

MEMORANDUM

Problems of Organization and Administration of the New York Stock Exchange

The Securities and Exchange Commission submits herewith for the consideration of the special committee appointed to study the organization and administration of the New York Stock Exchange, an outline of certain of the important problems to which it feels the Committee should give its careful attention. With respect to some of these questions, the Commission has definite proposals to make; as to others, while it is not prepared to propose the solution, it makes suggestions for consideration; concerning the residue, which includes a multitude of the varied and detailed incidents of the conduct of exchange business, it feels it sufficient to pose certain representative aspects of the entire problem of the proper functioning of an exchange as a public institution.

I

Internal Organization and Executive Management

It is felt that the Governing Committee of the Exchange should be rendered more representative of the various types of member firms of the Exchange and of the partners of such firms who are not individual members of the Exchange by virtue of holding a seat on the Exchange. This might be accomplished through a reconstitution of the Governing Committee itself and through various changes in the electoral system of the Exchange.

To this end, it is suggested that the franchise be extended to all partners of member firms so that firms and individuals will have a proportional voice in the election of the Governors. The

Nominating Committee should be abolished and some substitute system of nomination instituted such as nomination by petition or direct primary.

The existing classification of persons eligible to become members of the Governing Committee (5 "members" to one "governing member") should be revised so that all members and partners of members will be eligible to hold office as Governors.

In order to obtain proportional representation on the Governing Committee of the various classes of members and member firms, all members and partners of members should be required to register with the Exchange according to functional classifications (such as specialists, commission brokers, etc.), each such class to be entitled to representation on the Committee in the ratio which it bears to the entire body of members and partners so registered.

The executive management of the Exchange should be reconstituted so as to provide the Exchange with a degree of executive efficiency of as nearly a disinterested nature as possible.

The first step in such a program should provide for a full time salaried president with a background of executive and business experience, who should not be, or have been, a member of the Exchange or a partner of any registered firm, and who should not be in any way engaged in the securities or banking business as such. Such an official should be employed by the Exchange under contract for a definite term to the end that complete independence in his field of activity will be assured. He should have authority to select his executive staff and should have complete government of the Exchange and its business, subject to the approval of the Governing Committee on matters of major policy such as alterations and interpretations of the Constitution and Rules of the Governing Committee and the expenditure of funds.

As a second major step, all standing committees of the Exchange should be provided with expert staffs competent to discharge the functions and duties assigned to the Committee. This

would be particularly important in the cases of the Committee on Business Conduct and the Committee on Stock List. In fact, the present Executive Assistant to the Committee on Stock List and his staff constitute an excellent example of the type of expert staff which to one degree or another should serve every committee of the Exchange. These expert staffs should be vested with authority to discharge the entire work of the Committee through the consideration and investigation of cases, complaints, applications, etc., and periodic recommendation to the Committee membership for the taking of appropriate action.

The effectiveness of this plan must, of course, depend upon closer relationship between the Commission, the executive force and the Committees of the Exchange. This is a very practical element upon which the success of any reorganization program must depend. Furthermore, experience has persuaded the Commission that the procedure of certain committees should be radically revised and that their effectiveness should be heightened through the making public of all important actions taken by them.

The number of members of the Governing Committee, as presently constituted, is so large as to render that body too cumbersome to be the deciding factor in Exchange management and subjects it to the possibility of control by a small organized group of its members. The same holds true to a lesser degree of the various standing committees whose members are appointed from among the Governors. With a full time executive and expert equipment, the present administrative duties of the Governing Committee and the standing committees should be materially lessened. Hence, it is recommended that the number of Governors and other committee members be substantially reduced.

In this connection the Commission suggests for consideration the matter of providing for representation of industrial interests on the Governing Committee. It is felt that perhaps those

companies engaged in industry and commerce, whose securities are listed on the Exchange might well have a voice in the conduct of Exchange business through representation by one or two or more persons on the Governing Committee. Just how these representatives would be selected, the Commission is not prepared to suggest, although it is definitely of the opinion that they should not be selected from among persons engaged in the securities or banking businesses.

Some recent public reports have made the suggestion that the Commission might have some authority with respect to, or take some part in, the appointment or naming of members of the Governing Committee or the executive officers of the Exchange. It should be made clear that the Commission does not regard such action to be within its powers and has no desire to inject itself into the internal management of any Exchange in any such manner as has been suggested.

Some consideration should also be given to the reduction in the number of memberships on the Stock Exchange, perhaps through setting up a fund to buy in those seats which are put up for sale from time to time due to death or resignation.

II

Establishment and Revision of Rules and Practices
and the Improvement of the Regulatory or
Disciplinary Process.

The Commission is of the opinion that there are many problems of a lesser nature, but none the less fundamental, than those discussed above which press for solution. These matters concern themselves largely with the day to day conduct of business by members of the Exchange and their partners and employees. They involve questions of the interpretation and enforcement of the rules of the Exchange with respect to factual situations, the appropriate functions of the various types of members, and the standards and business methods of all persons engaged in doing an exchange business. Indeed, the solution of some of these problems the Congress has by statute committed to the Commission, which direction cannot be disregarded in the absence of their treatment by the Exchange in a manner satisfactory to the Commission and to the standards embodied in the law.

These problems are of such a nature as to lend themselves to ready solution by a vigorous and public-minded organization of experts devoid of self-interest. There are set forth below a few of the more important matters of this kind to which the Commission has been turning its thinking over the past months. The Commission feels that the Committee may wish to consider concretely some of these problems and that certainly the presence of all of them and of many others of the same general type should be given due weight in the making of any recommendations for executive and expert personnel.

The problem of functional segregation of members and registered firms is one expressly raised by the statute. Suggestions for its solution range from straight broker-dealer segregation

through a variety of less clear-cut plans such as the adoption of a rule that firms and partners thereof which carry customers' accounts be prohibited from trading on margin.

The Act again requires the study of the problem of the specialist's trading. Many suggestions have been made with respect to this -- prohibiting the specialist from trading for his own account on orders accepted by him for execution, prohibiting trading by the specialist for his own account in securities in which he is registered except in situations where he has either no bids on his book or no offers in which case he may trade on the open side, and the like.

Furthermore, certain of the present rules relating to trading on the floor might be made more simple and definite in the interests of regulation and enforcement, and perhaps additional rules adopted to restrict various types of excessive trading.

The present "daylight trading" rules, while effective and beneficial to a certain extent, do not curtail effectively the speculative activities of members and partners having almost unlimited capital with which to trade. Consideration might be given to the establishment of a prescribed maximum dollar position available for individual members' trading, dependent upon their financial resources.

The chronological sequence records of trades required by the "daylight trading" rule is apparently not definite enough to yield the desired information as to trading. These provisions might be amplified by requiring more detailed records, daily reports of transactions by members and firms and by odd-lot dealers, and perhaps the time-stamping of executions by members on the floor. Appropriate requirements could be found to limit the demoralizing effect of certain types of short-selling of securities.

Consideration should be given to limiting the handling of discretionary accounts by members or partners or employees of member firms to situations involving the most unusual

circumstances. The writing or endorsement by members or member firms of puts, calls or other options raises the question of whether or not customers' obligations are properly secured, especially from the point of view of the margin requirements.

Would it be desirable to require minimum deposits of cash or securities in connection with the opening of margin accounts.

More careful supervision over the opening and maintenance by member firms of branch offices might well be instituted by the Exchange.

The problem of cut-throat competition is raised by the lack of uniformity in rates of interest on customers' debit balances. Study should be made of the advisability of fixing a uniform spread for members carrying margin accounts between the interest requirements or money cost of the member and the interest charged to customers.

Great advantage might flow from a rule requiring that customers be advised in writing at some reasonable time in advance of all requirements for additional margin, either under Regulation T, the Exchange maintenance of margin rule, or the individual requirements of the various members.

The subject of rehypothecation of customers' securities is one for thorough going study and rigid regulation.

This is to mention but a few of the many problems of greater or lesser importance to the Exchange and to the public which deals with and through it. There are many others of a like nature and more will be presented from time to time in accordance with changing conditions. They are the questions which good management can and should deal with promptly and effectively.

INSERT:

PART "I" OR PART "II"

It is suggested that capital requirements for members of the Exchange might well be increased, perhaps with variations according to the type of business done. Such provision might be adopted immediately as to all members or it might be placed in effect only as to persons becoming members in the future. Also it is felt that a member should be required to pay for his seat in full and hold it in his own right and not subject to any liens or claims; in other words, to abolish the existing practice of borrowing to finance the purchase of a seat.

The Commission feels that periodic financial statements of members and member firms should be required and published by the Exchange. In this connection fresh consideration should be given to the form in which members report their capital and indebtedness and the items which are properly allocable to either.