

M E M O R A N D U M

July 30, 1963

To: Department Heads  
(Executive, Administration & Finance, Stock List,  
Floor, Member Firms, Public Relations, Research  
& Statistics, Stock Clearing Corp.)

From: G. Keith Funston

Subject: Operation - S.E.C.

In order to handle in an orderly manner the several reports of the S.E.C. Special Study Group, your cooperation with the following procedure will be appreciated.

1. The staff of the Exchange should study the S.E.C. report with a completely open mind, as though it were a management consultant's report prepared by a firm which we had employed. Undoubtedly, some of the suggestions are impractical or unwise. Nevertheless, others may well be worthy of adoption. We should try hard to search out those which are worthwhile and would benefit investors or the public interest, and urge that these be adopted.
2. Chapters 1-9 of the S.E.C. report have been already assigned to the departments as outlined in the attached list. Each department is responsible for (a) knowing the details of the assigned section, (b) analyzing its implication for the Exchange, (c) marshalling facts to counterbalance factual error, (d) suggesting the Exchange position on recommendations made or problems raised, and (e) following through to see that these Exchange positions are established and advanced.
3. Alger B. Chapman, Jr. is designated as the Exchange's liaison officer with the S.E.C. in connection with this Operation - S.E.C. He will arrange for department heads to contact proper officers in the S.E.C. to get clarifying answers to questions which may arise out of the report, will check on progress and format of staff reports called for in the next paragraph, and will arrange for and attend all conferences in Washington.

4. As soon as possible, but by September 3rd at the latest, each department head will have prepared for every section assigned to him a separate memorandum covering each recommendation made by the S.E.C. and including a statement of the Exchange's present position and also a tentative statement of the position the Exchange should take in this regard. Present or past Exchange policy or historical precedent may suggest a tentative position on certain points. Staff thinking or informal position papers may suggest positions on others. Undoubtedly on some recommendations a department head will not be in a position to make any suggestions. He is not expected at this time to reconcile conflicting opinion on controversial matters which are not covered by present policy. This is the function of the Board of Governors. In such cases he should indicate the further information necessary or the study steps that need to be taken before a position can be tentatively decided upon. A brief summary sheet (one or two pages) should be prepared with four columns headed: "S.E.C. Recommendation," "Present Position," "Tentative Position of the Exchange," and "Further Steps Required."

5. At the September policy meeting the Board will be given our assessment of the main problem areas, and of the important policy decisions that will be required, and such ideas of the suggested priority as we may have obtained by that time from the S.E.C.

6. The initiative in implementing the report rests with the S.E.C. It is not incumbent on the Exchange to initiate discussions but only to respond fully when asked to do so by the S.E.C. It shall be the endeavor of the Exchange where necessary to work out in private conference with the S.E.C. satisfactory adjustments in the recommendations made in the report -- solutions which will benefit the investor and the public interest. The responsible department head will be expected to lead the Exchange team in the Washington conferences and in presenting the matter to the Board of Governors. In such negotiations the Exchange staff will plan to have present at least one Governor and one expert in the field under discussion. No commitment will be made binding the Exchange except with the approval of the Board of Governors given at a policy meeting.

7. A small Steering Committee of the Board of Governors may be appointed to guide the President in handling the issues raised in the report and in working on any problems of immediate urgency in this connection.

Attachments

*Keith Johnston*

Report of Special Study of Securities Markets, SEC: Assignment  
of Recommendations for Consideration

Floor Department

Chapter III - Broker-Dealers, Investment Advisers and Their  
Customers -- Activities and Responsibilities

Section E: Delivery of Securities

(2) The required making of "buy-ins" upon "fails to deliver."

Chapter IV: Primary and Secondary Distributions to the Public

Section B: New Issues

(8) The clarified application of Rule 10b-6 while stock is held by broker-dealers "for investment," or in connection with "shelf registrations," "inventory work-outs," and unregistered distributions.

Chapter VI - Exchange Markets

Section D: Specialists

(1) The making of "a number of important specific improvements in specialist practices, regulatory concepts and procedures."

(2) The restriction of specialist dealings to that degree "so far as practicable to those reasonably necessary to maintain a fair and orderly market" (Saperstein Interpretation).

(3) The more vigorous enforcement of the requirement that specialists participate in their stocks only "to the extent reasonably necessary to maintain a fair and orderly market."

(4) The requirement that specialists have capital sufficient to carry at least 1,200 (and preferably 2,000) shares of each of their registered issues.

(5) At the opening, prohibition of specialists from dealing so as to upset the public balance of supply and demand; after the opening, the limitation upon specialists' ability "to

reach across the market;" the more vigorous enforcement that specialists "participate in reasonable volume at each price level" so as to provide "continuity with reasonable depth ..." so that their quotations be "reasonable," "not merely nominal."

(6) The carrying by specialists of their registered securities only in trading accounts (i.e., not in investment accounts).

(7) The clarification of specialists' permissible brokerage functions -- definition of market and limited price orders; continued prohibition of specialists' acceptance of "not-held" orders, their granting of stops under certain conditions; the required reporting on the tape of all executions; specialists' prohibition from unfairly dealing with or for customers and from servicing or carrying public customers' accounts.

(8) The required publicity of specialists' dealer activity; the Exchange's prohibition from representing its tick tests as fair market stabilization indexes.

(9) The examination of possible improved specialist block procedures -- e.g., an Exchange administered capital fund for specialist loan purposes; a specialist - and/or Exchange administered contributory stand-by capital fund; a specialist-administered limited group self-insurance plan.

(10) The required reporting to the Commission by the Exchange of apparent specialist capital violations, margin calls; the prohibition of specialists' clearing firms from terminating such arrangements or from making margin calls without prior notice to the Exchange; the temporary or permanent reassignment of underfinanced specialists' stocks.

(11) The required development of certain improved specialist surveillance procedures.

#### Section E: Odd-lot Dealers

(1) The further evaluation of "problems affect[ing] smaller investor."

(3) The greater regulation of odd-lot transactions and of off-setting round-lot transactions; the required systematic reporting and surveillance of such off-setting transactions.

(6) The required reduction of the round-lot unit, in high priced issues. (See VIII.B (2), infra)

Section F: Floor Traders

- (1) The abolishment in stages of floor trading.
- (2) The possible service of floor traders as "auxiliary specialists."

Section H: Short Selling

- (3) The curtailment of short selling during periods of price decline.

Section J: Automation -- Its Needs and Possibilities

- (2) The expansion of the Exchange's current reporting procedures to provide more complete and accurate floor trading volume data.

Chapter VIII - Trading Markets -- Interrelationships

Section B: The Basic Allocation Between Exchanges and Over-the-Counter (as Primary Markets)

- (2) The reduction in size, in high-priced issues, of odd-lot units. (See VI.E (6), supra)

Report of Special Study of Securities Markets, SEC: Assignment  
of Recommendations for Consideration

Member Firms Department

Chapter II - Qualifications of Persons in the Securities Industry

Section F: Summary, Conclusions and Recommendations

(3) The requirement of more extensive data in broker-dealer and investment adviser SEC registration forms and updating reports.

(4) The treatment of the individual rather than of the firm as the appropriate unit for regulatory purposes.

(6) The requirement by industry entrance candidates (individuals, and firms) of proof of competence and experience; character and integrity; financial capacity and responsibility.

(7) The regulation and coordination of the various self-regulatory agencies' entrance examinations; and the adoption of limited specialist examinations.

(8) The requirement that registered firms' "key personnel" be experienced.

(11) The setting of certain net capital minimum requirements for broker-dealer firms, as well as for their branch offices and salesmen.

(12) The setting of certain net capital minimum requirements for underwriting firms.

Chapter III - Broker-Dealers, Investment Advisers and Their  
Customers -- Activities and Responsibilities

Section B: Selling Practices

(1) The more energetic supervision by broker-dealers of their personnel's selling activities; the adoption of certain regulatory procedures.

(2) The self-regulatory agencies tightening of their member firms' supervisory, surveillance and enforcement procedures.

(3) The establishment of more effective selling practice controls and procedures by firms, self-regulatory agencies, and the Commission.

(4) The greater emphasis upon the concept of suitability by the Commission and self-regulatory agencies.

(6) The greater standardization of sales personnel compensation.

#### Section D: Protection of Customers' Funds and Securities

(1) The adoption by the Commission and self-regulatory agencies of stricter net capital rules, particularly with respect to the treatment of free credit balances.

(2) Wider Commission rule-making powers with respect to the segregation by brokers of excess margin and fully-paid securities.

(3) Wider Commission rule-making authority with respect to brokers' ability to loan customers' securities.

(4) The more flexible formulation and administration of broker-dealer net capital rules "hair cut provisions."

(5) The amendment of the Bankruptcy Act to permit the more equitable treatment in bankruptcy proceedings of "street name" customers' securities and free credit balances.

#### Section E: Delivery of Securities

(1) The strengthening by the NASD of its "markings to the market" and other clearance rules and procedures.

#### Section F: The Broker-Dealer as Corporate Director

(1) The establishment of higher ethical standards for broker-dealers acting also as underwriters, corporate directors, and advisers to issuers and/or customers.

### Chapter IV - Primary and Secondary Distributions to the Public

#### Section B: New Issues

(8) The more clarified application of Rule 10b-6 to stock held by broker-dealers for "investment," or in connection with "shelf registrations," inventory "work-outs," or unregistered distributions generally.

Section C: Unregistered Distributions

(2) The requirement of further data in customers' confirmations, by broker-dealers participating in unregistered offerings.

Chapter VI - Exchange Markets

Section E: Odd-lot Dealers

(2) The making of a cost study of the odd-lot business, exclusive of costs incidental to stock borrowing and customer firm information services.

(6) The required disclosure of odd-lot differentials due on customers odd-lot confirmations.

Section H: Short Selling

(2) The closer regulation of (-) and (0-) ticks exempted arbitrage transactions.

(3) The study of certain possible restrictions upon short-selling during "down-markets."

Section I: Commission Rates

(1) The study of the possible revision of NYSE commission schedules with respect to volume orders.

(2) The study of the possible provision by the NYSE of associate memberships, and/or reduced non-member commission rates.

(3) The study of the possible provision of volume discounts in the NYSE rate structure.

(4) The study of the feasibility and desirability of separate rate structures for the basic brokerage function and for auxiliary services -- or of a maximum rate schedule for all services.

(5) The development and clarification of "reasonable standards" for the setting of public commission rates according to certain suggested bases and formulas.

(6) The required filing by exchange members of income and expense reports to their exchanges and to the commission; the development of improved rate-setting standards and procedures.

(8) The required showing, on customers' confirmations, of odd-lot differentials paid.



Chapter VIII - Trading Markets -- Interrelationships

Section C: Institutional Participation of Block Transactions

(3) The consideration of institutional block purchase or sales practices and needs in any contemplated volume-discount rate structure modifications.

Section E: Allocation Among Exchanges -- The Regional Exchanges as Primary and Secondary Markets

(2) The provision in the Exchange's commission rate structure, of volume or block discounts, and for preferential access to non-member broker-dealers.

Chapter IX - Obligations of Issuers of Publicly Held Securities

Section B: Protection for Investors in Listed and Unlisted Securities

(7) The authorization by the Commission of rule making powers to compel and regulate the giving by broker-dealers of proxies (presumably for their "street name" customers).

Report of Special Study of Securities Markets, SEC: Assignment  
of Recommendations for Consideration

Public Relations - Advertising and Promotion

Chapter III - Broker-Dealers, Investment Advisers and Their  
Customers -- Activities and Responsibilities

Section B: Selling Practices

(5) The greater use by selling personnel of data filed by issuers with the SEC; their specific reference to such data to customers.

Section C: Research and Investment Advice

(1) The prohibition of broker-dealers' unjustifiable representation of their research capabilities.

(2) The elimination by the self-regulatory agencies of their broker-dealer members' irresponsible, deceptive practices.

(3) The strengthening by the self-regulatory agencies of their market letter surveillance programs.

(4) The prohibition of reckless investment advice by broker-dealers, investment advisers; their subjection to possible civil liabilities.

Chapter IX - Obligations of Issuers of Publicly Held Securities

Section B: Protection for Investors in Listed and Unlisted  
Securities

(8) The required dissemination of data filed by issuers with the Commission also to appropriate Commission and NASD offices, to broker-dealers making markets or recommending purchases, and by them to their customers.

Report of Special Study of Securities Markets, SEC: Assignment  
of Recommendations for Consideration

Research and Statistics

Chapter VI - Exchange Markets

Section G: Members' Off-Floor Trading

(1) The requirement that Exchange members report also their off-floor trades.

Section H: Short Selling

(1) The required separate and systematic reporting of public and member short sales, "short sales against the box," arbitrage and hedging short sales.

(2) The more close regulation of (-) and (0-) tick exempted arbitrage transactions.

Chapter VIII - Trading Markets -- Interrelationships

Section C: Institutional Participation of Block Transactions

(1) The continuous availability of an "adequate body of information" concerning institutional transactions on securities markets; the periodic holding of joint Exchange-Commission conferences to appraise the impact of institutional transactions on securities markets.

(2) The Commission's recommendation of the amendment of the Federal Welfare and Pension Plans Disclosure Act, to require pension plans to disclose their portfolios.

Section D: Over-the-Counter Markets in Exchange-Listed Securities

(1) The evaluation of the advantages of competition between the "third" OTC market in listed securities, and the exchanges.

(2) The disclosure of more data concerning the "third" market and its broker-dealer "market makers."

Report of Special Study of Securities Markets, SEC: Assignment  
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Stock Clearing Corporation

Chapter III - Broker-Dealers, Investment Advisers and Their  
Customers -- Activities and Responsibilities

Section E: Delivery of Securities

(4) The modernization and improvement of existing securities handling, clearing and delivery systems.

Report of Special Study of Securities Markets, SEC: Assignment  
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Stock List

Chapter IV - Primary and Secondary Distribution to the Public

Section C: Unregistered Distributions

(1) The requirement that broker-dealers managing unregistered offerings make certain prior notifications to the Commission.

(3) The clarification of Rule 10b-6 in respect of unregistered distributions.

Section F: Integration with Previous Filings

(1) The permitted use by issuers complying with Sections 13, 14 and 16 of the 1934 Act of short-form statements when registering additional issuances.

(2) The amplification of Forms 8-K, 9-K, 10-K, etc., to provide more reliable information on a current basis; to subject such forms to 1933 Act registration statement examining procedures; to waive 40-day prospectus delivery requirement for offerings made subject to short-form statements.

Chapter VIII- Trading Markets -- Interrelationships

Section B: The Basic Allocation Between Exchanges and  
Over-the-Counter (as Primary Markets)

(1) The more "dynamic" reevaluation by the Exchange of their original and delisting standards.

Section E: Allocation Among Exchanges -- The Regional  
Exchanges as Primary and Secondary Markets

(3) The promotion of "one or more regional exchanges as primary markets, significantly competing for primary listings with the New York exchange."

(4) The promotion of the new listing on regional exchanges of "OTC-listed" issues suitable to auction markets, and of marginal NYSE and Amex listings.

## Chapter XI - The Obligations of Issuers of Publicly Held Securities

### Section C: Corporate Publicity and Public Relations

(1) The establishment by the exchanges...of high standards for the dissemination of corporate information by their listed companies.

(2) The extension of criminal sanctions and civil liabilities to issuers and/or their agents intentionally and recklessly disseminating false and misleading statements.

(3) The requirement that issuers disclose in their registration statements, offering circulars, proxy statements, up-dating reports, etc., the compensation of their public relations counselors with stocks, warrants, etc.

Report of Special Study of Securities Markets, SEC: Assignment  
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Administration and Finance

Chapter VI - Exchange Markets

Section E: Odd-lot Dealers

(4) The study of the possible automation of odd-lot executions, and effects on costs, floor operations and odd-lot differentials; the elimination, modification, etc., of the odd-lot firms' information services to other firms.

Section J: Automation -- Its Needs and Possibilities

(1) The further use of automation in all Exchange operations, e.g., odd-lot executions, specialist operations surveillance, et al.

(2) The expansion of the Exchange's automation procedures to provide more market data at the time of individual order executions.

Report of Special Study of Securities Markets, SEC: Assignment  
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Executive Department

Chapter VI - Exchange Markets

Section I: Commission Rates

(7) The required submission by the exchanges, in advance, of their commission rate revision proposals.

Section J: Automation -- Its Needs and Possibilities

(3) The more close coordination between the exchanges and of their member firm reporting procedures, and of their own automation programs.

Chapter VIII - Trading Markets -- Interrelationships

Section B: The Basic Allocation Between Exchanges and Over-the-Counter (as Primary Markets)

(3) The availability of more extensive "crucial" facts concerning various individual OTC and Exchange markets.

Section E: Allocation Among Exchanges -- The Regional Exchanges as Primary and Secondary Markets

(1) The continued promotion of the multiple trading of the regional exchanges.

(5) The study of possible regulation against the "undue" control by NYSE members of the regional exchanges.



Floor Dept.	-	Mr. Vanderbeck ✓ + O'Reilly ✓
Member Firms	-	Mr. Coyle ✓ and / <del>Mr.</del> Mr. Bishop ✓
Public Relations	-	Mr. Lawrence } ✓
Research & Stat.	-	Mr. Lawrence } ✓
Stock Clearing	-	Mr. Crissy ✓
Stock List	-	Mr. West ✓
Admin. & Finance	-	Mr. Klem ✓
Executive Dept.	-	Mr. Gray ✓

Also: Full Set to Mr. Gray ✓ *from only of attachments*  
 Full Set to Mr. Chapman ✓  
 " " GK 7 (HMW)

The Board of Governors is receiving a copy of Mr. Funston's Memo only - no attachments.

*Must be in government or not to be included in material given to the Board*