	105500.-		495.50	50.-	3.52		104950.98	
	1000	Republic Steel	RS	41	41000.-		395.-	50.-	1.37		40553.63	
	100	Textron Inc.	TXT	44 1/2	4450.-		41.25	5.-	.15		4403.60	
	100	U.S. Steel	X	41	4100.-		39.50	5.-	.14		4055.36	
TOTALS	3000				183287.50		1253.15	148.75	6.14		181879.46	

Figure 13

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TRADE DATE/SETTLEMENT DATE

Every transaction involves two critical dates. The date of execution is known as the trade date. The day when delivery and payment is expected is known as the settlement date. Listed and most over-the-counter transactions involve a five-day settlement: that is, a trade effected on a Monday, is settled five business days later or on the following Monday.

COMPARISON AND RECONCILEMENT

Trades executed on the various exchanges or in the over-the- counter marketplace on behalf of a firm's customer are transacted by verbal agreement between executing participants. On the exchanges, these participants are known as floor brokers; in the over-the-counter arena, they are known as traders. As no written agreement changes hands, trade verification or comparison is performed later in operation cycle. The responsibility for this function lies with the P&S Department.

As each trade under consideration was consummated on behalf of a customer, the offsetting or contra broker side (the firm that the customer's firm traded with) must agree in all details of the trade with that reported to the customer. The process of verifying brokerside trades is known as comparison. Reconciling customer trades with the offsetting broker transaction is known as reconcilement.

Comparison can be effected by broker-to-broker verification or through the facilities offered by a clearing corporation or, as it is more commonly known, a clearing house. National Securities Clearing Corporation (NSCC) and Stock Clearing Corporation of Philadelphia (SCCP) are examples of clearing corporations.

Figure 13

Broker-to-broker comparison involves each firm that was a party to the trade sending a comparison (a written or computer-produced document giving the details of the transaction) to the contra or opposing broker. In other words, if a brokerage firm executes one hundred trades with one hundred firms, the firm sends one hundred comparisons, one to each firm. In the same fashion, each of the contra firms sends a trade comparison to each firm that they traded with—and so on. Fortunately, the industry does not process all its trade comparisons through this method.

The greatest quantity of transactions are compared through a clearing house. The participants submit their trade data to one central location. With all this data collected, the Clearing House performs a comparison. It matches buyers with their stated sellers and sellers with their stated buyers. Those transactions in which the buyer and seller agree are reported to the submitting firms as *compared*. If a submitting firm's data does not agree with an opposing firm data, it is reported as *uncompared*. Finally, if an opposing firm submitted data that does not compare with its named firm's data, it is reported to the named firm as an Advisory. See Figure 14.

A CONTRACT REPORT

While this last paragraph may appear confusing, it really isn't. Let us assume that we are firm A. We submit two trades to the Clearing Corporation for comparison.

(1) We bought 100 shares of XYZ @ 421/2 from brokerage firm B, and (2) we bought 100 shares of XZZ @ 351/8 also from brokerage firm B. Brokerage firm B reported to the Clearing Corporation that they sold 100 XYZ @ 421/2 and 100 XZZ @ 351/4 to us. The clearing corporation performs its match routine and reports to us that the trade for 100 shares of XYZ @ 421/2 is com-

pared. However, our trade of 100 XZZ @ 351/8 is reported as uncompared. The clearing corporation also informs us or advises us that Broker B wants to sell us 100 shares of XZZ @ 351/4. Brokerage Firm B's report will reveal that they are compared on 100 XYZ @ 421/2 but uncompared on their sale of 100 XZZ @ 351/4. The Clearing Corporations report to firm B will also advise them of the fact that Brokerage Firm A wants to purchase 100 shares of XZZ from them at a price of 351/8.

As the trades that Brokerage Firm A is trying to compare with the contra firms were executed on behalf of A's customers; Firm A must not only reconcile broker differences but also customer differences. The net result of this reconcilement is that for every customer transaction, there will be an opposing broker transaction. These transactions must balance as to shares, security, execution price and trade money.

The P&S Department must research each discrepancy and make the appropriate corrective entry. The resolution of the discrepancy may result in an adjustment to be made to the customer transaction or a correction to the firm's broker side transaction. See Figures 12 & 13.

Corrections to the customer transaction necessitate corrective confirmations being sent to the customer as well as the adjusting entries being processed through the entire operating cycle. See Figures 10 & 11.

For trades having a five-day settlement cycle, all corrections to the broker side entries should be effected by the third business day following the trade date. This is necessary to allow the Cashier's Department sufficient time to prepare for settlement. Any trade not resolved by the P&S Department by the morning of the third business day, must be returned to the place of execution for reconcilement. Executions in listed securities are

90

CLEARING MEMBER	CM NO	TRADE DATE MO	DAY	YR	PURCHASE CONTRACT	SETTLEMENT DATE MO	DAY	YR	MANHATTAN SECURITIES CLEARING CORPORATION
BROKER A & CO.	035	12	10	XX	Regular Way	12	17	XX	PAGE

COMPARED PURCHASES							UNCOMPARED PURCHASES				ADVISORY DATA				
SELLER	ACCOUNT OF	QUANTITY	CONTRACT AMOUNT	SETTLE DATE	UNIT PRICE	ADJ RECORD	SELLER	ACCOUNT OF	QUANTITY	CONTRACT AMOUNT	SELLER	ACCOUNT OF	QUANTITY	CONTRACT AMOUNT	CONTROL NO
CNS		XYZ & Co. Inc.													
	XYZ	Cusip	98344892		Settle PX CNS										
590		100	4,250.00		42 1/2										04343114
CNS		XYZ Limited													
		Cusip	989489314		Settle PX CNS										062413893
							590		100	3512-50	590		100	3,525.00	140482941

SCL 10
REV 10 77

ADJUSTMENT OF ODD PENNY BREAKAGE RESULTING FROM COMPARISON ON TOTAL CONTRACT VALUE BASIS AT EACH UNIT PRICE

ADJUSTMENT CODES
A1 ADDED BY ADVISORY D3 DELETE CONTRACT COMPARED ITEM OR ADVISORY
A2 SUPPLEMENTAL ADD BY SELLER D4 DELETE ADD BY SELLER
? DESIGNATES DATA REQUIRING SPECIAL VERIFICATION
* DESIGNATES TRANSACTION OUT OF HI-LO PRICE RANGE

SPECIAL CODES (OTHER THAN 100 ROUND LOTS)
TWO DIGIT CODE ABOVE DESIGNATES ROUND LOT SHARES TRADED AS 10 - 10 SHARE ROUND LOTS 25 - 25 SHARE ROUND LOTS ETC *
OL ODD LOT K STOCK FAIL DELETE
A7 FAIL ADD BY SELLER

sent to the executing floor brokers. OTC transaction return to the firm's traders. These individuals contact the opposing firm's representative with whom they originally traded with and between the two resolve the difference.

As stated earlier in this section, not all transactions are compared through a Clearing Corporation. These transactions must be compared on a trade for trade basis with the opposing brokerage firm. Both firms exchange comparisons. If a firm agrees with the details of the opposing firm's "comp," the firm will affix its stamp to it and return the stamped copy to the sender. The firm's stamp on the opposing firm's comparison is official acceptance of the transaction. If, on the other hand, the firm does not agree to the terms or does not know the trade at all, it will mark the opposing firm's trade comparison "DK" for don't know and return the "comp" to the originating firm. Each DK'd item must be researched by the sending firm. If it cannot be reconciled by the P&S Department, the original transaction is returned to the executing person for reconcilement.

This concludes the comparison section. All transactions between firms must be compared. Comparison cycles differ among the types of security, their marketplace, and their respective settlement cycle. Regardless of these differences, at the end of the comparison cycle, customer's transactions must agree or balance with street or broker side trades.

Work of the Margin Department

The Margin Department performs several highly specialized and important functions: It keeps up–to–date records of each customer's purchase and sale of securities, and each customer's deposit and withdrawal of funds. No money or securities may be paid or delivered to a customer unless authorized by the Margin Department. In addition, this Department keeps records of, and watches carefully, each *margin* transaction in a customer's account. Thus, it makes certain that no violation of the margin rules takes place.

Some securities houses now use computers to do part of the work of the Margin Department. In other securities houses, all the work is still done by hand. However, no matter how the work is performed, the basic procedures and rules we shall study here are the same. So, for our purposes here, we shall assume that all functions are performed by hand.

Before we begin our study of the Margin Department, let's review some of the things we learned about customer accounts. You will recall that when a customer opens an account with a securities house, he tells the registered representative the kind of account he wants to open—a *cash* account or a *margin* account.

A *cash* account means just what the name implies: The customer agrees to pay promptly the full price of each security he buys. In a *margin* account, on the other hand, the customer agrees to pay a certain prescribed

percentage of the purchase price; the broker lends him the balance of this price.

Generally, when a customer opens an account with a brokerage firm, a notice to that effect is sent to the Margin Department. The notice shows the customer's name, his account number, and the kind of account (cash or margin) that he has opened. This information is placed on the *customer's account card.*

RECORDS AND RULES FOR A CASH ACCOUNT

A customer's account card is usually divided into *debit* and *credit* columns.

The *debit* column shows securities purchased by the customer or received for his account. It also shows any moneys owed to the brokerage firm. Thus, if the customer owes the firm any money for the purchase of securities, we say he has a *debit balance.*

On the other hand, the *credit* column shows all sales of securities made by the customer or delivered for his account. It also shows any moneys deposited by him or owed to him from the sale of securities. Thus, if the customer has not been paid the proceeds of a sale, or elects to keep the money on deposit with the broker, we say the customer has a *credit balance.*

To illustrate:

John Customer buys 100 shares of XYZ common. The total amount is $5,000 including commissions. The P & S Department will prepare a customer's confirmation, showing the details of the transactions. It will send a copy of this confirmation to the Margin Department, which uses the confirmation to make the entry in the debit column, as shown in Figure 15, on page 94.

CUSTOMER NAME
John Customer
CONTACT
STANDING INSTRUCTIONS
SECURITY VALUE
LEDGER BALANCE
EQUITY
DATE
DESCRIPTION
PRICE
DEBIT
CREDIT
BALANCE
DEBIT UNLESS MARKED CR
ACCOUNT NUMBER
8/12
100
XYZ
5000 —
5000 —

Figure 15

Since this is a cash account, John must pay for the stock in full. When his check is received by the firm, the Margin Department is notified and an entry is made in the *credit* column, as shown in Figure 16.

Following are the rules governing *cash* accounts:

1. When a customer enters an order to purchase a stock, he must have sufficient funds in his account or he must have agreed to make prompt payment in full.

2. If the purchase order is executed, the customer should pay the purchase price in full by the settlement date, but he can pay it not later than the seventh business day. In other words, if a customer buys stock on, say, Monday, he should pay for it by the following Monday, but not later than the following Wednesday.

If the customer does not pay for the stock by the seventh business day, then the broker must cancel the trade or liquidate the account. To *liquidate the account,* means that the broker sells the security. Under special circumstances, the broker may apply for an extension of time in which the customer can pay for the purchase.

3. When a customer enters an order to sell *long* the broker must know that the customer owns the security. If the security is not in the broker's possession, the broker must be assured that the customer will deposit it promptly in his account. A *long* sale means that the customer is the owner of the security, and that it is either in his, or in his broker's, possession.

4. If a customer buys a security and then sells it before paying for it, his account is *restricted.* This means that the broker may not execute new purchase orders for the customer for 90 days, unless the customer deposits

Figure 15

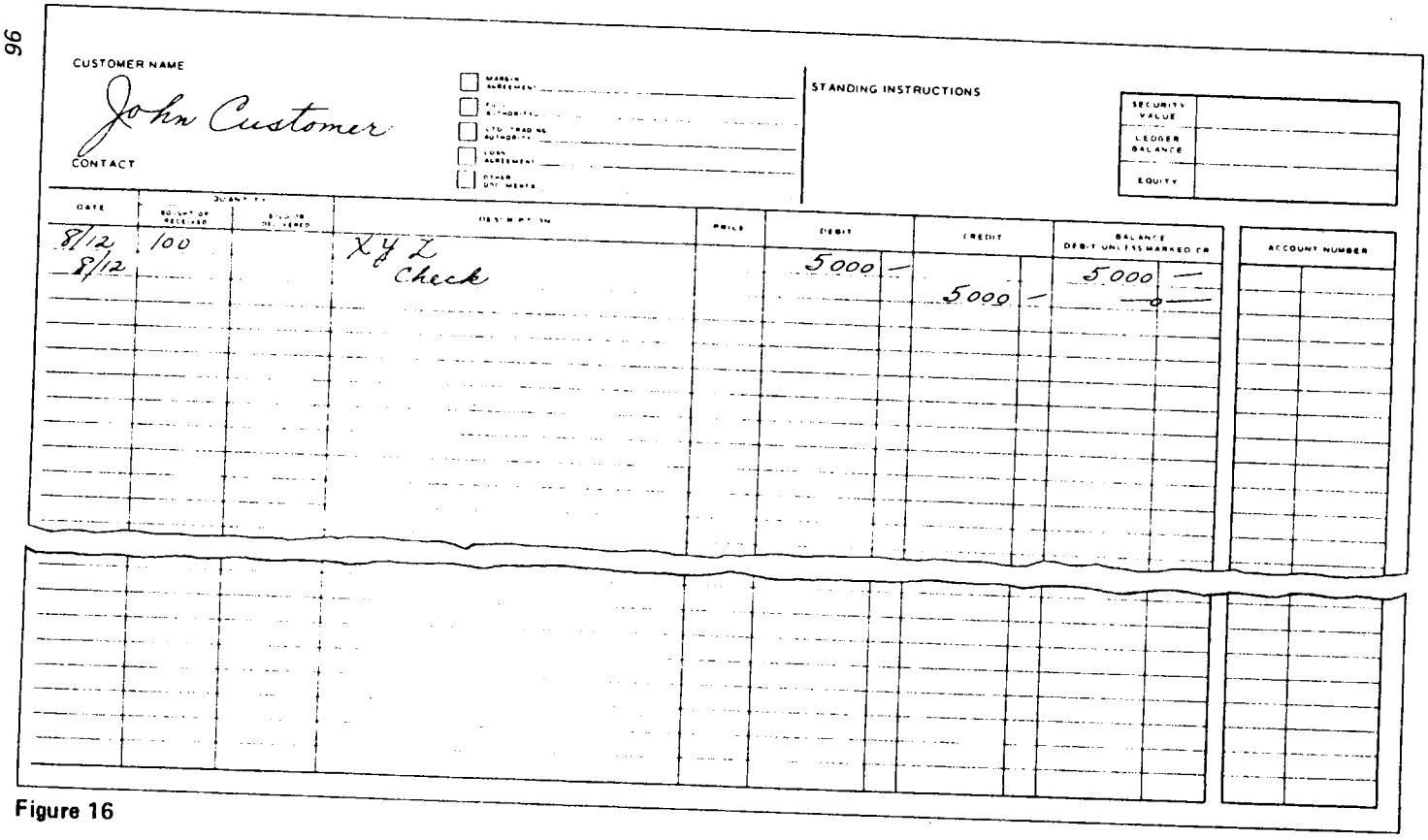

CUSTOMER NAME
John Customer
CONTACT
STANDING INSTRUCTIONS
SECURITY VALUE
LEDGER BALANCE
EQUITY
DATE
DEBIT
CREDIT
BALANCE DEBIT UNLESS MARKED CR
ACCOUNT NUMBER
8/12 100
8/12
X Y Z Check
5000 —
5000 —
5000 —
—0—

Figure 16

enough money in his account to pay for the securities before the new orders are executed. However, the account will not be *restricted* if the customer pays for the purchase within seven business days *and* does not withdraw the proceeds of sale before he makes payment.

To illustrate:

John Customer buys 100 XYZ common on Monday, but he does not pay for the stock. On Wednesday of the same week, Mr. Customer sells the 100 XYZ common. He asks that the check for sale proceeds be sent to him. *The account is restricted.*

Suppose on this same transaction Mr. Customer pays for the shares of stock on Friday. Then, on the following Tuesday, he asks that the check for the sale proceeds be sent to him. The account is *not* restricted.

5. A customer may not sell a security *short* in a cash account. Instead, short sales must be made in a *margin account.* A *short* sale means that the customer is selling stock he does not own but which he hopes to buy back at a later date, at a lower price. Until such time as the customer buys back the stock, the broker borrows the stock for him from someone else.

RECORDS AND RULES FOR MARGIN ACCOUNTS

Before we begin our study of *margin* accounts, let us again note the differences between a *cash* account and a *margin* account. We should bear in mind that the broker must pay for the stock in full whether the purchase is made in a cash account or in a margin account.

To illustrate:

> A customer buys stock for $5,000. If the purchase is made in a *cash* account, the customer will promptly send his check for $5,000 to the broker. However, if the purchase is made in a *margin* account, then the customer will send the broker a check for only part of the purchase price. He will borrow the balance from the broker. The loan from the broker is the customer's *debit balance*. While this loan is outstanding, the customer will pay interest on it to the broker.

When a customer buys a security in a *cash* account, he can order that the certificate be delivered to him, or he may leave it with the broker for safekeeping. But when a customer buys a security in a *margin* account, he leaves the certificate with the broker.

A customer who wants to buy on margin must open a margin account; he can then use the account to either buy on margin or buy for cash. However, if a customer opens a cash account, he is limited to making cash purchases only in that account. If he later changes his mind and wants to buy on margin, then he must open a margin account.

The Margin Agreement

When a customer opens a margin account, he signs an agreement. Among other things, this agreement gives the broker the right to use the securities in the account as collateral for the broker's loans. This agreement that allows the broker to pledge the customer's securities is called a *hypothecation agreement.*

Remember, when a customer buys on margin, he borrows part of the purchase price from the broker. The broker, in turn, has to borrow the money from a bank.

The broker uses the securities in the margin account for collateral.

On the other hand, a broker cannot take a so—called hypothecation agreement from a customer who has a cash account. Since the customer has made full payment for the stock, it belongs to him. Thus, it cannot be used by the broker as collateral for the broker's loans.

BASIC TERMS USED IN MARGIN ACCOUNTS

To become a margin clerk, you must have specialized training. Among other things, you must learn the meanings of certain basic terms, explained below.

Credit Balance

The *credit balance* is the amount of cash left in a customer's account after he has paid for all his purchases in full. The proceeds of a short sale would also be considered a *credit balance.*

To illustrate:

> A customer deposits $2,000 with the broker at the time he opens his account. The customer then buys 100 shares of XYZ stock, costing $3,000. Several days later he sends the broker a check for $3,000. Since the $3,000 check is in full payment of the purchase, the customer still has his initial deposit of $2,000 in his account. This $2,000 would be his *credit balance.*

Debit Balance

The *debit balance* is the amount of money a customer, who is buying on margin, has borrowed from his broker

to finance the purchase. The debit balance will not change because of any increase or decrease in the value of the security so purchased. However, the debit balance will change when the customer makes another margin purchase in his account.

To illustrate:

A customer buys on margin 100 shares of XYZ stock worth $6,000. The customer sends the broker a check for $4,800. Thus, he owes the broker $1,200. This $1,200 is his *debit balance.*

Current Market Value

Generally, the *current market value* of a security is the closing price of that security as of the preceding business day. For example, to find the *current market value* of a security on Tuesday, you would take the closing price of that security on Monday. However, there are these exceptions: On the day a security is purchased, its current market value for that day is the total cost of that security, including the commission. And on the day a security is sold, its current market value for that day is the net amount, that is, the amount minus the commission, fees, and taxes.

To illustrate:

On Monday a customer buys on margin 100 shares of XYZ stock at $50 a share. The total cost is $5,044—$5,000 plus $44 commission. Thus, on Monday, the *current market value* of XYZ stock would be $5,044, the total cost of the stock to the customer.

The closing price of XYZ stock on Monday is $52 a share. So its *current market value* on Tuesday would be 100 x $52 or $5,200.

Equity

The *equity* in an account is the difference between the current market value of the securities in the account and the customer's debit balance. Stated another way, *equity* equals *current market value* minus *debit balance.* It represents the customer's ownership interest in the account.

A customer's equity will fluctuate with the market value of the shares in his account. If the market value of the shares rises, his *equity* will be larger. On the other hand, if the market value of his shares decreases, then his *equity* will be smaller.

To illustrate:

On April 15, customer buys on margin 100 shares of XYZ stock for a total cost of $5,000. On the same day, the customer deposits $4,000 with his broker, leaving a *debit balance* of $1,000. The closing price of the stock on April 15 is $52 a share, and on April 16 the closing price is $48 a share. What is the *equity* in the customer's account on April 15, April 16, and April 17?

Answer: On April 15, his *equity* is $4,000. Remember, that the current market value of a security on the date of purchase is the total cost of that security. Thus, on April 15, the *current market value* of the security was $5,000. Subtracting $1,000 (the *debit balance*) leaves an equity of $4,000.

However, on April 16, the customer's *equity* is $4,200. Since the closing price of stock on the day before was $52 a share, its *current market value* is now $5,200. Subtracting the *debit balance* of $1,000 leaves an *equity* of $4,200.

But on April 17, the *equity* in the account would be $3,800. Since the closing price of stock on the day before

was $48 a share its *current market value* is now $4,800. Subtracting the *debit balance* of $1,000 leaves an *equity* of $3,800.

Review

Before we continue with our study of margin accounts, let us review the more important things we have learned. We have learned that when a customer *buys on margin,* it means that he pays only a part of the purchase price. He borrows the rest of the money from his broker. The amount of money that the customer owes the broker is called the *debit balance.* This *debit balance* does not go up and down with the price of the stock.

The customer's *equity* is the difference between the *current market value* of his stock and his *debit balance.* This equity fluctuates with the price of the stock. If the price of the stock goes up, the customer's *equity* becomes greater. And if the price of the stock goes down, the customer's *equity* will become smaller.

THE MARGIN RULES

Transactions in a *margin* account are governed by the rules of the Federal Reserve Board, the rules of the stock exchange on which the security is traded, and the rules of the firm handling the account. As a margin clerk, it is your job to see that none of these rules are broken. A violation of the Federal Reserve rules or, say, the New York Stock Exchange rules could mean that penalties would be imposed on your firm.

Initial Margin Requirements

The *initial margin* is the amount of money that a customer must deposit with his broker when he buys a

security on margin. Both the Federal Reserve Board and the New York Stock Exchange have rules on initial margins.

The Federal Reserve Board by spelling out how much money a broker can lend a customer fixes the amount of money that the customer must deposit when he *buys on margin.* This amount is usually stated as a percentage of the purchase price. If the Federal Reserve Board says that a broker may lend a customer 20% of the current market value of a security, the customer must put up the other 80%. The percentage loaned by the broker is called the *maximum loan value.* Thus, if the broker lends 20%, then 20% is the *maximum loan value.*

To illustrate:

Customer buys 100 shares of XYZ stock on margin. The total cost is $5,000, including the commission. If the maximum loan value is 20%, then the broker can lend the customer $1,000 (20% of $5,000). Thus, the customer must make a deposit of $4,000 ($5,000–$1,000).

However, the customer does not have to make his deposit in cash. He may, instead, deposit securities having a loan value equal to the amount of the cash. Thus, in the above example, the customer could deposit $4,000 in cash, or he could deposit securities having a loan value of $4,000 ($20,000 of Security × 20% = $4,000).

The New York Stock Exchange also has rules governing the initial margin. Since the Federal Reserve Board's rule is a *minimum* margin requirement, it must give way to the New York Stock Exchange's rule when the latter rule requires a larger deposit.

To illustrate:

Customer opens a margin account and buys 100 shares of XYZ stock on margin at a total cost of $2,000. How much money must he deposit with the broker?

Answer: $2,000. *Reason:* Under the Federal Reserve Board's rule, the maximum loan value is 20% of current market value. If you followed this rule, the customer would have to deposit $1,600 (80% of $2,000). However, the New York Stock Exchange rule requires a minimum initial deposit of $2,000 in a margin account. Since this rule calls for a larger deposit, it must be followed.

In addition to the rules of the Federal Reserve Board and the New York Stock Exchange, each brokerage firm normally has its own margin rules. These rules, can not be less stringent than those of the Stock Exchange. For example, a brokerage firm's rules could not permit a customer to make a deposit of, say, $1,800, when the Stock Exchange requires a deposit of $2,000. However, a brokerage firm could require that a customer make a deposit of more than $2,000.

Time For Deposit of Margin

The rules also specify the time within which a margin customer must deposit the necessary funds with the broker. At present, the rules state that a customer who buys on margin must deposit the required amount within five business days after the transaction.

To illustrate:

If a customer buys a security on margin on a Monday, he would have to deposit the required amount by the following Monday. However, under the rules, if there are exceptional circumstances, the broker may ask for an extension of time.

It is the job of the margin clerk to see that the necessary deposits are made on time. He keeps track of this through the customer's account card. You may recall that when the customer buys stock the date is noted on his account card. If the margin clerk finds that the

customer has not made the necessary deposit, he will notify his department head. Under the rules, the brokerage firm must liquidate the purchase, if the deposit is not made on time.

Maintenance Requirements

In addition to initial margin requirements, the New York Stock Exchange also has what it calls *maintenance* requirements. These requirements spell out the amount of equity the customer must have in his margin account after he has bought the securities. The purpose of these requirements is to protect the brokerage firm against any losses should the price of the security go down.

Under the New York Stock Exchange maintenance rules, a customer who has a *long* position in securities must maintain an equity of 25% of the market value of these securities. Thus, if a customer has securities with a current market value of $10,000 in a margin account, his equity would have to be at least $2,500 (25% of $10,000).

To illustrate:

> Customer has a *debit balance* of $2,500 in his margin account. The *current market value* of the securities in this account is $8,000. Thus, the *equity* in his account is $5,500 ($8,000 − $2,500).

In the above example, the account would meet the *maintenance requirements* of the New York Stock Exchange. *Reason:* Under this requirement, the customer must have an equity of $2,000 (25% of $8,000), but his actual equity is $5,500. This $5,500 is greater than the $2,000 minimum. However, should the price of the securities drop sharply, then the customer may not meet the maintenance requirement.

To illustrate:

> Customer has a *debit balance* of $2,500 in his margin account. The *current market value* of the securities is now $3,000. Thus, his *equity* in the account is $500 ($3,000–$2,500). However, under the Stock Exchange rule, his equity in the account must be at least $750 (25% of $3,000). Since the equity ($500) is less than the maintenance requirement ($750), the account is undermargined.

An account becomes undermargined when the equity in the account falls below the maintenance requirement. The customer must then bring it up to the maintenance requirement–here 25%. Generally, when an account becomes undermargined, the margin clerk will issue what is known as a *margin call.* That is, he sends the customer a notice that the customer must deposit additional moneys or his account will be liquidated.

Most brokerage firms have maintenance requirements that are greater than those of the New York Stock Exchange–usually, from 30% to 35% of the *current market value.* In some brokerage firms, the maintenance requirement is even higher. Thus, as a practical matter, a customer will get a *margin call* long before his account hits the New York Stock Exchange maintenance requirement of 25%.

QUICK REVIEW

The Margin Department keeps up–to–date records of each customer's account. It also makes certain that each account complies with the margin rules.

The Margin Department also keeps track of the time between the purchase of a security and the customer's payment for the security. If the customer for some good

reason does not make the payment within the specified time, then the brokerage firm may request an extension of time.

When a customer is buying on margin, his account must meet the initial margin requirements and also the maintenance requirements of the New York Stock Exchange and the brokerage firm.

If at any time a customer fails to make the necessary deposit for a margin purchase or fails to meet the maintenance requirements, then his account must be liquidated. Generally, when a margin account falls below the maintenance requirement, the broker will send the customer a *margin call* before he orders the account liquidated.

A brokerage firm may impose its own initial and maintenance requirements. Often these are higher than those of the Federal Reserve Board and the New York Stock Exchange.

Work of the Cashier's Department

The Cashier's Department, more popularly called the *Cage,* handles all securities and money that come into or go out of a securities house. The work of this department is divided among several sections. In this lesson, we shall study these major sections: the Box Section; the Receive and Deliver Section; and the Stock Transfer Section.

THE BOX SECTION

At one time, each securities house kept its securities in large individual metal boxes. These *boxes* were stored in a bank vault overnight and were brought to the firm's office each morning. From this practice was derived the name *Box* or *Box Section.* Today, some firms still keep their securities in boxes; others keep them in other places, such as trays.

In short, the Box Section of a securities house is the place where securities are stored. A record is made of each stock certificate that comes into or goes out of the Box.

When securities come into the Box Section, they are sorted into one of three groups or boxes. For our purposes, we shall call these groups Box 1, Box 2, and Box 3.

Box 1

Here the firm keeps all fully paid securities that have been transferred into the names of the customers, and which the customers have asked the firm to hold for them. Securities in this box are said to be in the *name of* the customer, or in *safekeeping.* In other words, the firm is here acting as a custodian. A security placed in this box stays there until the customer asks that it be delivered to him. Or if the customer sells the security, it will then be taken out and delivered to the buying broker.

Box 2

Here the firm keeps securities not needed as collateral for a margin account (that is, *free* or *excess* securities). It also keeps here customers' fully paid securities that have been transferred into the firm's name, and that the firm is holding for the customers. Securities in this box are said to be in *segregation.*

At this point, we should note that the decision whether a security should be placed in *safekeeping* or in *segregation* is made by the Margin Department, which then sends the instruction to the Box Section. The margin clerk must initial and date the instructions and so, too, must the clerk in the Box Section who carries out the instructions.

Box 3

All other securities are kept in this box. Generally, these are securities that have just been received by the brokerage firm, and for which no instructions have yet been issued by the Margin Department. These securities are said to be in the *active* box. Usually, when securities

are needed for deliveries or loans, they will be taken from this box first.

RULES FOR GOOD DELIVERY

Study Figure 2, on page 47. It is the face of a specimen stock certificate. You will note that it has a space for inserting the name of the owner (or owners) of the shares represented by the stock certificate. When the owner or owners sell the shares, they endorse the assignment form on the reverse side of the certificate. Figure 17 is a specimen assignment form. However, instead of endorsing the assignment form on the reverse side of the certificate, the owner may sign a separate assignment called a *stock power.* Figure 18, on page 112, is a specimen stock power.

When we say a certificate is a *good delivery* we mean that the certificate is negotiable—that is, it is freely exchangeable. Stated another way, a certificate is a *good delivery* if it contains the necessary endorsements and tax stamps on the reverse side of the certificate. If it does, then the certificate will be accepted by the buyer or his broker, or by the transfer agent for issuance of a new certificate in the new owner's name.

Many certificates are registered in the name of a securities house. These certificates are said to be in *street name.* They are a *good delivery* when they are properly endorsed by the firm and the necessary tax stamps are affixed.

However, stock certificates may also be registered in the names of persons other than brokerage firms—for example, in the names of individuals, partnerships, corporations. Certificates may also be registered in the name of a *nominee;* that is, the name of a person or company other than the true owner. The purpose of registering the certificate in the name of a nominee is to speed up the handling of the certificate.

Figu

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

A FULL STATEMENT OF THE DESIGNATION, RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS OF THE SHARES OF EACH CLASS AUTHORIZED TO BE ISSUED AND THE DESIGNATION, RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS OF THE SHARES OF EACH SERIES OF EACH CLASS SO FAR AS THE SAME HAVE BEEN FIXED BY THE BOARD OF TRUSTEES AND THE AUTHORITY OF THE BOARD OF TRUSTEES TO DESIGNATE AND FIX THE RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS OF OTHER SERIES WILL BE FURNISHED TO ANY SHAREHOLDER UPON REQUEST AND WITHOUT CHARGE.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM	— as tenants in common	UNIF GIFT MIN ACT —	.....Custodian..... (Cust) (Minor) under Uniform Gifts to Minors Act ..... (State)
TEN ENT	— as tenants by the entireties		
JT TEN	— as joint tenants with right of survivorship and not as tenants in common		

Additional abbreviations may also be used though not in the above list.

For value received, _____ *hereby sell, assign and transfer unto*

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

_____

PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS OF ASSIGNEE

_____ *Shares*

of the Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint _____

_____

Attorney to transfer the said stock on the books of the within-named Company with full power of substitution in the premises.

Dated, _____

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER

_____

THIS SPACE MUST NOT BE COVERED IN ANY WAY

Figure 17

SAMPLE OF STOCK POWER

– Assignment Separate from Certificate.

For Value Received, ...

hereby sell, assign and transfer unto .....

.....

.....

..... (.....) *Shares of the* .....

Capital Stock of the .....

standing in ..... *name on the books of said* .....

..... *represented by Certificate No.* ..... *herewith*

and do hereby irrevocably constitute and appoint .....

..... *attorney to transfer the said stock on the books of the within named*

..... *with full power of substitution in the premises.*

Dated .....

In presence of

.....

Figure 18

The Endorsements

A certificate registered in the names of persons other than a securities house is a *good delivery* if:

1. The certificate has been signed by the owner.
2. The owner's signature is guaranteed by a broker or a commercial bank. If the security is traded on the New York Stock Exchange, the signature guarantee must be by a member firm or by a commercial bank.
3. The certificate has the necessary tax stamps affixed, or a notation that the tax has been paid, or a notation that it is exempt from taxation.

Signature on the Certificate

The owner's signature must correspond to his name as it appears on the face of the certificate. For example:

1. A certificate registered in name of *John Jones* must be signed *John Jones*—not J. Jones or Jack Jones.
2. A certificate registered in name of *Dr. William Jones,* should be signed the same way.
3. A certificate registered in name of *Mrs. Mary Jones* should be signed Mrs. Mary Jones—not Mary Jones or Mrs. John Jones.

If a certificate is registered in the name of two or more persons as "tenants by the entireties" or as "tenants in common," the certificate must be signed by all the persons named thereon. A certificate registered in the name of a partnership, however, should be signed in the name of the partnership.

SETTLEMENT CYCLE

All transactions executed and compared brokerage firms must eventually settle. Selling firms deliver securities to the buying firms, and buying firms pay the contracted amount to the selling firm when the delivery is effected. The settlement, in some cases necessitate physical or actual delivery; in other cases, the delivery is made and paid for through Book Entry.

Physical delivery is conducted on a firm-to-firm basis. The receiving firm prepares checks on the morning of settlement day, payable to the delivery firm, and waits for the security to be delivered. Upon receipt of the security, the receiving firm releases the appropriate check. As the amount of money for the transaction is determined from the firm's records, the importance of comparison discussed in the P&S section becomes apparent. If the delivery firm's records states a different sum to be received upon security delivery, the receiving firm will "DK" or "bounce" the delivery thereby returning it to the selling firm without paying for it.

The clearing corporation made a major step forward when it offered netting and allotting and single security settlement. As all transactions entering the clearing corporation's settlement cycle have been compared, then for each buyer there is a seller at an agreed price. The only difference that could exist between the many shares of a given issue that were traded is the execution price. Therefore, the clearing corporation establishes a common price for settlement purposes and then debits or credits the firms account, the difference between their established settlement price and one actual execution price. The clearing corporation can "net out" each firm's position in a particular security.

For example, trades settling for a given day in XYZ:

Transactions	Settlement Price	Adjustment
Firm A—B 100 @ 42 1/2	43	+ $ 50.00
S 300 @ 43	43	0
B 100 @ 42	43	+ $ 100.00
☐ Net seller 100 @ 43		+ $ 150.00
Firm B—B 300 @ 43	43	0
S 100 @ 43	43	0
S 200 @ 42	43	— $ 200.00
☐ Flat		— $ 200.00
Firm C—S 100 @ 42 1/2	43	— $ 50.00
B 100 @ 42	43	+ $ 100.00
B 100 @ 43	43	0
☐ Net buyer 100 @ 43		+ $ 50.00

As a result of the netting and allotting processing process, two balance orders will be issued by the clearing corporation. One instructs Broker A to deliver 100 shares to Broker C @ $4,300, the other, instructs Broker C to receive 100 shares from Broker A for $4,300. The clearing corporation debits and credits the firms accordingly (i.e. credits A $150, debits B $200 and credits C $50). See Figure 19.

Balance orders drastically reduced the number of deliveries that have to be made daily to settle transactions.

Through this settlement process, called netting, firms are spared the need to receive and deliver securities that basically duplicated each effort. As a result of a firm's trading activity, the transactions in the same security are paired off, leaving a firm with one position per security to contend with. This position might be to receive, to deliver, or to be flat (buys equal sells).

Under the trade-for-trade and balance-order settlement, securities have to be delivered and paid for to satisfy the firms obligations. If the firm is unable to deliver securities on settlement date, the procedure is referred to as a Fail. The selling firm has a "fail to deliver," the buying firm records a "fail to receive." When the selling firm delivers the security, the buying firm pays the money due, and both firms clean up these fails.

DEPOSITORIES

Until the concept of a central depository became a reality, settlement of either trade for trade or balance orders necessitated the physical delivery of securities. The depository concept calls for all the participating firms to deposit securities into a central location. With the securities on deposit, settlement could be effected by book entry. Instead of the delivering firm physically delivering the security, it simply instructs the depository to remove the security from its booked position and enter the security in the account of the receiving firm. Payment is then made and the transaction settled without the physical certificate ever moving. The brokerage industry now has a vehicle that could expedite settlement without having to move or deliver physical certificates. One problem still exists—fails. Depository Trust Company is one of the industry depositories.

The depository acts as an extension of the firm's own Cashier's Dept. On instruction from the firm's cashier it submits positioned securities to a transfer agent for reregistration into the name of another. The firm can also instruct it to receive or deliver securities on its's behalf.

CLEARING CORPORATIONS: CONTINUOUS NET SETTLEMENT

Fails, both receive and deliver, could accumulate on a firm's records. The firm could have multiple fails in the same security from various settlement dates. It would have to wait until securities were received, thereby "cleaning up" its fails or receives before it could deliver them and "clean up" its "fails to deliver." A concept known as Continuous Net Settlement was devised. It uses the facilities of a clearing corporation and a depository. Under this concept, trades of a firm settling in a given security are netted to a single receive or deliver position. These positions are posted to the firm's account at the clearing corporation. Computer-produced tapes or "mag" tapes are sent to the depository and passed against firm's position account. If the net selling firm's position has the security available, it is used to clean up the settlement position. The clearing corporation then instructs the depository who the receiving firm is to be, and the depository enters the quantity received into that firm's account. This procedure permits the net seller and net buyer to settle their transactions without the physical security ever moving. If the deliverer does not have security available, fails are opened on the clearing corporation record, a fail to deliver for the net settler and a fail to receive for the net buyer. The next day's settling trades are netted, but they also include the previous fail position. Therefore, the firm's account is always being updated. For example, on a given day, Firm A is a net receiver of 100 shares. The net seller is unable to deliver the security, so it becomes a fail to receive for Firm A. The trades from the following day reflect that Firm A will be a net deliver 100 shares. Under continuous net settlement, the previous day's fail to receive is included with the next day's settling trades which result in Firm A being netted to a zero balance. See Figure 19.

By including the previous day's fail position, if any, in with the next day settling trades, the firm's position

MANHATTAN SECURITIES CLEARING CORPORATION

CNS PROJECTION REPORT

MEMBER NUMBER

MEMBER NAME BROKER A & COMPANY

TODAY'S DATE 12/10/XX
SETTLEMENT DATE 12/17/XX

D B	TODAY'S CURRENT POSITION	TOMORROW'S SETTLING TRADES PURCHASED/SOLD(-)	TOMORROW'S STOCK DIVIDENDS REC/DEL(-)	TOMORROW'S PROJECTED NET POSITION LONG/SHORT(-)	TOMORROW'S PROJECTED MARKET VALUE LMV/SMV(-)	SECURITY DESCRIPTION	SETTLING TRADES DAY AFTER TOMORROW ★
	300	100		400	16,123.00	XYZ & Co. Inc.	
		100		100	3,512.00	XYZ Limited	

IMPORTANT THIS IS NOT A FINAL REPORT. PROJECTED POSITIONS MAY CHANGE DUE TO TODAY'S SETTLEMENT ACTIVITY. YOU MUST ADJUST YOUR PROJECTED POSITION TO REFLECT TODAY'S ACTIVITY

★ DATA REPRESENTS COMPARED TRADES FROM T + 1 AND T + 2 CONTRACTS ONLY. FINAL SETTLING TRADE QUANTITY WILL INCLUDE TRADES COMPARED ON T + 3 AND "AS OF" TRADES

CNS 2 REV 3-77

Figure 19

per security, is constantly being updated and the possibility of having multiple fails to receive and deliver has been eliminated.

MONEY SETTLEMENT

With continuous net settlement, money settlement for transactions is against the clearing corporation. All transactions settled in all of the CNS eligible securities are netted to one money settlement. The value of various securities received and delivered on behalf of a firm are netted into one "money receive" or "money payment" figure. If it is a "money receive," the clearing corporation pays the firm. If the value of the security received is greater than that delivered, the firm pays the clearing corporation. One money settlement suffices for all settled transactions.

The movements between clearing corporation and the depository are controlled by the firms Cashier's Department. It is the responsibility of the Cashier to insure that there are adequate securities on deposit at the depository and that only securities not needed for seg requirements (customer cash and margin accounts) are used to clean up transactions.

THE STOCK TRANSFER SECTION

Among other things, the owner of stock has the right to receive dividends when declared. He also has the right to vote his shares of stock at stockholders' meetings.

So that the corporation will know to whom to pay dividends and to whom to send notices of meetings, as well as other notices and reports, the corporation keeps stock books. In these stock books, it lists the names of all persons to whom it has issued certificates of stock. You will recall that a certificate of stock is merely evidence that the person whose name is written on the face of the certificate is the owner of the shares.

The person whose name is listed in the corporation's stock books is called a *stockholder of record.* And, as we have learned, his name is on the certificate of stock issued by the corporation.

When the stockholder of record sells his stock, his rights pass to the new owner. However, the corporation cannot make the necessary changes on its stock books, unless it is notified of the sale. The way the corporation is notified, is when it receives a request to *transfer* the certificate from the former owner's name to that of the new owner.

HOW STOCK IS TRANSFERRED

As a practical matter, most corporations do not handle the mechanical details of transferring stock. Instead, the corporation will arrange with a bank or trust company to act as its *transfer agent.* Thus, when you want to transfer stock you send it to the corporation's transfer agent.

Steps in the Transfer of Stock

1. The certificate of stock, together with transfer instructions, is sent to the corporation's transfer agent.
2. The transfer agent cancels the old certificate and issues a new certificate in the name of the new stockholder of record.
3. The transfer agent changes the corporation's stock book to show the name of the new stockholder of record.

In addition to having a transfer agent, most corporations also appoint another bank as *registrar.* The registrar's job is to keep an accurate record of the exact number of shares of stock issued by the corporation. This is done so that the corporation will not issue more shares than it is authorized to issue. Before a new stock certificate can be delivered to the new owner, it must be verified by the registrar.

Thus far we have spoken of stock being transferred into the name of the new owner (purchaser). However, the customer need not have the stock transferred into his name. Instead, he can have it transferred into his broker's name or into the name of a nominee.

If the customer has the stock transferred into his broker's name or his nominee's name, then the broker or nominee will become the *stockholder of record,* and the customer or actual owner will become the *beneficial owner.*

As *beneficial owner,* the customer retains his dividend, voting and other rights. However, he has to act through the *stockholder of record* when he wants to exercise these rights.

DUTIES OF THE STOCK TRANSFER SECTION

It is the job of the Stock Transfer Section of a securities house to send securities out for transfer and to get them back again. However, the clerks in this Section cannot act on their own; they must have instructions. Usually, these instructions will originate with the customer. For example, let us say that a customer has purchased 100 shares of XYZ common stock. The customer wants a stock certificate for these shares registered in his name. When the certificate is issued, he wants it delivered to him.

Here are the steps involved:

Step 1. The customer contacts his registered representative and gives him the transfer instructions. The registered representative, in turn, will send these instructions to the Margin Department, which must approve all transfer instructions.

Step 2. If the Margin Department approves the transfer instructions, it will then send them along to the Cage.

Step 3. In the Box Section of the Cage, a clerk will take a stock certificate in *street name* from the active box and send it along with the transfer instructions to the Stock Transfer Section.

Step 4. When the certificate and the transfer instructions are received in the Stock Transfer Section, a transfer clerk will make a record of the certificate number. He will also examine the certificate to make

certain that it is a *good delivery.* Then he will send the certificate and the instructions to the proper transfer agent. Most transfer agents, especially those of corporations whose stock is listed on the New York Stock Exchange, maintain offices within the vicinity of the Exchange. These offices are in New York City's financial district.

Step 5. When the new certificate comes back from the transfer agent, it goes again to the Stock Transfer Section. There a clerk checks the certificate against his copy of the transfer instructions to make certain that the securities were properly transferred. If there is any error in transfer—for example, the number of shares are wrong, or the owner's name is not properly stated on the certificate—it is the clerk's responsibility to catch the error. He would then have to return the certificate to the transfer agent and get back a corrected certificate.

Step 6. The transfer clerk sends the new certificate to the Deliver Section of the Cage, which sends it out to the customer. You will recall that the customer in our example wanted the new certificate delivered to him. However, if the customer had wanted the broker to hold the certificate, then the transfer clerk would send it to the Box Section, where it would be stored.

TRANSFER OF STOCK THROUGH THE DEPOSITORY TRUST COMPANY

As you have read, the Depository Trust Company (DTC) will make transfers of stock for brokerage firms that have securities on deposit in their DTC accounts.

The stock transfer clerk, when he receives transfer instructions, would fill in a transfer form. Figure 20 is a specimen transfer form. He would attach the transfer instructions to the form and send it to DTC, which would then take care of the transfer. When DTC gets the new

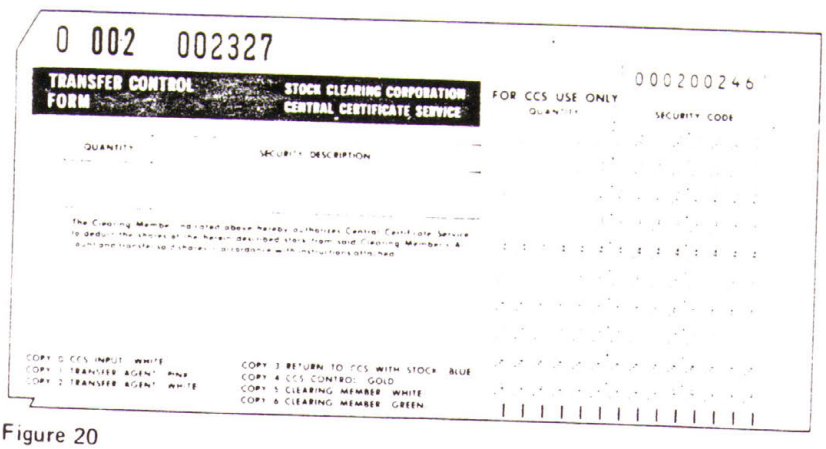
certificate back from the transfer agent, it would send it to the firm together with a copy of his transfer instructions.

QUICK REVIEW

The work of the Cage is handled by several sections.

The *Box Section* acts as the warehouse for securities. When securities come into the Box Section, they may be placed in *safekeeping,* or in *segregation* (if the Margin Department has so instructed). Or they may be kept in the *active* box. A record of the box location in which a certificate has been placed is maintained. When securities are taken out of the box, another record is made.

The Receive and Deliver Section. All securities received by a brokerage firm are taken in by the Receive and Deliver Section. Before a security is taken in or sent out, the number of shares and name of the security must be verified against the blotter entry. The certificate is then examined to make certain it is a *good delivery*. Lastly, a record must be made of the certificate number on the blotter.


0 002 002327

TRANSFER CONTROL FORM

STOCK CLEARING CORPORATION
CENTRAL CERTIFICATE SERVICE

FOR CCS USE ONLY

00020024 6

QUANTITY

SECURITY CODE

QUANTITY

SECURITY DESCRIPTION

COPY 0 CCS INPUT WHITE
COPY 1 TRANSFER AGENT PINK
COPY 2 TRANSFER AGENT WHITE
COPY 3 RETURN TO CCS WITH STOCK BLUE
COPY 4 CCS CONTROL GOLD
COPY 5 CLEARING MEMBER WHITE
COPY 6 CLEARING MEMBER GREEN

Figure 20

A security is a *good delivery* when it contains the necessary endorsements—the owner's signature and the signature guarantee—as well as the necessary tax stamps. Such a certificate is freely exchangeable between brokers and may be transferred, if that is necessary.

Round lot and odd lot deliveries of listed securities can now be effected through any national depository. Each of these depositories have established interfaces with each other, which permits settlement at the main office location of most firms.

The Stock Transfer Section. The transfer of stock involves canceling the old stock certificates and issuing new ones. It also involves changing the corporation's stock books to reflect the new stockholder's name. All of this is done by the corporation's *transfer agent* on instructions sent it by the brokerage firm's Stock Transfer Section.

In summary, the Stock Transfer Section processes securities for transfer. It acts on instructions received from the Margin Department. Before the stock is sent to the transfer agent, it is checked for the necessary endorsements, and a record is made of the certificate numbers. When the new certificates are returned, they are checked to make certain they've been properly transferred. The new certificates will then be sent to the Box Section, if the brokerage firm is to hold the certificates. Or they will be sent to the customers, if the customers have so instructed.

Work of the Dividend Department

In this lesson, we shall study the work of the Dividend Department. This department keeps track of dividends declared by corporations on their stocks. It collects the dividends on those stocks the firm holds for the accounts of its customers and credits these customers with the dividends. The Dividend Department also makes claims for any dividends due the firm's customers that have been paid to someone else.

The owner of stock in a corporation has several rights. One of these—and it is a very important one—is the right to receive dividends when declared by the corporation.

As you have read, when a corporation declares a dividend, it pays the dividend to those whose names are registered on its stock books; that is, to the *stockholders of record.* If the purchaser of stock has the shares registered in his name, then he has no problem: The corporation will send him a check for his dividend.

However, many customers have their shares transferred into the brokerage firm's name. When stock is registered in a brokerage firm's name, that firm becomes the *stockholder of record.* The customer becomes the *beneficial owner.*

The customer, as *beneficial owner,* is entitled to dividends. However, the brokerage firm will receive the dividends, since it is the *stockholder of record.* When the brokerage firm receives a dividend check, it is the

job of the Dividend Department to see that the check is credited to the customer's account.

To illustrate:

Customer buys 100 shares of XYZ common and has it registered in the name of Brokerage Firm. XYZ declares a dividend of 25 cents a share. It will send a dividend check for $25 (100 shares x 25 cents) to Brokerage Firm. There the check will go to the Dividend Department which will credit the dividend to the customer's account.

A brokerage firm may hold several hundreds—and even thousands—of shares of stock in the same corporation for the accounts of many customers. Normally, all these shares will be registered in the brokerage firm's name. When the corporation declares a dividend on its common stock, it will send the brokerage firm *one* check for the dividends on all these shares.

Usually, even before the dividend check is received, a list will be prepared. This list will show the names of the customers who own the stock, together with the number of shares each owns. When the check is received by the brokerage firm, the dividend clerk will figure out how much should be credited to each customer.

To illustrate:

Brokerage Firm has 500 shares of XYZ common stock registered in its name. The shares are owned by four different customers:

Customer A – 100 shares; Customer B – 200 shares; Customer C – 150 shares; Customer D – 50 shares.

XYZ declares a dividend of 25 cents a share and sends Brokerage Firm a check for $125 (500 shares x 25 cents).

The dividend would be credited to each customer's account, as follows:

Customer A	100 shares	$ 25.00
Customer B	200 shares	50.00
Customer C	150 shares	37.50
Customer D	50 shares	12.50
Total		$125.00

So far, we have been studying how the Dividend Department credits dividends to the customers' accounts. Now, let us go on and study the other jobs the Dividend Department does. So that you will better understand these jobs, you will first have to learn some other things about the payment of dividends.

THE LANGUAGE OF DIVIDENDS

Usually, when a corporation decides to declare a dividend on its common stock, it will send out a notice to that effect. The notice is sent well in advance of the date on which the dividend will be paid. If a corporation declares a dividend payable on April 1, it may announce this on March 1.

Copies of this notice are sent to the stock exchange on which the corporation's stock is listed, to the newspapers, and to financial publications. The stock exchange sends a summary of the notice to its members. The summary gives the brokerage firms this information.

Dividend Rate

This is the amount of dividend the corporation has decided to pay. The dividend rate is given as a dollar and cents amount per share—for example, 20 cents a share or $1.25 a share.

By knowing the dividend rate, you can figure the amount of the dividend check your firm should get from the corporation.

To illustrate:

> Brokerage Firm holds, as stockholder of record, 1,000 shares of XYZ common stock. XYZ declares a dividend at the rate of 25 cents a share. This means that Brokerage Firm will receive from XYZ a dividend check for $250 (1,000 shares x 25 cents).

Payment Date

When a corporation declares a dividend, it also fixes the date on which the dividend will be paid. This date is called the *payment date.*

The Dividend Department makes a record of this date. If it does not receive the dividend check on or shortly after that date, then it will check with the corporation to find out why the firm did not receive payment.

Record Date

When a corporation announces that it will pay a dividend, the notice of dividend will usually contain a sentence that reads like this: "The company will pay the dividend to all stockholders of record on the company's books on March 20."

Thus, we say that March 20 is the *record date.* This means that a stockholder's name must be registered on the corporation's stock books on March 20, if he is to receive the dividend.

In other words, the record date—here March 20—is a cutoff date. If a stockholder's name is not registered on

the corporation's stock books by the record date, he will not receive the dividend.

To illustrate:

> XYZ Corporation announces that it will pay a dividend on April 1 to stockholders of record on March 20. You buy XYZ stock on March 13. But you do not have it transferred into your name until March 21. Since March 20 was the *record date,* you will *not* get the dividend from the corporation,

The Dividend Department has to keep track of the record dates set by corporations that are going to pay dividends. Then, if customers buy stock in these companies shortly before the record date, the Dividend Department will issue instructions to the Stock Transfer Section to have the stock transferred by the *record date.*

Ex-Dividend Date

As you know, when your firm sells stock for a customer, it has five full business days to deliver the stock to the buyer. Actually, since Saturdays and Sundays are not counted, a week usually elapses between the date stock is sold and the date it is delivered. Thus, as you can see, many times it will be impossible for the buyer to have the stock transferred into his name by the record date.

To illustrate:

> The record date is Friday, August 23. You buy the stock on Monday, August 19. The seller does *not* have to deliver the stock until Monday, August 26. Thus, it will be impossible for you to have the stock transferred into your name by August 23, the record date.

In view of this, the securities industry has established

what it calls an *ex–dividend date.* This date is usually four business days before the record date. On that date, the stock is said to go ex–dividend. When a stock goes ex–dividend, it means the stock is sold without the dividend.

Stated another way, a customer who buys stock between the ex–dividend date and the record date is not entitled to receive the dividend. However, during this four–day period when the stock is selling ex–dividend, the price of the stock is reduced by the dividend rate.

To illustrate:

> Friday, August 23, is the *record date,* and the *dividend rate* is 50 cents a share. On Monday, August 19, the stock will sell *ex–dividend.* If the price of the stock on that day is $50 a share, it will be reduced to $49.50 a share.

CLAIMING DIVIDENDS DUE THE FIRM'S CUSTOMERS

Most claims for dividends will arise because the stock was not transferred by the record date. For example, if a customer buys stock a day or two before the *ex–dividend* date, it may not be possible to get the stock transferred before the record date.

Since the customer bought his stock before it went ex–dividend, he's entitled to the dividend. However, the corporation's books did not show him as the *stockholder of record* on the record date. Thus, the corporation will pay the dividend to the person who was the stockholder of record on that date.

When this happens, it is the job of the Dividend Department to claim the dividend from the previous stockholder of record. If such stockholder is an

BROKER & CO.

MEMBERS NEW YORK STOCK EXCHANGE

When the books of the Company closed for the current dividend on the shares of stock indicated below, the certificates for the shares, registered in your name, were not transferred to the purchaser's name on or before the date of record in order for the purchaser to receive the dividend directly from the Company.

No. Shares	Description of Stock	Ctf. No. Registered in your name	Div'd Rate	Record Date	Payable Date

Although you sold the shares before the date of record, you were the registered owner on the books of the Company and therefore received, or will receive, a dividend from the Company on the aforementioned shares to which you are not entitled.

To settle the claim made on us by the actual owner of the shares on the date of record, may we ask that you send us this dividend after you have received it from the Company. By so doing we guarantee to hold you free and harmless from any further claim in the matter.

Very truly yours,

Figure 21

individual, the dividend clerk will make the claim against this individual. On the other hand, if the previous stockholder of record is a brokerage firm, the Dividend Department claims the dividend from that firm. Figure 21 and Figure 22 are specimen forms used to claim dividends.

BROKER & CO.

MEMBERS NEW YORK STOCK EXCHANGE

Dear Sirs:

On_____ when record of stockholders was taken by_____ for a dividend of_____ per share on their _____ stock, payable_____, we or a client of ours held_____ shares, which was registered in the name of_____

We wish to claim the above dividend amounting to $_____ and would appreciate your check therefor, in consideration of which we agree to hold you free from all claims for loss or damage that may arise by reason of your complying with our request.

Very truly yours,

_____

Firm Signature

Certificates presented:
Letter of Evidence Presented:
Certificate numbers:

Figure 22

DEPOSITORIES

All stock maintained with the depositories, such as DTC, is transferred into the name of its nominee. When a corporation declares a dividend, DTC receives a single check for the dividends on this stock. It then credits each broker with the amount he is entitled to. The broker's Dividend Department, in turn, credits the dividends to each customer's account.

QUICK REVIEW

Dividends declared on stock registered in the brokerage firm's name are paid to the brokerage firm. The Dividend Department figures out the amount of the dividend that belongs to each customer. This is based on the number of shares each customer owns. The Dividend Department then credits the proper amount to each customer's account.

When a corporation declares a dividend, it sends out notice of this action. The notice is sent out in advance of payment. It gives this information:

1. The *dividend rate.* This is the amount per share each stockholder will receive.

2. The *payment date.* This is the date on which the dividend is payable to the stockholders.

3. The *record date.* This is the last date on which stockholders' names must be registered with the corporation for them to receive the dividend.

Using this data, the Dividend Department can figure the amount of the dividend check the corporation should send the brokerage firm and when it should be received. It can also figure to which customers to credit the dividend.

Stock usually is sold *ex–dividend* four business days before the *record date.* Anyone who buys stock between the *ex–dividend* date and the *record date* does not receive the dividend. However, during those four days the price of the stock is reduced by the amount of the dividend.

When a customer buys stock shortly before the *ex–dividend date,* the Dividend Department must make certain the stock is transferred by the *record date.*

Sometimes, however, stock cannot be transferred by the *record date.* In such case, the dividend is paid to the previous stockholder of record. Then the Dividend Department must claim the dividend for the firm's customer from that *stockholder of record.*

Work of the Stock Record Department

In this lesson you will learn about the Stock Record Department. This department keeps up–to–date records of each security the firm holds for its customers. The records are kept by name of the security. They show who owns the securities, how many shares, and where the securities are located (for example, the box, stock transfer). In effect, then, the Stock Record Department keeps an *inventory* of securities.

Think back to the lessons about the Margin Department and the Cage. The *Margin Department,* you will recall, keeps its records by name of customer. The *Cage,* on the other hand, keeps daily records. However, no attempt is made in the Cage to keep these daily records either by name of customer or name of security.

If you wanted to know which customers own, say, XYZ common stock and the number of shares each owns, you would have to go to the Stock Record Department. There you could get the information easily and quickly.

The Stock Record Department keeps its records by name of issuing company–for example, AB Company, GM Company, and WX Company. If the issuing company has more than one class of security outstanding, the Stock Record Department will keep a separate record for each class–for example, AB common, AB $4 preferred, AB convertible preferred.

In addition to giving the names of the customers who own a particular security and the number of shares each

customer owns, the stock record will also show where the security is located—that is, in the box, in transfer, in fail to receive, etc.

HOW INFORMATION IS KEPT IN THE STOCK RECORD

In some brokerage firms the stock record is maintained by computer. In other firms it may be kept on large ledger sheets or on cards. However, no matter in what form the stock record is maintained, the information is practically the same. For our purposes, we shall assume it is kept on large ledger sheets. Figure 23 is a specimen of a stock record ledger sheet.

Study Figure 23. You will notice that the sheet is divided into two sections: The upper section is called the *long* position, the lower section is called the *short* position. If many customers own a security then one page will be devoted to the *long* position and another page will be used for the *short* position.

The *long* position is also called the debit side; the *short* position is called the credit side.

You will better understand the *long* position and the *short* position, if you think of them in this way:

Long (Debit) Position

Think of *long* as meaning "we owe them." In other words, entries in the *long* position show the number of shares of a security the brokerage firm (we) owes its customers and other brokerage firms (them).

To illustrate:

A customer, B. St.Clair, buys 75 shares of XYZ common which he leaves with the brokerage firm. Until such time as the shares are delivered to Mr. St.Clair or he sells them, the

XYZ COMMON					
LONG	8/5	8/6			
FAIL TO DEL.	...	100			
STOCKS BORROWED	100	200			
B. ST. CLAIR	75	125			
J. KEITH	100	/			
R. JOHNS	150	150			
S. BARTON	200	300			
TOTALS	625	875			
SHORT	8/5	8/6			
BOX	75	175			
TRANSFER	50	100			
SEGREGATION	200	200			
FAIL TO REC.	...	100			
STOCKS LOANED	100	/			
FIRST STATE BANK	100	100			
C. FRAZER	100	100			
E. SAWYER	...	100			
TOTALS	625	875			

Figure 23

brokerage firm (we) owes Mr. St.Clair (them) the 75 shares of XYZ common.

Another customer, J. Keith, is the owner of XYZ common. He places an order with his brokerage firm to sell these shares and the order is executed. Mr. Keith, however, is on

vacation, so he does not send the stock to his brokerage firm. Because of this, the brokerage firm (we) cannot deliver the stock to the buyer's brokerage firm (them). This, you will recall, is a *fail* to deliver. Thus, Mr. Keith's brokerage firm (we) owes the buyer's brokerage firm (them) 100 shares of XYZ common.

Short (Credit) Position

Think of *short* as meaning "they owe us." Thus, entries in the *short* position show the number of shares of a security others (they) owe the brokerage firm (us).

To illustrate:

S. Barton, who has bought another 100 shares of XYZ common, has given no transfer instructions to his brokerage firm. Until he does the stock will stay in the active box (labelled "Box" on the stock record). Though securities in the Box are actually in the brokerage firm's possession, the Box is treated as though it were separate and apart from the brokerage firm. Thus, the Box (they) owes the brokerage firm (us) 100 shares of XYZ common.

The customer, B. St.Clair, buys an additional 50 shares of XYZ common and gives instructions to transfer the shares to his name. The Stock Transfer Section sends a certificate for 50 shares of XYZ common to the transfer agent. Along with it go instructions to issue a new certificate in B. St.Clair's name. Until the new certificate is issued, the transfer agent (they) owes the brokerage firm (us) 50 shares of XYZ common.

POSTING THE STOCK RECORD

Usually, the stock record for each security is *posted* daily. *To post* means to enter or record information in the stock record books.

Study Figure 23 again. It shows entries for two days, 8/5 and 8/6. Note that the total number of shares in each account is carried over to the next day. However, if there has been activity in an account, then the next day's entry will show shares added to or subtracted from the account.

To illustrate:

C. Frazer sold short 100 shares of XYZ common on 8/5. To sell short, as you will recall, means the customer has sold stock he does not own. His brokerage firm has to borrow the stock for him. Thus, you see an entry of 100 shares in the "Stocks Borrowed" account and 100 shares in C. Frazer's account.

Again, E. Sawyer sold short 100 shares of XYZ common on 8/6. The brokerage firm again had to borrow the 100 shares for him. Thus, there is an addition to the "Stocks Borrowed" account to increase the total number of shares borrowed to "200."

THE DAILY "TAKE–OFF" OR SUMMARY

The Stock Record Department obtains its information for posting the stock record from these sources:

1. The Purchase and Sales Department which daily sends the Stock Record Department copies of customers' confirmations (purchases and sales).

2. The daily Cage records of the "fail" accounts, bank loans, stocks loaned and borrowed; also, the box and stock transfer records.

From this information, the Stock Record Department prepares a summary each day of changes in each security. This summary is more popularly called a *take–off.*

XYZ COMMON			8/6
50	B. ST. CLAIR		
	J. KEITH	100	
100	S. BARTON		
	E. SAWYER	100	
100	FAIL TO DEL.		
100	STOCKS BORROWED		
	FAIL TO REC.	100	
100	STOCKS LOANED		
	TRANSFER	50	
	BOX	100	
450		450	

Figure 24

Figure 24 is a specimen *take–off* sheet for XYZ common, as of 8/6. Amounts to be added to the *long* position are shown on the left–hand side of the take–off sheet; amounts to be subtracted are shown on the right–hand side.

Conversely, amounts to be added to the *short* position are shown on the *right–hand* side of the take–off sheet, while amounts to be subtracted are shown on the left–hand side.

The take–off sheet for each security must be balanced, as shown in Figure 24, before it is posted in the stock

record. If the take–off sheet does not balance, you should retrace your steps to locate and correct the differences.

Compare the take–off sheet (Figure 24) with the stock record page (Figure 23); it will help you understand how the stock record is posted.

BALANCING THE STOCK RECORD

The daily entries made on the stock record of each security should be balanced. This means that the total number of shares in the *long* position must equal the total number of shares in the *short* position.

QUICK REVIEW

The Stock Record Department keeps track of all securities the brokerage firm holds for its customers. This record is kept by name of security.

From the stock record, it is possible to learn which customers own a particular security and the number of shares each owns. Also, the stock record shows the location of the shares of stock–in the box, transfer, bank loans, etc.

A take–off sheet is prepared each day, showing changes in each security. Using this take–off sheet, the stock record is then posted. The information is taken from copies of customers' confirmation and the records of the Cage.

The stock record for each security should be balanced each time entries are made. Balancing means the total number of shares in the *long* position must equal the total number of shares in the *short* position.

Work of the Proxy Department

The main function of the Proxy Department is to act as an intermediary between corporations and their stockholders with respect to voting rights, corporate reports, and so forth. Because many stockholders have their shares registered in the names of brokerage firms, corporations are unable to communicate directly with these stockholders. Instead, a corporation has to send the notices, reports and other material to the brokerage firms whose names appear on the corporation's list of stockholders. The Proxy Departments of these firms send these materials to the firm's customers who are the actual owners of the stock. And when these customers want to give instructions on how their shares are to be voted at the meeting, they send back their instructions to the Proxy Department which forwards them to the corporation.

Before you begin your study of the Proxy Department, let us review some of the things you have learned about the rights of stockholders.

In an earlier lesson, you learned that stockholders have several important rights. Among these is the right to vote for the election of the directors who will manage the corporation. Also, the stockholders have the right to vote on matters that affect the corporation as a whole. For example, a corporation must obtain the approval of its stockholders, when it wants to sell all of its assets to another corporation, or when it wants to merge with another corporation. Again, when a corporation wants to go into another line of business, it often has to obtain the approval of its stockholders.

However, many stockholders keep their shares in the name of a brokerage firm. When stock is registered in the name of a brokerage firm, the firm becomes the *stockholder of record,* and the customer becomes the *beneficial owner.* Though the stockholder, as the beneficial owner, does *not* lose his voting rights, it does create problems of communication between the corporation and its stockholders. This is where the Proxy Department steps in to help the corporation and the stockholders.

STOCKHOLDER VOTE BY PROXY

Most corporations normally hold stockholder's meetings each year. At the meeting, the stockholders are asked to vote for the election of directors. They may also be asked to vote on other matters for which their approval is required by law.

A stockholder may, if he so wishes, attend the meeting in person and there cast his vote. Actually, however, very few stockholders personally attend the meeting of stockholders. Instead, most stockholders vote by *proxy;* that is, the stockholder appoints another person to vote for him.

THE PROXY

The word proxy has two meanings:

Generally, it means a person who is authorized to act for another. Thus, a person who is authorized to vote at a meeting of stockholders for an absent stockholder is called a *proxy.*

To illustrate:

> You are a stockholder of XYZ Corporation, and you have been informed that the corporation will hold a meeting of

stockholders on a certain date. However, you are unable to attend the meeting in person. So you appoint John Doe to vote your stock at the meeting. John Doe is your *proxy*.

On the other hand, the written authorization that a stockholder gives to another person is also called a *proxy*. When signed by the stockholder, this authorization (proxy) permits the person named therein to vote for the stockholder at the meeting of stockholders. Figure 25 is a specimen proxy.

MANAGEMENT PROXY—THE ABLE & BAKER CORPORATION
PROXY FOR ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD APRIL 27, 19..

The undersigned hereby constitutes and appoints JON VAN KECK, N. HIRAMSHORE and THOMAS WHITE, and each of them, with power of substitution, as attorneys and proxies to appear and vote all of the shares of stock standing in the name of the undersigned, at the Annual Meeting of Stockholders of The Able & Baker Corporation, to be held at 999 The Street, Your City, Your State, on Wednesday, April 27, 19.., at 10:00 A.M., and at any adjournments thereof:

1. FOR ☐ AGAINST ☐ adoption of a By-law amendment that would decrease from nine to eight the number of Directors. (Management favors a vote "FOR".)
2. WITH ☐ WITHOUT ☐ authority to vote for the election of directors. (Management favors "WITH.")
3. FOR ☐ AGAINST ☐ approval of the appointment of A.J. & Co., as auditors for the Corporation.
4. Upon such other business as may properly come before the meeting or any adjournment thereof.

The shares represented by this proxy will be voted as specified. If no choice is specified, the proxy will be voted FOR Items (1) and (3) and will be deemed to appoint the proxies WITH authority to vote for the election of directors.

The undersigned hereby acknowledges receipt of the Notice of Meeting and Proxy Statement.

Dated ....., 19...

.....

(Please sign name exactly as it appears hereon.)

Figure 25

Study Figure 25. Note that it has spaces for the stockholder to indicate how he wants his shares voted on the matters that will come before the meeting. Note, too, that it authorizes certain named persons to vote for the absent stockholder at the meeting. In other words, the proxy serves as both a ballot and an authorization.

When a corporation decides to hold a meeting of stockholders it has to send a notice of the meeting to each stockholder. Figure 26 is a specimen notice of meeting.

Study Figure 26. You will note it tells the stockholder the place, time, and date of the meeting. In addition, it tells him what matters will come before the meeting for a vote.

THE ABLE & BAKER CORPORATION

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of THE ABLE & BAKER CORPORATION will be held at the principal office of the Corporation, 999 The Street, Your City, Your State, on Wednesday, April 27, 19...., at 10:00 A.M., for the following purposes:

1. To consider and act upon the adoption of a proposed By-law amendment that would decrease from nine to eight the number of Directors.
2. To elect eight Directors of the Corporation.
3. To consider and act upon the approval of A.J. & Co., as auditors for the Corporation.
4. To transact such other business as may properly come before the meeting, or any adjournment or adjournments thereof.

Only stockholders of record at the close of business on March 18, 19.... will be entitled to vote at the meeting.

If you do not expect to be present in person at the meeting, please sign, date and fill in the enclosed proxy and return it by mail in the enclosed addressed envelope.

By Order of the Board of Directors

Robert Pratt, *Secretary*

Your City, Your State

March 25, 19....

Figure 26

THE RECORD DATE

The *record date* is a date fixed by the corporation for determining which stockholders shall be eligible to vote at the meeting of stockholders.

Normally, a corporation will fix a date from 10 to 40 days before the date of the meeting as the record date. This means that a stockholder's name must be listed on the corporation's stock books on that date, if he is to be entitled to vote at the meeting. Stated another way, the record date acts as a cutoff date. If a stockholder's name is not listed on the corporation's stock books by that date, he usually will not be allowed to vote at the meeting.

To illustrate:

XYZ Corporation announces that it will hold a meeting of stockholders on April 1. It fixes March 20 as the date for determining which stockholders may vote at the meeting. You buy XYZ stock on March 13; but it is not transferred into your name until March 21. Since March 20 is the *record date,* you cannot vote your shares at the meeting on April 1. However, you may ask the seller to give you a proxy and in that way you can vote at the meeting.

HOW THE PROXY DEPARTMENT HELPS CORPORATIONS

As you have read, a corporation recognizes only those stockholders whose names are listed on its stock books. These are the so–called *stockholders of record.* Thus, if you own stock in a corporation and the stock is registered in your name, there is no problem: The corporation will send directly to you the notice of meeting, the proxy, and all other proxy materials.

However, if you have your stock listed in the name of a brokerage firm, then that firm is the *stockholder of record*—and you are the *beneficial owner.* In that event, the corporation will send the notice of meeting and other materials to the brokerage firm.

Many corporations are aware of this practice of customers keeping their stock in the names of brokerage firms. So that these customers—the *beneficial owners*—will get the notices of meeting and other materials, most corporations get in touch with the brokerage firms and ask for their cooperation. Here is what they do:

Several days before the record date, a corporation will inform the Proxy Department of brokerage firms that the corporation is going to hold a meeting of stockholders. At the same time, it will ask the Proxy Department to let it, the corporation, know how many sets of notices of meetings, proxies and other material, the Proxy Department will need for its customers—the *beneficial owners* of the corporation's stock.

When the Proxy Department receives this notice, it will have prepared a list of customers who own the corporation's stock, together with the number of shares each customer owns. From this list, the Proxy Department knows how many sets of material it will need for its customers. It orders these sets of material from the corporation.

As quickly as it can, the corporation sends the sets of material to the Proxy Department which, in turn, mails each customer a set of material.

Each customer who wants to vote at the stockholders meeting by proxy, will check the proper places on the proxy, sign it and send it back to the Proxy Department. When the Proxy Department receives the

customer's instructions, it will then send a proxy to the corporation. In that way, the customer is able to exercise his voting right without actually being present at the meeting of stockholders.

Because the brokerage firm's name appears on the corporation's stock books as the *stockholder of record,* it must sign the proxy. Thus, when a customer sends back his signed, proxy, the Proxy Department will fill in a blank proxy in accordance with the customer's instructions and have it signed in the name of the name of the brokerage firm. It is this proxy, signed in the name of the brokerage firm, that the Proxy Department sends to the corporation.

Usually, if a customer does not give his brokerage firm instructions on how to vote, then the brokerage firm may vote the customer's shares for him. However, a brokerage firm may not do this, if the matters to be voted on at the stockholder's meeting affect the legal rights of the stockholders, for example, a merger of the corporation with another corporation.

QUICK REVIEW

Many customers have their stock registered in the name of a brokerage firm. Thus, the corporation cannot communicate directly with them. Instead, when the corporation is going to have a stockholder's meeting, it will send notices of the meeting, proxies and other material to the Proxy Department.

It is the job of the Proxy Department to send each customer who is a *beneficial owner* of stock, a notice of meeting, proxy and other material. This material has been sent to the Proxy Department by the corporation. In this way, the customers can if they wish vote by proxy.

If the customer wants his vote counted at the meeting, he marks the proxy, signs it, and returns it to the Proxy Department. The Proxy Department in turn, will send a proxy to the corporation. Thus, the customer can exercise his voting rights as though he was actually present at the meeting.

When a customer does not send in instructions on how his stock is to be voted at the stockholders' meeting, the brokerage firm may usually give a proxy for him.

Glossary

The securities industry has a language of its own. It will help you in your work, if you will learn and understand the meanings of the words and expressions that make up this special language.

ACCELERATION CLAUSE: A provision in a bond that gives the bond holder the right to demand payment of the face amount of the bond when the corporation defaults in the payment of interest.

ACCOUNT EXECUTIVE: (See: *Registered Representative*)

ACCRUED INTEREST: The interest that has accumulated on a bond since the last payment of interest was made. For example, if interest was last paid on July 1 and the bond is sold on September 15, the seller would be entitled to receive the interest that has accumulated since July 1 and up to September 15.

ALL OR NONE: Instructions given by customer that his entire order shall be executed or not at all.

ALLIED MEMBER: Any general partner or voting stockholder who is not himself a member of a stock exchange.

AMERICAN STOCK EXCHANGE: (See: *Stock Exchange*)

AMEX: The popular name for the American Stock Exchange.

ANNUAL REPORT: A financial statement sent by a corporation to its stockholders each year, containing information about sales, operating costs, earnings, dividends, wages and corporate policies.

ARBITRAGE: A trading technique used to profit from differences in the price of a security. For example, if a security sells for $15 in New York and $16 in San Francisco, you would buy the security in New York and, at the same time, sell it in San Francisco, thus making a profit on the transaction. Also may be used to buy stock rights or a convertible security and to sell the stock obtainable from exercise of the rights or convertible security.

ASKED: (See: *Offer*)

ASSETS: All money and property owned by a corporation or owed to it, such as cash, buildings, machinery, accounts receivable.

AT THE CLOSE: A market order that is to be executed at or as near the close of trading as is possible.

AT THE OPENING: Also referred to as "at the opening only." A market or limit order that must be executed at the opening of trading in a stock or not at all. If the order or any part is not so executed, then it is cancelled.

BEAR: One who believes that the price of stocks will go down.

BEAR MARKET: A term used to indicate that the prices of stocks are declining.

BEARER BOND: A bond that is payable to the holder because the owner's name has not been registered on the books of the issuing corporation.

BENEFICIAL OWNER: The true owner of stock that has been registered in the name of another person.

BEST EFFORTS: Refers to an agreement by an underwriter to buy from the issuing corporation only those securities he is able to sell to the public.

BID: The highest declared price a buyer is willing to pay for a security at a particular time.

BID AND ASK: (See: *Quotation*)

BIG BOARD: The popular name for the New York Stock Exchange.

BLOTTER: A list, usually prepared daily from the customers' confirmations, and that shows each purchase and sale contract made by the securities house for the accounts of its customers. The blotter contains complete details of each transaction, such as name of receiving or delivering broker, number of shares, name of security, the price and the amount of money that has to be paid or received.

BLUE CHIP: Refers to the common stock of a corporation that consistently earns money and has a long history of paying dividends on its stock.

BLUE SKY LAWS: The popular name for laws enacted in most states to protect investors against fraud in the sale and purchase of securities.

BOARD ROOM: Popular name for the room set aside in a brokerage firm for customers, where they can watch the prices of stocks and enter orders to buy and sell stocks.

BOILER ROOM: The name applied to those who go in for the high–pressure sale by telephone of worthless securities.

BOND BROKER: A member of the New York Stock Exchange who specializes in buying and selling bonds for member firms.

BOND HOUSE: A securities house that specializes in trading in U.S. government and municipal bonds in the over-the-counter market.

BOND OR BONDS: A certificate evidencing the written promise of a corporation to repay a specified sum of money borrowed from the holder of the bond or bonds.

BOOK: Refers to the notebook used by a specialist in stock to record the buy and sell orders left with him by commission brokers.

BOX: A large metal tin or tray in which securities houses usually keep their securities.

BROKER: A person who acts as an agent for his customers in the purchase of sale and securities. For this service, the broker receives a commission from the customer.

BROKER–DEALER: A securities house that does business in the over–the–counter market.

BROKERS' LOANS: Money borrowed by brokerage firms for various purposes; among them, financing customers' purchases of stock on margin, underwriting of new issues.

BUCKET SHOP: The practice of accepting money from persons for the purchase or sale securities, without actually executing the orders; instead, the bucket shop operator gambles that the customer is wrong. Strict supervision of the securities market has practically put bucket shops out of business.

BULL: One who believes that the price of stocks will go up.

BULL MARKET: Used to indicate that prices of stocks are rising.

CAGE: (See: *Cashier's Department*)

CALL LOAN: A loan that may be terminated (called) at will by either the borrower or the lender. Such loan is used mainly to finance the purchase of securities. If not terminated, the loan is assumed to continue in force at the prevailing rate of interest for such loan.

CALLABLE BOND: A bond issue that may be paid off, in whole or in part, before maturity by the issuing corporation.

CALLABLE PREFERRED: Preferred stock that may be redeemed (paid–off) by the issuing corporation under definite conditions stated at the time the preferred stock is issued.

CAPITAL: The actual wealth or total assets of a business. Also means that portion of the consideration a corporation receives on the issuance of its stock and which it sets up on its books in accordance with the laws of the state in which the corporation is organized.

CAPITAL STOCK: The total combined ownership interest of all the stockholders in a corporation, as represented by the outstanding common and preferred shares of stock.

CASH ACCOUNT: An account in which the customer will pay in cash or by check for securities he buys.

CASH SALE: Refers to a transaction calling for the seller to deliver, and the purchaser to pay for, the security on the same day on which the transaction was intered into. For example, in a cash sale made on, say Monday, the seller must deliver the security being sold on that day and the buyer must pay for it on that day.

CASHIER'S DEPARTMENT: A division of the Operations Department that handles all securities and money that are received or delivered by a securities house.

CENTRAL CERTIFICATE SERVICE: Now known as Depository Trust Company (DTC).

CERTIFICATE: A paper given by a corporation to each stockholder as evidence of that stockholder's ownership interest in the corporation.

CLEARING HOUSE: A central agency set up by a stock exchange where brokers can exchange their comparison tickets on purchase and sales contracts, and make deliveries of securities.

CLOSED–END TRUST: An investment trust whose shares may be bought and sold, like shares of other corporations, on a stock exchange or in the over–the–counter market. (See: *Investment Trust*)

COLLATERAL: Stocks, bonds or other properties the borrower gives to the lender as security for payment of the loan.

COLLATERAL TRUST BOND: A bond that is secured by stocks and bonds owned by the issuing corporation.

COMMISSION: The fee a broker charges a customer for purchasing or selling securities for that customer.

COMMISSION BROKER: Also called "Commission House Broker." A stock exchange member who executes orders on the floor of that exchange for his firm's customers.

COMMON STOCK: The form of security that represents an ownership interest in a corporation.

COMPARISON TICKET: A memorandum of a purchase or sale contract made between brokers.

CONTINUOUS NET SETTLEMENT (CNS): A settlement method by which previous positions are netted with current positions to effect single security settlement, usually through book entry.

CONTRACT SHEET: A listing of compared and uncompared transactions sent to each member firm by a stock clearing corporation.

CONVERTIBLE BOND: A bond that may be exchanged by the owner for common stock or another security of the issuing corporation.

CONVERTIBLE PREFERRED: A preferred stock that may be exchanged by the owner for common stock of the issuing corporation.

CORPORATION: An organization that is formed under a state statute for the purpose of carrying on an enterprise.

COUPON BOND: A bond that has detachable interest coupons attached to the bond. Each coupon is, in effect, a written promise by the issuing corporation to pay the specific amount of interest due on the coupon on a fixed date. The bondholder may collect payment on the due date of the coupon by presenting the coupon to any bank.

CREDIT BALANCE: Usually the money left in a customer's account after he has paid for all his purchases in full.

CUMULATIVE PREFERRED: A preferred stock on which any omitted dividends accumulate and which must be paid before any dividends may be paid to other stockholders.

CURRENT ASSETS: Money and property a corporation may reasonably expect to convert into cash usually within a year, such as cash on hand or in banks, accounts receivable, inventory.

CURRENT LIABILITIES: Obligations that a company will usually have to pay within one year.

CURRENT MARKET VALUE: Generally, as used in connection with margin trading, means the closing price of a security as of the preceding business day.

CUSTOMER'S BROKER: (See: *Registered Representative*)

CUSTOMER'S CONFIRMATION: A memorandum of the purchase or sale of a security that is prepared in the Purchase and Sales Department and that gives the customer all details of his purchase or sale.

CUSTOMERS' MAN: An older name for a Registered Representative. (See: *Registered Representative*)

DAY ORDER: An order for the purchase or sale of securities that, if not executed, expires automatically at the end of the business day on which it was entered.

DEALER: A person or firm acting as a principal, rather than as an agent, in the purchase and or sale of securities.

DEBENTURE: Also called an "unsecured bond." A bond that contains a promise by the issuing corporation to pay its debt to

the bondholder, and for which the corporation has pledged no specific property as security.

DEPOSITORY TRUST COMPANY: A central depository into which participants deposit securities thereby enabling book entry settlement of transactions, stock loans, account movement, and so on.

DEBIT BALANCE: The amount of money a customer who is buying on margin has borrowed from his broker to finance his (the customer's) purchases.

DIRECTOR: A person who is elected by the stockholders to control and manage the business affairs of corporation. The director must act together with all the other directors of the corporation. The directors appoint the operating officers of the corporation, such as the president, vice president, secretary, treasurer and other officers. Ordinarily a corporation can act in corporate matters only through its board of directors, unless some special authority is conferred by the directors on an officer who is not a director. Among other things, the directors decide if dividends shall be paid to the stockholders, the amount of such dividends and the date or dates when such dividends shall be paid.

DISCOUNT: The difference between the face amount of a bond and the lower price paid by a buyer.

DISCRETIONARY ACCOUNT: An account over which a broker or some other person has been given discretion by the customer as to purchases and sales of securities, including the kind of securities, the time when and the prices to be paid or received. The discretion may be complete or limited.

DISTRIBUTION: The sale of a large block of stock to the investing public.

DIVIDEND DEPARTMENT: A division of the Operations Department, that is charged with the collection of dividends and crediting these dividends to customers' accounts.

DIVIDEND OR DIVIDENDS: Generally, a distribution of its earnings by a corporation to its stockholders.

DIVIDEND RATE: The amount of dividends a company has decided to pay, usually expressed in dollars and cents.

DO NOT REDUCE OR "DNR": Instructions given by a customer that a limited order to buy, or a stop order to sell, or a stop

limit order to sell is not to be reduced on the ex–dividend date by the amount of an ordinary cash dividend. "DNR" instructions do not apply to other distributions; for example, when a stock goes ex–rights or "ex" a stock dividend.

DOWN TICK: Refers to the sale of a security at a price lower than the preceding sale.

EARNINGS REPORT: Also called "profit and loss statement" or "income statement." A financial statement published by a corporation, that shows its earnings or losses over a specific period of time.

EITHER/OR ORDER: Also called an "alternative" order. Instructions by a customer that broker either sell (buy) a particular stock at a limit price, or sell (buy) on stop. Execution of one part of the alternative results in cancelling the other part.

EQUIPMENT TRUST CERTIFICATE: A security, generally issued by a railroad, to pay for new equipment and which is secured by the equipment.

EQUITY: As used in margin trading, it means the excess of the current market value of a security over the debit balance. Also means a common or preferred stockholder's ownership interest in the issuing corporation.

EXCHANGE DISTRIBUTION: A special method that permits the sale of large blocks of stock on the floor of the stock exchange. Subject to certain conditions, a broker can sell a large block of stock by soliciting orders to buy from customers, and asking other brokers to solicit such orders from their customers. Usually, the seller pays a special commission and so the buyer pays no commission.

EXCHANGE TICKET: (See: *Comparison Ticket*)

EX–CLEARING HOUSE: Refers to a security transaction for which delivery and payment will be made by the brokers directly between themselves, instead of through a clearing house.

EX–DIVIDEND: Means "without the dividend." When a stock sells "ex–dividend," it means the purchaser will not receive the dividend already declared but not yet paid.

EX–RIGHTS: Means "without the rights." When a stock sells

"ex–rights," the buyer is not entitled to the rights to subscribe that have been offered by the corporation to its stockholders.

EXTRA, OR EXTRA DIVIDEND: Refers to a cash or stock dividend that has been declared by a corporation in addition to its usual dividend.

FACE AMOUNT: Usually the dollar amount that appears on the face of a bond and which the corporation has promised to repay to the holder.

FACE VALUE: (See: *Face Amount*)

FAIL TO DELIVER: Refers to the inability of a selling broker to complete his contract by making actual delivery of the security involved to the receiving broker. In such case the receiving broker has a "fail to receive."

FAIL TO RECEIVE: (See: *Fail to Deliver*)

FILL OR KILL: Instructions given with a market or limit order that the order is to be executed in its entirety *immediately.* If, after making his bid or offer, the broker finds no one who will accept it, he must consider the order cancelled.

FIRM COMMITMENT: Refers to the agreement of an underwriter to buy the entire issue of a security from the issuing corporation at a specified price.

FIRM PRICE: The price at which a security can be bought or sold, in the over–the–counter market for such period of time as the seller may name.

FISCAL YEAR: The yearly period used by a corporation for its accounting purposes. Though most companies operate on a calendar–year basis, others find it expedient to use a different annual period; for example, from April 1 of one year through March 31 of the next year, or September 1 of one year through August 31 of the next year.

FIXED ASSETS: Property of a corporation, such as buildings, machinery, equipment, furniture and fixtures.

FIXED CHARGES: These are payments of money a company has obligated itself to make, usually at stated periods of time, such as the interest on a bond issue.

FLAT: A method of trading in certain kinds of bonds. Usually used in trading *income bonds* which do not pay interest unless the interest has been earned, or bonds on which the issuing

corporation has defaulted in the payment of interest. When bonds are traded "flat," the seller is not entitled to receive in addition to the price the interest that has accumulated since the date of the last interest payment. The seller of a bond that is traded "flat" must deliver the bond with all unpaid coupons attached or a due bill authorizing the buyer to collect any payments of interest that may be made by the issuing corporation in the future.

FLOOR: The popular name for the area where stocks and bonds are bought and sold on an exchange.

FLOOR BROKER: A member of a stock exchange who executes orders to buy and sell listed securities on the floor of that exchange.

FLOOR TRADER: (See: *Registered Floor Trader*)

FUNDED DEBT: Means the long–term outstanding debt of a company, such as bond issues, bank loans and the like. The total of these obligations is referred to as the company's funded debt.

G.T.C. OR GOOD 'TIL CANCELLED: Also called "open" order. When this term appears on an order to buy or to sell a security, it means that the order is to remain in effect until it is either executed or cancelled.

GENERAL MORTGAGE BOND: A bond issue that is secured by a mortgage on all the property owned by the issuing corporation.

GILT–EDGED: Used to describe the bond issue of a company that has consistently made profits and that has paid interest on its bonds without interruption.

GIVE UP: This term has two meanings: (1) When Broker A executes an order given to him by Broker B with Broker C, Broker A tells Broker C that he (Broker A) is acting for Broker B and then gives Broker B's name to Broker C. (2) If you have an account with A & Co. and you are in a town where that firm has no office, you may go into the office of another brokerage firm and ask them to buy or to sell stock for you, telling them you have an account with A & Co. After making certain that you have an account with A & Co., the brokerage firm may execute your order and tell the other party that they are acting for A & Co. and give the other party A & Co.'s

name, or the brokerage firm may send your order to A & Co. which will then execute it for you. Either way you would pay only the regular commission on the order.

GOOD DELIVERY: Used to indicate that a certificate for a security has all the necessary endorsements and meets all other requirements so that title to the security can be transferred by delivery of the certificate to the buyer.

GOVERNMENT BOND: Refers to debt obligations of the U.S. Government.

GROWTH STOCK: Used to describe the stock of a company whose earnings are expected to go up fairly quickly and so result in boosting the market price of the stock.

GUARANTEED BOND: A bond as to which payment of the interest or principal, or both, has been guaranteed by a company other than the issuer of the bond.

GUARANTEED STOCK: Generally preferred stock as to which payment of dividends has been guaranteed by a company other than the issuer of the stock.

HYPOTHECATION AGREEMENT: An agreement signed by a customer that permits his broker to use securities in the customer's margin account as collateral for loans made to the broker.

IN–AND–OUT: Refers to a trader who buys and sells the same security within a short period of time; for example, a day or a week.

INCOME BOND: Usually a bond on which interest is paid only when earned, but the face amount will be paid on the maturity date.

INDENTURE: The written agreement that sets forth the maturity date, rate of interest and other terms of a debenture issue. (See: *Debenture*)

INDEPENDENT BROKER: (See: *Two–dollar Broker*)

INITIAL MARGIN: The amount of money or its equivalent that a customer must deposit with his broker when the customer buys a security on margin.

INTEREST: The compensation paid by a lender to a borrower for the use of money. A bondholder (lender) receives interest from a corporation (borrower).

INVESTMENT BANKER: (See: *Underwriter*)

INVESTMENT TRUST: Usually means a company that is mainly engaged in the business of investing, reinvesting, or trading in securities. (See: *Closed–end Company; Mutual Funds*)

INVESTOR: A person who usually buys securities in order to receive regular dividend income and who is concerned with the safety of his original investment.

IMMEDIATE OR CANCEL: Instructions given with a market or limit order and which require that all or part of the order be executed as soon as the broker enters his bid (or offer); the part of the order not executed is cancelled.

ISSUE: Refers to a particular class of a corporation's securities; for example, common stock issue. Also used to mean the actual distribution of a corporation's securities.

LEGAL LIST: A list of securities that insurance companies, banks and fiduciaries are permitted by law to invest in.

LIABILITIES: A general term that means the claims against a corporation, such as wages and salaries, accounts payable, taxes, loans, and so forth.

LIEN: The right to hold or deal with another's property which has been given as security for a debt.

LIMIT ORDER: Also called "limited order" or "limited price order." An order to buy or sell a security at a price specified by the customer or at a better price if such price can be obtained.

LISTED SECURITIES: A general term that refers to any security that has met the listing standards of a stock exchange and so has been approved for trading on that exchange.

LIQUIDATING DIVIDEND: A dividend paid by a corporation that is going out of business, from cash or property remaining after the sale of its assets and payment of all debts.

LIQUIDATION: The process whereby stocks, bonds and other property are converted into cash. As applied to a corporation, it means that the corporation is terminating its existence.

LOAD: (See: *Sales Load*)

LONG: A term used to signify that the customer owns a specific amount of a particular security. For example, when you say

a "customer is long 100 XYZ," you mean that the customer owns 100 shares of XYZ stock.

MANAGEMENT: Means the directors and officers of a corporation who operate the corporation for the stockholders.

MANIPULATION: Trading in a security in order to give a false or misleading impression of activity in the security, or to raise or depress the price of the security and so induce its purchase or sale by others. Manipulation of securities is unlawful.

MARGIN: Money or its equivalent deposited by a purchaser of securities with a broker to cover the difference between the amount the broker may lend and the market price of the security.

MARGIN CALL: A notice sent to a customer by a broker demanding that the customer deposit additional money or securities in his margin account.

MARGIN DEPARTMENT: A division of the Operations Department. Its function is to keep up–to–date records of each customer's purchase and sale of securities and to watch carefully margin transactions in a customer's margin account. [98]

MARKET MAKER: A broker–dealer firm that stands ready to buy or sell a particular security in the over–the–counter market at prices the firm has quoted.

MARKET ORDER: An order to buy or to sell a security at the best possible price that can be obtained.

MARKET PRICE: Usually means the last reported price at which a security has been sold.

MARKET VALUE: (See: *Market Price*)

MARK–UP: This term refers to the difference between what a dealer has paid for a security and the price at which he sells the security to another person.

MATCHED AND LOST: Refers to the actual tossing of a coin by two brokers to decide who shall buy (or sell) a stock for which each has made a bid (or offer) at the same time.

MATURITY DATE: The date on which a bond comes due and will be paid by the issuing corporation.

MAXIMUM LOAN VALUE: Refers to the percentage of the

purchase price that a broker may lend to a customer who is buying a security on margin.

MEMBER CORPORATION: A brokerage firm that is organized as a corporation and that has at least one director–holder of voting stock who is a member of an organized stock exchange. [20]

MEMBER FIRM: A brokerage firm that is organized as a partnership and that has at least one general partner who is a member of an organized stock exchange.

MORTGAGE BOND: A bond issue that is secured by a mortgage on the issuing corporation's property.

MUTUAL FUNDS: The popular name for an open–end investment trust. This is an investment trust that continually sells new shares to investors and stands ready to buy back its outstanding shares. (See: *Investment Trust*)

MUNICIPAL BOND: A bond issued by a state or a local government, or an agency of a state or local government.

NATIONAL ASSOCIATION OF SECURITIES DEALERS' INC,: Also called NASD. An association of broker–dealers who do business in the over–the–counter market; the Association supervises and regulates the trading conduct of its membership.

NATIONAL SECURITIES CLEARING CORPORATION (NSCC): A clearing corporation established to compare and settle transactions effected on the NYSE, AMEX, and over-the-counter marketplaces.

NEGOTIABLE: A security that contains the proper endorsements, so that title to the security can be made by physical delivery. (See: *Good Delivery*)

NET ASSET VALUE: Used in connection with mutual fund shares. Is the value per share arrived at by a mutual fund, usually once each day, by computing the market value of all securities owned and deducting its liabilities. The remainder is then divided by the number of shares outstanding to arrive at the net asset value per share.

NET CHANGE: Refers to the difference between the closing price of a stock on one day and its closing price on the

following day. The net change in the price of a stock is shown as either a *plus* (+), meaning up, or a *minus* (−), meaning down. For example, if the closing price of a stock yesterday was 44, and it's closing price today is 45, the net change would be shown as "+1," meaning up $1 a share from the last sale yesterday.

NEW ISSUE: A stock or bond that is sold by an issuing corporation for the first time. The funds obtained from the sale of the new issue may be used by the corporation for working capital, or to finance new plant or equipment, or to retire outstanding securities of the corporation.

NEW YORK STOCK EXCHANGE: (See: *Stock Exchange*)

NOMINEE: A person or company in whose name a security may be registered; such person or company not being the true owner of the security.

NON–CUMULATIVE PREFERRED: A preferred stock on which omitted dividends do not accumulate. (See: *Cumulative Preferred*)

NON–PARTICIPATING: A preferred stock that does *not* give the holder the right to participate with the common stockholders in a distribution of earnings.

NO PAR VALUE: Means that no dollar amount of value has been assigned to its shares of stock by the issuing corporation.

ODD–LOT: Generally, an order to buy or sell from one to ninety–nine shares of stock.

OFF–BOARD: Means trading in unlisted securities in the over–the–counter market. Also, used to describe a transaction in listed securities *not* executed on a stock exchange.

OFFER: The lowest price at which a seller is willing to sell a security.

OPEN ORDER: (See: *Good "Til Cancelled"*)

OPTION: A promise made by a person to hold an offer open for an agreed period of time, and which is binding on the person making the promise. (See: *Puts and Calls*)

ORDER DEPARTMENT: A division of the Operations Department that receives customers' orders and transmits them

either to the floor of a stock exchange or the trading department to be executed. The order department also receives notices of executed trades and transmits such notices to the registered representatives.

ORDER ROOM: (See: *Order Department*)

OVER–THE–COUNTER FIRM: An organization that buys and sells securities in the over–the–counter market.

OVER–THE–COUNTER MARKET: Refers to the thousands of securities houses throughout the country who buy and sell securities over a large network of telephones and teletype instruments. All trading in securities which does not take place on a stock exchange is handled in the over–the–counter market.

PAPER PROFITS: The profit–that is, difference between purchase price and present market value–on a security that is still owned by the investor. When he sells the security, the investor will then have an actual profit.

PAR OR PAR VALUE: Means the dollar amount assigned to each share of stock by the issuing corporation.

PARTICIPATING PREFERRED: Means that the holder of this stock is entitled, in addition to receiving a stipulated dividend, to participate with the common stockholders in any distribution of earnings.

PARTNER: A person who carries on a business with one or more other persons as co–owners.

PARTNERSHIP: The name given to a business conducted by two or more persons as partners.

PASSED DIVIDEND: A regular dividend that has not been declared by the directors of a corporation.

PAYMENT DATE: Date fixed by a corporation for payment of a declared dividend.

PINK SHEETS: The name given to a publication that prints quotations by dealers for over–the–counter securities.

POINT: When used in connection with a purchase and sale of stocks means a rise or decline of one dollar in price. For example, when we say a stock has gone up three points, we mean each share of that stock has increased $3 in price.

However, when used in connection with bonds, a point means an increase or decrease of $10. That is because bonds are quoted as a percentage of $1,000. For example, if we say a bond has gone up two points, we mean it has gained 2% of $1,000 or $20 in value.

POST: A booth or trading location on the floor of a stock exchange at which stocks assigned to that location are traded.

POSTING: To enter or record information in books of account, like a stock record.

POST–30: A security that is traded in ten–shares units, instead of in one–hundred share units, because of the low volume of transactions in this security. On the New York Stock Exchange, these securities are traded at Post–30 and so are called Post–30 stocks.

PREFERRED STOCK: A class of stock having a prior claim on the issuing corporation's earnings and which claim must be paid before any payments may be made to holders of the corporation's common stock.

PREMIUM: The amount by which the price paid by the buyer of a bond or preferred stock exceeds the face amount of the bond or the par value of the preferred stock.

PRICE–EARNINGS RATIO: A method used to determine whether a stock is selling at too high a price. To obtain the price earnings ratio, divide the market price of the stock by its earnings per–share. For example, if a stock is selling at $80 a share and it is earning $4 a share, its price–earnings ratio is 20 to 1 ($80 divided by $4).

PRIMARY DISTRIBUTION: The original offering to investors of securities that have never before been issued. The offering may be made by the issuing corporation itself, or through an underwriter.

PRINCIPAL: A dealer who buys or sells stock for his own account acts as a "principal." Also, a customer is the "principal" of the broker who executes his order.

PRIOR PREFERRED: A preferred stock that has priority as to dividends and other rights over other preferred stocks issued by the same corporation.

PROFIT TAKING: The sale of securities by an investor to realize his profits. (See: *Paper Profits*)

PROPRIETOR: The name given to the owner of a one–man business.

PROPRIETORSHIP: A business that is wholly owned by one man.

PROSPECTUS: A document containing information about the company, its management and its business, that must be given to purchasers of a security that is being offered to the public for the first time.

PROXY: A person who is authorized to vote the shares of an absent stockholder at the meeting of stockholders. Also means the written authorization given to such person.

PROXY DEPARTMENT: A division of the Operations Department that helps corporations communicate with their stockholders.

PROXY STATEMENT: A document containing specified information that must be sent to stockholders at the time they are asked to sign proxies for a meeting of stockholders.

PURCHASE AND SALES DEPARTMENT: A division of the Operations Department that is concerned with the preparation of customers' confirmations and the comparison of securities transactions with other firms.

PUTS AND CALLS: An agreement that gives the holder the right, at his election, to receive or deliver a specified number of shares of stock at a stated price on or before a stipulated date. The holder of a *put* has the right to sell (put) the stock; the *holder of a call* has the right to buy (call) the stock. The seller of a *put* must accept delivery of the stock and pay the stated price to the option holder; the seller of a *call* must make delivery of the stock at the stated price to the option holder. Puts and calls may run for 30, 60, 90 days or more. The holder of the put or call pays a premium (commission) for the option. A person buys a *put* because he believes the price of the stock will go down. If he believes the price of the stock will rise, then he may buy a *call*. Of course, if he doesn't exercise the option, then he loses only the premium he has paid to the seller.

RECORD DATE: The date fixed by a corporation for determining stockholders to whom dividends will be paid, or who will be entitled to vote at a meeting of the stockholders.

REDEMPTION PRICE: The price an issuing corporation must pay when it wants to redeem its outstanding bonds before maturity, or call in outstanding preferred stock.

REFINANCING: The sale of a new security and use of the proceeds to pay off an outstanding debt. For example, when a company sells long–term bonds and uses the proceeds to pay off an outstanding short–term bank loan.

REFUNDING: The sale of a new issue of bonds by a corporation to pay off an outstanding bond issue; usually done to save interest. For example, if a corporation has outstanding a 6% bond issue, it might want to refund this issue, if and when interest rates go down, say, to 4 1/2%.

REGISTERED BOND: A bond that has been registered in the owner's name on the books of the issuing corporation. To transfer ownership, the registered owner must endorse the bond.

REGISTERED FLOOR TRADER: A member of the New York Stock Exchange buys and sells securities on that exchange for his own account.

REGISTERED REPRESENTATIVE: An employee of a securities house who has met certain standards as to background and knowledge of the securities business.

REGISTRAR: Trust company or bank charged with keeping accurate record of stock issued by a corporation, so that corporation will not issue more shares than are authorized.

REGULAR WAY: Means that a contract for the purchase and sale of a security is subject to the normal rules for delivery. (See: *Settlement Date*)

REGULATION T: The name for Federal Reserve Board's regulation governing the amount of credit that brokers and dealers houses may extend to customers who buy securities on margin.

REGULATION U: The name for the Federal Reserve Board's regulation governing the amount of credit that banks may extend to customers who borrow money to buy securities on margin.

RESTRICTED ACCOUNT: Means that a broker may not buy securities for a particular customer for a specified period of time, unless the customer has on deposit enough money in his account to pay for the securities before his orders are executed.

REVERSE SPLIT: The opposite of a "stock split." In a reverse split, the corporation increases the par value or stated value of the stock in order to decrease the number of shares outstanding. For example, if you own 100 shares of stock and the corporation authorizes a reverse split of 1–for–4, you would get 25 shares in exchange for your 100 shares. (See: *Stock Split*)

RIGHT OR RIGHTS: A privilege given to stockholders of a corporation to buy new securities of the corporation in proportion to the number of shares each stockholder owns.

ROUND–LOT: Refers to the unit of trading in a security. Generally, a "round lot" is one hundred shares or multiples thereof.

SAFEKEEPING: Refers to a fully paid security that has been registered in the name of the customer, but which the securities firm holds in its possession as custodian for the customer.

SALES LOAD: Means that part of the sales prices of mutual fund shares that covers the selling commissions and other costs of distribution. Usually, the investor pays the sales load only when he buys mutual fund shares.

SCALE ORDER: An order to buy or sell a specific number of shares of a security at stated variations in price. For example, an order to buy 1000 shares of stock to be executed in 200–share lots; the first 200 shares at a stated price, the other lots as the price goes down, say, 1/2 point.

SCRIP: A certificate issued to stockholders of a corporation, and which may be exchanged for fractional shares of stock or the equivalent in cash by a fixed date. Scrip is usually issued in

connection with a stock dividend or stock split. For example, a corporation declares a stock dividend and, as a result, some stockholders will receive fractional shares, say, 1/4 share. Instead of a stock certificate, the corporation may issue scrip.

SEAT: The popular name for a membership on a stock exchange.

SECONDARY DISTRIBUTION: Also called "secondary offering." A method for the redistribution to the public of a large block of securities that had previously been sold to one person or a small group of persons.

SECURITIES AND EXCHANGE COMMISSION: More popularly known as SEC, An agency established by Congress to administer the Federal securities laws.

SECURITIES INDUSTRY: A general term that includes the stock exchanges, the over–the–counter market, and the brokers and dealers who trade on the stock exchanges and in the over–the–counter market.

SEGREGATION: Refers to securities set aside for a customer by a broker when certain conditions have been met.

SELLER'S OPTION: A special kind of transaction in which the seller is given the right to deliver the security being sold within a stated period of time, usually not less than 6 business days nor more than 60 days.

SELLING AGAINST THE BOX: This is similar to a *short sale,* with this exception: The seller already owns the stock being sold, but keeps possession of it and so has the broker borrow equivalent stock with which to make delivery. If the market price of the stock does not drop, the seller can deliver the stock he owns to make good on the stock loan. (See: *Short Sale*)

SERIAL BOND: A bond issue that matures in small amounts at stated periods of time.

SETTLEMENT DATE: Refers to the date on which brokers settle (that is, deliver or receive) their contracts for the purchase and sale of securities.

SHORT COVERING: Refers to the purchase of stock so that stock previously borrowed to make delivery on a short sale may be returned.

SHORT POSITION: Means the total number of shares of stock a customer has sold short and which he has not covered as of a particular date.

SHORT SALE: Means that a customer is selling a security he does not own and which he has borrowed to make delivery.

SINKING FUND: Money regularly set aside by an issuing corporation to redeem its bonds.

SPECIALIST: A member of a stock exchange whose function is to maintain an orderly market in certain stocks.

SPECIAL OFFERING: The sale of a large block of stock on the floor of the Stock Exchange. The sale is made in accordance with special procedures worked out by officials of the Exchange.

SPREAD: Usually the difference in the bid and ask prices of a security.

STOCK AHEAD: Means that a customer's order to buy or sell a stock at a certain price has not been executed because other orders at the same price had been entered before his and so had priority.

STOCK DIVIDEND: A dividend that is usually paid in a company's own stock instead of in cash.

STOCK EXCHANGE: A private association of brokers having a central meeting place for the purchase and sale of securities.

STOCKHOLDER: Also called a "shareholder." The name given a person who owns common or preferred stock in a corporation.

STOCKHOLDER OF RECORD: Person whose name is listed as the owner on the company's stock books.

STOCK RECORD: The ledger sheets or cards used by brokerage firms to keep an inventory of all securities.

STOCK RECORD DEPARTMENT: A division of the Operations Department that keeps up–to–date records of each security a firm holds for its customers.

STOCK RIGHT: (See: *Right or Rights*)

STOCK SPLIT: A method used by corporations to increase the number of shares outstanding, but without changing each stockholders proportionate ownership interests in the corporation. Usually accomplished by reducing the par value, or the stated value of the stock. For example, if you own 100 shares in a corporation that has 1 million shares outstanding, and the corporation declares a 2–for–1 split, you would now own 200 shares and the corporation would have 2 million shares outstanding. However, your ownership interest in the corporation would remain the same. (See: *Reverse Split*)

STOP LIMIT ORDER: An order to buy or to sell a security and which becomes a limit order that will be executed at the limit price or at a better price, when the price of the security reaches or sells through, the stop price specified by the customer.

STOP ORDER: Also called a stop loss order. An order used by a customer to protect a paper profit in a security or to keep down a possible loss in a security. The stop order becomes a market order when the price of the security reaches, or sells through, the price specified by the customer.

STOPPED STOCK: An order usually given to a specialist by a commission broker, whereby the specialist guarantees the broker's order will be executed at a specified price. If the broker is able to execute the order at a better price, the stop is cancelled.

STREET NAME: Refers to a security that is registered in the name of a broker instead of the name of the broker's customer.

SUBJECT PRICE: Means the price is subject to confirmation by the broker–dealer who has quoted it.

TAKE–OFF: A summary of daily changes in a security. Information reflected in the take–off is posted to the stock record.

TAX–EXEMPT BONDS: (See: *Municipal Bonds*)

TICKER: An instrument that prints the price at which a stock has been traded on an exchange within minutes after the trade is executed.

TIME ORDER: An order that becomes a market order or limit order at a stated time.

TIP: "Inside" information, not generally known by stockholders and the investing public, that is given to a favored few persons.

TRADE DATE: Means the date on which a contract for the purchase and sale of a security has been entered into.

TRADER: An employee of a securities house who executes orders in over–the–counter securities for customers. Also, can mean a person who buys and sells securities for his own account for short–term profit.

TRADING POST: (See: *Post*)

TRANSFER: Usually means the actual recording of a change in ownership of a security on the books of the issuing corporation by its transfer agent.

TRANSFER TAX: A tax imposed by the State of New York on the sale or transfer of shares of stock by one person to another person. The seller pays the transfer tax.

TWO–DOLLAR BROKER: A member of the New York Stock Exchange who executes orders for other brokers on that exchange.

UNDERWRITER: A person who buys newly issued securities from a corporation and tries to resell these securities to the public at a higher price. Also called an "investment banker" or "investment banking firm."

UNLISTED SECURITY: A security not admitted for listed trading on a stock exchange.

UNLISTED TRADED PRIVILEGES: Refers to those securities that have been given trading privileges on a stock exchange at the request of a member of that exchange, and not a request of the issuing corporation.

UNSECURED BONDS: (See: *Debenture*)

UP TICK: Also known as "plus–tick." Means a sale made at a price higher than the preceding sale. (See: *Down Tick*)

WHEN ISSUED: Shorthand for "when, and if issued." Indicates that the security involved has been authorized for issuance, but settlement of purchase and sales transactions will not take place until the security is actually issued.

WIRE HOUSE: A brokerage firm that has a network of communications (telephone or teletype) that link the main office to the firm's branch offices and offices of correspondent firms.

WIRE ROOM: (See: *Order Department*)

WARRANT: A certificate that gives the holder the privilege of buying securities at a specified price within a fixed time. Some warrants have no fixed time limit. A warrant may sometimes be offered with the security as an inducement to investors to buy that security.

YIELD: The return on investment that an investor will receive from dividends or interest. This is expressed as a percentage of the current market price of the security, or, if the investor already owns the security, of the price he paid. The return on *stocks* is figured by dividing the total dividends paid in the past calendar year by the price. For example, if a stock paid $3 in dividends and your price for the stock is $30 a share, the return is 10% ($3 divided by $30). The return on *bonds* is figured by dividing the interest by the price of the bond. For example, if a 5% $1,000 bond sells at $800, the return is 6.25% ($50 divided by $800). On the other hand, if a 6% $1,000 bond sells at $1,200, the return is 5% ($60 divided by $1,200).

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*CA. BAR ONLY
**N.Y. BAR ONLY

May 15, 1986

**Re: Prudential Insurance Company of America v. State of Alabama, et al.
Superior Court of New Jersey
Chancery Division: Essex County
Docket No. C-4937-83E**

Dear Attorney and Unclaimed Property Administrator:

In connection with the above captioned matter, enclosed please find Report of Lead Counsel together with true copies of proposed settlement documents. All of the enclosed documents have been reviewed and approved by Lead Counsel.

The Report of Lead Counsel provides a detailed summary of the course of this litigation as well as the basis for Lead Counsel's recommendation to settle. Your attention is called to Page 10, Section V of the Report of Lead Counsel captioned Settlement Documents To Be Executed. For your convenience, the documents which require the signature of an official of the chief legal office of your State or your unclaimed property administrator have been marked with yellow tabs.

If you desire further information regarding this litigation or the operation of the proposed settlement, please contact Richard Hammer, Esq., (313) 256-2517 or David J. Epstein, Esq., (213) 552-9415.

Please sign the settlement documents where indicated and return them as soon as possible to:

ROBERT P. ZOLLER, ESQ.
HANNOCH WEISMAN
4 BECKER FARM ROAD
ROSELAND, NEW JERSEY 07068-3788

We are attempting to conclude this matter by June 1, 1986.

Thank you for your attention to this matter.

RECEIVED
MAY 19 1986
Department of State Treasurer
ESCHEAT FUND

Sincerely,

RONALD M. STURTZ
For Lead Counsel

RMS/t
enc.

P 145 675 529

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED
NOT FOR INTERNATIONAL MAIL

(See Reverse)

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P.O., State and ZIP Code Roseland, NJ 07068-3788	
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Certified Fee ✓	
Special Delivery Fee	
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Return receipt showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	$
Postmark or Date	

PS Form 3800, Feb. 1982

* U.S.G.P.O. 1984-446-014

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P 145 675 529

MAIL

PS Form 3811, July 1983

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6. Signature – Agent
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7. Date of Delivery
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8. Addressee's Address (ONLY if requested and fee paid)

DOMESTIC RETURN RECEIPT

Prudential Case – RTA

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RE: Prudential Insurance Company
v. Alabama, et al.
Docket Number C-4937-83E
Superior Court of New Jersey

I. Report of Lead Counsel:

A. Background of Litigation.

Enclosed please find various documents relating to he proposed settlement of the above-referenced litigation.

On November 23, 1983, the Prudential Insurance ompany ("Prudential") filed an interpleader action in the uperior Court of New Jersey seeking an adjudication concerning he proceeds of more than 261,000 unclaimed outstanding checks ssued by it in the sum of $3,024,000 and deposited with the ourt. Thereafter, pursuant to order of court these funds were eposited in certificates of deposit. The court on July 11, 1984 ppointed the following Lead Counsel to conduct discovery in the itigation:

David J. Epstein (for Florida, Iowa, Pennsylvania and Wisconsin), Peter K. Shack (for California), Ronald M. Sturtz (for Virginia), Richard L. Hammer (for Michigan), Paul Shanley (for Massachusetts) and Bart T. Murphy (for Illinois) (certain other Lead Counsel were appointed and either withdrew or did not participate).

B. Discovery.

Certain of Lead Counsel participated in extensive scovery concerning the origins of these unclaimed checks. scovery included interviews with numerous employees of udential regarding the record-keeping systems of Prudential for claimed property. Two sets of written interrrogatories were rved by Lead Counsel and answered by Prudential. Additionally, ousands of pages of manuals, accounting records, system ocedures, surveys, owner records and other documents were viewed and analyzed. The purpose of this discovery was ofold: 1) to ascertain whether Prudential had correctly ported the amount of the unclaimed property it held and 2) to termine which states were entitled to claim the property.

C. Results of Discovery.

Based on the discovery, Lead Counsel ascertained at the $3,024,000 deposited with the court herein did not clude the total sum of the checks issued by Prudential and ill outstanding. For the time period 1883 (sic) to December 7, 82 an analysis of Prudential's records revealed that in its

"Prudential Unclaimed Funds System" (PUFS) there were outstanding 261,052 unclaimed checks totaling approximately $4.8 million. Prudential, however, had conducted a study of 1565 randomly drawn outstanding checks each in excess of $200 ("Error Rate Survey") and based on that study had concluded that 37% of the $4.8 million in outstanding checks --$1,776,000-- were erroneously shown on its records as outstanding. Accordingly it paid into court the sum of $3,024,000, i.e. $4.8 million less the $1.7 million.

Lead Counsel reviewed the results of the Prudential error rate survey and concluded that it was seriously flawed in numerous respects. The attached memo of David J. Epstein dated August 20, 1985 sets forth in detail various examples of errors contained in the Prudential survey. Based on the magnitude of the survey and the non-availability of records, it was not possible to accurately calculate the correct amount of outstanding checks. (The analysis set forth in the attached memo was prepared on a "best case" basis.)

Additionally, in connection with the error rate survey, Prudential prepared an estimate of the amount of outstanding checks for which it would be possible to obtain a last known address of the payee of the check if Prudential were to review the records available to it. In many cases the records in the PUFS system contain no last known address. In the error rate survey, Prudential resorted to a variety of records it otherwise retained and other sources such as telephone directories, etc. in order to determine if a last known address could be ascertained.

Prudential concluded that based on its analysis at best 35% of the last known addresses of the payees of the outstanding checks could be ascertained. (Prudential believed that since the address survey was conducted on checks over $200 that the percentage of locatable addresses would in fact be lower. The average amount of a check in the PUFS system is $18.39 and Prudential asserted their record maintenance procedures for these smaller checks includes less information than is retained for the checks of $200 or more.)

Lead Counsel prepared an analysis of the Prudential address survey. Based on this analysis it appeared that the Prudential survey was incomplete in various respects. The record retention practices appeared to vary substantially among Regional Home Offices. Additionally there were significant variations among the various types of outstanding checks. Prudential was not prepared to permit any further review of its records without a formal court order. Additionally, the expense of conducting such a review of warehoused and archived records at the Regional Home Offices and warehouses located throughout the United States appeared to be prohibitive. No conclusion could be reached regarding the likelihood that such further efforts would yield a higher address rate.

Discovery also involved an analysis of whether Prudential held any further and additional amounts of unclaimed property not included in the PUFS system. Certain Lead Counsel concluded that it appeared there were further sums owing; however, Prudential took the position that such matters were beyond the scope of the within interpleader action. The proposed settlement does not release Prudential from any such claims which any state may elect to subsequently assert.

D. Recommendation to Settle Litigation.

1. Prudential Has Agreed to Pay an Additional $1,276,000.00.

Prudential has agreed that as additional consideration for a settlement agreement, it will pay the further sum of $1,276,000. This further sum is intended to satisfy the claim by Lead Counsel that the Prudential error rate survey overstated the amount of errors in the PUFS system. Lead Counsel believe that for several reasons the payment of this additional amount represents a favorable settlement of the issue. The total payment by Purdential will be $4,300,000 which represents 89% of the $4.8 in the PUFS system. Audits by various states of numerous other insurers have documented error rates well in excess of 11%. For example, errors are regularly caused by failure to cancel an outstanding check when a duplicate payment is issued. It is not unusual for record-keeping systems to fail to eliminate outstanding checks which were voided because of errors in the preparation of the check, e.g., incorrect name, amount, or address. This situation frequently occurs when the checks involved are quite old, as in the within case, and the company was not maintaining the integrity of the system for unclaimed property reporting purposes. (The Prudential error rate survey identified that 21% of the outstanding checks in the PUFS system were erroneously shown as outstanding as a result of failure to cancel checks that had been voided, stopped, and/or replaced.) Additionally a substantial amount of the checks were issued prior to the adoption of unclaimed property laws by the various states. In the event of litigation, Prudential may have very strong arguments based on the statute of limitations and/or the "reach back" limitations in the various state laws.

Accordingly, Lead Counsel believe that if this issue were to be litigated, there is little likelihood that a more favorable result could be obtained and there is a meaningful chance that less money would be awarded.

2. Determining the Amounts to Which Each State is Entitled:

a. Address Records are not Available.

The Supreme Court in Texas vs. New Jersey 379 U.S. 674, 85 S. Ct. 626 (1965) set forth the rules of

priority to be applied to competing state claims to abandoned property.

The first priority claim is accorded to the state of last known address of the missing owner according to the books and records of the obligor. If an address is not set forth, the obligation is subject to claim by the obligor's state of incorporation, in this case, New Jersey. In that event, another state can reclaim the property from the state of incorporation if it can prove the owner resided in the reclaiming state.

Prudential's PUFS system does not include addresses of the payees of the 261,052 outstanding checks comprising the original fund of $4.8 million. In preparing its error rate survey, Prudential was able to locate the addresses of 35% of the payees of the checks which exceeded $200 in value. Address information was obtained from a variety of sources including other records of Prudential such as information prepared in connection with the check payment, review of policy information and cross-referencing to information available on other policies inforce for the payees. Additionally, Prudential searched telephone directories and other sources of information not available in its business records.

Considerable efforts are required to locate address information. In most cases the information is stored in various warehouses throughout the country. Prudential would not permit an independent review of its records by Lead Counsel without a formal court order which it intended to oppose. However, Prudential did represent to Lead Counsel that most records were no longer available since they had been discarded according to company record retention policies. In addition, Prudential advised that the indexing to warehoused records was frequently inadequate to permit the location of the necessary record without literally searching every box in the warehouse. Based on its efforts in identifying addresses in its error rate survey, Prudential estimated the cost of researching its records would be $127.26 per check (Plaintiff's Report on Informal Discovery, November 19, 1984). Lead Counsel do not have any independent information regarding the costs of search but believe such costs to be very substantial.

As discussed above in Paragraph I C., Lead Counsel conducted its own review of the Prudential address survey. The results of our survey were inconcluaive because of the manner in which Prudential had prepared its survey. For example, in many instances, it could not be ascertained whether Prudential had in fact concluded an address was available. Based on the review, it appeared that there were significant variations in record retention practices among the various Regional Home Offices and within the various types of policies. Without a very significant investment of additional time and effort in reviewing records located at the various warehouses and Regional Home Offices it is not possible to conclude whether a greater

percentage of addresses could be located. However, based on the average amount of the outstanding checks --$18.39-- and the age of the checks --197,000 checks totaling $3,195,000 that are more than ten years old-- it appears that significantly increasing the address rate is unlikely. Audit experiences with other insurance companies confirm similar record keeping practices. Additionally, there is a possibility that the 35% address rate was overstated for the reasons discussed below.

b. Who Has The Obligaton to Search For Addressees?

Prudential will not voluntarily undertake to further search its records in order to ascertain whether it has a last known address for each of the 261,056 outstanding checks. Its position is that the cost of the search, $127.26 per check exceeds the average value of the checks. $18.39. If the issue were litigated, it appears that at least for a substantial number of the checks the states would be required to pay for the cost of the search.

In Pennsylvania v. New York, 407 U.S. 206, 215, 92 S. Ct. 2075, 2080 (1972), the Supreme Court held "that as a matter of fairness, the claimant states, and not Western Union, should bear the cost of finding and recording available addresses". It may be possible to distinguish the Pennsylvania V. New York case on the basis that the records in that case were prepared before most, but not all, of the states had adopted unclaimed property laws. The argument would be that a holder having no prior notice of a record-keeping requirement is not required to bear the expense imposed by a retroactively enacted requirement. The Supreme Court apparently recognized this distinction since it stated "as for future money order transactions, nothing we say here prohibits the states from requiring Western Union to keep adequate address records." 407 U.S. at 215, 92 S. Ct. at 2080.

It is not clear that the state unclaimed property laws that are based on the 1954 Uniform Disposition of Unclaimed Property Act (and the 1966 Revision) include a requirement of recording and retaining addresses of owners. Section 11(b) (1) of the Uniform Act appears to be permissive and 11(b) (2), if mandatory, probably applies only to the proceeds of matured policies; such funds are not included in the outstanding checks in the within case. Additionally, since the Court in the Pennsylvania v. New York case specifically considered the 1966 Uniform Act (see 407 U.S. at 215, n.8, 92 S. Ct. at 2080, n.8) it appears that the Court was holding that there was no requirement of address retention in the Uniform Act.

A very substantial expense would be incurred in researching the earlier outstanding checks. For example, most states adopted all inclusive unclaimed property laws during the late 1950s and throughout the 1960s. (Some of these states had earlier enacted unclaimed laws which presume the abandonment of matured life insurance policies. However, most if not all of the funds in the within case would not be covered by those laws.) Accordingly, since 101,112 checks --

totaling $575,727-- were issued before 1960 the cost of researching such items would be prohibitive and would exceed the value of most of the checks.

Assuming the states would be successful in requiring Prudential at its own expense to research its records for last known addresses of more recently issued checks, another factor must be considered. Most state laws provide for amounts under $25 to $100, depending on the state, to be reported in the aggregate i.e., without the name or address of the owner. Therefore, the results of the search would be discarded and the information used solely for the purpose of allocating the property among the defendant states. Accordingly, there would appear to be no justification for the states to deplete the fund with costs incurred in locating addressees for checks issued prior to the adoption of a state's unclaimed property law. The wisdom of imposing such search costs on Prudential for subsequently prepared records would also appear to be dubious. As discussed below, a different issue is presented as to which state has the priority claim in this case.

c. The Burden of Proving an Address Exists

If addresses could be located by searching Prudential's records and Prudential is not required at its expense to obtain this information, then the issue is whether, as between New Jersey and the other states, who has the burden of proving an address exists. In Pennsylvania v. New York, the identical issue was raised and discussed in the Report of Special Master. The enclosed letter from David Epstein to Herb Glickman dated November 12, 1984, extensivlely reviews this issue. The Special Master concluded that the state of incorporation could not claim all the property on the theory that ascertaining the addresses was not "feasible." Instead, the Special Master ordered that the states must bear the costs of the search. The Supreme Court adopted the proposed decree which required such a search.

New Jersey has contended that it is entitled to all the property. It has agrued that where the cost of the search exceeds the value of the property that such a situation is tantamount to there being no last known address. Lead Counsel disputed this contention. In Pennsylvania v. New York, the amount of the funds was $1.5 million, and the cost of the search was estimated to be $175,000.

Thus it would appear that if this matter were litigated, it is likely that the states may be required to pay for the cost of the record search. However, if New Jersey's contentions were accepted, the other states would lose all the property. As discussed above, the costs of making the search would substantially, if not entirely, deplete the fund. Since most of the items would not be advertised because they fall below the various states' advertising minimums, the results of the search would be fruitless.

As previously discussed, the address survey conducted by Prudential concluded addresses could be

located for 35% of the property. New Jersey has agreed that for purposes of a settlement with the states, it will accept 40% as the address availability rate. Lead Counsel for the reasons discussed above recommend acceptance of this settlement proposal.

d. Withdrawal of Claim by New York

During the course of discovery, it was ascertained that New York had previously audited the records of Prudential in 1977 and 1981 and entered into settlement agreements with Prudential in the total sum of $605,024.82. In order to determine whether any of these amounts should be treated as a payment to New York of its share of the outstanding checks in the PUFS system, Lead Counsel made a demand for New York's audit findings and its work papers. No information was provided, but instead -perhaps understandably- New York has withdrawn from the litigation and has released all claims it might otherwise have to the outstanding checks. As a result of New York's withdrawal, its share of the settlement is redistributed among the states. The settlement agreement does not waive or otherwise affect any claims which any state might have against New York in connection with this matter.

II. TERMS OF PROPOSED SETTLEMENT:

A. Settlement Fund

All states, except New York for the reasons indicated above in Paragraph I.D.2.d., will receive a share of the settlement fund which will include the following monies:

Prudential Interpleader Payment	$3,024,000.00
Interest earned through 4/24/86 on Interpleaded Payment	715,327.10
Additional Prudential Settlement Payment	1,276,000.00
Total Settlement Fund 1/	5,015,327.10

B. Distribution of Settlement Fund

Pursuant to the Defendants' Settlement Agreement forty percent (40%) of the total settlement fund will be distributed pro rata to all states including New Jersey but excluding the state of New York. These funds represent the portion of the outstanding checks for which last known addresses of the payees are deemed to be available (New Jersey is included because addresses would exist for New Jersey as well as the

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1/ This amount will be increased to include interest earned for the period subsequent to 4/24/86. Fees and expenses in the amount of $73,591.40 will be deducted from the Total Settlement Fund prior to distribution, see Defendants' Settlement Agreement paragraph E.

remaining states). The remaining sixty percent (60%) is allocable to New Jersey as the state of incorporation of Prudential representing property for which no last known addresses of the payees exist.

The forty percent (40%) will be distributed among the states according to the formula attached to the Defendants' Settlement Agreement entitled "Method of Allocation." This formula was derived from a weighted average of the percent of total benefits, total insurance in force, and total premiums paid in each state during the period 1967 to 1983 . (This period was selected based on the availability of records and approximately 80% of the outstanding checks were issued during this period. The period used is believed by Lead Counsel to be a representative period.) Experience has confirmed that unclaimed property held by life insurance companies is directly related to the three variables used in the Method of Allocation. Accordingly, Lead Counsel believe that averaging these variables represents a fair and equitable allocation. The 4th column of the Method of Allocation chart represents the average of the first 3 columns, and the 5th column sets forth the pecentage of the settlement fund, after excluding New York, that your state will receive.

Set forth below is an example of how the fund will be distributed:

	3/
Total Settlement Fund	$5,015,327.10
Less Fees and Expenses	$ 73,591.40
Net Settlement Fund	$4,941,735.70
40% Share to States	x .40
Amount Payable to States	$1,976,694.28
% of Fund for Alabama	x.008946
Settlement Fund to be Paid to Alabama	$ 17,683.51

To determine the amount your state will receive multiply the amount of $1,976,694.28 by the number (as a percent) which appears opposite the name of your state on the Method of Allocation Schedule.

D. Other Settlement Terms

1. Prudential Settlement

The terms of the settlement with Prudential are set forth in the enclosed Settlement Agreement. In addition to the monetary terms discussed above, the other significant provisions included in the Settlement Agreement are as follows:

2/ The figures were derived from schedules which appear in Prudential's Annual Statements and in part were provided by Prudential. The averages have been weighted by the amount of outstanding checks in the PUFS system issued during each of the years.

3/ To be increased for interest earned subsequent to 4/24/86.

a.) The litigation is settled by agreement among the parties and is not subject to Court confirmation (Par. C. 1.). Prudential was insistent on this point. Apparently, they were concerned that somehow a precendent would be set; see also Par. M. (paragraph references are to the Settlement Agreement).

b.) Prudential will be unconditionally released from all claims in connection with the 261,052 checks in the PUFS system (Par. F.). As discussed above, any claims a state may have for other types of abandoned property are not released.

c.) All discovery material obtained by Lead Counsel must be returned to Prudential; however, Prudential must retain such materials until July 1, 1996 (Par. K.). Apparently, Prudential is concerned that the documents obtained may be used in connection with claims a state may have for other types of unclaimed property. The 10 year retention period will assure that such documents are available for a reasonable period should your state assert any further claim.

d.) Such records as Prudential has in its PUFS system are delivered to New Jersey for permanent retention (Par. J.), and Prudential shall retain other information necessary for claim payments for a period of 5 years (Pars. G. and L.).

2. New Jersey Settlement

The terms of the settlement between New Jersey and the other states are set forth in the Defendants' Settlement Agreement. The significant provisions include the following terms:

a.) For purpose of administering the distribution of the settlement funds, all funds are placed in custody of the State Treasurer of New Jersey (Par. A.) (paragraph references are to the Defendants'Settlement Agreement).

b.) As discussed above, 40% of the funds are to be distributed among the states, including New Jersey and excluding New York according to the Method of Allocation Schedule (Pars. C. and D.).

c.) Lead Counsel fees and expense reimbursements in the amounts set forth in Paragraph E shall be deducted from the fund prior to distribution. Enclosed herein are statements from Lead Counsel setting forth in detail the expenses incurred and services performed by Lead Counsel. The enclosed Declaration of Ronald M. Sturtz sets forth the provisions of New Jersey law regarding the payment of fees and expenses from interpleaded funds.

d.) New Jersey is released from any claims as to the amount distributed to your state (Par. G.).

e.) If the records of Prudential set forth an address of a claimant, the state of last known address shall pay the claimant so long as it has not exhausted the funds received in the settlement (Par. H.). Since the average amount of the outstanding checks is $18.39, and Prudential estimated it would cost $127.20 per check to research an address, it is unlikely that any claim for reimbursement will be made.

The Confirmation of Defendants' Settlement Agreement sets forth the following significant terms:

a.) New Jersey is released from all claims (Par. A.)

b.) In the event legal proceedings are instituted against New Jersey involving any allocable portion of the settlement paid to your state, the state agrees to intervene and defend. In the event of any judgment for any such amounts paid to your state, you agree to reimburse New Jersey in an amount not to exceed the amount of such funds you received less any claims you previously paid. Lead Counsel is not aware of the existence of any pending claims or the basis for any potential claims.

III. NATIONAL ASSOCIATION OF UNCLAIMED PROPERTY ADMINISTRATORS ENDORSES SETTLEMENT

The Executive Committee of the National Association of Unclaimed Property Administrators has reviewed the proposed settlement and endorses acceptance of this settlement.

IV. STATES NOT CONSENTING TO THE SETTLEMENT AGREEMENT

The settlement herein contemplates that all the defendants will agree thereto. Lead Counsel are advised that Prudential will not agree to a settlement which does not include all defendants. In the event that any state objects, Lead Counsel shall request a hearing with the Court and including the objecting state.

V. SETTLEMENT DOCUMENTS TO BE EXECUTED

The $3,024,000 originally deposited by Prudential in the within action has been invested in a certificate of deposit which expired on April 24, 1986. Thereafter the funds have be reinvested in an account paying daily interest. Lead Counsel request that the settlement documents be returned prior to May 25th in order to permit distribution of the funds by June 1, 1986.

1. Confirmation of Settlement, and General Release of the State. This agreement must be conformed and retyped by your state to provide the information which appears within the parentheses. This agreement is to be executed by the official who administers your state's unclaimed property program.

2. Consent to Order for Dismissal, etc. This agreement is to be executed by the office of the Attorney General or your jurisdiction's chief legal officer.

If you desire further information regarding the conduct of the discovery or the operation of the proposed settlement agreement, please contact Richard Hammer (213) 251-2517 or David Epstein (213) 552-9415.

Very truly yours,

David J. Epstein, Esquire
Lead Counsel

/s/ Richard L. Hammer
Richard L. Hammer, Esquire
Lead Counsel

Ronald M. Sturtz, Esquire
Lead Counsel

/s/ Paul Shanley
Paul Shanley, Esquire
Lead Counsel

/s/ Bart T. Murphy
Bart T. Murphy, Esquire
Lead Counsel

/s/ Peter K. Shack
Peter K. Shack, Esquire
Lead Counsel

MEMORANDUM

FROM: DAVID J. EPSTEIN

DATE: AUGUST 29, 1985

RE: ANALYSIS OF PRUDENTIAL ESCHEAT LIABILITY

Prudential paid approximately $3.1 million into court as an estimate of its liability for unclaimed funds which it had not previously reported and delivered. This amount was calculated by applying an error rate of 37% to the $4.8 million which its records reflected as outstanding. As set forth in Exhibit A, this study is seriously flawed and indicates that perhaps as much as $4.5 million should have been interplead.

Subsequent to questioning of the validity of the estimate, Prudential prepared a further study of the $4.8 million (note for Richard Gorevitz from Kathleen Greist, November 6, 1984) (the "Greist memo"). The Greist memo sets forth various adjustments to the $4.8 million which appear to reflect Prudential's effort subsequent to the interpleader action to specifically identify the accounting errors contained in the original estimate. Based on these subsequent studies Prudential has identified $3,784,447.91 which is abandoned. This figure is understated however, since it excluded $201,652.25 on the theory the items are time barred. Prudential however, has never asserted the bar of limitations eg. Howard Rosen statement, 11/7/84; these monies were paid into court and thus the plea of limitations was not asserted see Marsh v. Nebraska St. Brd. of Agric. 217 Neb.622,350 N.W. 2n 535 (1984) and State v. Tex. Elec. Service Co. 488 S.W. 2d 878 (1972) . Thus Prudential has waived the bar, see So. Carolina Tax Comm'n v. Metropolitan Life Ins. Co. 266 S.C. 34,221 S.E. 2d 522 (1975). Additionally the sum of $117,467.82 was not included since these amounts were not yet escheatable. The settlement will give Prudential a release for this amount and therefor it should be included. Another $156,494.22 was also excluded on the theory that these were sums owing to Prudential. In Prudential's records I have located considerable evidence that checks were made payable to Prudential as part of an accounting system procedure to reflect over remittances, etc. and thus represent escheatable sums. Accordingly, based on the Griest memo Prudential owes the following amounts:

Amount per Griest memo		$3,784,447.91
Additions:		
Prudential Payee	154,494.22	
1985 & later escheat	117,467.82	
Time barred	201,652.25	
Total owing		$4,258,062.20

Prudential may argue that the adjustments made in the Griest memo are only partial and that they are continuing to identify the errors. In that case they should identify any further errors they have located and we can adjust the total owing.

On the other hand Prudential is subject to claims for interest and penalties in numerous states. (Prudential in a previous settlement with New York paid 6% interest.) In the event of litigation the states may be able to collect penalties. For example, there appears to be a very substantial difference between the error rate they estimated for purposes of making the interpleader payment and the error rate actually documentated in the Griest memo. If Prudential cannot explain or reconcile the difference, the states should at the minimum be able to collect penalties at least equal to their attorney fees in establishing the correct liability.

Exhibit B sets forth an approximation of the minimum amount of interest which certain of the states are entitiled to under their laws. Accordingly, Prudential would now appear to owe $_____ in interest or a total sum of $_____ .

EXHIBIT A

PRUDENTIAL ESTIMATE OF ERRORS

The Pufs system includes $4,800,000.00 of unclaimed checks issued through 1983 for which Prudential claims it has no addresses. Prudential based on a study entitiled Validation of Records Submitted for Escheat (the "Prudential Study") claims that 37% or $1,776,000.00 of the items included in the $4.8 million are not validiy escheatable. Accordingly, Prudential paid into court the sum of $3.1 million, i.e. $4.8 million less $1.7 million.

Prudential arrived at its 37% error rate by conducting an examination of 1565 randomly drawn cases, each of which was at least $200.00. Prudential then reviewed its records to ascertain if the funds were validly owing and whether the payees could be located through a "fairly routine search". Based on the Prudential study it identified 402 cases which it concluded were in error. (See Summary of Results, Error Categories). In order to calculate the error rate Prudential then adjusted the number of cases in the sample, 1565, downwards to 1092 to reflect the cases for which it could not locate records. Thus 402/1092 yielded the 37% error rate.

In order to correctly calculate the error rate it is necessary to adjust Prudential's findings. In the first instance, if the payee has not been located and paid, the item must be reported and delivered as abandoned. Prudential has a choice:(1) it can search for the 145,158 payees it estimates it can find (226,810 error cases x 64%) and deduct the amounts actually paid from the $4.8 million, or (2) it can report and deliver the amounts and the states will hold them until the payees come forward. Thus the error rate should be adjusted to exclude the "inadequate search" category which would leave 145 "error cases" and an error rate of 145/1092 or 13% (see Summary of Results Error Categories). Applying the 13% to $4.8 million would yield errors of $624,000.00 and therefor $4.2 million should have been paid to court.

Further adjustments are also required. Another error category is "Should Be Applied to Policy". This category represents uncashed policy dividend checks and return of premium checks which Prudential contends should have been applied to in force policies. The various state unclaimed property laws do not provide for such treatment and the policy terms have no such provision. However, the states - wisely - allow the recrediting of such amounts to an active policy. Prudential, however, apparently has not reviewed its records, identified each amount for which it can locate the policy, and in fact credited the policy. Accordingly, the error rate needs to be further adjusted to exclude the 30 cases in this category (115/1092 = 10%). Thus the $4.8 million should be reduced to only $4.32 million.

The Prudential study assumes that the error rate should be calculated based on the number of cases for which files could be located i.e. 1092 rather than using the total number of cases in the selected sample. This procedure is questionable. If Prudential has a record of an outstanding item but has no further records to prove or disprove that it is a duplicate payment, voided check, etc. then the item should be included in the survey. In other words, the fact Prudential has no further records with which to impeach its record of an outstanding item makes that item subject to escheat. Therefore the error rate should be calculated as 115/1565 = 7%. 7% of $4.8 million is $326,000.00. Accordingly, Prudential owed $4.5 million.

There are numerous other questions regarding the reliability of the Prudential Study. For example, the errors are not randomly distributed among the Regional Home Offices. One RHO on an item count basis was responsible for 40% of the duplicate payment errors, another RHO caused 51% of the in lieu / Replacement check errors. If the dollar amount of these errors, as distinguished from the item count, was not a similar percentage then the result could be radically affected. Similarly, 3 RHO generated 70% of the 145 accounting error cases. Stratification of the results may have yielded a considerably different error rate. The results are further affected by not statistically adjusting or "smoothing" out the results to get a better fit with the data.

DAVID J. EPSTEIN
ATTORNEY AT LAW
TWO CENTURY PLAZA, SUITE 2060
2049 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067
TELEPHONE (213) 552-9415

November 12, 1984

Herb Glickman
Dept. of Law and Public Safety
Division of Law
Richard J. Hughes Justice Complex
CN 112
Trenton, New Jersey 08625

Re: Prudential v. Alabama, et al.

Dear Herb:

Enclosed please find a copy of the Report of Special Master in Pennsylvania v. New York, 407 U.S. 206, 92 S.Ct. 2075, 32 L.Ed.2d 693 ("Western Union case"). Please ignore my annotations on the enclosed.)

I believe the Report provides the basis for the settlement of the within matter. As noted in the Report, the facts in the Western Union case are very similar to those in our case. First, Western Union's ledger records did not indicate the address of the owner (sender or payee). Many of Prudential's records in the Pufs system similarly do not have an address of the payee (Report pp. 8 and 9, para. 6). Second, other records of Western Union, i.e. application forms, in many but not all cases, include the address of the sender (Report p. 9, para. 6). Prudential has comparable records such as policy applications, claim files, check registers, etc. which also provide addresses for the payees whose names appear in the Pufs system. Third, efforts to recover the Western Union addresses would be costly because of the large number of records to be reviewed -- over 200,000 transactions costing $175,000 to review. In the case of Prudential, the work to recover addresses would appear to be at least as great.

Like New Jersey in our case, New York as domiciliary state in the Western Union case claimed "the right to such funds 'where it is not feasible to determine the identity of the last known address of the creditor from the books of Western Union'" (Report p. 12). In this regard the Special Master noted that New York's claim covers situations "where the sender did include his address

on his application form, but where the expense of relating the records to the ledger entry is too great to justify the process" (Report p. 12) (emphasis added). The Special Master further noted that "it is difficult from the records to associate an item with the underlying papers" (Report, p. 17).

New Jersey's claim in our case appears to be based on the identical premise. Additionally, New York made the argument that it was entitled to all property since the addresses were not in "reportable" form and that other states could recover from New York in subsequent proceedings presumably on a showing that the creditor's address was not in New York.

The Special Master concluded that New York had "the burden of establishing the facts basic to its authority" (Report p. 16). The Special Master specifically found that the difficulty or cost of the record search would not excuse New York from proving the absence of an address. Accordingly, the Special Master stated:

> "It would not suffice under the ruling of Texas v. New Jersey to establish that it would be difficult or expensive to search the records for this information. The apparent agreement of all the parties that the ascertainment of the addresses is not 'feasible' is probably based on the fact that Western Union's ledgers do not give the necessary information and that a search of 200,000 transactions with 300,000 ledger entries would be necessary at a cost of $175,000.00" (Report, p. 16) (emphasis added).

The Report also found that the applications for money orders were a part of Western Union's records notwithstanding the company's failure to enter this information in its ledger records. The reasoning of the Master on this issue is particularly persuasive. "The Special Master finds that these applications are part of the records of Western Union within the meaning of Texas v. New Jersey. Otherwise the power to determine between the rival claimants for unclaimed monies would be delegated to the debtor which could enter the addresses upon its ledgers or not and thus affect the rights of the claimants" (Report, p. 18).

Thereafter the Supreme Court adopted the Special Master's proposed decree verbatim, Pennsylvania v. New York, 407 U.S. 223, 92 S.Ct. 2880, 32 L.Ed.2d 704 (1972). Accordingly, "each item of property in question in this case as to which a last known address of the person entitled thereto is shown on the books and records of the defendant is subject to escheat or custodial taking only by the state of that last known address, as shown on the books and records of defendant." In addition to property the owners of which reside in New Jersey according to the records of Prudential, New Jersey can also claim property for "which there is no address of the person entitled thereto shown on the books and records" of Prudential. 407 U.S. at 223, 92 S.Ct. at 2880, 32 L.Ed.2d at 704 (emphasis added).

Therefore New Jersey can claim only that portion of the funds on deposit herein for which it either establishes an address in New Jersey or for which it proves there is no address. New Jersey's burden in this regard cannot be doubted since the Supreme Court in its decision expressly noted that the Special Master's Report required the state of domicile of Western Union to establish "'as to all escheatable items the absence from Western Union's records of an address for the creditor'". 407 U.S. at 214, 92 S.Ct. at 2079. The enormity of this task had undoubtedly been considered by the Court since Pennsylvania had argued that the Special Master's Report "would require an examination of every money order application, one by one, to determine whether the sender has filled in the blank for his address", Exceptions of Plaintiff, Commonwealth of Pennsylvania, to Report of Special Master, p. 4. Similarly the Report had also noted the address record problem, stating it was not possible to determine the number of items having no address "because it is difficult from the records to associate an item with the underlying papers", Report, p. 17.

There would appear to be no basis to distinguish the holding in the Western Union case. While the process of associating Prudential's address records with the name of the payee is a difficult one, the situation in Western Union was identical. Any other solution would reach the exact result expressly disapproved by the Special Master in Western Union -- the debtor should not be allowed to determine the claim between rival claimants merely by

entering or withholding from its ledgers the addresses of owners.

Very truly yours,

David J. Epstein

DJE:sr

cc w/enclosures:

Peter K. Shack
Bart T. Murphy
Richard L. Hammer, Jr.
Mark A. Moreno
Wendy Schaefer
Ronald M. Sturtz
Greg Gaskins
Paul Shanley

METHOD OF ALLOCATION

ES	TOTAL BENEFITS %	TOTAL INFORCE %	TOTAL PREMIUMS %	AVERAGE %	% OF PRUDENTIAL PAYMENT
AMA	0.8377	0.7997	0.8513	0.8296	0.8946
KA	0.0444	0.0702	0.0519	0.0555	0.0598
ONA	0.6490	0.5303	0.6367	0.6053	0.6528
NSAS	0.3905	0.3677	0.4061	0.3881	0.4185
FORNIA	12.5060	9.1530	11.5903	11.0831	11.9515
RADO	1.2804	1.1601	1.3211	1.2539	1.3521
ECTICUT	1.7001	1.9382	1.8484	1.8289	1.9722
WARE	0.2625	0.3527	0.3143	0.3098	0.3341
. COLUMBIA	0.4104	0.4355	0.3945	0.4135	0.4459
IDA	3.9297	3.2560	3.5794	3.5884	3.8695
GIA	1.3034	1.6047	1.4475	1.4519	1.5656
II	0.4875	0.4983	0.5203	0.5020	0.5414
O	0.2193	0.2288	0.2677	0.2386	0.2573
NOIS	7.4416	7.0494	7.7389	7.4100	7.9905
ANA	2.7508	2.8331	3.0957	2.8932	3.1199
	0.8466	1.0945	1.0271	0.9894	1.0669
AS	0.6289	0.8110	0.7849	0.7416	0.7997
UCKY	0.8596	0.9571	0.9134	0.9100	0.9813
SIANA	0.9355	0.8766	0.9654	0.9258	0.9984
E	0.4608	0.5289	0.5383	0.5093	0.5492
LAND	1.8974	2.0144	1.9532	1.9550	2.1082
ACHUSETTS	2.5742	2.8990	2.5877	2.6870	2.8975
IGAN	3.7069	4.1666	3.9046	3.9260	4.2336
ESOTA	1.5801	1.8266	1.7271	1.7113	1.8453
ISSIPPI	0.3610	0.3349	0.3652	0.3537	0.3814
OURI	1.8608	1.7872	1.8362	1.8281	1.9713
ANA	0.2312	0.1734	0.2500	0.2182	0.2353
ASKA	0.3789	0.4817	0.4762	0.4456	0.4805
DA	0.2767	0.2026	0.2729	0.2507	0.2704
HAMPSHIRE	0.3387	0.4434	0.4193	0.4005	0.4318
JERSEY	9.5385	12.2435	8.9769	10.2530	11.0583
MEXICO	0.4004	0.4703	0.4252	0.4320	0.4658
H CAROLINA	1.1150	1.3385	1.2124	1.2220	1.3177
H DAKOTA	0.1387	0.1472	0.1681	0.1513	0.1632
	6.4436	6.3543	6.3907	6.3962	6.8973
HOMA	0.7181	0.9013	0.8376	0.8190	0.8832
ON	0.9314	0.6108	0.8428	0.7950	0.8573
SYLVANIA	9.1832	10.2174	9.5610	9.6539	10.4102
TO RICO	0.0683	0.0605	0.0596	0.0628	0.0677
E ISLAND	0.2945	0.3934	0.3456	0.3445	0.3715
H CAROLINA	0.5418	0.6256	0.6211	0.5962	0.6429
H DAKOTA	0.1199	0.1527	0.1604	0.1443	0.1556
ESSEE	0.9815	0.9414	1.0506	0.9912	1.0688
S	3.5532	3.1346	3.7005	3.4628	3.7341
	0.4506	0.3401	0.4311	0.4073	0.4392
ONT	0.2040	0.2414	0.2307	0.2254	0.2430
INIA	1.2213	1.5371	1.4230	1.3938	1.5030
INGTON	1.8178	1.1647	1.7262	1.5696	1.6925
VIRGINIA	0.9030	0.6547	0.8027	0.7868	0.8484
ONSIN	2.0775	2.3472	2.3190	2.2479	2.4240
ING	0.0746	0.0749	0.0774	0.0756	0.0816

100.0000

DEFENDANTS' SETTLEMENT AGREEMENT

WHEREAS, on November 23, 1983, The Prudential Insurance Company of America, a New Jersey corporation, commenced an action in the Superior Court of New Jersey, Chancery Division (Essex County vicinage), entitled "The Prudential Insurance Company of America, etc. v. State of Alabama, et als.," and bearing docket number C-4937-83E, which action seeks an adjudication concerning the proceeds of certain unclaimed outstanding checks issued by the Insurer; and

WHEREAS, service of process was duly made upon each of the defendants, being the fifty sovereign States of the United States of America, the Commonwealth of Puerto Rico, and the District of Columbia; and

WHEREAS, by a certain Order dated July 11, 1984, and entered in the aforesaid cause, Lead Counsel was designated for the defendants other than the State of New Jersey; and

WHEREAS, a Settlement Agreement has been entered into by The Prudential Insurance Company of America, through its counsel, by the State of New Jersey, through the Attorney General of New Jersey, and by Lead Counsel, which Agreement is expressly subject to review and confirmation by an official or officials of The Prudential Insurance Company of America and of the Defendants in the litigation aforesaid; and

WHEREAS, the said Settlement Agreement provides, inter alia, that the proceeds of the unclaimed outstanding checks (as defined in Paragraph A of that Agreement), comprising a fund in the

amount of $4.3 million, shall be paid to the State Treasurer of New Jersey; and

WHEREAS, the State of New York has disclaimed any right, title, or interest in the proceeds of the unclaimed outstanding checks involved in this litigation and has agreed to the dismissal of the litigation aforesaid and to the payment of the proceeds of the unclaimed outstanding checks to the State Treasurer of New Jersey; and

WHEREAS, the State of New Jersey and the other Defendants (other than the State of New York) have decided to conclude this litigation upon an amicable basis and without any adjudication by the Court as to the respective claims or rights of any defendant in or to all or part of the proceeds of the unclaimed outstanding checks:

NOW THEREFORE, the State of New Jersey, through the Attorney General of New Jersey, and Lead Counsel aforesaid agree to a settlement of all disputes or claims among the defendants in the aforesaid litigation upon the following terms, to wit:

A. The State Treasurer of New Jersey will take possession of all proceeds of the unclaimed outstanding checks, comprised of the unclaimed fund in the amount of $4.3 million and all interest earned upon the fund paid into court in the aforesaid litigation (originally $3.024 million);

B. The State Treasurer of New Jersey shall pay to the State of New Jersey sixty percent (60%) of amount received, in

recognition of its claim as the State of the corporate domicile of The Prudential Insurance Company of America;

C. The remaining forty percent (40%) of the amount received by the State Treasurer of New Jersey shall constitute a fund for distribution to all of the Defendants (including the State of New Jersey, but excluding the State of New York) in recognition of the claims of the Defendants to custody of unclaimed property due to citizens of their respective States;

D. The State Treasurer of New Jersey will distribute the forty-percent (40%) fund in accordance with the percentage allocation set forth in the Allocation Schedule that is annexed hereto and made a part hereof;

E. After making payment of the amount due to the State of New Jersey pursuant to the annexed Allocation Schedule, but before making payment of the amount due to the remaining States, the State Treasurer of New Jersey shall deduct from the remaining funds and pay the following sums, to wit:

1. The sum of $ 0 to the Commonwealth of Massachusetts as reimbursement for the expenses incurred by

Paul E. Shanley, Esq., as lead counsel;

2. The sum of $ 1,861.17 to the State of Illinois as reimbursement for the expenses incurred by Bart T. Murphy, Esq., as lead counsel;

3. The sum of $ 2,346.13 to the State of Michigan as reimbursement for the expenses incurred by Richard L. Hammer, Jr., Esq., as lead counsel;

4. The sum of $ 2,141.13 to the State of California as reimbursement for the expenses incurred by Peter K. Shack, Esq., as lead counsel;

5. The sum of $ 35,119.50 to Ronald M. Sturtz, Esq., as compensation for legal services rendered by him as lead counsel, and the sum of $ 1,860.93 as reimbursement for expenses incurred; and

6. The sum of $ 25,245.00 to David Epstein, Esq., as compensation for legal services rendered by him as lead counsel, and the sum of $ 6,517.54 as reimbursement for expenses incurred;

F. After making payment of the said reimbursements and counsel fees, the State Treasur-

er of New Jersey shall disperse the remaining fund to the States in accordance with the Allocation Schedule, but after apportioning the total reimbursement and counsel fee payments among those States;

G. The States receiving the distribution shall unconditionally release the State of New Jersey from any claim or liability as to the amount distributed;

H. If a claim for restitution is made by an apparent owner or party entitled to the proceeds of an unclaimed outstanding check, and if the records of The Prudential Insurance company of America verify that the claimant resided in a certain State at the time of the issuance of the check, that certain State shall make restitution to the claimant so long as the total amount paid to all claimants does not exceed the amount received in the distribution; and

I. This Agreement shall have no precedential force or bind any of the States in any other litigation or circumstances other than as to the unclaimed outstanding checks involved in this litigation.

This Settlement Agreement is expressly subject to review and confirmation by an official or officials of the respective

States and [illegible] become valid and binding only when confirmed by all of those officials. The signatories hereto agree to seek review and confirmation of this Settlement Agreement by the respective approving officials promptly and to recommend and urge confirmation.

This Settlement Agreement embodies the entire agreement of the signatories hereto. There are no promises, terms, conditions, or obligations other than those set forth herein. This Agreement supersedes all previous communications, representations, or agreements, either verbal or written, among any of the parties or signatories hereto.

W. CARY EDWARDS
Attorney General of New Jersey
Attorney for Defendant,
The State of New Jersey

Dated: May 14, 1986

By: Herbert K. Glickman
Herbert K. Glickman
Deputy Attorney General

Dated: May 14, 1986

Ronald M. Sturtz, Esquire
Lead Counsel

Dated: May 14, 1986

David Epstein, Esquire
Lead Counsel

Dated: May 14, 1986

/s/ Paul Shanley
Paul Shanley, Esquire
Lead Counsel

Dated: May 14, 1986

/s/ Bart T. Murphy
Bart T. Murphy, Esquire
Lead Counsel

Dated: May 14, 1986

/s/ Richard L. Hammer
Richard L. Hammer, Jr., Esq.
Lead Counsel

Dated: May 14, 1986

/s/ Peter K. Shack
Peter K. Shack, Esq.
Lead Counsel

METHOD OF ALLOCATION

STATES	TOTAL BENEFITS %	TOTAL INFORCE %	TOTAL PREMIUMS %	AVERAGE %	% OF PRUDENTIAL PAYMENT
ALABAMA	0.8377	0.7997	0.8513	0.8296	0.8946
ALASKA	0.0444	0.0702	0.0519	0.0555	0.0598
ARIZONA	0.6490	0.5303	0.6367	0.6053	0.6528
ARKANSAS	0.3905	0.3677	0.4061	0.3881	0.4185
CALIFORNIA	12.5060	9.1530	11.5903	11.0831	11.9515
COLORADO	1.2804	1.1601	1.3211	1.2539	1.3521
CONNECTICUT	1.7001	1.9382	1.8484	1.8289	1.9722
DELAWARE	0.2625	0.3527	0.3143	0.3098	0.3341
DIST. COLUMBIA	0.4104	0.4355	0.3945	0.4135	0.4459
FLORIDA	3.9297	3.2560	3.5794	3.5884	3.8695
GEORGIA	1.3034	1.6047	1.4475	1.4519	1.5656
HAWAII	0.4875	0.4983	0.5203	0.5020	0.5414
IDAHO	0.2193	0.2288	0.2677	0.2386	0.2573
ILLINOIS	7.4416	7.0494	7.7389	7.4100	7.9905
INDIANA	2.7508	2.8331	3.0957	2.8932	3.1199
IOWA	0.8466	1.0945	1.0271	0.9894	1.0669
KANSAS	0.6289	0.8110	0.7849	0.7416	0.7997
KENTUCKY	0.8596	0.9571	0.9134	0.9100	0.9813
LOUISIANA	0.9355	0.8766	0.9654	0.9258	0.9984
MAINE	0.4608	0.5289	0.5383	0.5093	0.5492
MARYLAND	1.8974	2.0144	1.9532	1.9550	2.1082
MASSACHUSETTS	2.5742	2.8990	2.5877	2.6870	2.8975
MICHIGAN	3.7069	4.1666	3.9046	3.9260	4.2336
MINNESOTA	1.5801	1.8266	1.7271	1.7113	1.8453
MISSISSIPPI	0.3610	0.3349	0.3652	0.3537	0.3814
MISSOURI	1.8608	1.7872	1.8362	1.8281	1.9713
MONTANA	0.2312	0.1734	0.2500	0.2182	0.2353
NEBRASKA	0.3789	0.4817	0.4762	0.4456	0.4805
NEVADA	0.2767	0.2026	0.2729	0.2507	0.2704
NEW HAMPSHIRE	0.3387	0.4434	0.4193	0.4005	0.4318
NEW JERSEY	9.5385	12.2435	8.9769	10.2530	11.0563
NEW MEXICO	0.4004	0.4703	0.4252	0.4320	0.4658
NORTH CAROLINA	1.1150	1.3385	1.2124	1.2220	1.3177
NORTH DAKOTA	0.1387	0.1472	0.1681	0.1513	0.1632
OHIO	6.4436	6.3543	6.3907	6.3962	6.8973
OKLAHOMA	0.7181	0.9013	0.8376	0.8190	0.8832
OREGON	0.9314	0.6108	0.8428	0.7950	0.8573
PENNSYLVANIA	9.1832	10.2174	9.5610	9.6539	10.4102
PUERTO RICO	0.0683	0.0605	0.0596	0.0628	0.0677
RHODE ISLAND	0.2945	0.3934	0.3456	0.3445	0.3715
SOUTH CAROLINA	0.5418	0.6256	0.6211	0.5962	0.6429
SOUTH DAKOTA	0.1199	0.1527	0.1604	0.1443	0.1556
TENNESSEE	0.9815	0.9414	1.0506	0.9912	1.0688
TEXAS	3.5532	3.1346	3.7005	3.4628	3.7341
UTAH	0.4506	0.3401	0.4311	0.4073	0.4392
VERMONT	0.2040	0.2414	0.2307	0.2254	0.2430
VIRGINIA	1.2213	1.5371	1.4230	1.3938	1.5030
WASHINGTON	1.8178	1.1647	1.7262	1.5696	1.6925
WEST VIRGINIA	0.9030	0.6547	0.8027	0.7868	0.8484
WISCONSIN	2.0775	2.3472	2.3190	2.2479	2.4240
WYOMING	0.0746	0.0749	0.0774	0.0756	0.0815
					100.0000

INSTRUCTIONS TO BE FOLLOWED WITH RESPECT TO COMPLETING YELLOW TABBED PORTIONS OF SETTLEMENT DOCUMENTS

TAB #1 - to be signed by official of State's Chief Legal Office.

TAB #2 - Retype Page #1 providing the information as requested in the parentheses.

TAB #3 - to be signed by State's Unclaimed Property Administator and to be witnessed.

TAB #4 - Retype Pages 1 and 2 providing the information as requested in the parentheses.

TAB #5 - to be signed by the State's Unclaimed Property Administrator and to be witnessed.

SETTLEMENT AGREEMENT

WHEREAS, on November 23, 1983, The Prudential Insurance Company of America, a New Jersey corporation, commenced an action in the Superior Court of New Jersey, Chancery Division (Essex County vicinage), entitled "The Prudential Insurance Company of America, etc., v. State of Alabama, et als.," and bearing docket number C-4937-83E, which action seeks an adjudication concerning the proceeds of certain unclaimed outstanding checks issued by the Insurer;* and

WHEREAS, service of process was duly made upon each of the defendants to the aforesaid cause;

WHEREAS, by a certain Order dated July 11, 1984, and entered in the aforesaid cause, Lead Counsel was designated for the defendants other than the State of New Jersey; and

WHEREAS, with the cooperation of the Insurer, informal discovery of information and records was conducted by Lead Counsel and counsel for the State of New Jersey; and

WHEREAS, the parties have decided to conclude this litigation upon an amicable basis and without any adjudication by the Court upon any aspect involved:

---

* As used in this Settlement Argument, "Defendants" shall mean and include all of the fifty sovereign States of the United States of America, the Commonwealth of Puerto Rico, and the District of Columbia. "Insurer" shall mean the Plaintiff, The Prudential Company of America.

NOW THEREFORE, The Prudential Insurance Company of America, through its counsel, The State of New Jersey, through the Attorney General of New Jersey, and Lead Counsel, agree to a settlement of the aforesaid litigation upon the following terms, to wit:

A. The unclaimed outstanding checks involved in this litigation are defined to mean and include the 261,052 outstanding checks in the Prudential Unclaimed Funds System (PUFS) as of December 7, 1982, and as shown on PUFS Surplus Items Analysis Run, dated December 21, 1982, which checks were issued between 1883 and 1982 and for which, in PUFS, there is no name or no last known address or State of residence of the person entitled to that check's proceeds;

B. For the purposes of this Settlement, the parties agree that the unclaimed outstanding checks comprise an unclaimed fund in the amount of $4.3 million;

C. The aforesaid litigation in the Superior Court of New Jersey shall be dismissed by consent, with prejudice and without costs:

    1. No portion of the Settlement Agreement shall be placed upon the record, nor shall any party present the settlement to the Court for review or confirmation;

    2. Counsel for the Insurer, Lead Counsel, and counsel for the State of New Jersey shall execute an appropriate form of Consent Order for dismissal of the litigation for

filing with the Court, and the respective Attorneys General or appropriate officials of the other defendants shall execute an appropriate form of Consent to the filing and entry of the aforesaid Order for dismissal;

D. No counsel fees are to be sought or allowed to counsel for any party and paid out of the proceeds of the unclaimed fund before its turnover to the State Treasurer of New Jersey as hereinafter provided;

E. Counsel for the Insurer, Lead Counsel, and counsel for the State of New Jersey will consent to the form and entry of an Order directing that the fund originally paid into court ($3.024 million) and all income earned thereon be paid to the State Treasurer of New Jersey; the respective Attorneys General or appropriate officials of the other defendants shall execute an appropriate form of consent to the terms of that Order;

F. The defendants shall execute a general and unconditional Release addressed to the Insurer and releasing any and all claims or demands concerning the unclaimed outstanding checks, as defined in Paragraph A supra, and any interest and penalties assessable or collectable thereon;

G. Upon request of a Defendant, the Insurer will examine and advise the Defendant of information it has

concerning a claim received from the apparent owner or party entitled to the proceeds of an unclaimed outstanding check.

H. Upon presentation of the Release, Consents to the dismissal, and Consent Order for payment to the State Treasurer of New Jersey, duly executed by officials of each of the defendants, the Insurer will pay-over to the State Treasurer of New Jersey the sum of $1.276 million;

I. Upon full payment of the unclaimed fund to the State Treasurer of New Jersey, the insurer shall be relieved of and held harmless by the State of New Jersey from any and all liabilities for any claims, as set forth in N.J.S.A. 17B:31-6.

J. The Insurer will deliver to the State Treasurer of New Jersey, a true, legible, and complete copy of the PUFS Surplus Items Analysis Run, dated December 21, 1982;

K. The defendants and their counsel shall deliver to counsel for the Insurer all documents and materials acquired during informal discovery from the Insurer and all copies that were made therefrom; however, the Insurer shall maintain these discovery materials among its permanent records until at least July 1, 1996;

L. In accordance with N.J.S.A. 17B:31-10 the Insurer shall retain its records in connection with the unclaimed outstanding checks for a period of five

(5) years after payment of the unclaimed fund to the State Treasurer of New Jersey, and such records shall be made available to the defendants upon request in the event of a claim against a defendant for payment of all or any part of such unclaimed fund by a person claiming to be entitled thereto;

M. This settlement shall have no precedential force or bind any of the parties in any other litigation or circumstances other than as to the unclaimed outstanding checks set forth in Paragraph A supra.

This Settlement Agreement is expressly subject to review and confirmation by officials of The Prudential Insurance Company of America and of the defendants in this litigation and shall become valid and binding only when confirmed by all of those officials. The signatories hereto agree to seek review and confirmation of this Settlement Agreement by the respective approving officials promptly and to recommend and urge confirmation.

This Settlement Agreement embodies the entire agreement of the signatories hereto. There are no promises, terms, conditions or obligations other than those set forth herein. This Agreement supersedes all previous communications, representations, or agreements, either verbal or written, among any of the parties or signatories hereto.

ROSEN, WEISS, McCARTHY & BURSTEIN, P.C.
Attorneys for Plaintiff

Dated: _____ By: _____
Howard T. Rosen, Esq.

STRYKER, TAMS & DILL, ESQS.
Attorneys for Plaintiff

Dated: _____ By: _____
Richard B. McGlynn, Esq.

W. CARY EDWARDS
Attorney General of New Jersey
Attorney for Defendant,
The State of New Jersey

Dated: May 14, 1986 By: Herbert K Glickman
Herbert K. Glickman
Deputy Attorney General

Dated: May 14, 1986 _____
David Epstein, Esq.
Lead Counsel

Dated: May 14, 1986 /s/ Paul Shanley
Paul Shanley, Esq.
Lead Counsel

Dated: May 14, 1986 /s/ Bart T. Murphy
Bart T. Murphy, Esq.
Lead Counsel

Dated: May 14, 1986 _____
Ronald M. Sturtz, Esq.
Lead Counsel

Dated: May 14, 1986 /s/ Richard L. Hammer
Richard L. Hammer, Jr., Esq.
Lead Counsel

Dated: May 14, 1986 /s/ Peter K. Shack
Peter K. Shack, Esq.
Lead Counsel

EXHIBIT I
(1 OF 2)

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	190151	12/19/84	12/19/84

Ident. No.	Account Name	CH. No.	Sepcial Delivery Instructions
: :		0370	Asiel & Company 20 Broad Street New York, New York 10005

CASHIERS DELIVER

	WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL	
DEL	SLD	500	556139-10-3	MACY		21,500.00

EXHIBIT I
(2 OF 2)

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	9999999	XX/XX/XX	XX/XX/XX

Ident. No.	Account Name	CH. No.	Special Delivery Instructions
: :		370	
:370 :			

CASHIERS DELIVER

WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL
SLD	1800	370-442-402	GM PFD E	

NET AMOUNT

70,200

EXHIBIT II

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	200130	12/20/84	12/20/84

Ident. No.	Account Name	CH. No.	Special Delivery Instructions
:370 :		0211	BEAUCHAMP & CO. 50 Broad Street New York, New York 10005

WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL
BOT	8,100	027627-10-8	AMER MOTORS	

NET AMOUNT

32,400.00

WEEKLY STOCK RECORD
BROKER X

Date	Account 1B	Position Long	Position Short	Segregation	Safekeeping	Transfer	Date	Account 1B	Position Long	Position Short	Segregation	Safekeeping	Tra
)7/32/6	BOEING COMPANY									NYSE CCS	097923-10-5		
)9/21/77	01399701606	200		200		I	09/26/77	02941311606	1000		500	500	
)9/21/77	01605002039	400				I	09/21/77	03134351031	200		200		
)9/21/77	01659082126	200		200			02/03/78	03291541070	300		300		
)9/21/77	01709852152	400		400			09/21/77	03351911046	448		448		
)9/21/77	01818002039	200				I	02/23/78	03648982121	100				
)9/21/77	01821492220	200					02/21/78	65028463452		300			
)9/21/77	01827701606	1000		1000		I	02/02/78	97001040		500			
)2/17/78	01839602011	200		181		I	02/23/78	97981010		9074			
0/11/77	01872131022	100		100			09/21/77	98982210		2800			
1/30/78	01993471221	100		100			09/20/77	98982910		1000			
9/21/77	02184802038	100		100			02/22/78	98984110		2300			
1/23/77	02757412055	500											

EXHIBIT IV

Broker X

BD200D - SECURITIES PAID

02/21/84

		RCD DATE	PAY DATE	DIV RATE
441560-10-9	HOUGHTON MIFFLIN CO.	02-08-84	02-22-85	.220000

SHORT NAME	ACCOUNT	NET POSITION LONG	NET POSITION SHORT	STOCK DIV. LONG	STOCK DIV. SHORT	CASH DIV. DEBIT	CASH DIV. CREDIT	TYP TAX	MESSAGE
O'CONNOR HE	065-002537-1	300					66.00		Gross Div
							66.00**	Div	Net Div
O'CONNOR HE	065-002545-1	300					66.00		Gross Div
							66.00**	Div	Net Div
	960-102004-1		600			132.00			Gross Div
TOTALS		**600**	**600**			**132.00**	**132.00**		GROSS DIVIDEND TOTALS
									NRA TAX TOTAL
									TEFRA TAX TOTAL
						132.00	132.00		NET DIVIDEND TOTALS

3/7

:COMPANY CHECK :
: :
:CREDIT THRU DTC :
: 132.00 2/22 :
:CREDIT A/C CHARGE :
: :
:BROKERS CHECKS :
: :
:W/O :
: :

Dr Siac 1,100.00
Div Adj

EXHIBIT I
(1 OF 2)

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	190151	12/19/84	12/19/84

Ident. No.	Account Name	CH. No.	Special Delivery Instructions
: :		0370	Asiel & Company 20 Broad Street New York, New York 10005

CASHIERS DELIVER

	WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL
DEL	SLD	500	556139-10-3	MACY	21,500.00

EXHIBIT I
(2 OF 2)

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	9999999	XX/XX/XX	XX/XX/XX

Ident. No.	Account Name	CH. No.	Special Delivery Instructions
: :		370	
:370 :			

CASHIERS DELIVER

WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL
SLD	1800	370-442-402	GM PFD E	

NET AMOUNT

70,200

EXHIBIT II

BROKER X

: PARTIAL DELIVERY
:DELIVERED
:FAILURE TO DELIVER

Orig. No.	Trade Date	Settlement Date	Date Delivered
: :	200130	12/20/84	12/20/84

Ident. No.	Account Name	CH. No.	Special Delivery Instructions
:370 :		0211	BEAUCHAMP & CO. 50 Broad Street New York, New York 10005

WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION	SYMBOL
BOT	8,100	027627-10-8	AMER MOTORS	

NET AMOUNT

32,400.00

WEEKLY STOCK RECORD

BROKER X

Date	Account 1B	Position Long	Position Short	Segregation	Safekeeping	Transfer	Date	Account 1B	Position Long	Position Short	Segregation	Safekeeping	Trans
07/32/6	BOEING COMPANY									NYSE CCS	097923-10-5		BA
09/21/77	01399701606	200		200		I	09/26/77	02941311606	1000		500	500	I
09/21/77	01605002039	400				I	09/21/77	03134351031	200		200		
09/21/77	01659082126	200		200			02/03/78	03291541070	300		300		I
09/21/77	01709852152	400		400			09/21/77	03351911046	448		448		
09/21/77	01818002039	200				I	02/23/78	03648982121	100				
09/21/77	01821492220	200					02/21/78	65028463452		300			
09/21/77	01827701606	1000		1000		I	02/02/78	97001040		500			
02/17/78	01839602011	200		181		I	02/23/78	97981010		9074			
10/11/77	01872131022	100		100			09/21/77	98982210		2800			
01/30/78	01993471221	100		100			09/20/77	98982910		1000			
09/21/77	02184802038	100		100			02/22/78	98984110		2300			
11/23/77	02757412055	500											

EXHIBIT IV

Broker X BD200D - SECURITIES PAID 02/21/84

		RCD DATE	PAY DATE	DIV RATE
441560-10-9	HOUGHTON MIFFLIN CO.	02-08-84	02-22-85	.220000

SHORT NAME	ACCOUNT	NET POSITION LONG	NET POSITION SHORT	STOCK DIV. LONG	STOCK DIV. SHORT	CASH DIV. DEBIT	CASH DIV. CREDIT	TYP TAX	MESSAGE
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							66.00**	Div	Net Div
O'CONNOR HE	065-002545-1	300					66.00		Gross Div
							66.00**	Div	Net Div
	960-102004-1		600			132.00			Gross Div
TOTALS		**600**	**600**			**132.00**	**132.00**		GROSS DIVIDEND TOTALS
									NRA TAX TOTAL
									TEFRA TAX TOTAL
						132.00	132.00		NET DIVIDEND TOTALS

3/7

COMPANY CHECK
CREDIT THRU DTC
132.00 2/22
CREDIT A/C CHARGE
BROKERS CHECKS
W/O

Dr Siac 1,100.00
Div Adj

COUNSEL PRESS INC.
11 EAST 36TH STREET, NEW YORK, NEW YORK 10016
(212) 685-9800; (516) 222-1021; (914) 682-0992

(104354)