

For RELEASE April 30, 1963

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

Special Market Study
Release No. 25

On April 3, 1963, the first segment (five chapters) of the Report of its Special Study of Securities Markets was filed with Congress by the Securities and Exchange Commission. On the same day, a hearing was held before the Interstate and Foreign Commerce Committee, House of Representatives, at which Chairman William L. Cary and other representatives of the Commission appeared and testified. Subsequently, in a letter dated April 5, 1963, Committee Chairman Oren Harris requested an indication of the Commission's position with respect to the conclusions and recommendations set forth in the five chapters of the Report. Mr. Harris' letter and the reply letter dated April 19, 1963, from Mr. Cary are set forth below.

* * * * *

"Dear Chairman Cary:

"I am sure that you appreciate that our Committee cannot but be impressed with the manner in which you have undertaken the assignment which the Congress placed upon you nearly two years ago to undertake a study of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations. Your presentation to the Subcommittee on Commerce and Finance Wednesday afternoon was helpful in an understanding of the magnitude of the task and of the nature of the reports which you are furnishing to the Congress.

"I think it appropriate that you furnish the Congress with the results of the study and investigation as carried on by your special

- 2 -

study group inasmuch as any study of the character such as is this necessarily involves a consideration of the role which the Commission itself has played during the years being examined. On the other hand, the resolution does direct the Commission itself to report on its own recommendations to the Congress and the record in this specific regard seems a bit ambiguous.

"I note that in the five chapters prepared by the special study group which you have submitted as the first segment of your complete report each has a summary section containing conclusions and recommendations of the study group. In some chapters this appears at the end of the chapter whereas in others this summary is under different sections of the chapter. (It is understood that when you have completed all of the chapters, you have the thought of pulling together these summaries of conclusions and recommendations into one volume.)

"It appears to me accordingly in the light of the language of section 19(d) and of the discussion before the Subcommittee last Wednesday, that it might be appropriate for you to indicate to us as to each of these recommendations which:

- "(1) You have adopted as your own as set forth in your transmittal letter;
- "(2) You have designated as the subject of the Commission's rule-making process (as you indicated Wednesday you had initiated through letters addressed to industry representatives requesting them to create advisory committees for such consideration); and
- "(3) You are holding in abeyance for further consideration as to treatment in either of the ways above or possible rejection in their entirety.

Sincerely yours,

OREN HARRIS, M.C.
CHAIRMAN"

* * * * *

"Dear Mr. Harris:

"I appreciate your letter of April 5 and your generous comments with respect to the Report of the Special Study of Securities Markets --

- 3 -

the first segment of which we submitted to you on April 3. You point out that Public Law 87-196 directs the Commission itself to report to the Congress on its own recommendations, and it might be appropriate for the Commission to indicate its views as to the specific recommendations already made by the Special Study.

"May I say first of all that we stand strongly behind the Report of the Special Study, as indicated in our letter of transmittal. With some reservations as to Part D of Chapter III and Parts B and C of Chapter IV -- which we are holding in abeyance -- we accept all the general recommendations made in the chapters of the Special Study which were submitted to you (Chapters I-IV and IX). We are exceedingly fortunate to have assembled such a superlative group from private law practice, the universities, and the Commission staff to conduct this study. The Report will be the most comprehensive of its kind in over 25 years and should be the keystone for regulatory and industry action.

"The major objective of our letter of transmittal was to emphasize the legislative proposals and to report to Congress the principal ones which we hope to submit at the earliest possible time. We are keenly aware of your admonition to have these presented promptly, and further believe them to be an essential ingredient of investor protection and a prerequisite for further action, including rule-making. Accordingly, we are now concentrating our efforts on drafting detailed statutory proposals and explanatory materials. At the same time, we shall over the next six weeks devote our attention to examining the balance of the Report which has been promised by the end of May. For these reasons we are not yet focussing upon the exercise of rule-making power, which is involved in numerous areas covered by the Report.

"After the legislation has been considered and the whole Report submitted, we shall direct our attention to the rules recommended by the Special Study -- which require appropriate submission to the public under the Administrative Procedure Act -- and to other recommendations which will necessitate joint efforts with the industry. In certain areas, of course, we cannot provide immediate answers. As the Special Study's letter of transmittal to the Commission indicates, it would be impossible for the Special Study (or for the Commission) to propose 'complete or final' answers to all the questions which they have posed. Indeed, 'for some of the most knotty there is merely an indication of the possible approaches . . . that may point the way to future solutions.'

"As you will note, many of these recommendations consist of a statement of an objective to be attained, together with suggestions as to possible methods of accomplishing it, either by rules or policies

- 4 -

of the Commission or by rules or policies of self-regulatory agencies. As the Report of the Special Study recognizes, there are many instances where further exploration of alternatives is necessary to select the best method of accomplishing a specified end, and it may be that the method ultimately selected may differ to some extent from that recommended by the Special Study.

"Moving now to the specific suggestion in your letter, we shall attempt to indicate as to each of the recommendations of the Study those which we have adopted as appropriate for legislation, those we have designated as the subject of Commission rule-making process and those we shall hold in abeyance for further consideration (whether legislative or rule-making).

"Chapter II. Qualification of Persons in the Securities Industry.

"We are in agreement with all twelve conclusions and recommendations. They are an attempt to develop standards of character, competence, and financial responsibility and are the basis of legislative proposals, with three exceptions (Items 3, 11, and 12) which can be handled under our rule-making authority. With respect to Items 11 and 12 relating to net capital requirements, the Commission will also provide in the legislative proposals that the self-regulatory organizations may have the same power with respect to financial responsibility as they would have with respect to character and competence.

"Chapter III. Part B. Selling Practices.

"We are in agreement with all seven conclusions and recommendations. Only Item 7 involves a legislative proposal, which was included in our letter of transmittal. This would provide the Commission with more flexible sanctions and the power to focus disciplinary action upon individual salesmen and branches.

"Many of the recommendations in III B. are of a general nature which will require continuous development, achieved in large part through discussion with the industry, through action of the self-regulatory agencies, and in some particulars through the exercise of rule-making power. The improvements suggested relate to supervision over selling practices, development in surveillance and enforcement procedures and in existing concepts of suitability, availability of information to customers, and modes of compensating salesmen.

"Item 3 of the recommendations involving selling practices falls most clearly within our rule-making power and would require designation

of retail transactions as solicited or unsolicited, filing of customer complaints, and information as to the investment goals of the customer.

"Chapter III. Part C. Research and Investment Advice.

"We are in agreement with all five recommendations and conclusions. The fifth is a legislative proposal, i.e., that registered investment advisers other than broker-dealers should be organized into an official self-regulatory association. We are still exploring the way in which it can best be achieved.

"Items 2 and 4 in our opinion can be handled by rule. Item 2, relating to the content of market letters and investment advisory materials, would require disclosures of sources of information, research techniques, existing positions in stocks recommended, persons responsible for the preparation of market letters, and other matters. Item 4 in effect would prohibit reckless dissemination of written investment advice.

"The other conclusions and recommendations (Items 1 and 3), generally discouraging indiscriminate advertising of research and advisory facilities, and recommending the strengthening of market letter surveillance, are directed to the self-regulatory agencies. We shall make every effort to foster action on their part.

"Chapter III. Part D. Protection of Customers' Funds and Securities.

"We accept the underlying principles, but wish to hold in abeyance the last four of the five conclusions and recommendations. The first, suggesting a reserve in cash or government bonds of some part of the free credit balances, can be carried out under our rule-making authority. Some additional time and attention, however, will have to be devoted to the exact mode of carrying it out. Items 2, 3 and 5 are inter-related proposals and technical in nature. We would prefer to bring them to Congress at a later date. Item 4 calls for further study.

"Chapter III. Part E. Delivery of Securities.

"We agree with the four conclusions and recommendations, which are addressed in large part to the industry and self-regulatory institutions. We shall lend our support in seeing that they are carefully considered.

"Chapter III. Part F. The Broker Dealer as Corporate Director.

"This is a general rather than a specific recommendation which we and the self-regulatory organizations should pursue.

"Chapter IV. Primary and Secondary Distributions to the Public.
Part B. New Issues.

"We are generally in agreement with most of the conclusions and recommendations, but wish to hold in abeyance, for further study, parts of Items 2 and 3. The first item is a general conclusion rather than a recommendation and we accept it as a preamble to the recommendations which follow.

"The second is a series of proposals for rule-making which are intended to eliminate or temper certain factors which contributed to the 'hot issue' market of 1961 and early 1962. We feel that subrecommendations (a) and (b) relating to allotments of securities can and should be adopted but believe the balance, i.e., (c), (d) and (e) warrant further consideration. The third item (conditioning acceleration upon delivery of a prospectus or offering circular in substantially final form to any recipient of an original allotment two days before sales are made) raises a considerable number of problems and hence falls within the group held in abeyance.

"We agree with the fourth item extending the requirement of delivery of prospectuses from 40 to 90 days in the case of new issues and have incorporated this within our legislative proposals for registered securities. We believe the same principle can be applied to Regulation A offerings by rule.

"As to the fifth item, we agree with the conclusion that the NASD should strengthen its enforcement of the prohibition against free-riding and withholding, but the mechanics of achieving this will have to be considered further.

"With respect to Items 6 (review of underwriting arrangements) and 7 (relating to options, warrants or 'cheap stock' in public offerings), we are in full agreement and shall take such action as is required by us and sponsor appropriate action by the NASD.

"We agree with Item 8 that the Commission should take appropriate steps to clarify the application of Rule 10(b)(6) and shall take the necessary action.

"Chapter IV. Part C. Unregistered Distributions.

"This part has three recommendations. We accept in principle the concept of notifying the Commission of these types of distributions for the purposes of information and enforcement. However, with respect to

- 7 -

both the balance of the first recommendation and also the second one, we are inclined to hold them in abeyance for further consideration.

"The third item is merely a reference back to earlier material in Part C on which we have already expressed agreement.

"Chapter IV. Part D. The Intra-State Exemption.

"We agree with the objective. The proposal to have advance notice of offerings filed with the Commission has been achieved in part by a recent rule of the NASD requiring a similar notification from its members. We shall hold in abeyance any decision as to how much further we should go beyond the action which the NASD has taken.

"Chapter IV. Part E. Real Estate Securities.

"We have already adopted the recommendation that all distributors of and dealers in securities (including real estate securities) should be required to be members of a registered securities association. As previously noted, we are proposing legislation along those lines. The second item is a suggestion for further study of the problems in this field -- which have been a continuing object of our consideration.

"Chapter IV. Part F. Integration with Previous Filings.

"The integration of disclosure requirements under the Securities Act and the Exchange Act is a long-term program and warrants serious thought, but the final objective can only be achieved in gradual steps. Sometime ago we instituted a short-form registration statement with respect to debt securities (S-9) and we shall now undertake a second step, the preparation of a comparable short-form for certain equity securities on the basis discussed in the first conclusion and recommendation.

"In connection with the first two paragraphs of the second item, we have been reevaluating the scope and content of our present reporting and proxy requirements and of our examining procedures.

"We concur with the last paragraph of the second item that the waiting period for short-form filings should be kept to a minimum and have put this into effect. We are also seeking legislative authority to reduce in our discretion the time period during which dealers are required to deliver prospectuses.

- 8 -

"Chapter IX. Obligations of Issuers of Publicly Held Securities.
Part B. Protections for Investors in Listed and Unlisted Securities.

"Chapter IX relates to extension of disclosure through reporting requirements and proxy statements and of the insider trading provisions to a larger number of companies -- whose securities are traded over-the-counter. There are eight recommendations in Part B. We have adopted them all but one and have embodied them in our legislative proposals wherever necessary. We shall hold in abeyance Item 7(c), amending Section 16(b). In addition to the recommendation of the Special Study, we shall offer these related proposals: first, authorizing the Commission to suspend trading of an over the counter security; second, requiring the filing of material contracts upon the registration of a security; and third, obligating a company to distribute to its stockholders information similar to proxy material where proxies have not been solicited.

"Item 8 is a general approach with which we agree, and we shall explore the economic and technical problems involving the feasibility of increasing dissemination and use of filed information.

"Chapter IX. Part C. Corporate Publicity and Public Relations.

"There are three recommendations in Part C. They meet with our general agreement. Item 1 recommends that stock exchanges and the NASD should establish high standards for the dissemination of corporate publicity, and we shall take steps to encourage this proposal. Based upon the recommendation in Item 2, we shall propose a statute designed to prohibit false and misleading corporate publicity. We did not include this in our letter of transmittal because our views had not yet crystallized.

"Item 3 concerning the disclosure of compensation paid to public relation counselors or firms meets with our full accord and is within our rule-making power.

"I believe this makes explicit our views with respect to all the recommendations made by the Special Study to date. As we indicated in the initial paragraphs of this letter, we are proceeding now with our legislative proposals and shall subsequently consider the exercise of our rule-making authority. It should be recognized that many of the recommendations of the Special Study were directed at encouraging action on the part of the self-regulatory institutions. Although in full accord, we would point out that at the present time our statutory powers to

- 9 -

achieve these improvements are limited. Much, of course, can be carried out on the initiative of the Exchanges and the NASD, but it is our belief that as a program of self-regulation is fostered and expanded, correspondingly broader powers of oversight are needed.

"Although we have not had the benefit of the final conclusions of the Special Study on the role of self-regulatory institutions, the Chapters already submitted inevitably call for their increased participation in the regulatory system. At the same time it has become clear that our power to alter and supplement the rules of the NASD is more limited than our power in connection with the Exchanges. This unevenness is unwarranted, particularly in the light of the NASD's growing responsibilities. Accordingly, we are proposing as part of our legislative program some limited extension of oversight over the NASD so that it may be available if the public interest should require.

"A copy of this letter is being sent to the Chairman of the Senate Banking and Currency Committee.

Faithfully yours,

William L. Cary
Chairman"